Technology:

Good Use, Hype, Bubble, Slowdown:

1999 – 2001

- Tech stocks rose rapidly from Oct 1999 to March 2000. This was a real stock bubble.

- The increase in stock prices was based mainly on hype and a fever to get rich quickly.

- Legions of experts said crazy things.

- Investment grew at absurdly fast levels in telecom.

- Many dot-coms failed. See story about business “models from Mars.”

- There are about 17 items and 59 pages here.

Roy Jenne
5 July 2001
The Technology Slowdown, the US Economy

Roy Jenne
June 2001

The NASDAQ stocks (mostly tech) peaked in March 2000. It was a big stock bubble. It had been based on a ton of hype and insane analyses for a long time.

Following are some of the stories in this set of papers, mostly during Sep 2000 to Jan 2001. There are about 17 items and 53 pages here plus 6 pages in front.

1. IT budgets rock boat *(Computerworld, July 20, 1998)*

2. Profit woes push stocks down again *(WSJ, Dec 7, 2000)*

3. Business models from Mars *(BW, Sep 4, 2000)*
   - Many people were great at hyping tech stocks
   - The business models were often terrible
   - This shows how crazy things can get

4. The USA tech problems of year 2000

5. The tech slump *(BW, Dec 18, 2000)*

6. The information paradox *(BW, Feb 22, 1999)*
   - Where is the value from information technology?

7. Ways To Use Technology *(RJ, 11 Dec 2000)*
   - My comments

8. Legions of experts said crazy things (my title) *(Forbes, Dec 11, 2000)*

9. Corporate tech budgets fall at high speed *(WSJ, Dec 28, 2000)*

10. Telecoms’ wake-up call *(BW, Sep 25, 2000)*
    - Investment has grown at absurdly fast levels

11. Crucial driver of US productivity may be improvements in machine tools *(WSJ, Sep 28, 2000)*

12. Slowly but surely, the economy is cooling *(BW, Dec 25, 2000)*

13. How sweet it was *(BW, Dec 18, 2000)*
    - After a gonzo year, forecasts of an ad slump
14. How the fiber barons plunged the nation into a telecom glut (WSJ, June 18, 2001)
   - Plus: US industrial output falls for eighth month (NY Times, Jun 16, 2001)
   - More about the economy in June 2001

15. Suddenly sexy (BW, Sep 18, 2000)
   - Now that the tech bubble has burst, financial stocks are even more buoyant.

16. It could happen again (Forbes ASAP, Aug 21, 2000)
   - The new economy and safe world of 1900 - 1914.

17. Tough times in Techland

#
Telecom Industry
Faces Massive Layoffs

As market values plummet, firms trim staff, shift focus toward new areas

BY JULEKHA DASH

Competitive pressures have prompted telecommunications firms to eliminate thousands of positions in recent months as they shift their focus to areas of higher growth.

Thirty-one Internet companies that specialize in telecommunications products and services have announced layoffs within the past six months, according to The Industry Standard magazine.

Verizon Communications in New York reported last week that it would cut 10,000 jobs through attrition and reductions in the use of consultants and the amount of employee overtime. And a week earlier, Milpitas, Calif.-based PCTel Inc. announced an 11% headcount reduction and a hiring freeze.

“My phone is ringing more often these days with candidates looking for positions,” said Richard Murphy, a recruiter at Miami-based The Recruiters Group Inc., which specializes in the telecommunications sector.

Downward Trend

Brownlee Thomas, an analyst at Cambridge, Mass.-based Giga Information Group Inc., said that unlike last year, when the market values for these firms were soaring, many are now tanking along with the rest of the stock market. As a result, many telecommunications companies are laying off customer service representatives and low-level technicians, said Thomas.

At Verizon, about 1,500 employees will lose their jobs, but, in most cases, they will be given a chance to transfer to other divisions, said spokesman Peter Thonis, noting that areas such as data services are growing 30% per year vs. 3% to 4% growth for voice services.

Bedminster, NJ-based Verizon Wireless Inc. is also growing at a clip of about 20% per year, said Thonis.

Sprint Corp. eliminated 200 to 250 jobs in the desktop services area in November but gave workers the chance to seek jobs in other divisions, said company spokeswoman Katrina Bawcom.

Wayne Mitchell worked at Sprint Enterprise Network Services in Dallas for about 18 months as a technical service consultant before he was laid off. He was offered another job, but it involved installing third-party software.

It “was not a challenging opportunity,” said Mitchell, who is still unemployed but has been talking with recruiters about jobs in systems administration and desktop and customer support. “I decided not to do that, and then the economy started taking a drop, and the opportunities dried up really fast.”

The slump in the telecommunications industry seems to be hitting everywhere. Even big-name firms like Lucent Technologies Inc. have seen their share prices plunge. Last week, Lucent traded at less than $15 per share; its 52-week high was about $75 per share.

The Murray Hill, NJ-based networking equipment provider announced last month that it would eliminate 10,000 jobs.

While long-distance carriers AT&T and WorldCom haven't announced layoffs in recent
Some Stock Investors Turn Bullish

Continued From First Page

in early April. The Dow Jones Industrial Average, in March, tumbled to 19.9% below its January 2000 high.

But since April 4, the Nasdaq is up more than 31%, and the S&P 500 up nearly 15%. The industrial average, from its March 22 low until just before last week's pullback, surged 20%. It's now up just under 16% from the low.

"We are all trained to look at this rationally and objectively, but I've got to say that there also was a gut feel that this couldn't go down too much farther," says Jon Brorson, director of stocks at the money-management arm of Northern Trust Corp. in Chicago. "We all sat together in meetings and said this has got to turn, this has got to turn. It was basically one of those chewed-on-pencil kinds of things." The firm has urged its clients to shift some money out of cash reserves and into stocks.

Technology stocks took some of the worst punishment over the past 15 months, but even some long-time skeptics about tech stocks don't expect the broad market to fall much more. Although the incredibly strong index soared 35% between late May and mid-July, only to falter and give back all of its gains and more. Then in January, the Nasdaq jumped 25%, only to retreat and eventually hit another new low. Those rallies proved to be "bear traps," or short-term bounces in a broader downturn. Some think the latest surge will be the same.

There are ample reasons for caution. Despite its recent gains, the Nasdaq index still is down well over 50% from its high. That means it would have to more than double to return to the record of 5048.62 hit in March of last year. This could take years. As the index tries to claw its way back, some investors who bought Cisco or Amazon.com near the highs will be tempted to sell out and cover some losses, hampering any rebound.

"What do I find interesting is the willingness of people to come back to places in the market that burned them pretty badly," such as tech stocks, says Mr. Morris of Lord Abbett. "These are people with third-degree burns and they..."
The Technology Slowdown; the US Economy

Even those companies that are raising tech spending are focusing strictly on purchases with a clear payoff.

TECH SPENDING SLOWDOWN

BUSINESS PURCHASES OF COMMUNICATIONS EQUIPMENT

NEW ORDERS FOR INFORMATION-TECHNOLOGY EQUIPMENT

CONSUMER SPENDING ON TELEPHONE SERVICES

BAD-NEWS BEARS GET VOCAL

Even if the Nasdaq starts rising, the industry downturn is real. Will it take the economy down, too?
IT budgets rock boat

BUSINESSES ROB OTHER UNITS TO PAY TECH BILLS

By Barb Cole-Comolski

Some are calling it the bailout of information systems.

Faced with increasingly bloated IS budgets, some companies are being forced to use money once earmarked for other departments to keep IS afloat.

"From the chairman on down, people understand that it costs more to get IT people now," said Bill Hickmott, manager of technical professional staffing at Liberty Mutual Systems in Portsmouth, N.H.

At some sites, this diversion of funds is resulting in ill will. One university, for example, is grappling with the fact that software engineers now earn more than associate professors, according to a consultant who has worked with the institution. It is also putting pressure on IS to slash costs, IS managers said.

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More funding urged for IT R&D

An advisory committee appointed by President Clinton is expected to release a report this month that says federal research and development funding is inadequate and that if it isn't increased, the U.S. risks "being overcome by nations with a clearer plan and a stronger view of the future," according to a draft obtained by the IDG News Service. The committee advised Clinton to boost federal investment in software, scalable information infrastructures and high-end computing and to create a new agency to manage overall information technology R&D funding.

Computerworld  July 20, 1998
The Technology Boom; the US Economy

Roy Jenne
18 Dec 2000

The US economy has been slowing down in recent months. The talk and the news was still all rosy in Aug 2000. Now in Dec 2000, there are increasing worries that the US economy will slow down too much.

The talk about technology has been increasing during the past few years. The NASDAQ stock index gives a feeling for what the world of technology is doing. The NASDAQ index was about 2800 during Sep and Oct 1999. Then it rapidly climbed to 5049 on March 10, 2000. There were stories about how the stock prices were much higher than the value of the tech firms, or the possible future profits could justify. But the main news was that the tech world was wonderful, and that people were making a ton of money by buying these stocks.

During Jan – Mar 2000 the tech stocks were madly going up, as we said. But the DOW index of industrial stocks was going down. The heads of major industrial firms were getting angry. They thought: We work hard to deliver real value to the customer and the stock buyer, but the stock buyers reward the tech stocks, not us.

After March 10, 2000, the tech stocks have been going down. The NASDAQ stock index recently went below its value for Sep and Oct 1999 (which was before the huge increase to 5049). Now the tech sales are slowing, and people are worried. It is slowly being recognized that some of the tech spending for investment was too much when compared with the likely returns on the investment. In Fall 1999, the wave of the future was companies that made on-line sales. The hype was way too much. There will be on-line sales, but many of these "dot-com" companies have gone out of business during 2000.

What worries me in Dec 2000? For several years, both consumers and business have been spending more than their incomes. Therefore, debt has been building up. Now the spending is slowing down. Some change was needed, but we don’t want consumers to spend too little. The spending by consumers determines two-thirds of the US economy. If people spend too little, the economy sinks.

The stories here have been selected to give readers a better feeling for what has happened. It has been an interesting story that affects everyone.
Economic Trends

BY GENE KORETZ

BAD-NEWS BEARS GET VOCAL

More economists use the "R" word

Most economy-watchers regard the recent spate of downbeat economic news as a cloud with a bright silver lining. It indicates that the Federal Reserve is finally getting the soft landing it has been seeking. A small but growing group of economists, however, have begun to use the dreaded "R" word with increasing frequency.

In their view, the odds have now shifted in favor of an outright recession in the next year. "We will need a lot of luck to avoid a downturn in 2001," says David Levy of the Jerome Levy Economics Institute of Bard College.

Other outspoken economic bears include Lacy H. Hunt of Hoisington Investment Management in Austin, Texas, and economic consultant A. Gary Shilling. While all three economists have often been more pessimistic than the consensus in the past, their views have darkened considerably in the past month.

In general, they sketch a similar recessionary scenario, but differ somewhat in their arguments. Hunt, for example, notes that the leading indicators have been trending down for nine months—the longest such decline since the last recession. And both Hunt and Shilling stress that the lagged effects of monetary restraint, which can take as much as a year to appear, are finally starting to really bite.

All three bears agree that the sharp plunge in technology stocks and the widening market decline now threaten the expansion. Whereas the huge wealth increases generated by rising stock prices led households to stop saving and take on debt, the absence of those increases already is hurting sales of cars and other durable items. "As people realize they need to resume saving out of their paychecks, debt loads will feel heavier, and the sales picture will get uglier," says Levy.

The market decline is also curbing investment spending by high-tech companies that find venture capitalists more wary and by Old Economy companies whose lenders are spooked by the impending slowdown. At the same time, notes Hunt, the huge buying binge by both businesses and households of durable goods and capital equipment during the long expansion implies that pent-up demand has been satisfied.

"With private borrowing now totaling a record 130% of gross domestic product," he says, "many will decide it's time to pay off debt and digest these acquisitions." Since business investment, especially of high-tech items, has fueled half of recent growth, the expansion may lose one of its major engines.

Two other developments that have increased the downside risk for the U.S. economy are the rundown in energy prices, which has drained purchasing power from households and businesses the world over, and widespread signs of slowing growth overseas. Where economists once assumed that pickups abroad would offset sluggishness in the U.S., the new threat, says Levy, is that "each slowdown will reinforce the other."

Can a recession be avoided? Shilling is dubious, but the others think it's still possible if the Fed moves sooner toward lower interest rates. "From a policy standpoint," says Hunt, "the window of opportunity is rapidly closing."

WHEN DIRECTORS HAVE A BIG STAKE

Shareholders benefit big, too

Lately, more and more companies have been giving stock to outside directors as part of their compensation. But does this really improve corporate performance? The answer—according to a study by Donald C. Hambrick and Eric M. Jackson of the Columbia Business School—is yes, but only if the directors acquire significant equity stakes.

Using data collected by McKinsey & Co. on 40 sectors of the economy from 1986 to 1997, the researchers identified two companies from each sector whose stock market performance was similar in 1987 but then diverged sharply over the next decade. One member of each pair was a "star," whose stock returns far exceeded its sector's average, and the other was a "laggard."

Hambrick and Jackson report that pair members were similar in board size, number of outsiders, ages, director tenures, and even the size of equity holdings by insider directors. But they differed markedly in the amount of shares held by outside directors.

Among the stars, the outsiders' median holdings in 1987 came to 1.3% of company stock. Among the laggards, it was 0.1%. Some 45% of the stars had at least two outside directors who owned $500,000 or more worth of stock, compared with only 16% of the laggards.

The authors conclude that the outsiders' large initial stakes in the stars had a major impact on their subsequent superior performance, and they advise companies to structure compensation so that new outside directors can quickly acquire meaningful stakes. As one director put it: "I'm in for half a million dollars, and I can tell you I'm a heck of a lot more attentive to this company than I have been to the others."

CHANGING JOBS DURING A BOOM

In the '90s, did the desire wane?

You might think more workers would start looking for a better job as the economy expands and unemployment falls. But in the second half of the 1990s, the share of employed workers actively searching for a new job slipped from 5.6% to 4.5%, notes the Labor Dept.

The drop occurred among workers of all ages, but was more pronounced among those under 25. Job-search activities are always highest for workers in their early 20s and decline as people age. Similarly, highly educated workers are more likely than the less-educated to be looking for a different job.

Workers who lack health coverage or an employer-provided retirement plan are twice as likely to be seeking a new job as those who enjoy such benefits. And the most likely by far are those who are working part-time involuntarily.
Profit Woes Push Stocks Down Again  
**Dec 7, 2000**

Nasdaq Loses 3.2% After Its Record Gain

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**WEDNESDAY'S MARKETS**

**By E.S. Browning**  
*Staff Reporter of The WALL STREET JOURNAL*

Just as investors were starting to hope that the worst was over, earnings disappointments raised their ugly heads again, and the Nasdaq Composite Index gave back one-third of Tuesday's historic 274.06-point gain.

The Dow Jones Industrial Average gave back two thirds of its own 338.62-point Tuesday advance, knocked down both by technology stocks such as International Business Machines and Intel and by banking stocks such as J.P. Morgan. Many analysts said the real culprit for the day's swoon was an earnings warning from Bank of America.

The Nasdaq composite, dominated by tech stocks such as Intel, fell 3.23%, or 39.30 points, to 2796.50. The Dow industrials gave up 2.15%, or 234.34 points, to close at 10683.38. Trading was heavy. The Nasdaq composite now is 45% off its March record, while the Dow industrials are 9% down from their January record.

"This is a little surprising," said Alfred Kugel, senior investment strategist at Chicago fund-management group Stein Roe & Farnham. "They are taking back more than I expected."

Treasury bonds again soared, however, in part because investors moved some money to their relative safety. The yield of the 10-year Treasury note, which falls when the note's price rises, hit 5.295% in late New York trading, its lowest level since April of last year.

The dollar declined as foreign investors moved money out of U.S. stocks. Outside the U.S., stocks advanced in dollar terms.

Some analysts blamed the tech declines on Apple's warning of a loss for the current quarter, which came after the close of regular trading Tuesday. But others noted that the markets seemed to be weathering that news until Bank of America chimed in with a warning about more bad loans than expected and sharply lower...

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**Number of Dot-Com Job Cuts Climbed 19% in December**

*By a WALL STREET JOURNAL Staff Reporter*

CHICAGO—The number of dot-com layoffs accelerated in December, increasing 19% from November's record total, according to a study.

December marked the seventh straight month of consecutively increasing cuts in Internet jobs, reported job-placement firm Challenger, Gray & Christmas Inc.

U.S. companies announced plans to cut 10,459 jobs in December, up from 8,789 in November, the firm said.

The figures are hardly surprising given that the past several months have seen a rash of layoffs at Internet companies, which have been slashing work forces to trim expenses and conserve cash as many struggle to survive in the economic downturn.

More dot-com companies have gone out of business including online retailer Pets.com as venture-capital funding and other financing dries up.

In recent weeks, consulting company Scent Corp. announced it would cut 25% of its work force, while HomeGrocer.com, which is being acquired by Webvan Group Inc., trimmed more positions at its company.

The new report shows that the number of layoffs at Internet companies increased in the second half of the year. From January through June, dot-com job cuts totaled 5,097.

That figure was six times as high, rising to 36,177, for the period between July and December.

This year, 41,515 positions were trimmed from 496 companies, Challenger said.

Among the categories, Internet-service companies such as consulting, financial and information-service companies led the job cuts with 19,535, followed by retail dot-com companies with 9,523.
 Stocks take a big tumble

Inflation surge sends Nasdaq, Dow falling, dims recovery hopes

By Lisa Singhania
Associated Press

NEW YORK — The Nasdaq composite index fell to its lowest level in nearly two years Wednesday after an unexpected surge in inflation intensified investors' fears about the future.

The Dow Jones industrial average also plunged more than 200 points in heavy trading after the government reported the biggest increase in consumer prices in 10 months.

Analysts said the data made already nervous investors even more reluctant to take strong positions in a market that might not recover for a while.

"These inflation numbers were something that was not supposed to happen, and when you're in a tenuous market ... investors get scared," said Barry Hyman, chief investment strategist for Weatherby Securities. "There's just too many unknowns in front of the market at this point."

The tech-focused Nasdaq dropped 49.41 to 2,268.94, a decline of 2.1 percent and its lowest close since March 3, 1999. It is now nearly 56 percent below its all-time high from March of last year.

The Dow closed down 204.30 at 10,526.58, a loss of 1.9 percent and its weakest finish since Jan. 12.

The Standard & Poor's 500 index fell 23.67 to 1,255.27, a 1.9 percent drop and its lowest close in 16 months.

All three indexes are down for the year. The Dow is off 2.4 percent for the year, the Nasdaq down 8.2 percent and the S&P off 4.9 percent.

Wednesday's losses came on a Labor Department report showing a 0.6 percent gain in its Consumer Price Index for January — chiefly because of increases in natural gas and electricity prices, which have since eased.

Those numbers caught some market watchers off guard, although many believe that, at least in the short term, the inflation picture has become more benign.

See STOCKS on 5B

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BLOOMBERG COLORADO INDEX

State stocks lose again; index down 8% in February

By Samantha Zee

DOW 10,526.58 - 204.30
NASDAQ 2,268.94 - 49.41

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Tech stocks among big losers

STOCKS from 1B

for now, the data are an aberration rather than the beginning of a trend.

"In the current circumstances, these numbers are not as big a deal," said Merrill Lynch chief economist Bruce Steinberg. "The economy is weak, and you just don't get inflation developing in these circumstances."

But investors were not reassured. A broad stock selloff intensified late in the day after fluctuat-
Consumers Hit Pause Button on New Digital Gadgets

By EVAN RAMSTAD

Staff Reporter of THE WALL STREET JOURNAL

Of all the retailers this season, the electronics stores seemed to have the best situation: Shelves were full of nifty new gadgets, from digital cameras to pocket organizers to digital videodisk players. Nearby, powerful personal computers and big-screen TVs tempted shoppers.

But even the lure of fun toys wasn't enough to counter a malaise brought on by lousy weather, an endless election, higher energy prices and slumping consumer confidence.

Now, as electronics makers and retailers prepare for their big annual gathering in Las Vegas next week, both are scratching their heads to figure out how they can get customers excited again.

"The most interesting development of the year is, despite the introduction of so many hot new products, the sales trend at stores still slowed," says Peter Caruso, a retail analyst at Merrill Lynch.

Retailers did their best to turn the tide, resorting to promotional rebates and financing tactics they hadn't used since 1997. Both Best Buy Co. and Circuit City Stores Inc. offered no-interest-for-a-year financing. For post-Christmas shoppers, Best Buy also offered 10% off an unlimited number of DVD movies to purchasers of a DVD player, while Circuit City offered a free set of surround-sound speakers to buyers of Dolby digital audio receivers.

Even so, several large chains told investors they wouldn't meet expectations for sales and profit growth. Their stocks, the highest in retailing a year ago, fell to among the lowest.

Still, this year will set a record for U.S. consumer electronics sales. At the Consumer Electronics Show in Las Vegas next week, the industry's largest trade group, the Consumer Electronics Association, is expected to say that about $90.1 billion worth of electronic goods were shipped to U.S. retailers this year, up 10% from a year ago and 5% higher than its original forecast.

"It was a year that was much more variable than we've seen in the past few years," says Alan McCollough, chairman and chief executive officer of Circuit City. "It used to be new sales trends would take hold and they'd be with you for a while. We've seen this year bounce around."

In retrospect, retailers may have simply gotten carried away with their own excitement. For much of 2000, TV sales defied gravity and appeared headed to break the unit record set in 1994. Audio-product sales also rose strongly, and sales of PCs, though not as strong as in previous years, were at least growing.

Spurred by the robust sales, many retailers started stocking up on products for the busy Please Turn to Page B7, Column 1
Dot-com closures in January match November record

By Randy Whitestone

San Francisco — Dot-com companies continued to close at a record pace in January, with 49 ceasing operations, matching the record number of closures in November, according to research and advisory firm Webmergers.com.

An additional 112 firms were bought for $5.3 billion, said San Francisco-based Webmergers.com. Of those, 60 were Web sites, acquired for $623 million, one-sixth the year-ago figure of $3.7 billion for 57 Web sites as valuations fell.

In 13 months, 270 dot-coms have closed, 181 of them in the past four months, the company said.

"There were almost two weddings for every funeral in January," said Tim Miller, Webmergers.com's president. "We advise startups to begin planning for M&A as an exit option from the very beginning, at the business plan stage, and to start a concerted search for strategic partners or acquirers at least six to nine months before (they're) scheduled to burn through current cash reserves."

Infrastructure acquisitions accounted for more than two-thirds of all dollars spent on purchases in January as Ariba Inc. paid $2.5 billion to buy Agile Software Corp., which lets manufacturers and suppliers exchange information online.

Among shutdowns, 24 were electronic commerce firms and 14 content providers. The rest were access and infrastructure firms.

Feb 21, 2001

Rocky Mountain News
Internet Technology

Internet Companies

Give Me Your Tired.com, Your Poor.com

Eco Associates rehabs Net casualties for resale

Scott J. Hyten is known for roughing up Net startups, so you might expect entrepreneurs would run when they see him coming. In fact, Hyten, managing partner of the venture-capital firm Eco Associates, is a popular man these days. Eco specializes in investing in startups that are out of money and nearly out of time. In the past five months, he has received several hundred e-mails from frantic Internet entrepreneurs begging for his tough love. “I am the last resort,” he says. “When there are no doors left to slam in your face, you come here.”

Sounds risky, but Hyten believes the time is right for bottom-fishing. The eight-month-old Austin (Tex.) firm has raised $100 million to put into once promising startups felled by an unforgiving stock market and their own recklessness. So far, Eco has made six investments, totaling $30 million, including stakes in California golf gear e-tailer Chipshot.com, New York music and news Web site operator Urban Box Office, and drkoop.com Inc. In August, Eco and a group of California investors bought a 70% stake in the Austin health-information Web site for $27.5 million.

Cutting fat is Eco’s specialty. The firm looks for dot-coms with an established brand name, a busy Web site, and bloated expenses. After Eco enforces a strict weight-loss plan, its goal is to sell off its newly lean acquisitions to deep-pocketed, established companies that are looking for an online outlet. Finding waste was particularly easy at drkoop.com, where the bill for on-site massages totaled $9,000 a month and catered lunches on Fridays cost $15,000 per week. Eliminating those perks, firing 42 workers and the entire senior management team, and renegotiating money-losing partnerships have brought as much as $30 million in annual savings, says Hyten. He plans on selling the company soon.

Discipline W elcome d. Doing business with Hyten is no gentle experience for the once high-flying entrepreneurs, but they’re willing to put up with it. For the executives at Mall.com, a struggling Austin-based online shopping center, relinquishing power was more a relief than a sacrifice, says Pete Freix, the company’s newly promoted CEO. After blowing millions of dollars on misguided marketing attempts, including NASCAR race sponsorships, the company’s Web site was still unfinished. Says Freix: “Everything was out of control. We were a company in need of discipline.”

That’s exactly what Hyten gave Mall.com. After investing $5.8 million in November, he chopped the staff from 55 to 15 and slashed marketing to the bone. Instead, the company lured shoppers with coupons and other promotions. The result: The monthly operating loss—previously $1.1 million—was axed by 65%, and the Web site is averaging 1.2 million visitors per month, compared with 200,000 in July.

Hyten is a relative newcomer to both the venture-capital game and the art of cost-cutting. A former senior vice-president at tech consulting giant Computer Sciences Corp., he helped launch Austin venture-capital firm Interface Capital Partners in 1998, focusing on Internet startups. But when the dot-com meltdown came, he and his partners decided to hedge their bets with the Eco fund. Hyten predicts Eco will enjoy a rate of return of more than 100% over three years.

There are plenty of skeptics. Peter J. Nolan of Leonard Green & Partners, a Los Angeles buyout firm, has looked at hundreds of Web businesses but hasn’t found one worth rescuing. “The business models just plain don’t work,” he says. Hyten, however, is convinced that some of these companies are salvageable. And if Eco can resuscitate drkoop, it will have gone a long way toward proving there’s still life left in some of the seemingly terminal dot-com cases.

By Lori Hawkins in Austin, Tex.

Eco’s Recent Bets

| DRKOOP.COM | a health Web site. Eco’s Investment: $27.5 million, with others. |
| EXOPLEX | a technology services company. Eco’s Investment: $2.4 million. |
| MALL.COM | an online shopping mall. Eco’s Investment: $5.8 million. |
| URBAN BOX OFFICE | a network of sites featuring music, sports, and news. Eco’s Investment: $8 million, with others. |
PEOPLE KEEP ASKING IF THE TECHNOLOGY drubbing is over—or will be soon. As long as folks keep asking, you don’t have to. It isn’t over until they stop asking. The end is silent. Make no mistake, this is the middle of the bursting of a classic sector bubble. That should now be obvious to most. Less obvious is how these things end.

It is somewhat paradoxical, but sometimes a big sector correction, such as the 27% drop in the Russell 2000 Small-Cap Growth index over ten months in 1990, takes less time than a small correction, such as the 17% drop over 15 months in 1997-98. Either way, the correction takes a long time as investors first absorb the initial downward shock, then overreact.

My Mar. 6 column was devoted to showing you that the structural qualities of this sector bubble are almost identical to those of the 1980 energy bubble, and that the 1981-82 bursting was a great road map for the present situation. So far it has been.

My May 29 column detailed how the first downdraft is followed by a recovery of 50% or so of the lost ground. Three or four more downdrafts then alternate with partial recoveries, which abort in months. For tech, the first of those recoveries was June through September.

This goes on, hitting lower lows, until fully half those who jumped on the momentum play conclude they never need to own another tech stock for the rest of their lives. Longtime tech devotees won’t bolt, but most never adherents to the religion will become absolute atheists. They’ll sell, suffering real losses. Only then is the slide at an end.

Thus far this drop, which started in March, is about ten percentage points steeper and running five months faster than its 1981-82 twin. But that will slow. Note that the 1981-82 drop took 25 months to end. There is painfully plenty of time ahead—maybe another 5 to 15 months.

If you’re still overweight in technology, use the partial recovery to lighten up. By that I mean: If you’re managing your portfolio against the S&P 500, where tech is 27% of the U.S. market, you might reduce your tech weight to something like 16%. If, as this column does, you manage against the world via the Morgan Stanley’s World index (see “America Versus the World,” Nov. 27, 2000), where technology is 21%, then have 12% in tech.

Why have any technology stocks at all? Because among portfolio management’s most basic rules is: Always know that you may be wrong and that you must come out okay even when you are. If I’m dead wrong and tech soars, owning none of it will make you very sorry. You would not be able to beat your index with just the non-tech stocks, which will lack the needed oomph to catch up. If I’m right about technology, underweighting the sector will enable you to beat your benchmark.

Finally, among techs, own only the biggest and highest in quality. From the March peak through November America’s 15 largest tech stocks (measured by their March market caps) were down 35%, versus 43% for the Nasdaq Composite. But more important, they didn’t impede the way many of the tiny tech stocks did. And they won’t.

When tech falls, the best stocks in the short term are those that have what is called an inelastic demand for their products. That means if they raise product prices, consumers buy less, but not much less. Think of drugs, tobacco and (to a lesser extent) energy. Linking tech with drugs is a perfect example of blending stocks that are short-term negatively correlated. When tech zigs, drugs zag.

Among drugs right now I like: Germany’s Schering (57, SHR, www.schering.de), formerly part of Schering-Plough. It is a new stock, but it has longstanding strengths in a wide array of drug categories, with particular power in birth control. The global overpopulation problem won’t go away, so the need for contraception will grow. Despite drug industry consolidation, this recently divorced company is well-equipped to prosper on its own.

Akzo Nobel (53, AKZOY, www.akzonobel.com) combines drugs and chemicals. It is also the world’s largest paintmaker. If Akzo stock doesn’t rise, don’t worry. It’s also among the world leaders in antidepressants.

Danish Novo-Nordisk (89, NVO, www.novo.dk) is the world’s largest insulin maker. At 20 times trailing earnings and 2.3 times sales, it is cheap.

Kenneth L. Fisher is a Woodside, Calif.-based money manager. Find past columns at www.forbes.com/fisher or use your CueCat device on the cue code (right) to take you there instantly.
MODELS FROM MARS

Welcome, class of 2020. Today our virtual MBA lesson is on what we now refer to as the annus horribilis of the E-commerce Age. True, the year 2000 was marked by many notable headlines, among them the revelation that the cast of Survivor really stayed at the Fiji Hilton and not on that island. But today we will talk about the year that marked the nadir of the dot-com demise. In 2000, e-commerce companies tanked in the stock market, the companies couldn't get desperately needed additional financing, newspaper headlines screamed layoff after layoff, and many of the companies eventually went bust.

According to a survey by Webmergers Inc., in the first seven months of that year, of 289 dot-com startups, 41 collapsed, 22 were sold in fire sales, and 83 withdrew their plans for initial public offerings.

The problem was that the business models stank—i.e., the companies just couldn't make money. Amazon.com Inc., the poster child of the New Economy, ran up losses totaling $1.5 billion from its inception in 1994 to July of that year, and its stock fell some 70% off its all-time high. "Venture capitalists and investment bankers were the first to dream up these business models. They were great at hypeing stocks, but miserable when it came to delivering the goods," said David Tocci, co-author of a best-selling business book in 2000 called Digital Capital: Harnessing the Power of Business Webs.

Let's review some of the great flawed business models of that period:

**MODULUS TOILETUS PAPYRUS** (The Toilet Paper Model): A model most often assigned to the online grocers such as Webvan Group Inc. and Peapod Inc. in which items such as toilet paper and Häagen-Dazs were purchased over the Internet, then packaged and delivered to the front doors of millions of Americans. No middlemen, no problem—right? But there was a problem. With grocery margins as thin as 2% and things like packaging and delivery so expensive, it could cost the companies as much as $40 an order, and they struggled to make money. What's more, they realized that the warehouses they set out to deal with weren't technologically up to snuff, so they built their own. Webvan, for instance, doled out some $1 billion to build 26 state-of-the-art automated warehouses. They also didn't factor in tomatoesqueezer—those persnickety customers who insisted on actually seeing and touching produce and other perishables. Most of the online grocers were eventually bought out by offline competitors that already had warehouses and distribution centers intact. Peapod, for instance, was snatched up by the owner of the Stop & Shop Supermarket Co.

**MODULUS OBSCURUS** (The B or Not 2B Model): Sometimes called the B2B2EC model or the "Whatever" model, this was designed to morph through various configurations until whoever was in charge got it right. Adopted by companies such as mortgage.com, which, after losing $11 million on revenue of $11 million in the second quarter of 2000, decided it would focus on building an online mortgage infrastructure for other lenders rather than providing mortgage services to consumers. Another one, AskJeeves.com, the consumer search-service tool that was not reaping its targeted share of advertising revenues, decided midstream to push its software as a corporate search tool. Mortgage.com's stock dropped as much as 94% off its all-time high; Ask Jeeves Inc. was down 92%. Some of these companies succeeded, others continued morphing into other letters of the alphabet.

**MODULUS MALCONTENTUS** (The Mal-Content Provider Model): Content sites like APBNews.com, Salon.com, and TheStreet.com were anything but content, as in happy. In 1999, Salon lost $18.3 million on sales of $8 million. Beaten down by a variety of bigger players like America Online Inc. and Yahoo! Inc., which mostly purchased and displayed the content of others, these sites barely had a chance. What's more, as stand-alone entities, they were at a huge disadvantage in the media biz, where economies of scale continue to be a big advantage. The ones that charged for subscriptions had the hardest time of all. With so much free content on the Web, why pay? But...
even free sites that relied on ad revenues struggled. Sure, by 2002, $13 billion was spent on Web advertising annually, but there was still too much competition for ads from print and television. By and large, only sites tied to larger media organizations—ones that could leverage content, workers, and advertising across different channels—succeeded. The deep pockets backing these sites didn’t hurt.

**MODULUS MESHUGGENUS (Just Plain Crazy Model):** Exemplified by such companies as AllAdvantage.com, which actually paid customers who would submit to filling out demographic information and be tracked as they surfed the Internet. AllAdvantage lost $102.7 million through the middle of 2000 and was forced to withdraw its IPO. Another company, Buy.com Inc., originally planned to sell electronic goods at wholesale prices, hoping to profit from advertising because of the horde of customers that would flock to its site. Buy.com jettisoned its model and began to mimic traditional retailers, pricing some products cheaply as “loss leaders.”

**MODULUS CRITICUS SICKLUS (The Critically Ill Model):** Health sites were odd hybrids of content companies, sometimes featuring advice and sometimes selling vitamins, prescriptions, and the like. This model needed intensive care from the start. Companies such as drkoop.com Inc., Healthcom/WebMD, and MediConsult.com faced things like spiraling losses, layoffs, and defections of top-level execs. In 2000, drkoop’s stock fell some 96% from its all-time high. Problems boiled down to limited advertising and too much competition from general-content sites and sites of hospitals and health foundations.

At the height of the annus horribilis 2000, the flawed logic behind the business models seemed of little consequence to the venture capitalists and investment bankers. They simply loaded up on cheap stock and excitedly awaited the company’s IPO. When the stock skyrocketed and the lockup period ended, most of them quickly cashed out, looking for the next cash cow.

Spurring all this on were dot-com cheerleaders at brokerages and investment banks. As they enthusiastically cartwheeled from business model to business model, they assisted in drumming up short-lived exuberance for each among investors. “Buyer aggregators,” “surf-and-turfs,” and “metamediators” were treated like flavors of the month. E-commerce sector plays were mercurial too. B2C (business-to-commerce) was in one day, B2B (business-to-business) the next. There was even B2G (business-to-government) and B2E (business-to-employee); then B2B2E—companies that decided they needed to swing the other way, or maybe both ways.

But what about the P2P Model—the path to profitability? Few dot-coms adopted that one. In hindsight, it’s clear that it cost too much for those companies to acquire customers. It’s not that folks didn’t want to buy online—in 2000, customers spent some $40 billion online, and that continued to increase. The biggest problem was that most e-businesses were entering crowded fields. “Many seemed to have hid in basements and concocted business plans, totally unaware that six other teams were building the exact same model,” said Michael May, a digital commerce analyst at Jupiter Communications. The Internet made competition worse because customer retention was elusive. Jupiter reported that 76% of customers visited two or more sites, comparing prices before making a purchase. Consider Internet department store more.com. It spent an eye-popping $10.06 on marketing and ad costs to reap only $1.49 in revenue per visitor in 1999. Also, profit margins at most of these companies were just too low.

In an about-face, brick-and-mortar companies such as Wal-Mart Stores Inc. and Gap Inc. started beating e-commerce companies at their own game. With multiple channels—stores, catalogs, and the Net—they produced three times the annual sales volume per customer of a single online site. “We’re seeing traditional brick-and-mortar players gaining more and more online revenues because they’ve got existing infrastructure,” said Carl Lenz, director of research at Gartner Group Inc.

As we now know, the biggest winners in online commerce were brick-and-mortars or companies like eBay Inc. that created entirely new commercial transactions via the Internet—ones that would be difficult or impossible in the offline world. “It all comes down to the fact that the Web is essentially an information medium,” said Kevin Murphy, an analyst at the Gartner Group.

Today, we don’t even use the term “Internet business model” unless it’s meant as slang, referring to something that is inherently faulty or quickly outdated (Modulus Outmodudex).
IF HE WINS...

How Bush Would Govern
The Economic Team
The Senate’s New Power Blocs
Dealing With Global Hot Spots

THE TECH SLUMP

Even if the Nasdaq starts rising, the industry downturn is real. Will it take the economy down, too?
THE TECH SLUMP

Slowing growth, not negative growth, is what's in store. But that's bad enough.
Not long ago—"it was different"

Not long ago, it was easy to dismiss worries about an impending technology slump. Sure, PC sales growth was slowing—but industry bellwethers such as Gateway Inc. and Hewlett-Packard Co. were still expanding smartly. Yes, chip giant Intel Corp. reported that growth would ease, but only because of the weak euro. Granted, telecommunications companies were slowing purchases of new equipment, but hey, look at networking-gear supplier Cisco Systems Inc.'s 66% growth rate. Technology is way too strategic an investment to cut, right?

Wrong. Suddenly, not even an imminent end to the Presidential fight, a strong hint from Federal Reserve Chairman Alan Greenspan that he may be close to lowering interest rates, and the consequent 10% rise in the Nasdaq on Dec. 5 can banish the awful truth about tech spending: Instead of big across-the-board hikes—a trend that has been going on for years now—countless corporate info-tech officers are scrutinizing every penny. Some are even talking about cutting back the budgets they pour into tech. Clearly, tech spending is no longer the magical elixir that helped supercharge the economy for a record 37 straight quarters.

For now, no one is talking about an actual downturn in overall tech spending. Slowing growth, not negative growth, are in store. But after the phenomenal performance the sector has boasted in recent years, that will be plenty painful. And every week, new evidence that growth is slowing mounts. In recent days, networking-gear maker 3Com, PC maker Gateway, and chipmakers LSI Logic and Xilinx, and electronics retailer Circuit City all warned that earnings will fall short of expectations, knocking their stocks down as much as 36%. Then, on Dec. 5, Apple Computer Inc. dropped a bomb, saying that slower-than-expected PC sales will vaporize $600 million in fourth-quarter revenues from its original estimate of $1.6 billion. As a result, Apple will post its first loss in three years, sending its stock down 16% on Dec. 6, to 14, the lowest level since March, 1999. Says Apple CEO Steve Jobs: "It looks like we're facing a broad economic slowdown that will affect many segments."

Moreover, the unexpected turn for the worse seems certain to reverberate throughout techdom—forcing consolidation that will extend far beyond the tiny dot-coms that have been the victims so far this year. Unable to survive past the easy-money days, a lot of companies, from niche e-tailers to the umpteenth optical-networking upstart, will simply vanish. "A gigantic scrubbing is going to happen," says Joel Ronning, CEO of Digital River, which runs Web sites for 3M, Novell, and others.

All this has Wall Street analysts backpedaling
Cover Story

faster than they can say "oops." On Oct. 1, according to earnings-estimate tracker First Call Corp., analysts predicted that tech-sector earnings would rise 29% in the fourth quarter. Now, they’ve slashed that estimate to 15%. Expectations for communications-gear companies are sliding even faster. From a 4% earnings decline expected on Oct. 1, analysts now foresee a 45% plunge. And for 2001, they’ve cut overall tech earnings projections from 24% to 17%.

That’s bad news—and not just for the tech sector. A tech slump would have an outsized impact on the overall economy. Tech spending and the huge productivity gains it has made possible have been the main engines of the record-breaking economic boom (page 62). But now, that tech engine appears to be sputtering. According to recent Commerce Dept. figures, the annualized growth in new orders for information-technology equipment fell to a meager 1.2% in the third quarter from 34% just a quarter before. And scaled-back spending by both consumers and businesses is putting an ever-tightening squeeze on tech players. The growth in consumer spending on telephone services, for instance, fell to 3.1%, a third of the rate a year ago. Meanwhile, business purchases of communications gear actually fell 2%, down from a growth rate of 65% in the first quarter. All of this has contributed to a sharp slowdown in gross domestic product. On Nov. 29, the Commerce Dept. reduced its GDP growth estimate for the third quarter from 2.7% to 2.4%, the slowest rate in four years.

Until now, the underlying problem persists: The great pools of money that fueled the tech-buying binge—the market for initial public offerings, the debt market, and corporate earnings—are starting to dry up.

The financial cracks in the tech juggernaut are plain to see. Venture capital is on the wane: Third-quarter venture investments totaled $25.9 billion, down 6.8% from the second quarter, according to fund watcher Venture Economics—the first drop since 1996. Crosspoint Venture Partners, for one, even dumped plans for a new $1 billion fund, partly because they can’t get returns from IPOs, which have slowed to a trickle. And debt markets, which drove furious investments in telecommunications equipment, have been bottled up as companies have struggled to make adequate returns on the huge investments already made on high-speed networks. Overall, telecom companies had been raising a total of $8.3 billion a month in debt and equity. Now, that spending has dwindled to a trickle, to just $1.3 billion in November.

Most damaging of all, however, is the extent to which the world’s largest purchasers of technology, from General Motors to Nestlé to First Union, are cutting a cold eye on all of their spending. In dozens of interviews with top technology purchasers, BUSINESS WEEK found that many companies are cutting back or rethinking big spending. Especially hard-hit are these purchasing trims: PCs and older telecommunications gear that don’t provide much profit bang for the buck.

"We will spend significantly less for the next couple of years," says John Hollenbeck, executive vice-president for technology at title insurer First American Financial Corp. "I’d say tech spending will be flat to down."

Even those companies that are holding the line or raising tech spending are focusing strictly on technologies with a clear payoff. That includes more efficient computer servers, fast networking gear to speed their operations, and Net software that cuts costs or forges stronger links with customers and suppliers.

So far, the cuts are acute in a few big industries. Telecom

ANGST IN THE AIR

Consensus earnings estimates are falling fast

DATA: FIRST CALL CORP.

56 BUSINESS WEEK / DECEMBER 18, 2000

Table: Overall Tech Sector

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the economy, it doesn't take long for CEOs to say: “Hey, wait a minute, what does this spending do for the bottom line?” says Ralph Szygenda, CIO’s chief information officer. “We’re just going to become more frugal.”

The slowing economy isn’t the only problem. Making matters worse, for the first time in 20 years, technology may be suffering from far more than its usual periodic bouts of overproduction that follow boom times. Now, it’s on the verge of plunging into a bona fide slowdown.

PLUNGING RETURNS. It’s all a far cry from the boom times of just a few months ago. What went wrong? For starters, flagging consumer demand. Some 60% of American households now own at least one PC, according to market researcher IDC. The PC slump is also hurting the company’s bottom line. They’re being forced to cut prices, leading First Call to reduce its estimate of 96% profit growth this year to just 18% next year.

Businesses are feeling the cold chill of winter, too, and they account for most technology spending. Take telecommunications companies. Hoping to tap into new markets such as wireless and the Internet, they’ve been jacking up capital expenditures by 30% a year for the past two years.

The glut of would-be players, coupled with revenues that have risen only 11% a year, means returns plumbed—and now, so is spending. Merrill, Lynch & Co. predicts that telecommunications spending will actually decline 1% next year, to $32 billion, and fall 5% more in 2002. That huge shift seems certain to wreak havoc with telecom suppliers. Especially vulnerable are those focused on older technologies, such as Lucent Technologies. Telecom suppliers had been counting on 15% to 30% hikes for years to come.

The falloff in corporate IT spending has spread worldwide, too, coming home to roost among American suppliers. In Europe, slow adoption of Microsoft Corp.’s new Windows 2000 software has pulled down corporate PC sales by over 20% this year, according to Context Research International Ltd. in London. That slammed the earnings of tech powerhouses Intel and Dell Computer Corp., which had counted on the European market for a sales boost. “We used to renew our PCs every three years,” says Jean-Claude Diapaux, IT director at Nestlé. “Now, we may keep our older Pentium II machines longer.”

Moreover, as the dust settles on the dot-com shakeout, it is becoming clear that the frenzied tech spending they unleashed in recent years was like a snowball, gathering up everything in its path. Up to now, even big companies chose

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Earnings forecasts fall
to spend huge sums just to keep pace with the dot-com up
starts that seemed poised to eat their lunch. With that threat
starting to melt, “there’s less pressure on brick-and-mortar
companies to spend a lot,” says Tom Kucharvy, president of
business consultant Summit Strategies Inc. “The days of the
Gold Rush of the Internet generation are over,” agrees GM’s
Szygenda. “Now, it’s ‘Show me the real benefits.’”

Compounding that caution is yet another hangover from the
‘90s high-tech-spending party: slowing investment in
some back-office software and hardware upgrades. Even
before the Internet and Y2K, corporations through most of
the decade were frantically upgrading their back-room sys-
tems with new software, such as database programs from
com-service providers. In November, Lu-
cent said it is lowering estimates partly
because it might not collect on some of
that revenue. “It’s absolutely a concern,”
even for still-booming companies such as
Cisco, says Jim Cottle, a technology ana-
lyst at the University of California En-
donment & Employee Pension Fund,
which owns shares of Lucent, Cisco, and
Nortel Networks.

To put all this in perspective, however,
even with the relentless doom-and-gloom
announcements, no one yet believes that technology-spend-
ing growth overall is going to turn negative. Indeed, despite the increasing signs of trouble,
market-research consultant GartnerGroup is
still sticking with estimates it compiled sev-
eral weeks ago that overall spending on info-
technology hardware, software, services, and tele-
communications as a whole could rise 11.6% next
year—just a hair under the 12% expected this
year. Moreover, not every company is cutting
spending. “We’re running at full bore,” says
Jim Yost, vice-president for corporate strategy
at Ford Motor Co., which is one of several
large corporations with no plans to trim infor-
mation-technology budgets. “The need to spend
it dollars has never been higher.”

Maybe. But it’s hard to see what hot new
products or services might turn the situation
around in the short term. In previous tech
downturns, new products and lower prices of-
ten provided the spark for a rebound. In 1990,
the arrival of Microsoft’s Windows 3.0 and the
advent of low-cost PCs from Apple and others
sparked new demand for PCs.

This time around, Windows 2000 doesn’t ap-
ppear to be a barnburner with corporations or
consumers, who find little reason to upgrade.
Some devices and services, including high-speed
data services such as
dsl, handheld computers, interactive TV
units, and Dvd players are selling well.
But together, these newfangled devices and
services aren’t much more than a
rounding error com-
pared with the PC in-
dustry. “There’s just not many products that cost $1,000 and
sell 120 million a year,” notes SoundView Financial Group ana-
lyst Mark Specker.

That’s why investors will be watching tech like hawks
from here on out. Michael Kwatinetz, a managing partner at
Azure Capital Partners, a San Francisco venture-capital
firm, for one, expects the dot-com meltdown to hit even
erver sales, which have been booming. If so, look out below,
says William T. Coleman III, CEO of software maker BEA
Systems Inc.: “If Cisco and Sun Microsystems start losing
sales, then there’s real trouble. There’s a recession going on.”
That hasn’t happened yet. But until the spending swoon
abates, neither the tech industry—nor the U.S. economy—
will be out of the woods.

By Robert D. Hof in San Mateo, with Peter Elstrom,
Steve Hamm, and Marcia Stepanek in New York, William
Eckhison in Brussels, Peter Burrows in San Mateo, and bu-
reau reports

Cover Story

Oracle Corp. and enterprise-planning software from SAP.
Now, for most large companies, that’s done, so growth is
slowing. “The internal stuff, reengineering stuff, has been
winding down,” says David Drew, chief information officer
for 3M. “Our information-technology costs will rise slowly,
but less than sales growth.”

**ABSOLUTE CONCERN.** As the tech-spending boom unwinds,
the problems could accelerate for a little-known reason:
Many technology suppliers essentially have been paying for
their own sales with aggressive financing of their customers’
purchases. Analysts think that’s especially a problem in
fast-growing areas such as networking gear, where startup
customers such as dot-coms suddenly go under and can’t pay
their bills. That creates a double whammy, because equipment
suppliers are not only looking at reduced sales going
forward but also at a loss of sales already booked.

Lucent, for instance, extended more than $7 billion in
financing to customers, many of them struggling young tele-

Strict Standard

Even those compa-
nies that are raising
tech spending are
focusing strictly on
purchases with a
clear payoff

PERSPECTIVE
THE INFORMATION PARADOX
REALIZING THE BUSINESS BENEFITS OF INFORMATION TECHNOLOGY

Is investing in Information Technology a smart move or merely an expensive corporate habit with little return?

Organizations today are investing in Information Technology (IT) like never before, to the point where spending on IT is the largest single element of capital investment for most enterprises. A wide range of desires is driving this spending—from routine productivity improvement to improved customer service to business transformation. Unfortunately, few of the executives approving multi-million dollar investments in Information Technology have a clear idea of the results that they expect to get. And once the money has been spent, they have trouble demonstrating clearly which benefits were actually achieved.

At the best of times, IT works productivity miracles and drives logistical breakthroughs. At the worst of times, advanced new information systems become “white elephants.” Some major IT delivery projects are canceled. Others take twice as long to complete and may cost 200%-to-300% more than expected. When the technology is finally delivered to desktops, too many people may spend weeks “playing around” with new software instead of using it to produce business results.

The Information Paradox

The fact is that the increasing amounts of money being spent on IT are not being consistently translated into business value. This is the Information Paradox—the conflict between the widely held belief that investing in IT is a “good thing,” and the all too frequent reality that we cannot demonstrate a connection between investments in IT and business results. In the words of Nobel prize-winning economist Robert Solow, “You can see computers everywhere but in the productivity statistics.”

What the Information Paradox means, in practical terms, is that managers face excessive levels of risk when designing and delivering IT-based business solutions. There is a small pack of leaders who consistently make winning investments in big-ticket business applications of IT. There is an equally small group of stragglers who rarely get it right. Then there is the silent majority: those who get it right sometimes but not often enough. This “hit or miss” approach must be replaced with a more rational way of aligning risks with rewards. Two questions are key to the solution:

• First, how to pick the winning IT investments?
• Second, how to realize the benefits from these investments, and know that you have done so?

This book, important reading for all business managers, presents a unique approach to help you answer these questions. Called the Benefits Realization Approach, and developed by DMR Consulting Group, a division of the Amdahl Corporation, it resolves the Information Paradox by introducing a new benefits-focused mindset that integrates technology with the process, organizational and people elements of your business.

Look for more information about THE INFORMATION PARADOX on www.informationparadox.com or to read a complete book chapter, please visit www.businessweek.com/ad section/specad.htm

This summary of the Information Paradox is sponsored by

Please visit our sponsor’s Web site at www.amdahl.com.
Ways to Use Technology

A. During Sep 1999 to April 2000 in USA

- A lot of hype about technology
- NASDAQ tech stocks went up by big leaps
- People were told that spending a ton of money on technology would help their business a lot.

B. The two ways to use technology:

1. Spend a lot of money and hope that it will do some good for the business.
2. Consider business processes and develop methods to make them better and more cost effective.

C. The status in Dec 2000:

- The tech world is getting more sane.
- Item B.1. above, is going out of favor.
- Tech stocks are way down after March 2000.
- Many dot com companies have gone out of business.
- More businesses want real results from tech spending (item B.2. above).

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**STRICT STANDARD**

Even those companies that are raising tech spending are focusing strictly on purchases with a clear payoff

Roy Jenne
11 Dec 2000
New Hopes?
Tech Stocks Get Boost

Dec 12  MONDAY'S  Wall St
2000  MARKETS

By E.S. BROWNING
Staff Reporter of The Wall Street Journal

Hopeful of an end to the electoral uncertainty and of a Federal Reserve interest-rate cut next year, investors bid technology stocks up strongly, sending the Nasdaq Composite Index above 3000 for the first time since Nov. 17.

In a second-consecutive session of strong gains, the tech-dominated Nasdaq Composite rose 3.35%, or 97.67 points, to 3015.10, up 16% from its Nov. 30 close of 2597.93.

Even after those gains, the index is still down 40% from its March 10 high. And on top of the election and interest-rate hopes, tech stocks got a boost from a long-time tech bear, Morgan Stanley Dean Witter investment strategist Barton Biggs. Mr. Biggs told CNBC that the Nasdaq was due to rebound after heavy selling.

"We could get a rally on Nasdaq back toward 3500, and a 10% rally" in the Dow Jones Industrial Average and the Standard & Poor's 500-stock index, Mr. Biggs said in an interview. But he added that he expects the rallies to be short term, and sees tech stocks coming under fire again in the new year, amid worries about future earnings.

The Dow industrials, less influenced by the volatile tech stocks, advanced 0.12%, or 12.89 points, to 10725.80, and the S&P 500 gained 0.75%. The Dow industrials, far less damaged than the Nasdaq this year, are down 8.5% from their January record, and the S&P 500 is 9.6% off its March record.

"What's driving it is the hope that we will have a quick conclusion to the presidential uncertainty," said Brian Comroy, head of listed trading at J.P. Morgan. In addition, many investors interpreted a speech by Fed Chairman Alan Greenspan last week to mean that the Fed may think about cutting interest rates next year.

Some investors who had taken money out of stocks have begun putting it back in, Mr. Comroy said, and the sight of the market recovering in recent days has made still more investors follow suit.

"When the market held, people started coming back into the tech stocks, started to take some chances," he said. "They are
Nasdaq Falls to Nearly 50% Below Record High

Earnings Warnings Push Index Down 4%; Blue Chips Lose 2%

By E.S. Browning
Staff Reporter Of The Wall Street Journal

Another barrage of stock-selling sent the Nasdaq Composite Index to nearly 50% below the record it hit in March, with a late-day rally softening the pain only a little.

Nasdaq, which made history with its record gains last year and early this year, now is piling up dubious milestones on the down side. Its 23% drop in November marked the second-worst month ever for Nasdaq since its inception in 1971, behind only the stock-crash month of October 1987 when it fell 27%.

Staggered by the latest pair of earnings warnings from technology companies, computer maker Gateway and chip maker Altera, the tech-led Nasdaq composite yesterday dropped 4.5%, or 109.00 points, to 2597.53. Nine months ago, investors had giddily celebrated Nasdaq's first close above 5000.

Trading was heated. Volumes on both the Nasdaq Stock Market and the New York Stock Exchange were their second-highest in history, both just shy of records set April 4, at the start of the Nasdaq sell-off.

Although the Dow Jones Industrial Average is less exposed to tech stocks than the Nasdaq, the selling spilled over to non-tech issues as well. The blue-chip index fell 0.2%, or 214.62 points, to 10414.49. The Dow Jones industrials are far from their low for the year of 9796.03, but they still are down 9.4% since the year began.

"It looks like they shot them all" yesterday, said Tim Morris, chief investment officer at Bessemer Trust in New York.

Mr. Morris said that, despite the late-day rally, "Nasdaq...
History: Oct 1999

This was written when the Tech mania was very strong.

From Oct 1999 to Mar 2000, the Nasdaq stock index went from 2,700 to a peak of 5,049 on March 10.

We're all tech investors now. At the end of the third quarter, the tech stocks in the Standard & Poor's 500-stock index accounted for a shade under 25% of the index' market capitalization, compared with 19% in December and a mere 7% in 1992.

If you are one of the millions of investors who have sunk some $750 billion into S&P index funds, either directly or through a 401(k) plan, one out of every four of your dollars is now in tech stocks.

BULGING SECTOR. Technology stocks surged from 21% to 25% during the third quarter. That's because tech made gains of 4.4% while other sectors lost ground. If not for tech stocks, notes portfolio strategist Leah Modigliani of Morgan Stanley Dean Witter, the S&P would have been down 9% during the quarter and down 1% year to date. With tech's contribution, the quarterly loss was 6.6%, and 1999 performance remained positive at 5.3%.

This tech bulge is not just a quirk of the S&P. The Russell 1000, a broader large-cap index, is 21.5% tech, too. And just about any U.S. diversified mutual fund that's making tracks these days is fueled by tech stocks as well.

One explanation for most funds' sluggish results is that they haven't invested enough in technology. "If tech is 25% of the market and you're underweighted in tech, it will take extraordinary stock picking to beat the s&p," says Thomas D. Stevens, chief investment officer for Wilshire Asset Management.

There is a downside to the market's dependence on tech stocks. They are more volatile, and contribute to sharp swings in the market that unnerve investors. Moreover, while tech companies account for one-quarter of the market cap, they contribute only 12.6% of operating earnings. So if one big tech player disappoints at profit time, the bad news reverberates over a large swath of the market. After the market closed on Oct. 12, Intel reported profits came in a few cents per share shy of expectations. That helped send the S&P down 2.1% the next day.

History shows any one sector cannot maintain its dominance forever. Energy peaked at 30% of the S&P in 1980, and it's now 6.3%. And consumer staples jumped to over 20% in the early 1990s, but they're only half of that today.

Still, there's a powerful case to be made that tech will rule for years. Investment strategist Jeffrey M. Applegate of Lehman Brothers urges clients to overweight technology in their funds because the companies are the principal beneficiaries of a powerful macroeconomic trend: the substitution of capital for labor. Driven by the falling cost of technology, capital-goods prices are declining at a 4% annual rate while labor costs are increasing by 3%. Says Applegate: "If these aren't the growth stocks of our era, I don't know what are."

And whether or not you invest in these companies, it's hard to imagine that the 75% of the market that's not technology would remain healthy if these stocks got sick. Let's go, tech.

Senior Writer Laderman writes about the stock market.

Oct 25, 1999, Business Week, Page 136
Good Use of Engineering and Technology

Here are some stories that show a good engineering focus and skills to try to make better products at lower costs. It is clear that the competition is intense. Buyers will want both good products and lower costs.

Singapore's order for 16 Airbus A3XXs means chocks away for the super-jumbo—and the end of Boeing's 30-year monopoly at the top end of the airliner market.

The deal has been won only after a vicious battle with Boeing. On the one hand, Airbus has been offering launch customers deep discounts to the $200-plus list price of the new aircraft. On the other, Boeing has been promising cheap versions of a stretched 747, which it plans to develop, at a cost of only $4 billion, as a spoiler to the A3XX.

Now remote. It had initially hoped to share the crucial Singapore order with Airbus: many commentators had thought that the airline would hedge its bets by buying some A3XXs but also signing up for the updated 747, known as the 747X. However, this is now thought to have been ruled out. Singapore may have been swayed by Airbus's promise that the A3XX will be 20% cheaper to run than today's jumbos—even though Boeing now claims that an upgraded 747 could match this improvement.

BOEING GETS BLOWN SIDEWAYS

A jumbo Airbus order hurts, but...
Europe Builds An Exciting Mars Mission
(At a good cost)
(Note the good technology planning)

Europe Targets 2003 Mars Touchdown

MICHAEL A. TAVERNA/ PARIS

A mission underway at the European Space Agency will mark Europe's entry into the Mars exploration effort while pushing the boundaries of Martian science and technology to new limits.

Mars Express is intended to conduct the most thorough search yet for the presence of water or other signs of life on the red planet, despite a budget that would make NASA planners blush. Mars Express will comprise an orbiter costing 150 million euros ($127 million) and a lander, Beagle 2, that will cost barely 50 million euros—by far the cheapest Mars project ever. The probe will be ESA's first Flexible mission—the agency's answer to NASA's "faster, better, cheaper" approach.

The likely presence of frozen water at the Martian poles has been long known. Previous missions have discovered water vapor in the planet's thin atmosphere, along with evidence on the planetary sur-

The Mars Express orbiter will carry seven instruments supplied by institutes in France, Italy, Germany and Sweden—all of them contributing in some way to resolution of the missing water mystery. "Each of them will represent an important innovation in Martian exploration," Cordi

dini said.

MARS EXPRESS is scheduled to be launched by a Starlre Soyuz/Fregat booster in June 2003 and to arrive in the vicinity of the red planet in the last days of 2003—virtually at the same time as two NASA landers and Japan's Nozomi orbiter.

Scientists are still working out how to coordinate the operations of these spacecraft—the most ever to be present on and around Mars at the same time—in order to maximize science return.

Despite its low cost, Mars Express is considered low risk owing to its use of existing technology and innovative management and process design.

- Transferring interface management tasks to industry and the academic community. In one instance, orbiter prime contractor Astrium is responsible for interacting directly with principal investigators and launch service providers, a job previously handled by Estec, ESA's technical unit. The result: Estec's Mars Express team comprises just 10 people—half the figure for a typical project. A major innovation was to farm out the entire lander module, comprising the entry, descent and landing unit and lander platform, to the academic com-

- Pushing miniaturization to the limits. Payload, lander, spacecraft and on-board fuel will not exceed 1,070 kg. (2,354 lb.) at launch. The seven-instrument orbiter science package will weigh just 116 kg., the lander only 60 kg.

This approach has made it possible to cut the time from concept to contract award from five years to one, and to shorten the design and development phase from six years to four. The number of models required has also been reduced.

"We are making savings, but we are not taking big risks," Rudi Schmidt, ESA project manager for Mars Express, stressed. Measures include:

- Making maximum use of off-the-shelf and preexisting technology. About 80% of the orbiter hardware will be borrowed from the Rosetta comet mission, which is to be launched the same year as Mars Express. Other elements, such as tanks and thrusters,
Tech aficionados had it all figured out in January. “There is simply outperformance and underperformance,” they crowed. Winners bought the rapidly growing tech stocks, regardless of price. Losers looked at fundamentals. “The world has changed,” they stated, “and the only ones in denial are the ones underperforming, and who will continue to underperform.” Value, according to these folks, was dead. Its fans were dinosaurs.

But something strange is happening in the dinosaur boneyard. For as the tech-laden Nasdaq gasps for breath, the dinosaur stocks are not only alive, but stomping out major appreciation. Is this simply a momentary phenomenon? Or is the change more profound?

Let’s first look at the Nasdaq. This index’s gain between January 1996 and February 2000 was the steepest climb enjoyed by any large index in the history of bull markets. The rise was powered by legions of experts who preached that here was one of the greatest technological revolutions this planet, at least, had ever known. Why shouldn’t a Priceline.com go from 16 to 162 at its high or an Amazon from 18 to 355? Forget cash flow, forget earnings, forget the fact that prices were running at 20 or more times revenues. These were all irrelevant when the new technologies would earn trillions.

Helping fuel the excitement were “new metrics” that would more accurately measure the boundless profits the tech tyros would reap. After all, the old fundamentals, used by investors for generations, were clearly obsolete. So battalions of analysts gleefully explained how they had discovered a new formula. Unfortunately, most broke down within weeks of launch.

In the past months we’ve seen Internet stocks crumble, followed more recently by technology blue chips such as JDS Uniphase, Dell, Lucent and Nortel. The Nasdaq is now 40% behind its high of last spring. It hit a new yearly low in November. The average tech stock is down 50% from its 2000 high—more than the drop in any major average since the 1930s—with many stocks down 80% or 90%.

So where is the Nasdaq heading from here? I wouldn’t be optimistic. Defenders of tech stocks say that, after a correction to bring the group down to more realistic levels, the index should bounce sharply. Oh, really? If a Juniper Systems was overvalued at 843 times trailing earnings, it’s hard to argue that the stock is fairly valued at a P/E of 589. Seems there may be a trifle more overvaluation to be squeezed out.

Add the increasingly widespread realization that these new stocks do not have magic amulets to protect them from the slowdown in the business cycle. They remain very vulnerable to more bad news. Look at the earnings torpedoes that have lopped valuations of giants like Lucent, Intel and Apple in half.

I was early in my call in January 2000 that the Nasdaq bubble was nearing its end. I’m not too early now. No question we will see sharp rallies in the weeks or months ahead, but I see Nasdaq touching 2500 to 2000 before the end of next year.

Fortunately for folks who have not put all their chips into technology, Nasdaq’s problems have helped the rest of the market, particularly value stocks. Fannie Mae, Freddie Mac, Nabisco and Washington Mutual, which I recommended early in the year while techies gleefully skewered them, are up 67%, 68%, 257% and 114%, respectively, from their early-year lows.

The comeback in value has taken place across the board—from oil to banks, from financial services to health care, from tobacco to utilities. A lesson to be learned is to stick with your convictions. Many value managers (including me) held fast as their portfolios took a shellacking, along with verbal abuse from a number of outspoken market savants. Value portfolios are now up substantially for the two-year period.

The shift in direction is not over. The reevaluation of value stocks is likely to continue for at least the next several years, because they are still very cheap relative to the market, even after their run-up. Here are several to consider: airline AMR (34), with a P/E of 5; Cooper Tire & Rubber (CTB, 9), P/E 6, yield 4.5%; missilemaker Raytheon (RTN.B, 33), P/E 30, yield 2.4%; and the Northeast’s Sovereign Bankcorp (SVRN, 7), P/E 9, yield 1.4%.

David Dreman is chairman of Dreman Value Management of Jersey City, N.J. His latest book is Contrarian Investment Strategies: The Next Generation. Find past columns at www.forbes.com/dreman or use your CueCat device on the cue code (right) to take you there instantly.

F O R B E S  •  D e c e m b e r 1 1 , 2 0 0 0  3 5 7
COMMENTARY
By Rich Miller and Laura Cohn

THIS IS YOUR CAPTAIN SPEAKING...

On Dec. 5, four years to the day after warning stock investors about irrational exuberance, Federal Reserve Chairman Alan Greenspan reassured the markets that the Fed is on the job. Wall Street liked what it heard, at least initially. The Nasdaq experienced its biggest rise in its 29 years, while Treasury bond prices tumbled up their best gain in almost four months. So did Corporate America. "Bush. Gore. Either one, we can work with [him]," says Ford CEO Jacques A. Nasser. "Just keep Alan Greenspan doing what he's doing."

DECELERATION BY DESIGN. Using the venue of a speech to community bankers, the Fed maestro took on the growing chorus of critics who worry that the country may be headed for a recession. He laid out his case that the economy is decelerating by design, not spiraling into an uncontrolled nosedive. While tacitly acknowledging that the soft landing he has engineered for the economy may end up bumpier than planned, he argued that things aren't as bleak as the pessimists on Wall Street—and on the Bush team—would have it. Behind the extraordinary round of jawboning: fear that excessive pessimism on the part of investors, consumers, companies, and lenders could turn a much desired slowdown into an unwanted slump.

Greenspan also made it as clear as a central banker can that the Fed stands ready to cut interest rates. If consumers and companies become too cautious about spending, or if the stock market falls too far, the Fed will be there with easier credit to cushion the fall.

His message was meant not only to reassay financial markets but also to signal some of his more hawkish fellow policymakers at the regional Fed banks that it's time for them to fall in line behind their leader. After six rate increases over the past year and a half, a rate cut could come as soon as the Fed's next policymaking meeting on Dec. 19, experts say. Still, it's more likely to occur in January, after the Fed has had a chance to assess the holiday shopping season.

But critics charge that it's already too late for a rate cut to be of significant help. "The odds of a recession are about 60%," says Brian Wesbury, chief economist at Griffin, Kubik, Stephens & Thompson in Chicago. "Even if the Fed were to cut rates today, they could not stop [the downturn] from happening because it takes time for monetary policy to affect the economy."

Other Wall Street worrywarts are gloomy for different reasons. "It's not just a monetary policy-induced slowdown," says James W. Paulsen, chief investment officer at Wells Capital Management. "It's coupled with a new-era economic slowdown in tech." And while higher rates and tighter financing conditions have played a role in the high-tech shakeout, deeper demand problems will continue to restrain spending on telecoms and PCS regardless of the level of interest rates.

Fed officials admit that the satinsmooth landing they had planned for the economy—with growth slowing to 3% next year from more than 4% this year—now looks unlikely. Oil prices, though down, remain stubbornly high. Corporate profit estimates have been slashed. Inventories of everything from cars to microchips are piling up. And labor costs have been rising.

The result: Growth next year could come in closer to 2%. While that's not bad by historical standards, it's well below the heady growth the U.S. has gotten used to. For many consumers and companies, it will feel like a recession. And if they cut back spending accordingly, it could turn into one.

Miller and Cohn cover the Federal Reserve from Washington.
Spending and incomes weaken

Continued from 1D

388,000 last week, the highest level in more than two years.

The 0.2 percent rise in consumer spending in October, the small-
ner than expected gain, was the third consecutive moun-
supposedly slowing economy.

WASHINGTON — Consumer spending rose in October at the
weakest pace in six months while the economy, which had been
booming after a recession, kept muddling through.

An increase in spending, which had been up sharply in recent
months, was expected to slow in October as the auto industry
recovered from a plant closure.

The Commerce Department said personal incomes fell by
0.2 percent in October, reflecting a drop in wages for work-
ers. But spending increased by 0.3 percent, showing that many
people were using their extra income to boost purchases.

Economists had expected a decline in spending, as many
people had cut back on discretionary spending in response to
higher taxes and the uncertainty surrounding the federal debt
ceiling.

In another sign of economic weakness, the Labor Depart-
ment said the number of laid-off workers filing new claims
for unemployment benefits rose to the overall economy is
slowing.
Corporate Technology Budgets Fall at High Speed

By Gary McWilliams
Staff Reporter of The Wall Street Journal

After several years of sky-high growth, corporate spending plans for information technology—computer servers, switches, software and the like—seem to be rapidly returning to earth.

Businesses are becoming more cautious, according to several recent surveys and business economists. Next year, investment in computers, communications and software is expected to rise just 12%, compared with an estimated 22% increase this year and a 26% jump in 1999.

Talk of a 2001 recession, weakening corporate profits and slowing consumer spending are all chilling the technology-spending outlook—an abrupt about-face from the euphoric expectations that were rampant as the year began. Then, dot-com start-ups seemed to mint money, consumers were spending heavily on personal computers and related items, and businesses of all kinds were outfitting themselves with the highest of high-tech communications companies—ceased to exist. And now, giants such as Ford Motor Co., Eastman Kodak Co. and Whirlpool Corp. are reporting weak fourth-quarter sales and cutting their 2001 forecasts.

As many companies look for ways to rein in spending, information-technology budgets are sure to shrink.

"Weakness in the fourth quarter is particularly significant," says Thomas Kraemer, a managing director and analyst at Merrill Lynch & Co. "It suggests that IT budgets are going to be pulled back in the next year."

Mr. Kraemer recently polled a group of 150 corporate computer executives for the second time on spending plans. While 78% of those queried initially said their budgets would rise, only 56% said so in a November polling.

The big reason: The economic outlook. With spending on computers and software now accounting for half of all business investment, such budgets are now "more economically sensitive than historically," he said.

National Association of Manufacturers economist Gordon Richards puts it another way. "The ability of American companies to buy PCs and invest in technology is limited by their ability to expand revenue," he says. Mr. Richards believes Turn to Page B4.

Drop in PC Sales Spurs a Decline In Chip Market

By Molly Williams
Staff Reporter of The Wall Street Journal

There was, after all, a year-2000 problem for makers of semiconductor chips—just not the one most companies expected.

Computers didn't go haywire last New Year's Eve. But, around September, things started getting ugly for makers of electronic parts. Sales growth fell off, and it isn't expected to get better anytime soon.

This wasn't supposed to happen: Optimism was high early in the year that demand for all kinds of chips would surge because of growing sales of computers, cellphones and other electronic devices that use them. "We started out on fire in 2000," says analyst Mark Edelson of Morgan Stanley Dean Witter.

Even when the broader stock market started its slide in April, the shares of semiconductor makers held up for several more months. Intel Corp., the largest chip maker, was cruising as demand soared for microprocessors and related products that go into personal computers. Indeed, the company was unable to make enough of its key products and twice boosted its capital-spending budget.

Texas Instruments Inc., too, was bullish about demand as late as July, saying that orders for its chips for use in cellphones remained strong. It, too, increased its capital-spending plans. At Micron Technology Inc., sales soared from year-earlier levels as the demand for its memory chips swelled faster than prices declined.

Then, in mid-September, Intel dropped the bomb that it wouldn't meet earnings expectations because PC demand was lackluster in Europe. That was the beginning of a string of disappointments for the company and its peers that has continued for the past three months.

Consumers Hit Pause Button on New Digital Gadgets

By Evan Ramstad
Staff Reporter of The Wall Street Journal

Of all the retailers this season, the electronics stores seemed to have the best situation: Shelves were full of nifty new gadgets, from digital cameras to pocket organizers to digital videodisk players. Nearby, powerful personal computers and big-screen TVs tempted shoppers.

But even the lure of fun toys wasn't enough to counter a malaise brought on by lousy business, an endless election, higher energy prices and slumping consumer confidence.

Now, as electronics makers and retailers prepare for their big annual gathering in Las Vegas next week, both are scratching their heads to figure out how they can get customers excited again.

"The most interesting development of the year is, despite the introduction of so many hot new products, the sales trend at stores still slowed," says Peter Caruso, a retail analyst at Merrill Lynch.

Retailers did their best to turn the tide, resorting to promotional rebates and financing tactics they hadn't used since 1997. Both Best Buy Co. and Circuit City Stores Inc. offered no-interest-for-a-year financing. For post-Christmas shoppers, Best Buy also offered 10% off an unlimited number of DVD movies to purchasers of a DVD player; while Circuit City offered a free set of surround-sound speakers to buyers of Dolby digital audio receivers.

Even so, several large chains told investors they wouldn't meet expectations for sales and profit growth. Their stocks, the highest in retailing a year ago, fell to among the lowest.

Still, this year will set a record for U.S. consumer electronics sales. At the Consumer Electronics Show in Las Vegas next week, the industry's largest trade group, the Consumer Electronics Association, is expected to say that about $90.1 billion worth of electronic goods were shipped to U.S. retailers this year, up 10% from a year ago and 5% higher than its original forecast.

"It was a year that was much more variable than we've seen in the past few years," says Alan McCollough, chairman and chief executive officer of Circuit City. "It used to be new sales trends would take hold and they'd be with you for a while. We've seen this year bounce around.

In retrospect, retailers may have simply gotten carried away with their own excitement. For much of 2000, TV sales defied gravity and appeared headed to break the unit record set in 1994. Audio-product sales also rose strongly, and sales of PCs, though not as strong as in previous years, were at least growing.

Spurred by the robust sales, many retailers started building up on products for the busy holiday season. Please Turn to Page B7.

Consumer Sales Slow...

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Companies Pare Budgets...

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...And Chip Makers Get Hurt

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Growth in R&D Spending By Firms to Slow in 2001

Falling Consumer Demand, Tech-Stock Drop Lead Reasons Cited in Study

By AMY MERRICK
Staff Reporter of The Wall Street Journal
U.S. companies plan to slow the spending growth rate for research-and-development next year in the wake of falling consumer demand and sliding stock prices, particularly in the high-tech sector, a much-watched national forecast concludes.

Companies plan to raise R&D spending in 2001 about 6.5%, down from increases of 10.3% in 2000 and 9.8% in 1999. Since the mid-1990s the rate of increase has fluctuated from a high of 11.8% in 1995 to a low of 8.5% in 1998.

The anticipated deceleration in spending growth reflects hard times at high-tech companies, which accounted for much of the escalation in late-1990s' R&D spending. But the rest of corporate America hasn't been spared, and the slowdown may continue past 2001. "Recent signifi-
cant changes in sales, earnings and stock-market fluctuations will result in a slower growth than in the past, and might signal the beginnings of continued moderation in industrial R&D expansion," says the report. The annual forecast, based on National Science Foundation data, is compiled by research organization Battelle Memorial Institute and R&D Magazine.

Although the rate of spending is expected to slow, companies aren't expected to hack too much from their expenditures, because their research cements the foundation for future products. Private industry is expected to spend $190.5 billion in 2001, compared with an estimated $179 billion in 2000, according to the Battelle/R&D study.

"We've enjoyed unprecedented prosperity in the economy primarily because of the technological advances coming from R&D," says Sung Won Sohn, chief economist for Wells Fargo & Co. He estimates that information technology, including such areas as computing and telecommunications, contributed 30% of national economic growth this year—far more than any other sector, he says.

Such companies will continue to spend on R&D though perhaps at slower rates. Despite its earnings warning this month, Microsoft Corp. has emphasized that it won't sacrifice its R&D budget. The software company spent $3.8 billion on R&D in the year ended June 30, and it plans to increase that spending 16% this year, to $4.4 billion, a spokeswoman says. That compares with a 23% jump in fiscal 2000.

While investors have grown jittery about Internet-related companies, some of the larger companies say that the market slide won't significantly affect their funding options.

"As a company which has established itself in the marketplace, albeit as a new player, with a large amount of cash in the bank, I don't think the same pressures are on us" as on startups, says Rick Bress,

Yahoo! Web Volume At Shopping Sites Soared in Holidays

By MYLENE MANGALINDAN
Staff Reporter of The Wall Street Journal
Yahoo! Inc. said order volume on its U.S. shopping Web sites nearly doubled during the holiday season from last year, sending its shares 5.5% higher.
High-Tech Downturn Is Gobbling Up Jobs in Europe

Trouble Comes as the Region Had Its Chronically High Unemployment Under Control

By CHRISTOPHER RHoads
Staff Reporter of The Wall Street Journal

BERLIN—BinTec Communications AG, a fast-growing data communications company based in Nuremberg, Germany, was planning to add 20 employees next year to the 78 it hired this year. But after two profit warnings in the fall, BinTec announced that 37 employees, or 17% of its work force, would be dismissed, including its chief technology officer and co-founder, Gregor Krauchuk.

Chief Financial Officer Uwe Skrzypiak concedes: "We were too enthusiastic."

Just as the boom in small high-tech companies fueled European job creation in the last several years, helping to lower the region's chronically high unemployment, the sudden downturn in the sector is now putting many people out of work. And plans for additional hiring at many companies are being scrapped.

Although unemployment continues to fall in the group of 11 nations that use the euro currency, to 8.9% in October from 9% in September, the pace of that decline is clearly slowing, reflecting the economy's softening and the growing need of scores of companies like BinTec to cut costs as revenues don't live up to expectations.

In Germany the number of jobless fell by 15,000 in November to 9.3%, nearly half the decline in October and well below the decreases of the previous two months. And since the job market is a lagging indicator of trends in the economy, those numbers should get worse before they get better, economists say. Morgan Stanley Dean Witter predicts the French economy will produce half as many jobs next year, about 250,000, as it did this year. The investment bank recently raised its projection of average euro-zone unemployment next year to 8.4% from 8.2%.

These are still heady numbers compared with the nearly 12% unemployment of just three years ago. And for many high-tech firms the lack of skilled workers remains a bigger problem than having too many.

But as profit warnings for full-year earnings multiply, so do layoffs and hiring freezes. Analysts expect more such announcements in the coming months, as the effect of high oil prices, stock market turbulence and the slowing U.S. economy continue to weigh on the outlook of many firms. In this month alone:

- Bull SA, the French computer company, said it intends to cut as many as 1,800 jobs, or 10% of its work force, during the next 18 months, mainly because of weaker-than-expected sales and the need to restructure.
- Geodys Internet Products AG, a Braunschweig, Germany, software concern, said it will lay off 70 workers, or 24% of its staff of 292, the first job cuts in its 10-year history.
- Framfab AB, a Stockholm Web consultancy, fired 940 workers to contain rising costs.

For other companies, a disappointing performance in the second half of this year means scaling back growth plans, and that is sure to show up in slower employment gains across the region. Vectron Systems AG, a maker of wireless cash registers in Muenster, Germany, had planned to expand its staff by another 56% next year, to 120 workers, after doubling it this year, but last week it warned that sales would be well below forecasts this year—about one million marks instead of the seven million marks promised. The main problem was delay in introducing key products to the market, says Thomas Stuemmler, the company's sales manager.

The result: no new hires in the near future, and layoffs are being considered. "We are stepping on the brakes," he says. "At the moment, we are not planning any big cuts, but we can't rule them out, either."

Like many fast-growing companies, Vectron made many of its hires in the past based on expected revenue. Now the company will wait until it sees the revenue—and solid profits—before it begins adding new workers, says Mr. Stuemmler.

Executive search firms are seeing the same, newfound caution throughout the sector. Christophe Lecerf, a high-tech consultant in the Paris office of search firm Korn Ferry International, sees two big changes from a half-year ago: Clients are scaling down their ambitions to focus on local markets, and investors are requiring clients to become profitable sooner.

That translates into fewer new hires. "Many are putting their recruitment on hold," says Mr. Lecerf. "They're not canceling their searches—they're just waiting" to see how the market develops.

The "spontaneous calls" he got from dot-coms earlier this year have decreased markedly. Mr. Lecerf is also seeing a growing number of return customers, or those recently placed whose new jobs were suddenly eliminated.

At BinTec, Mr. Skrzypiak attributes many of the company's woes to the exuberance of Germany's Neuer Markt, the exchange dominated by highflying tech firms.

"If you grow at only 30% or 40%, everybody says that's not sexy enough," he says. "But now each day all we see are profit warnings."

ECB Gives Forecast Of Cooling Growth

Vodafone, DoCoMo Gird for Wireless War

growth recovery

3.6% and 0.8% lower

leg-up on NTT DoCoMo, J-Phone handsets
TELECOM'S WAKE-UP CALL

The industry could be headed for a downturn

Just about any place you look in the telecommunications industry these days, there are signs of trouble. The stocks of the Big Three long-distance companies are all down at least 40% for the year. The biggest local-phone companies—Verizon Communications, BellSouth, and SBC Communications—have seen their shares slide. And there's a bloodbath among the dozens of telecommunications startups that have been founded in the past few years. The stocks of Viatael Inc., Nuri Communications Ltd., and several others have tumbled 75% or more since the beginning of the year. GST Telecommunications Inc., a Vancouver, Wash.-based provider of phone services in the Western U.S., had to auction off its assets in August after filing for bankruptcy protection.

What's going on? For the past three years, the telecommunications industry has been one of the economy's most promising sectors. In the wake of deregulation, companies have been pouring billions of dollars into new communications gear to deliver everything from telephone service over cable-TV networks to Internet access over mobile phones. Capital spending soared from $42 billion in 1996 to $82 billion in 1999. And it's likely to go higher. Analysts project telephone companies will invest more than $100 billion in their networks this year.

"WAY OVERCAPITALIZED." But now the evidence is growing that all that money isn't being well spent. While capital expenditures have soared 25.5% annually since 1996, telecommunications revenues have increased a modest 10.5% per year, to an expected $326.6 billion in 2000, according to Lehman Brothers Inc. The result is that for every dollar invested, telecommunications players are seeing less and less revenue produced. In 1998, there was 42¢ in new revenue for every $1 invested. This year, that's expected to fall to 34¢, according to Lehman Bros. That has put the squeeze on profits: Return on assets for the industry has dropped steadily from 12.5% in 1996 to an expected 8.5% in 2000. "It looks like the sector is way overcapitalized," says analyst Blake Bath of Lehman, which issued the first detailed report on the situation in early September. "Spending has grown at absurdly fast levels relative to the revenues and profits produced by that spending," says Bath.

What telecom companies have been doing is betting on the future. With the boom of wireless and data services,
Work Week

A Special News Report About Life On the Job—and Trends Taking Shape There

AGGRESSIVE HEALTH-CARE cost projections may not match real-life increases. Insurers and health-plan managers expect employee health-benefit cost trends to rise about 10% to 15% next year, depending on the type. The projections are based on past price moves, benefits usage and other factors and will help set employer rates for the coming year. But if recent history is a guide, costs could trail those projections. Segal Co., a New York benefits consultant, compared past projections with what actually happened and found that actual increases were usually smaller than projected increases.

Ed Kaplan, a Segal consultant, says overcompensation could lead to higher employer costs and the temptation to nibble away at employee benefits. “My concern is that the employer and the employee will get overcharged,” he says. Tight labor markets have helped keep employee costs down. Tom Wildsmith, policy research actuary for the Health Insurance Association of America, says projections are cyclical and have trailed actual costs in the past, and that employer cost cuts could account for the discrepancy.

“They’re not going to make changes that increase costs,” he says.
ClibPDF - www.fastio.com
Manufacturers Struggle, While Builders Flourish

BY YOCH J. DREAZEN

WASHINGTON—In Greenville, Miss., Fruit of the Loom Ltd. is shuttering a 500-employee factory. Bassett Furniture Industries Inc., in Bassett, Va., is cutting 280 jobs and closing a plant. And in Winder, Ga., Thrall North American Rail Car is shutting down its two production lines, laying off 348. These are rough times for the nation's old-line manufacturers, who are feeling the sting of higher interest rates, falling domestic demand and a global economic slowdown. For many construction companies, by contrast, business is better than it has been in months, as developers pour hundreds of millions of dollars into apartment buildings and business construction.

The two industries' differing fortunes, reflected in a batch of data released Friday, are complicating efforts to gauge the duration and intensity of the economic slowdown.

The National Association of Purchasing Management said its manufacturing index declined for the fourth consecutive month in November, indicating the sector continues to slow significantly. If extended over a year, the data would be consistent with an economy inching up an anemic 1.9%. The Commerce Department, by contrast, said that construction spending jumped 0.9% in October to its second-highest level on record, suggesting that the sector will offer a sizable boost to overall economic growth.

"This is not a normal slowdown," said Ian Shepherdson, the chief economist of High Frequency Economics in Valhalla, N.Y. "Not only do you have two sectors going in entirely different directions, but construction is incredibly strong. If we were anywhere near a recession, you'd see everything slow."

Still, many economists are growing more pessimistic. Last week, the government lowered its estimates of economic growth in the third quarter to just 2.4%, leading many analysts to pare their forecasts for the current quarter and the beginning of next year. The latest was Goldman, Sachs & Co., which on Friday sliced its fourth-quarter predictions to 2.7% from 3.8%.

Several economists, moreover, have taken the unusual step of publicly criticizing the Federal Reserve and urging it to cut interest rates to help avert a potentially significant economic slowdown.

In part, the economists are referring to data such as the NAPM report, which points to continuing weakness throughout the manufacturing sector. The overall in-

CONSTRUCTION HEATS UP AS MANUFACTURING COOLS

Construction Spending

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National Association of Purchasing Management Index

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The numbers, which analysts said still point to an economic "soft landing," were slightly better than had been expected. Investors had grown steadily more confident that weak economic data would spur the Fed to cut rates in coming months, and the NAPM numbers forced some slight rethinking. On Thursday, Fed funds futures—which allow investors to bet on the central bank's future course of action—were pricing in a 96% chance of a rate cut by the end of March. On Friday, the odds fell slightly, to 84%.

The strength of the construction sector also took analysts by surprise. Spending on new residential, public-sector and business projects had soared by a revised 1.9% in September and 2.1% in August, and many economists had been bracing for a decline. The revisions to the prior data, from 2.4% in September and 1.8% in August, about canceled each other out, and overall spending soared to a seasonally adjusted annual rate of $255 billion, the second highest on record.

CONSTRUCTION SPENDING

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There was a weak recession in 1991.
The production index dipped in the week ended Jan. 30. The unaveraged index also fell, from 143.0 to 142.9. After seasonal adjustment, coal production dropped 2.1%, with the largest declines in the states of Alabama and Virginia. Output of autos, trucks, steel, oil, and rail freight were also down. Only electric power output and lumber and paper gains. The monthly index for January was 142.3, down 0.1% from December’s index of 142.4.

BW production index Copyright 1999 by The McGraw Hill Companies

The production index was down for the fourth consecutive week. The unaveraged index also declined in the week ended Feb. 19, falling to 162.0 from 163.0. Rail freight traffic was down 2.4%, after seasonal adjustment, with a 0.7% decrease in carload freight from the previous week, and a 1.1% decrease from a year ago. Coal output dropped 6%, with 5,850 fewer railroad cars loaded this week. Production of steel, autos, trucks, and oil were also lower. Only output of electric power and lumber showed increases.

Summary of The BW Production Index

- It was 100 in 1992
- Jan 98 to Feb 99: from 137 to 142
- Jan 99 to Feb 2000: 147 to 163 (Quint 98%)
- Nov 99 to Dec 2000: from 156 to 176

* Flat from Aug to Dec 2000

So: During 1999 to Jan 98, it came up only from 100 to 137.
SLOWLY BUT SURELY, 
THE ECONOMY IS COOLING

Still, labor markets are probably tighter than the Fed wants

U.S. ECONOMY If you’ve been spending the better part of a Saturday morning waiting in a checkout line or searching for an elusive set of Powerpuff Girls bed sheets, you may wonder where the economic slowdown is. After all, if consumer demand is easing up, why can’t you find a parking space at your local mall?

Although this holiday shopping season is shaping up to be at least moderately successful, make no mistake about it: The latest government data show the U.S. economy is cooling. Retail sales fell in November thanks to weak car sales, and companies continue to issue profit warnings for the fourth quarter and beyond because of slower revenue growth.

Most important, the November employment report, the month’s first broad look at the economy, shows clear signs of a slowdown (chart). As expected, private-sector businesses hired fewer workers in November than they did the year before, the work week shortened, and the jobless rate ticked up. But the persistent increase in hourly pay suggests that the demand for labor is still growing faster than the supply of available workers.

Keep in mind that a slowdown doesn’t have to be abrupt, but a soft landing will feel different after a two-year boom. The economy does not appear to be headed for a hard landing. A survey of economists conducted by BUSINESS WEEK finds that forecasters, on average, expect the U.S. economy to grow 3.1% in 2001, and none of them expect an outright recession (page 66).

INDEED, THE WAGE ACCELERATION, evident in the November jobs data, indicates that the economy has not cooled enough to make the Federal Reserve rest easy about the inflation outlook. This is especially so given that productivity is expected to grow more slowly in the coming quarters and won’t be able to offset labor costs as much as in the past.

Policymakers will meet on Dec. 19, and they are expected to hold the federal funds rate target at 6.5%. But the Fed will very likely shift its view of the near-term risks in the outlook—a change all but announced by Fed Chairman Alan Greenspan in a Dec. 5 speech.

Instead of seeing an economy tilted toward rising inflation, the Fed may say that the economy’s risks are now balanced between excessive price pressures and excessively slow growth. That is, while the danger of an overly weak economy has risen, continued tight job markets mean the inflation risk has not diminished.

A soft landing will mean adjustments, though. Auto makers already are cutting production schedules and putting workers on temporary layoffs as the Big Three adapt to an annual rate of vehicle sales in the 16 million-to-16.5 million range instead of the record 18 million earlier in 2000.

Tech companies, meanwhile, are beginning to accept that new orders don’t always grow at yearly rates of 20% or 30%, as they did in 1999 and early 2000. In fact, tech orders from 1996 to 1998 had increased about 8% to 10% per year, but accelerated sharply in 1999 and early 2000, at least partly reflecting large outlays related to the Y2K phenomenon. It is important to note that orders have not fallen off a cliff; companies, after all, still need to invest in productivity-building equipment.

Consumers are also beginning to show some restraint, especially for big-ticket items. Retail sales dropped 0.4% in November, after no change in October. The weakness was concentrated in vehicle sales, which fell 2.2% in November. Excluding cars, store receipts rose 0.2% on top of a 0.4% advance in October. Sales at furniture stores were strong, reflecting the solid growth in the sales of new homes which need to be furnished.

Because of weak vehicle buying, retail sales in November were up just 5.2% from a year ago, half their yearly pace in early 2000 (chart). Nonauto sales haven’t slowed as much, but they are softer than in the first half. How much consumer spending eases up in 2001 may depend on how weak the labor markets become.

SO FAR, EMPLOYMENT GAINS are only slowing, not turning negative. True, layoffs are occurring in pockets of manufacturing and the dot-com sector, but elsewhere companies are still hiring. In November, nonfarm jobs grew by 94,000, but a quirky-looking drop of 54,000 government jobs held back the total number. Private payrolls rose by 148,000, not much different from
Business Outlook

their 158,000 average for the first 10 months of 2000.
The November jobless rate did inch up to 4% from 3.9%, but the rate has been between 3.9% and 4.1% since October, 1999. Looking ahead, though, job growth is at a pace that, if maintained in 2001, would cause the unemployment rate to edge gradually higher. But job gains would have to slow sharply to loosen labor-market conditions significantly.

The recent rise in initial claims for unemployment benefits, to a four-week average of about 350,000 from about 300,000 during the summer, suggests at least some small degree of slack in the job markets. To put that figure into perspective, during the 1994-95 soft landing, claims averaged between 360,000 and 390,000 for several months. The 1990-91 recession sent claims up to the 500,000 mark.

Before businesses resort to layoffs, they typically cut the hours of their existing employees. And that's happening. In November, the average workweek for production and nonsupervisory workers stood at 34.3 hours, 18 minutes shorter than in April. In the factory sector alone, the workweek has dropped a full hour.

SO FAR, THOUGH, CONSUMERS don't seem too worried about labor market conditions. The latest decline in consumer confidence seems to be driven more by stock-market jitters and uncertainty over the presidential election than by eroding job worries. In addition, the percentage of workers in November who are unemployed because they voluntarily left their last job remained well within the high range of the past two years. Last, the latest Manpower Inc. survey of hiring intentions shows no diminution of hiring plans in the first quarter, compared with a strong fourth quarter.

The still solid demand for labor explains why paychecks continue to increase. The average hourly wage for production workers increased 0.4%, to $13.94 in November. Pay is rising 4% from the year before, the fastest pace in almost two years (chart). What worries the Fed is that businesses might not be able to count on productivity gains to offset these rising costs. Companies will then face a tough choice of trying to raise prices while demand is slowing or seeing their profit margins— and stock prices—erode.

The job market is on track to create about 2 million jobs in 2000, down from the 2.8 million added in 1999. And job growth is likely to be weaker in 2001, but that's to be expected in a soft landing. It's another case of growth being relative. The outlook does not call for a flurry of pink slips. Instead, expect companies simply to hire fewer new workers next year.

BRITAIN

WHY THE FACTORY GEARS ARE GRINDING

British manufacturers can't seem to get a break. Just as the sterling's recent decline from oppressive levels began to raise hopes for a factory turnaround, worries about a global slowdown in demand are now clouding the outlook. Industrial production fell in October for the second month in a row after growing steadily since March.

Moreover, manufacturers can't count on an easing of monetary policy anytime soon to lift domestic factory orders. While interest rates have peaked, still-strong demand for services and an expected boost from government spending in 2001 will make the Bank of England's Monetary Policy Committee cautious about rate cuts. As expected, following a slight lowering of its growth and inflation projections for the coming year, the MPC on Dec. 7 left its benchmark interest rate at 6% for the tenth month in a row.

Nevertheless, amid signs of slower consumer spending and diminishing wage pressures, the financial markets are already pricing in a rate cut. The markets are impressed by several indications of slower growth and tame inflation, although none seem conclusive. Most recently, outside of energy and food, retail price inflation remains below the MPC's target of 2.5% (chart). In November, core inflation, less mortgage interest, stood at 2.2%, about where it has been since April, 1999.

Other good signs: House prices, one of the MPC's big inflation concerns, have slowed sharply, from a year-to-year growth rate of 16% in January to 7% in November. In addition, wage growth has cooled, from nearly 8% earlier this year to about 4%, a pace the MPC is more comfortable with.

Most important, demand appears to be cooling, given that holiday sales are off to an inauspicious start. But consumer spending has sped up in each quarter of 2000. The MPC has said that household demand must slow substantially so that the economy can accommodate the upcoming government stimulus. But once again, slower domestic demand will not help struggling manufacturers.
THE POLITICS OF PROSPERITY

The sizzling expansion and huge surplus are creating a new, upwardly mobile voter. Top issues: Education, health care, and sustaining the high-tech boom. Does either Bush or Gore have the right plan for the New Economy?
Delphi lowered its earnings forecasts and said it will close or sell operations, as the auto-parts supplier absorbs the blow of GM production cutbacks. (Articles on Pages A3, A8 and B1)

* * *

Compaq warned fourth-quarter results will lag far behind expectations due to weaker PC demand. Separately, NEC and Acer are taking further steps to refocus in hopes of improving profits. (Articles on Pages A3 and A22)

* * *

Kodak slashed its fourth-quarter forecasts over 35% and warned that it expects a weak first half of 2001. The firm cited a sharp slump in film sales. (Article on Page A3)

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Dec 13, 2000 Wall St J

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Purchasing managers said it is getting harder to pass along cost increases, a sign higher energy prices and a tight job market aren’t sparking inflation. (Article on Page A2)

* * *

Some big AT&T investors said they remain skeptical about the firm’s restructuring and management after talks with CEO C. Michael Armstrong. (Article on Page B8)

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Dec 13, 2000 WSJ

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There have been too many stories like this. More than usual. Roy Henne

Most stocks fell despite the apparent resolution of the election. The Nasdaq lost 3.72% as investors focused on weak prospects for tech-firm earnings. (Article on Page C1)

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Dec 14, 2000 Wall St J

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Retail sales fell 0.4% in November, hurt by the sharpest drop in auto sales in more than two years. Inflation remained tame; import prices rose 0.2%. (Article on Page A2)

Dec 14, 2000 Wall St J

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Compaq Warns Results to Trail Expectations

BY GARY McWILLIAMS
Staff Reporter of The WALL STREET JOURNAL

Compaq Computer Corp. joined the pile-up of technology companies skidding on weaker computer demand, and warned that fourth-quarter earnings and revenue will fall well short of Wall Street analysts’ expectations.

The world’s largest personal-computer maker said revenue for the fourth quarter will be between $11.2 billion and $11.4 billion, or about $1 billion below analysts’ forecasts. It blamed the sales shortfall on lower-than-expected home PC, business PC and server computer sales.

The projection means revenue will rise 6.8% to 8.8% from $10.48 billion a year ago. Just seven weeks ago, Compaq said it was confident of expanding revenue by 18% and confirmed analysts’ forecasts for earnings of 36 cents a diluted share. Earnings—before a $1 billion charge to write down high-tech investments—should come in between 28 cents and 30 cents a diluted share, the company said.

Compaq’s warning comes after similar cautions from rivals Gateway Inc., Apple Computer Inc. and suppliers Intel Corp. and Advanced Micro Devices Inc.

Compaq’s shares fell to $20 in after-hours trading yesterday. In 4 p.m. New York Stock Exchange composite trading, prior to the profit warning, its shares rose 53 cents to $20.77.

Please Turn to Page A10, Column 3

Dec 13, 2000 Wall St J

Whirlpool slashed its earnings estimates and said it would cut its work force and take $300 million or more in charges. The appliance firm cited a sharp drop in shipments to retailers. (Article on Page A3)

* * *

Illinois Tool cut its quarterly earnings forecast because of weak sales to a range of industries, adding to signs of a broader U.S. economic slowdown. (Article on Page A4)

* * *

GM is forming a joint venture with CNF to manage the flow of materials to plants and the distribution of vehicles. Separately, GM shares rose following John Devine’s appointment as CFO. (Articles on Page A6)

* * *
HOW SWEET IT WAS

After a gonz year, forecasts of an ad slump

every year in early December, executives from the world’s leading media companies gather in mid-town Manhattan for the Paine-Webber media conference, one of the industry’s biggest confabs. In recent years, it has been a particularly bullish affair as new mergers and technologies inspired giddy speeches by moguls about the coming world of “interactivity” and “convergence.” But at this year’s mediafest, now called the UBS Warburg media conference after Paine-Webber itself merged into the Swiss investment bank, the mood was sober. After a record-breaking year, ad spending—the revenue engine for media empires—is about to grind into lower gear.

Indeed, the year 2000 was exceptionally kind to media businesses, from newspapers to television networks to billboard companies. But no media exec with any sense of history expected it to last. Sure enough, at the conference, ad forecaster Robert J. Coen of media buying outfit Universal McCann made his much-anticipated prediction: Ad spending will grow 5.8% in 2001, down from 9.8% in 2000. Still, “we don’t see things falling apart just because there’s some softness here and there,” says Coen.

Some sectors of the media will feel more pain than others, though. Network TV advertising will grow only 1% in 2001, vs. 12.5% in 2000, Coen estimates. Besides the obvious loss of dot-com advertising, consumer companies are expected to cut back on ads, and high-tech gadgetry businesses might be headed for a shakeout. Slower consumer spending could pinch retailers, thus hurting ad revenues at newspapers, which are sensitive to swings in the re-
tail sector, says John Perriss, CEO of media buying firm Zenith Media Ltd. Meanwhile, advertising on the Internet will grow more slowly next year—60% in 2001, vs. 65% this year (page 172).

The clincher for U.S. ad spending in 2001, Perriss says, will be sagging corporate profits. Profit-growth estimates for the Standard & Poor’s 500 have been lowered in recent weeks to 11.4% in 2001, vs. 19% this year, according to First Call Corp. Even so, ad budgets aren’t the easy targets for cutting they once were, says Perriss. “Marketing is becoming more of a fixed cost for companies because of growing competition,” he says.

Of course, by almost any comparison, 2000 was extraordinary. Fueled early on by heavy dot-com ad dollars and then by highly rated reality TV shows like Survivor, as well as the Olympics and lucrative political spots, overall ad spending will have grown this year by 9.8%, to $236 billion, according to a Universal McCann estimate. That’s the highest growth rate since 1984, when spending rose 16%—in a much more inflationary year, one also marked by an Olympics and a Presidential election.

“CAPRIFICIOUS GROWTH.” In fact, for some companies, the first half of 2000 was mind-boggling. Ad revenue at Emmis Communications Corp., an Indianapolis-based TV and radio company, grew an extraordinary 25% to 30% in the first and second quarters. That’s because TV and radio, in particular, were the beneficiaries of national dot-com advertising, which all but dried up by July. “We knew that level of capricious growth would come to an end,” says Ralph Guild, chairman and CEO of Interep National Radio Sales Inc. He predicts more moderate growth of 8% in 2001. Indeed, Emmis’ ad growth rate has already returned to single digits, enough for Wall Street to react: Emmis stock is down 60% since January, to the $24 range, from highs of $62.

“The hard part with Wall Street is that it overreacts one way or the other,” says Emmis CEO Jeffrey H. Smulyan. Clearly, the Street doesn’t like what it’s hearing about ad tightening. In the past six weeks, analysts have repeatedly lowered their ratings on media stocks. At Merrill Lynch & Co., Jessica
Overbuilt Web
How the Fiber Barons Plunged the Nation Into a Telecom Glut
Qwest and Level 3 Battled While Demand Stalled: Outlook Is Tough for One
A Clash of Two Billionaires
June 18, 2001

BY REBECCA BLUMENSTEIN
Staff Reporter of THE WALL STREET JOURNAL
DENVER—As he rushed to lace America with fiber-optic cable, James Crowe wasn’t the sort to let anything stand in his way—not the Rocky Mountains and certainly not his crosstown rival, Joseph Nacchio.

By 1999, when Mr. Crowe’s Level 3 Communications Inc. started digging a line connecting Denver and Salt Lake City, Mr. Nacchio’s Qwest Communications International Inc. had already threaded its own cable through the most direct route, a seven-mile railway passage through the granite of the Continental Divide. Undeterred, Level 3 swerved an extra 70 miles through southern Wyoming, installing fiber at a blistering 19-mile-per-day pace.

But now, Level 3 has hit a wall even Mr. Crowe may have trouble overcoming. The company’s original ambition—to build nationwide networks laid some $90 billion of fiber during the past four years. Merrill Lynch & Co. estimates that only 2.6% of the capacity is actually in use. Much of it may remain dark forever.

The fiber glut underlies much of the uncertainty plaguing the telecom sector—and has even spilled over into the economy at large. Billions of dollars in shareholder value have evaporated in some of the biggest owners of fiber networks, including Global Crossing Ltd., Williams Communications Group Inc. and Genuity Inc. Many are struggling with massive debt: On Friday, 360networks Inc. said it was delaying a $10.9 million interest payment while it studies ways to preserve cash.

The carnage has spread to suppliers such as fiber-maker Corning Inc. and Lucent Technologies Inc. Also on Friday, Nortel Networks Corp., which makes gear for the Internet and telecom sectors, predicted a staggering $19.2 billion loss for the second quarter.

Level 3, meanwhile, is fast retrenching. Its stock is off 94% from its high, and executives are expected today to announce plans to lay off as much as 20% of the work force, among other cost-cutting moves. The company’s game plan: live off its stockpile of cash—some of it raised from Omaha construction magnate Walter Scott Jr., a close friend of investor Warren Buffett—until competitors die off and demand returns.

“The shake-out that is occurring is good for Level 3 in the long term, although it is awfully hard to convince someone who is sitting in a dentist’s chair being drilled that this is a good thing,” says Mr. Crowe. “It hurts.”

Level 3’s troubles represent an even bigger threat to the economy than the first round of the dot-com meltdown because the telecom companies involved are so much bigger. As a group, telecoms have gorged on some $650 billion in debt and are now falling in record numbers for the industry. The debacle is shaping up to be one of the biggest financial fiascoes ever, with losses to investors expected to approach the $150 billion government cleanup of the savings-and-loan industry a decade ago. And as more companies recognize the depth of their problems, the damage is likely to get worse.

To understand the origins of the mess, it helps to take a close look at two of the industry’s pioneers, Qwest and Level 3. Located just miles apart in the Rocky Mountain foothills, each sprang from the ambitions of an old-style Western billionaire. Each dazzled investors early on with visions of rapidly expanding demand for telecommunications bandwidth, only to run into difficulties when Internet usage didn’t soar as expected. But in the end, only one of the companies would figure out a way to shelter itself against the coming storm.

It has been said that the fiber-

etc

June 18, 2001
Wall Street
WASHINGTON, June 15 (Reuters) — Industrial output fell for the eighth consecutive month in May and plants operated at their slowest rate since 1983, the Federal Reserve said today.

The Fed’s report showed a drop of 0.8 percent in industrial production. Analysts had expected a decline of 0.4 percent. The weakness was broad based with the exception of autos.

“It was a disaster,” said David Orr, chief economist at First Union in Charlotte, N.C. The sustained decline exceeded the six-month drop in the last recession, in 1990-91, he said.

The report fed expectations among some economists that yet another aggressive half-point cut in interest rates might be in store when Fed policy makers meet in June 26 and 27 rather than the slimmer quarter-point reduction the markets are now anticipating.

Adding weight to this view were tame numbers on underlying inflation released by the Labor Department today, as well as a drop in a crucial measure of consumer sentiment.

The Consumer Price Index rose 0.4 percent in May, the Labor Department said, matching expectations. But that increase was mostly because of higher energy costs.

The University of Michigan’s consumer sentiment index, meanwhile, fell to 91.6 in its preliminary June reading from a final May reading of 92.0. While not as weak as the 88.4 scored in April, it was below consensus forecasts for 91.9.

Within the industrial production report, the May drop in output at the nation’s factories, mines and utilities was twice as steep as the decline of 0.4 percent forecast by economists in a Reuters survey. The May decline followed a drop-off of 0.6 percent in output in April.

Factory production, the largest component of industrial output, fell 0.7 percent in May after sliding 0.6 percent in April.

In May, industrial concerns operated at 77.4 percent of full capacity, down from 78.2 in April and the lowest since August 1983. The high-technology sector, which includes computers, semiconductors and communications gear, continued to slow, with production slipping 1.2 percentage points, to 70.3 percent, the lowest rate in 25 years, the Fed said.

Auto output, on the other hand, churned out a 2.4 percent increase. Vehicle assembly rose to an 11.84 million annual rate, up from an 11.54 million annual rate in April.

But manufacturers have been able to keep cars rolling off the assembly lines mainly by offering buyers big rebates and other incentives — a trend that might not last.
FRANK HAYES/FRANKLY SPEAKING

Counting Casualties

S
O HOW BAD is the Great Dot-Com Die-Off? That’s what a reader asked me in March. We all know that lots of Internet-related businesses have shut their doors in the past year. We’ve heard about the layoffs, the inability to get another round of funding, the ripple effect of abandoned office leases and downward pressure on IT-shop salaries.

But how bad is it? The 95% death rate predicted by Gartner Inc. President Michael Fleisher last year? Or the 5% counted by San Francisco research firm Webmergers Inc.?

Just how much of the sky has fallen, anyhow?

Answer: Plenty. And more of it is falling every month.

Never mind Gartner’s guesstimate. When Fleisher speculated last year that 95% to 98% of all dot-coms would be pushing up daisies by the spring of 2002, he had no numbers backing him up — just a firm belief that what he called “Old Economy concepts” would emerge triumphant over a bunch of twentysomethings playing air hockey and doing business without a realistic profit model.

He had no numbers. I finally found some.

According to Webmergers, at least 493 “substantial” Internet companies have gone belly-up since January 2000. That word substantial is important. Webmergers counts only companies that went public or got at least $1 million from venture capital firms or angel investors. By Webmergers’ reckoning, that leaves between 7,000 and 10,000 substantial dot-coms still alive.

That doesn’t sound too bad, does it? A 500-in-10,000 mortality rate is only 5%. So why all the hooah about a die-off?

Because that’s not all. Along with the official dead, Webmergers counts more than 1,500 mergers and acquisitions since the beginning of last year.

Think those don’t count as part of a die-off? Think again. Most of those companies had to be acquired. They had run out of funding. Their oxygen was cut off. They couldn’t survive on their own. And the vast majority of those dot-coms were acquired by other dot-coms — some of which were themselves acquired or put out of their misery.

Result: The real death rate among substantial dot-coms over the past year has been about 20%.

And they’re still dying. Another 2% of them disappear every month — about 50 closures and 120 or so mergers.

And the ones that haven’t died yet are gasping for air, with layoffs and spending cutbacks.

And remember, this is the cream. These are the companies whose ideas and proposals were so good that they got a million dollars of other people’s money. The rest of the dot-coms — the ones that never made a successful million-dollar pitch — are dying, too. We just don’t know how much worse off they are.

Should this worry people in corporate IT shops? Yes.

We should worry about the products and services we’ll never get from the companies that dropped dead. We should also worry about the products and services that big vendors may never offer us now that a big, free-spending part of their market has dried up.

We should worry about the people shed by those dead and dying dot-coms. We’ll hire some of them, and we’ll have to deal with their whipsawed expectations. We should also worry about our own best people, whose loyalty in sticking with us will be hard to reward with our own tight budgets.

Most of all, though, we should worry about the 80% or 70% or 60% of top dot-coms that will survive the die-off. The ones that make it will be lean, focused and deadly serious. They won’t be playing air hockey. They’ll be doing cutthroat, hard-edged business — the way you learn to do it only when you’ve faced death and survived.

And if they’re our competitors — well, then we’ll really have something to worry about.
East Asian economies

Falling (again)

A new strain of economic contagion is spreading through East Asia

Imagine that you had just recovered from a nasty bout of flu. You return to work, promise your doctor that you will give up smoking and join a gym, and then you fall victim to chicken pox. This is how the former East Asian tigers must feel. In 1997-98 they suffered a bruising financial crisis, and now, after only two years of recovery, many of these economies are facing the prospect of yet another slump. This time the recession virus is spreading not by currency speculators, but by the collapse in America’s information-technology investment.

East Asia’s two biggest export markets are America and Japan. America’s economy has slowed sharply over the past year and Japan’s is already in recession. As a result, exports and production are tumbling. Real GDP fell in Singapore, Taiwan and Thailand in the first quarter and probably shrank again in the second. Singapore’s industrial production fell by 11% in the year to May. South Korea and Hong Kong will be lucky to see GDP growth of 2-3% this year, down from rates of 9% and 10% respectively in 2000. Exports from East Asia, excluding China, have fallen by around 10% over the past year, compared with growth of almost 30% in early 2000. China’s GDP growth is holding up, but even its export growth has slowed from almost 40% to 4% over the past year.

Supply-chain dependencies

The smaller East Asian economies are among the world’s most open, with exports, on average, accounting for about 50% of GDP. Such openness has spurred their growth for several decades, but it also leaves them vulnerable to a global slump. Worse still, they are heavily dependent on the production of IT equipment. Morgan Stanley estimates that as much as two-fifths of Asia’s total GDP growth last year came from exports of IT to America. But America’s investment boom has now turned to bust: new orders for computers and electronic products fell by a third in the year to May. One reason why the collapse in investment has so far not pushed America into recession is that it has exported some of that recession to Asia.

America’s economic boom in the late 1990s, combined with Asia’s super-competitive currencies after devaluation, helped the crippled Asian tigers to recover more quickly than expected from their financial crises. However, while exports surged, domestic demand lagged behind. The result is that the Asian economies have become even more dependent upon exports. South Korea’s exports of goods and services jumped from 30% of GDP in 1996 to 45% last year; Thailand’s rose from 39% to 66%. Asia is therefore more exposed to a world slump than ever before. One reason why China’s economy is expected to grow this year by a more robust 8% is that it is less dependent on exports (only 23% of GDP) and much less dependent on IT. In addition, domestic demand looks more robust.

This does not mean that East Asia is heading for another financial crisis. Compared with 1997-98, economies are in much better shape. They now have current-account surpluses instead of huge deficits, and bigger foreign-exchange reserves. With the notable exception of Hong Kong and Malaysia, they have also abandoned the fixed exchange rates that were at the root of their previous meltdown.

During the late 1990s crisis, financial contagion swept through the region as capital fled one economy after another. Today a new strain of contagion is spreading through the global supply chain in IT equipment, as firms in America, Japan and Europe have outsourced their production abroad. East Asia is merely the most extreme case of the increased integration of economies. Global trade volumes grew twice as fast in the 1990s as the 1980s, so it is hardly surprising that trade now plays a bigger role in the global business cycle. Over the past couple of years America exported its boom, helping East Asia to recover; now it is exporting recession. Growth in the volume of world trade has slowed to around 4% this year from 13% last year—the sharpest deceleration since 1975.

The blame game

Many Asians blame the overseas slump for all their current economic woes. Some will wrongly conclude that further liberalisation should therefore be resisted. Actually, in the long run everybody benefits from a globally integrated market when there is diversity of demand and production. But overdependence on one economy brings drawbacks. Because domestic demand lagged, East Asia’s recovery was over-reliant on exports. Asia’s large trade surpluses are popularly seen as a sign of renewed economic vigour. In fact they partly reflect a failure to generate stronger domestic demand as a result of not completing promised structural reforms.

As economies bounced back from the crisis faster than expected, governments concluded that reform could wait. Firms have been slow to sell off assets and reduce debts. Banks have been slow to write off bad loans. Governments have failed to deregulate services, which could have created new jobs to offset the collapse in IT exports. Fragile banking systems and inadequate corporate restructuring continue to cramp domestic expansion. Lower interest rates are less effective in stimulating demand because banks saddled with too many bad loans are reluctant to lend more and debt-laden firms cannot borrow.

Governments are now likely to come under pressure to slow trade liberalisation. Instead they need to do the opposite: in order to diversify their trade. If the East Asians became more integrated through trade with each other and with China, they would be less dependent on the United States. The smaller Asians tend to view China as a threat, waiting to steal their markets. Yet China could in future become an important engine for regional growth.

Giving up smoking and having regular exercise do not prevent you from catching chicken pox, but healthier people tend to recover faster. Likewise, deeper reforms would not have prevented the global downturn from hurting Asia, but they would have helped to cushion the economy against an export slump. The risk now is that slower growth will cause politicians to shirk further away from tough reforms. It is much harder to quit smoking when you feel a little down.
Asian high-tech workers in America

Byting more than they can chew

FALLS CHURCH, VIRGINIA
Technology firms are finding some of their foreign recruits hard to shed

WHEN times get tight, Americans have often turned on immigrants. As the American economy slows once again, xenophobia has returned. Yet this time the foreigners under attack are highly educated, middle-class computer wonks, with the resources to fight back.

In 1992, the United States began its H-1B visa programme in response to a shortage of skilled labour. Under H-1B, American companies can search overseas to find workers in "specialty occupations", which includes researchers, high-tech staff and, somewhat surprisingly, fashion models. H-1B visas last for six years; after that, people can apply for permanent residence and, eventually, citizenship.

Since 1992, roughly 640,000 H-1B foreign workers, mostly from India and China, have been admitted to America, where they often make 20 times what they earned at home. Many Asian temporary workers are brought to America by "job shops", which then farm the H-1B's out to high-tech companies. As the labour market tightened in the late-1990s, job shops offered H-1B's big signing-up bonuses, limousine rides from the airport, and other benefits to entice them to America.

Now Silicon Valley is flooded with pink slips, and Asian H-1B's are vulnerable. An H-1B visa expires as soon as the holder gets laid off, so newly unemployed H-1B workers must scramble to find a new job within days, or risk deportation. The number of new H-1B workers has fallen by half this year, and in March and April at least 2,000 Indian high-tech professionals went home. In Falls Church, a suburb of Washington, DC, with a high proportion of Asian tech workers, message boards are full of "for sale" signs offering cars, apartments and other attributes of a middle-class American life.

For those who stay, life has also got tougher. Knowing the precarious nature of the Asians' status in the country, their employers can easily bully H-1B people to accept lousy pay deals ("indentured servitude", whines one). And Asian workers have to deal with complaints from their peers about stealing American jobs and depressing salaries.
ANDREW WILSON

H-1Bs Are Still Needed, Despite Slower Economy

IT'S BEEN EIGHT MONTHS since Congress raised the cap on H-1B visas from 115,000 to 195,000 annually through 2003.

Ironically, as if on cue, economic growth has slowed, and many companies have been forced to downsize. Does this mean that IT managers should file their H-1B recruiting handbooks underneath their Y2k compliance manuals? Simply put: No.

While staffing your IT department may not be as high a priority as it was a year ago, there's still a hunt for highly skilled computer professionals. In fact, during this period of budgetary restraint and slash-and-burn tactics, a quality IT worker can help increase business efficiency and reduce operating costs.

If you agree that the economy will recover and that a shortage of technological skills is a serious threat to a company's survival, here are two reasons IT managers should continue the H-1B hunt:

- Lack of domestic workers with crucial IT skills.
- There's still a tremendous shortage of highly skilled IT professionals in the U.S. The number of computer professionals coming out of colleges in both India and China dwarfs the number graduated by U.S. schools. In fact, according to the National Science Foundation, the number of U.S. engineering graduates has slipped more than 7% in the past decade.

Also, training programs funded by increased H-1B fees aren't producing individuals with the necessary technological talent. These programs were implemented to raise the skills of U.S. workers so they could fill the high-skill jobs now held by H-1Bs. Unfortunately, the programs are focused primarily on teaching basic computer skills to entry-level workers. While these programs are helping many Americans improve their lives, they're failing to address the shortage of U.S. workers who have the skills companies need.

- H-1B portability. The law raising the cap, the American Competitiveness in the Twenty-First Century Act, contains a provision that allows H-1B holders to start working for an employer as soon as his petition is filed. Therefore, if a company wishes to hire a critical individual already under H-1B status, it can do so quickly rather than be forced to wait three to five months. This is a tremendous benefit to companies that can't wait to fill their IT needs and that are adept at attracting highly coveted IT workers.

Luckily, the best places to go hunting aren't far away. Many H-1B professionals can be recruited while they're still on F-1 visas studying at U.S. universities. F-1 graduates are allowed one year of practical training after graduation, so there's a comfortable window of time during which they can work before their H-1Bs are approved.

Another great place to find IT professionals is Canada. U.S. companies have long been recruiting top high-tech talent from north of the border to help compensate for the shortage of computer professionals here. Corporate IT organizations are increasingly hiring Canadians with strong communication skills and cutting-edge technical knowledge. Also, Canadians can initially enter the U.S. quickly and easily under the North American Free Trade Agreement without having to go through the U.S. Department of Labor.

In the slowing economy, companies should review their IT hiring practices and analyze which emerging skills will soon be in demand. Until U.S. students become more interested in computer fields and government training programs catch up with technology, the hunt for H-1Bs will continue.
FOUR years is a long time in central banking. On December 5th 1996, Alan Greenspan, chairman of America’s Federal Reserve, gave his famous warning about irrational exuberance in the stockmarket. Yet four years on, to the very day, and with stockmarkets considerably higher than in 1996, Mr Greenspan injected some irrational exuberance of his own. With a reassuring speech that was taken to imply that the next move in interest rates would be downwards, and that the Fed was ready to ease if the economy slowed too sharply, he lifted share values by almost $600 billion in a single day. The Nasdaq rose by over 10%, its biggest-ever daily gain.

Mr Greenspan’s soothing words were lapped up by investors who had become nervous that America’s economy was heading for a hard landing. The economy is slowing more than expected; and last year’s tech bubble has clearly burst. Yet, as Mr Greenspan pointed out, none of the recent economic numbers should themselves cause alarm. A slowdown in the economy’s breakneck speed is exactly what was needed. Demand has outpaced supply for several years; to ease tight labour markets and to stop inflation rising, the Fed has raised interest rates by 1¾ percentage points since mid-1999, to 6¼%. Mr Greenspan seems to believe that a soft landing is on course, as weaker share prices and tighter financial conditions dampen consumer spending.

The fact that evidence of a slowdown generated so much gloom has merely highlighted the extent to which expectations were inflated. There is, indeed, a worrying circularity in the response to Mr Greenspan’s speech. Share prices soared because investors think that interest rates will be cut early next year. But that will happen only if consumer spending slows. If stockmarkets bounce too far, consumer spending will stay too strong—and interest rates will not be cut, and might even have to be raised.

The markets are now discounting a half-point cut in interest rates in the first half of 2000. This is surely premature. Both the core rate of inflation and the increase in wage costs have edged up this year. To relieve inflationary pressures, growth needs to stay below its sustainable rate for a longer period.

The Fed should be careful not to give the impression that it will underwrite share prices by cutting interest rates. The Fed’s past success in steering the economy may have created a moral hazard: if investors believe that monetary policy will support share prices, they will tend to take bigger risks.

Many investors also believe that tax cuts can be called in aid of a soft landing. Dick Cheney, who will be vice-president if George W. Bush moves into the White House, said this week that America may be on the “front edge” of a recession, and pledged that Mr Bush would push to cut taxes quickly. With a large budget surplus, this might seem sensible. But, not least because of the long lags before tax cuts take effect, they are a bad way to fine-tune economies. Fortunately, a weak presidency, combined with near-balance in Congress, should make it harder than ever to agree on changes in fiscal policy.

Although the Fed may yet steer the American economy to a soft landing, investors are underestimating the difficulty of its task (see pages 77-79). History shows, in fact, that central banks rarely manage it. That is partly because slower-growing economies are more vulnerable to external shocks than booming ones. It is also because slower growth exposes all sorts of economic and financial imbalances. The borrowing binge that has taken place in America on the assumption of ever-rising profits and share prices may seem especially unwise as growth slows. And pessimism can be as contagious as exuberance. There is a risk that America’s virtuous circle of high investment, faster productivity growth, and rising profits and share prices could turn vicious. If it does, the Fed will need to cut interest rates—but not before.

New worries, old economy

What does America’s economic slowdown and the bursting of its tech-share bubble mean for the fabled “new economy”? One lesson is that the old rules of economics still apply: the business cycle is not dead, and profits do still matter. As growth slows, the new economy will face its first big test: it should become clearer how much of America’s recent productivity-growth improvement is cyclical rather than structural. Some of it may reflect the fact that in boom times firms work employees harder; that will disappear in a downturn.

As GDP growth has slowed, productivity growth has also eased, from an annual rate of 6½% in the second quarter to 3½% in the third quarter. Where will it go now? If productivity growth falls only modestly, keeping inflation in check and supporting profits, a soft landing remains plausible. But if productivity growth comes down faster, it will make the Fed’s handling of a downturn far trickier. Unit labour costs would accelerate, and the dollar might tumble—making it hard to respond by cutting interest rates.

The Economist has long argued that the American economy is suffering from a financial bubble. The rr revolution is delivering genuine economic gains, but the markets are also being driven by unrealistic expectations of future productivity and profits growth. This should be no surprise: historically, technological revolutions and bubbles have gone hand in hand, from Britain’s railway mania in the 1840s to America’s enthusiasm for cars and electricity in the 1920s.

When those bubbles burst, investors lost their shirts; yet it suggests that rr will have a bigger impact than electricity. That is one good reason to fear that, in a downturn, America’s productivity may slow by more than most economists expect—adding to the chances of a hard landing. Mr Greenspan may have some explaining to do in December 2000.
Now that the tech bubble has burst, financial stocks are even more buoyant

Technology stocks, biotech stocks—who needs 'em? These days, there's a better game in town: good old-fashioned financials.

The Standard & Poor's Financials Index has soared 41% since the Nasdaq Composite Index crested on Mar. 10. By comparison, the PSE Technology Index is down 7% during that same period. The AMEX Biotech Index is up just 5%. Says Anna Dolpin, manager of T. Rowe Price's Financial Services Fund: "The day the tech market peaked was the day true value names in financial services started to rally."

The resurgence of bank and brokerage stocks, however, is not just an anti-tech reaction. Could it be, then, that financial stocks are suddenly sexy? In a way. They've got a lot going for them: the pace of takeovers has quickened—not just for brokerages, but for banks and mutual fund companies, too. Earnings are strong and improving, interest rates have leveled off, and nobody believes that the Federal Reserve will edge rates higher. Notes Louise Yamada, managing director of technical research at Salomon Smith Barney: "The underlying feeling, based on our bond work on the 10-year note, is that interest rates are going lower."

One financial stock after another, from commercial insurance to fund companies, has hit or is flirting with a 52-week high—Citigroup, MetLife, Merrill Lynch, American Insurance Group, and Amvescap PLC, which runs AIM and Invesco brand funds. Even small brokerage firms, such as Legg Mason and Raymond James Financial, are higher than they've been in a year.

Of course, stocks don't move in straight lines. And with such a big rally, it may well be that some profit-taking will set in. Some analysts say the sector may have already maxed out. Says Mark Constant of Lehman Brothers Inc.: "The premiums suggest that the downside risk could be pretty material."

But the fundamentals are so powerful that, over the long run, financials should continue to outpace the market. Although price-earnings ratios of financial-sector stocks have spiked in recent months, they're still 35% below the S&P 500-stock index. Earnings growth for the group is still strong and improving, says Richard Strauss, analyst for Goldman, Sachs & Co., who expects a 28% return on equity for the brokerage and asset-management industries in 2000, above last year's 25.8% record.

True, declining trading volumes, the evaporation of initial public offering underwriting, and the threat of Internet financial upstarts hit the brokerage stocks early in the year. But with the stock market performing better and IPOs picking up, earnings growth estimates have jumped to 31%, from 21% for the third quarter, and to 10%, from 4% for the fourth quarter, reports First Call Corp./Thomson Financial. Bear Stearns & Co. analyst Amy Butte is raising her profit estimates for Goldman Sachs Group, saying that private-equity investment and fixed-income trading—the most fragile areas of the business—had boost-
The inhabitant of London could order by telephone, sipping his morning tea in bed, the various products of the whole earth, and reasonably expect their early delivery on his doorstep. He could secure cheap and comfortable means of transport to any country....Most important of all, he regarded this state of affairs as normal, certain and permanent, except in the direction of further improvement."

The above quotation is from a famous pen-portrait of a civilized Londoner in 1914 by John Maynard Keynes. London on the eve of the First World War might seem another world to the denizens of the New Economy. It is like inviting comparison between a Merchant-Ivory movie and The Matrix. But the modern American businessperson should look again at this first global age and start to worry, for it carries a simple lesson: Global capitalism may be driven by technology, but it also relies on political will—and that will is tied to far more local, far less rational, forces than technology.

The London of 1914 that Keynes described was the epicenter of a capitalist system that seemed every bit as irreversible as the one in which we live today. Keynes was describing a time when capital and people moved around the world with ease: Gold sovereigns were just as widely accepted then as the American Express card is today. Best-selling writers such as H. G. Wells and Jules Verne predicted that time-travel was only around the corner, given the extraordinary pace of technological advance. Newspapers covered the new economy—Ford Motor Company, the spread of electrification, the new moving-picture industry—with the same breathless excitement that they now contemplate AOL- Time Warner, the wireless age, and the mapping of the human genome. The newly national market had allowed the creation of unimaginable new wealth: Ford, Rockefeller, and Carnegie were as admired and feared as Gates and Ellison are today.

IT COULD HAPPEN AGAIN

The new world of economy and safe 1900 – 1914.

Ever since getting rid of the protectionist Corn Laws in the 1840s, Britain had been a guarantor of the global free-trading system—just like the United States today. At the turn of the last century, British goods dominated the world’s markets. British military might protected the world’s trading routes. British culture was so powerful that foreigners even took to playing that most idiosyncratic of games, cricket. And most of the world accepted the British gospel of democracy, free trade, and globalization. But the real guarantor of the first global age seemed to be technology. Keynes’ global citizen used the telephone to buy goods and sell shares. Today, technodeterminists boast that the World Wide Web is making the world smaller in an unprecedented way, but its effect seems incremental when set beside the inventions in that earlier age. “All the ends of the earth will be wowed into the electric telegraph circuit,” Scientific American had predicted as long ago as 1852. The telegraph was—as Tom Standage points out in his book The Victorian Internet—hyped just as mercilessly. People even got married by telegraph. But by the turn of the century, the telephone, already in one in 10 homes in America, seemed to offer even more promise. Electricity was revolutionizing not just production systems but domestic life. The movie industry offered the first glimmer of mass global culture.

Then there were all the new forms of transport. Railways, steamships, and the new motorcar were making travel quicker and cheaper; the first aircraft were already in the skies. All around the world, bridges were being built, tunnels dug, and the system of post and telegram offices remorselessly expanded. Overseas travel, which had once been talked about in terms of “expeditions” and “grand tours,” was downgraded to mere “journeys.” On a trip to Italy in 1906, Keynes had been amazed by the ease with which he crossed borders, used his gold sovereigns, and kept in contact with his family.

Perhaps the most frightening thing of all, however, was the absolute assurance that the world would stay that way. For Keynes’ Londoner: “The projects and politics of militarism and imperialism, of racial and cultural rivalry, of monopolies, restrictions and excusions, which were to play the serpent to this paradise, were little more than the amusements in his daily newspaper, and appeared to exercise almost no influence at all on the ordinary course of social and economic life, the internationalization of which was nearly complete in practice.”

Just as the chattering classes today discuss books with titles like The End of History and Dow 30,000, the Edwardians debated The Great Illusion, Norman Angell’s 1911 best-seller, which argued that a major war had now become an impossibility. Just as technological gurus such as Nicholas Negroponte talk about the Internet so completely breaking down national borders that “our children are not going to know what nationalism is,” Samuel Morse and Thomas Edison were assumed to have solved the world’s problems. Any disturbances seemed as freakish as, well, a crowd of 50,000 protesters, some dressed as turtles, protesting against the World Trade Organization.

Of course it was not to be. Within a few years, the machine guns of the Somme had shot to pieces the Great Illusion. At the end of the Great War, countries rushed to put up barriers against immigration and “unfair trade;” throughout the 1920s, the world slithered further toward protectionism, and then in the wake of the Wall Street crash erected the economic barriers that ushered in the Great Depression. The world economy only recovered when those barriers were lifted after World War II.

In the process, the technology that had once seemed to be such an agent of globalization seemed to turn against it. The same railways that the technodeterminists had celebrated now rushed troops to the front. Motorized transport found its “killer app” in the tank. Airplanes, which one technodeterminist had predicted would herald “an age of peace” by making ground armies obsolete, added to the mayhem. Working people began to groan that electricity did not make their jobs easier but merely allowed the robber barons to force them to work through the night. In the 1930s, dictators (and even democrats) discovered that the movie camera could whip up nationalist propaganda.

THE LESSON TO LEARN

To point out that there are eerie similarities between the current era of laissez-faire capitalism and the last golden age is not necessarily to predict that the next 50 years will include two world wars, a great depression, and the resurgence of socialism. History does not repeat itself that exactly. But, if you look carefully, there are plenty of serpents in the garden today, hissing at the evils of free trade, immigration, and foreign capital; and plenty more people—perhaps most people—who are worried about the ferocity of global capitalism (see “Enemy of the Techno-State,” page 172).

One clear lesson from the last golden age for the modern American businessman is that the political popularity of global capitalism must be assessed on a global basis. Just because something is popular in Palo Alto, California, it may not be in Paris or even Peoria. That in a sense was the first mistake of Keynes’ Londoner. He might well have assumed that free trade was “normal, certain and permanent,” but his peers throughout continental Europe did not. Most European countries had responded to the “great grain invasion”—the influx of cheap grain from America and Russia from the 1870s onward—by increasing tariffs.

* The serpent to Paradise

[Image of a plane]
BRILLIANT SUMMARY OF FABULOUSLY INNOVATIVE ERA

The Renaissance—by Paul Johnson (Modern Library, $19.95). In a readable narrative style, this wee book packs more information, insight and historical perspective than do most volumes many times its length. Paul Johnson (soon to be a FORBES columnist) is an original—a historian who digs deep and renders lucid, enlightening, on-target interpretations.

Johnson begins with some historic background. Centuries before the Renaissance, Charlemagne wanted to create a cultural reawakening, but the political, economic and knowledge infrastructure was simply not there. In supposedly backward Medieval Europe the foundations were laid. The Roman Empire had made puny engineering, technological and artistic advances because it relied on copious use of human brawn, not brains. Thanks to labor shortages, feudal Europe did not have that luxury; it therefore was host to the creation of numerous innovations, such as the wheelbarrow and the stiff, padded horse-collar (quintupling the tractive power of horses, leading to their substitution for oxen), as well as major advances in sailing, cart building, bridge building and waterpower. Metal-heavy knights led France to breed bigger, stronger horses, which meant major productivity advances in plowing and transportation. This progress created wealth, which created a demand for culture. By the late 13th century, Italy had a flourishing goldsmith and jewelry industry, from which sprang the architects and artists who created the Renaissance.

Breakthroughs in art proliferated, including perspective in painting. The use of oil-based paints on canvas made art accessible as never before. Instead of being restricted to painstakingly painting on a wall, an artist could carry an easel anywhere; hence, the rise of portraiture. An epochal advance in literature was Dante’s The Divine Comedy, wherein he single-handedly took a dialect of Latin and virtually created the modern Italian language. The invention of movable type, an innovation of colossal impact, led to a proliferation of books and the dissemination of knowledge.

Johnson scintillatingly encapsulates numerous Renaissance figures. You come to appreciate what was wrought in painting, architecture, sculpture, writing and music. As this book shows, the Renaissance did more than resurrect the artistic, architectural and literary glories of Rome and Greece; it created its own new culture, which stands in vivid contrast to today’s bizarre cultural landscape.

The Renaissance started about 1300 AD

In Forbes mag
Jan 22, 2001
Techies.Com Changes Its Corporate Culture, Reviving Hope for IPO

On the evening of June 27, word went out to the 200-person staff on the south campus of Techies.com that everyone was to report to an "all-building" meeting the next morning. At 8 a.m. on the 28th, employees of the Edina, Minn., online recruiting company began filing into folding chairs. At 8:30 a.m., Chief Executive Officer Dan Frawley took the microphone.

He said a few words about change—the changing market conditions, the need to embrace change even when it wasn’t good for everyone. Then he got to the real point: "Sixty of you are going to lose your jobs today."

This isn’t what Mr. Frawley expected to be doing this summer. And it certainly isn’t what his employees expected to be hearing. In this space a few months ago, we told of the predicament of Techies.com. Last winter, as the stock market was roaring, Techies, a fast-growing Internet exchange for technology professionals and businesses seeking to recruit them, filed plans for an initial public offering. Employees had stock options and dreamed of overnight riches. The company looked forward to raising at least $60 million and pouring the cash into new products, brand-building and overseas expansion. But after Internet stocks started sliding this spring, Techies dropped its IPO. As we said at the time, the decision was prudent, but the real test for the company would be how it coped in successive months.

We decided to check back with Techies. When we first met Mr. Frawley and his management team in May, he was hoping the company might be able to tap the public markets in late summer or early fall. That won’t happen, he admits. But Techies is making some striking and difficult changes that just may guarantee its survival—if it can pull it off. The layoffs are just a piece of it.

Techies was following a business formula shared by most Internet companies: Focus on fast growth of revenue and market share and forget about profitability. As a result, it had racked up enormous losses—$37.7 million last year alone.

Since the beginning of this summer, however, the name of the game at Techies is profitability. After weekly conference calls with their investment bankers to assess the state of the market, Mr. Frawley and the Techies board have decided that Techies must become profitable within a year. "The definition of what is a viable business has changed," Mr. Frawley says.

Now, the company is following a simple equation: boost revenue and cut expenses. Chief Financial Officer Larry Straughnhoer says revenue rose to $7.6 million in the second quarter of this year, from $5 million in the first quarter. He says losses are "still significant," though he won’t give a figure. Nevertheless, he says, the monthly rate of burning through cash has been declining.

In cutting back expenditures, the entire climate of doing business at Techies is changing. "We’ve gone from an environment of endless opportunity and not enough time in the day to do all things you want to do, to really having to rigorously analyze and justify and really look at what we’re going to focus on," says Mark Engelt, director of e-learning business.

The company’s technology group had been working on about 18 projects; management scrapped about half of them. That lead to the 60-person layoffs. Techies added 27 new people in other areas, but the overall work force is down to around 400 people from more than 500 this spring.

Another big area of savings is in overseas expansion. The company scrapped plans to spend $10 million to build operations in foreign countries. It will now spend $2 million and pursue only joint ventures. The company is exploring partnerships with online and brick-and-mortar companies overseas, a cost-efficient approach that allows it to "utilize their infrastructure and their customer relationships," Mr. Frawley says.

Expenses overall are down 28% from the first quarter to the second quarter, Mr. Frawley says. Techies also received $30 million in additional cash from three of its venture-capital investors this summer.

One of this has been easy. After Mr. Frawley told the hushed room that June morning about the layoffs, he directed employees to five sheets of paper posted on the back wall. Each sheet directed the listed names to a room. Scott LaFrenz, 26 year old who had been with Techies 18 months, found his name and went to the room. There, a top executive told him and about 15 others: "I have the distinct displeasure of letting you know that in the reorganization, you’re jobs were eliminated."

Mr. LaFrenz recalls, "It was just quiet. People just kind of looking around, probably shocked." The company’s human-resources officials and representatives of an outplacement service spoke. Severance packages were revealed. About 10 minutes later everyone went back to their desks where they found cardboard boxes waiting. By the end of the day they were packed and gone.

Mr. Frawley says quick and decisive action was important. He has gone to great lengths to assure the rest of the staff that other layoffs won’t follow. "I may not like it but you understand the larger picture why you have to do it," he says.

"It’s the defense of a company."

But he’s eager to do the IPO, and says Techies will try it as soon as conditions are right. When does he hope that will be? "Yesterday," he replies.

Hilary Stout begins maternity leave next month. Paulette Thomas will be filling in.
Venture Fund Seeks Gems in Web’s Woe

By Bob Sechler
Dow Jones Newswires

AUSTIN, Texas—Scott Hyten considered himself a skeptic at the height of the “dot-com” investing boom, when Internet hype had propelled valuations into the stratosphere.

Now he is equally skeptical of the indiscriminate change in market sentiment that has relegated many of those same newly minted companies to the trash heap.

“I don’t think [prospects for e-commerce] were ever as good as people said” at the apex of the Internet bubble, Mr. Hyten said. “But they’re certainly not as bad as they say today.”

He and two fellow venture capitalists in Austin, Ronald Carroll and Steve Hicks, bought D-Rad, an internet startup, in 1999. The trio have formed Eco Associates, a partnership to comb through the roster of dot-com start-ups left for dead by others. The key, Mr. Hyten said, is to pick the right companies from the wreckage, meaning those that started off with sound ideas and have good brand names but simply “forgot to convert that concept into revenue.”

In August, Eco Associates helped lead a group of investors that sunk $27.5 million into drkoop.com Inc. for an estimated 75% combined majority stake. The deal valued shares of drkoop, which once traded as high as $45.75, at 35 cents each.

Eco, a combination of Mr. Hyten’s Interscope Capital venture fund and Mr. Hicks’s Capstar Partners, also has spent $5.8 million for a majority stake in closely held e-tailer Mail.com, although the exact percentage of its ownership hasn’t been disclosed.

The fund has made four other investments in closely held companies as well. One of them, Urban Box Office Network Inc., recently changed in a bankruptcy filing that Eco Associates reneged on an agreement to provide it with additional financing on top of previous loans totaling about $3.5 million. Executives of Urban Box Office, which filed for protection under Chapter 11 of the U.S. Bankruptcy Code last month, weren’t available for comment.

But Mr. Hyten said Urban Box Office didn’t follow through on its end of an agreement to add strategic partnerships in exchange for more funding. He said Eco Associates still intends to work with Urban Box Office to revamp its business model.

Regardless, Mr. Hyten said generally he has been surprised at how inexpensively Eco Associates has been able to invest in these on-the-rocks Internet companies, some of which he said have gone for as little as three cents on the dollar.

Barely $30 million of the $100 million that Eco Associates initially set aside for the endeavor has been used, and Mr. Hyten expects only “a few” new investments to be made in 2001, meaning the total may never be spent.

Mr. Hyten says the amount of investment that was pumped into profitless Internet start-ups at the height of the boom simply made executives at the firms “stupid.”

He added, “There was so much money that their bad behavior was reinforced by continuing investments.”

He points to Mail.com as an example, citing its high-dollar sponsorships of NASCAR races and a professional boxer. “It takes a good lead” to translate those kinds of promotions into online shopping, he said.

Mr. Hyten boasts that expenses are being slashed at all of Eco Associates’ portfolio companies, a byproduct of Eco’s effort to refocus business models and marketing efforts, outsourcing technology and cut staff.

At Mail.com, for instance, the cash burn rate has been cut to $150,000 a month—down from about $2 million, he said, while the burn rate at drkoop has been cut to about $8 million a quarter from $37 million.

Mr. Hyten acknowledges that he and his colleagues have higher expectations for things such as market penetration, but the smaller staffs retain higher expectations for things such as market penetration, he said.

At Mail.com, Chief Executive Pete Freix said the change in priorities under Eco Associates has been striking. Mr. Freix, a former Dell Computer Corp. executive, has seen both sides of the Internet boom. He joined Mail.com last December as vice president of operations and was promoted to chief executive after Eco became majority owner.

“We were in that typical dot-com world, where it was very fast-paced and your basic charter was to build a brand and build market share,” he recalled. “Revenue and the bottom line were somewhat secondary.

Now, with Mail.com’s staff cut to 15 from about 40 and a more focused mission for broad marketing efforts, the emphasis is on just the basic principles of running a business,” Mr. Freix said.

Mr. Hyten expects the payroll for Mail.com and Eco Associates’ other portfolio companies to be significant if they can achieve it. He bases the prediction on still-strong forecasts for online shopping and Internet use. Forrester Research, for instance, is forecasting $10 billion in online sales this holiday season.

“It’s still an enormous number” even though the sector has fallen from investors’ favor, Mr. Hyten said. “We think the market is still there.”

For RJR, UST Is Something to Chew On

Continued From Page C1

Combining Reynolds’s Camel. Win-
price, he calculates that this acquisition

Treasury Prices Conti-
But Two-Year Note At

By Michael S. Derby
Dow Jones Newswires

NEW YORK—Treasury prices fell for a second straight day as rebounding stocks drew interest away from bonds. Some of the selling also was in reaction to the high prices Treasurys had reached after a recent rally, traders said.

Despite the declines, a $10 billion auction of two-year notes saw solid interest, in contrast to a poorly bid sale of Treasury bills Tuesday, traders said.

Late yesterday, the benchmark 10-year Treasury note was down 16/32 point, or $5 per $1,000 face value, at 104 28/32. Its yield rose to 5.10% from 5.08% late Tuesday, as yields move inversely to prices.

Meanwhile, the 30-year Treasury bond’s price was down 17/32 at 111 20/32 to yield 5.45%, up from 5.41% Tuesday.

Analysts said the declines Tuesday and yesterday weren’t surprising after a rally in recent weeks that pushed yields to the lowest levels in 20 months.

At this point, the market lacks an immediate reason to do better,” said Peter McCaigue, bond-market strategist at Greenwich Capital Markets in Greenwich, Conn. “There’s no reason why we can’t have a correction” while waiting for more economic data to help clarify the economic and interest-rate outlook, he added.

One reason bonds had rallied in recent weeks is the market’s expectation that the Federal Reserve will aggressively cut interest rates in response to signs that economic growth is flagging.

Many foresee as much as one full percentage point’s worth of reductions in the Fed’s overnight borrowing-rate target in 2001—but it is a matter of waiting for more economic reports to justify such a scenario, analysts said.

Trading activity was fairly low yesterday, however, as usual is between the