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THE GHOST OF SUN MICROSYSTEMS?

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It was one of the faces of the 1990s tech bubble. In the right place at the right time, manufacturing computers when millions of households were clamoring for them. If there is an image for the zeitgeist of 1998 and 1999, picture a novice day trader dialing up on their first internet connection (remember that ear-piercing noise?), logging into their E*TRADE account and punching in a buy order. Cost of trade execution: $29.95, which seemed like the absolute basement. What's the stock ticker? As good a guess as any is JAVA: four letters of course, not three like the "Old Economy" stuff owned by the codgers that were still playing the Big Board[1]. JAVA was as hot as they came; Sun Microsystems' eponymous computer code was the future. Some teenagers with a misspent youth (ahem) came home from school and flipped on CNBC, not MTV. Across the tape came the usual suspects: EBAY, JDSU, YHOO—and yes, AMZN. At peak levitation, JAVA's market capitalization[2] was north of $200 billion—in quarter-century-ago dollars. But money was no object. A position in JAVA was a must for any self-respecting believer in the "New Economy".

I got to thinking about Sun when an anonymous Twitter account (@fly1nwa11) posted this quote by Sun's founder, Scott McNealy, in the wake of the tech crash:

> *But two years ago we were selling at 10 times revenues when we were at $64. At 10 times revenues, to give you a 10-year payback, I have to pay you 100% of revenues for 10 straight years in dividends. That assumes I can get that by my shareholders. That assumes I have zero cost of goods sold, which is very hard for a computer company. That assumes zero expenses, which is really hard with 39,000 employees. That assumes I pay no taxes, which is very hard. And that assumes you pay no taxes on your dividends, which is kind of illegal. And that assumes with zero R&D for the next 10 years, I can maintain the current revenue run rate. Now, having done that, would any of you like to buy my stock at $64? Do you realize how ridiculous those basic assumptions are? You don't need any transparency. You don't need any footnotes. What were you thinking?*

[1] Nickname for the New York Stock Exchange (NYSE), the world's largest stock exchange in terms of the market capitalization of its listed stocks. Two of the NYSE buildings are designated as National Historic Landmarks.

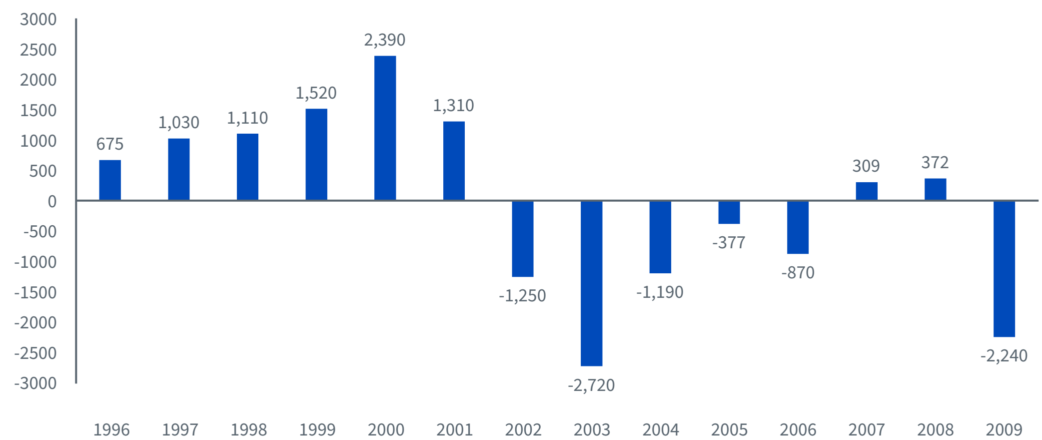
[2] Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

Unlike many of the speculative stocks of the day, JAVA was actually earning money—$2.39 billion in fiscal 2000 alone.

But that was the end of it.

Visions of never-ending profits turned into losses (Figure 1), sinking the stock hard and putting it in a funk for a decade. The once-$200 billion company had shriveled to a $7.4 billion price tag when Oracle gobbled it up in the throes of the 2008–2009 global financial crisis.

Figure 1: Sun Microsystems Operating Income ($ Mil.)



Source: Sharadar, via Fairlyvalued.com. Data as of Q2 of each year.

McNealy, Sun's CEO, wasn't alone in lamenting his stock's stratospheric price-to-sales ratio[3] of 10. According to Jesse Felder of The Felder Report, "There were 29 stocks (in) the S&P 500[4] that traded above ten times revenues at the peak of the dot.com mania."

Today there are 32.

[3] Price-to-sales (P/S) ratio: Share price divided by per share revenue.
[4] S&P 500 Index: Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

In fact, the Russell 1000[5], with twice as many stocks as the S&P, has 37 stocks trading for more than 10 times sales in the Tech sector alone, including Microsoft, which is 5.2% of the whole market (Figure 2).

The "Tech 37" that are equal to or above JAVA's peak price-to-sale ratio combine to 10.7% of the market. If you think Sun Microsystems was rich, consider this: Five of today's seven largest U.S. tech stocks trade for more than 15 times revenues.

Figure 2: Russell 1000 Tech Stocks with Price/Sales >10

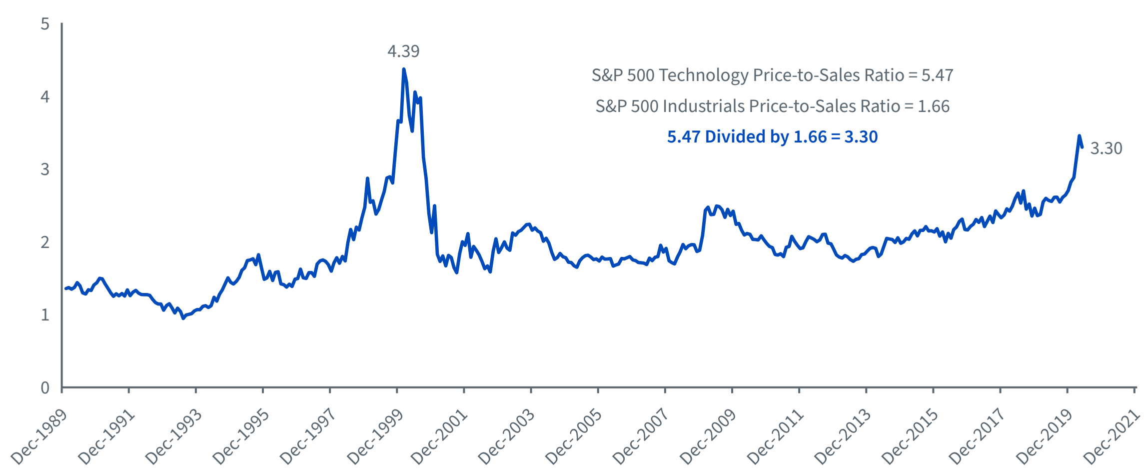
#	Company	Russell 1000 Weight	Price/ Sales	#	Company	Russell 1000 Weight	Price/ Sales	#	Company	Russell 1000 Weight	Price/ Sales	#	Company	Russell 1000 Weight	Price/ Sales
1	MICROSOFT CORP	5.20%	10.2	11	VERISIGN INC	0.08%	20.6	21	TRADE DESK INC/THE -CLASS A	0.04%	19.0	31	ZSCALER INC	0.02%	26.0
2	VISA INC-CLASS A SHARES	1.22%	15.8	12	ANSYS INC	0.08%	14.9	22	COGNEX CORP	0.04%	14.3	32	AVALARA INC	0.02%	19.4
3	MASTERCARD INC - A	0.96%	17.3	13	ATLASSIAN CORP PLC-CLASS A	0.08%	29.2	23	MONOLITHIC POWER SYSTEMS INC	0.03%	13.7	33	SMARTSHEET INC-CLASS A	0.02%	22.5
4	NVIDIA CORP	0.76%	19.6	14	FORTINET INC	0.08%	11.0	24	MONGODB INC	0.03%	25.8	34	DYNATRACE INC	0.02%	16.9
5	ADOBE INC	0.66%	15.3	15	RINGCENTRAL INC-CLASS A	0.07%	23.0	25	GUIDEWIRE SOFTWARE INC	0.03%	11.1	35	PAYLOCITY HOLDING CORP	0.02%	11.5
6	INTUIT INC	0.27%	10.6	16	DOCUSIGN INC	0.07%	22.3	26	HUBSPOT INC	0.03%	11.1	36	ANAPLAN INC	0.01%	16.7
7	SERVICENOW INC	0.26%	19.0	17	OKTA INC	0.07%	35.9	27	ASPEN TECHNOLOGY INC	0.02%	11.0	37	ELASTIC NV	0.01%	14.3
8	AUTODESK INC	0.16%	12.8	18	PAYCOM SOFTWARE INC	0.05%	21.0	28	UNIVERSAL DISPLAY CORP	0.02%	16.4				
9	SPLUNK INC	0.09%	10.0	19	TYLER TECHNOLOGIES INC	0.05%	12.3	29	CERIDIAN HCM HOLDING INC	0.02%	11.0				
10	TWILIO INC - A	0.08%	19.7	20	COUPA SOFTWARE INC	0.05%	33.7	30	ALTERYX INC - CLASS A	0.02%	18.5				

Sources: Bloomberg, WisdomTree, as of 5/19/20. Past performance is not indicative of future results. You cannot invest directly in an index.

[5] Russell 1000 Index: A measure of the performance of the 1,000 largest companies by market capitalization in the Russell 3000 Index.

Compare the Tech sector to one that doesn't necessarily have a gleam in its eye. The S&P 500 Industrials sector's price-to-sales ratio is 1.40. Tech's 5.19 multiple is 3.3 times higher (Figure 3).

Figure 3: S&P 500 Technology Price/Sales Ratio Divided by Industrials Price/Sales



Sources: Bloomberg, WisdomTree, 12/31/1989–5/19/2020. Past performance is not indicative of future results.

The March 2000 blowup in the S&P 500 Technology sector witnessed its price-to-sales hit 7.29, an all-time record. But inside the NYFANG+ Index[6], a 10-stock basket of today's darlings, four of them—Facebook, Netflix, Alibaba and Nvidia—now exceed that valuation (Figure 4).

What are investors paying for? The group has a return on equity (ROE)[7] of 14.2%. That's good, but is it worth double the price-to-earnings (P/E) multiple[8] of the Russell 1000, which has an ROE of 12.2% (Figure 4)?

[6] PNYFANG+ Index: An equal-dollar-weighted Index designed to represent a segment of the technology and consumer discretionary sectors consisting of highly traded growth stocks of technology and tech-enabled companies.
[7] Return on equity (ROE): Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.
[8] Price-to-earnings (P/E) multiple: Compares the earnings per share reported by a company to the market price of its common stock.

Figure 4: NYFANG+ Index Members			
NYFANG+ Index Member	**Price-to-Earnings**	**ROE**	**Price-to-Sales**
Communication Services			
Alphabet	28.9	18%	5.74
Baidu	18.2	1%	2.51
Facebook	25.9	22%	8.29
Netflix	91.6	32%	9.27
Twitter	126.9	16%	6.60
Consumer Discretionary			
Alibaba	37.4	29%	8.16
Amazon.com	115.9	19%	4.06
Tesla	5146.5	-2%	5.62
Information Technology			
Apple	24.7	62%	5.23
Nvidia	76.4	26%	19.55
NYSE FANG+ Index	**42.2**	**14.2%**	**5.82**
Russell 1000 Index	**21.3**	**12.2%**	**2.04**

Sources: Bloomberg, WisdomTree, as of 5/19/20. Past performance is not indicative of future results. You cannot invest directly in an index.

Here is an idea for using WisdomTree to avoid most or all of these stocks.

The Russell 1000 Index has more than a fifth of its weight in 8 of the 10 NYFANG+ Index members (Baidu and Alibaba are Chinese). In contrast, as of May 27, 2020, our large-cap value fund, DHS, the WisdomTree U.S. High Dividend Fund, held none of the 10 (subject to change). It screens for the highest dividend-yield companies in our U.S. equity baskets, with risk filters employed to seek to avoid troubled companies that have headline risk.

None of us knows if the next Sun Microsystems—or its plural form—is on this list. But here is the reality: There were a lot of companies in the 1990s that could seemingly do no wrong when you peered into the crystal ball. JAVA was just one of them. Also in the graveyard of the market's highflyers of yesteryear rest JDS Uniphase, AOL, Yahoo! and countless others. Yes, Amazon proved the naysayers wrong, though I hasten to ask if you would kindly introduce me to anyone not named Jeff Bezos who rode that one from $107 down to $6 without capitulating.

Many of the era's winners saw the party end in insolvency, while some—like eBay—survived, a shell of the thriving champion that many believed was inevitable. Others went the Sun Microsystems route, disappearing onto the list of years-later distressed asset acquisitions. Their former glory rests only in our memories—if we are willing to keep those memories fresh.

Twenty years from now, my guess is we will look back at today's valuations and tell a similar story about a handful of the stocks on the NYFANG+ list. Which ones will fall, no one knows.

But making money off stocks that trade at five, six, seven times sales is a tough errand.

Don't forget the ghost of Sun Microsystems.

Figure 5: DHS Holdings as of 5/29/2020		
1	Pfizer	6.08%
2	Verizon Communications	5.84%
3	Abbvie	5.64%
4	AT&T	4.99%
5	IBM	4.09%
6	Chevron	3.57%
7	Philip Morris International	3.22%
8	Cisco Systems	3.20%
9	Bristol-Myers Squibb	3.02%
10	Coca-Cola	3.00%