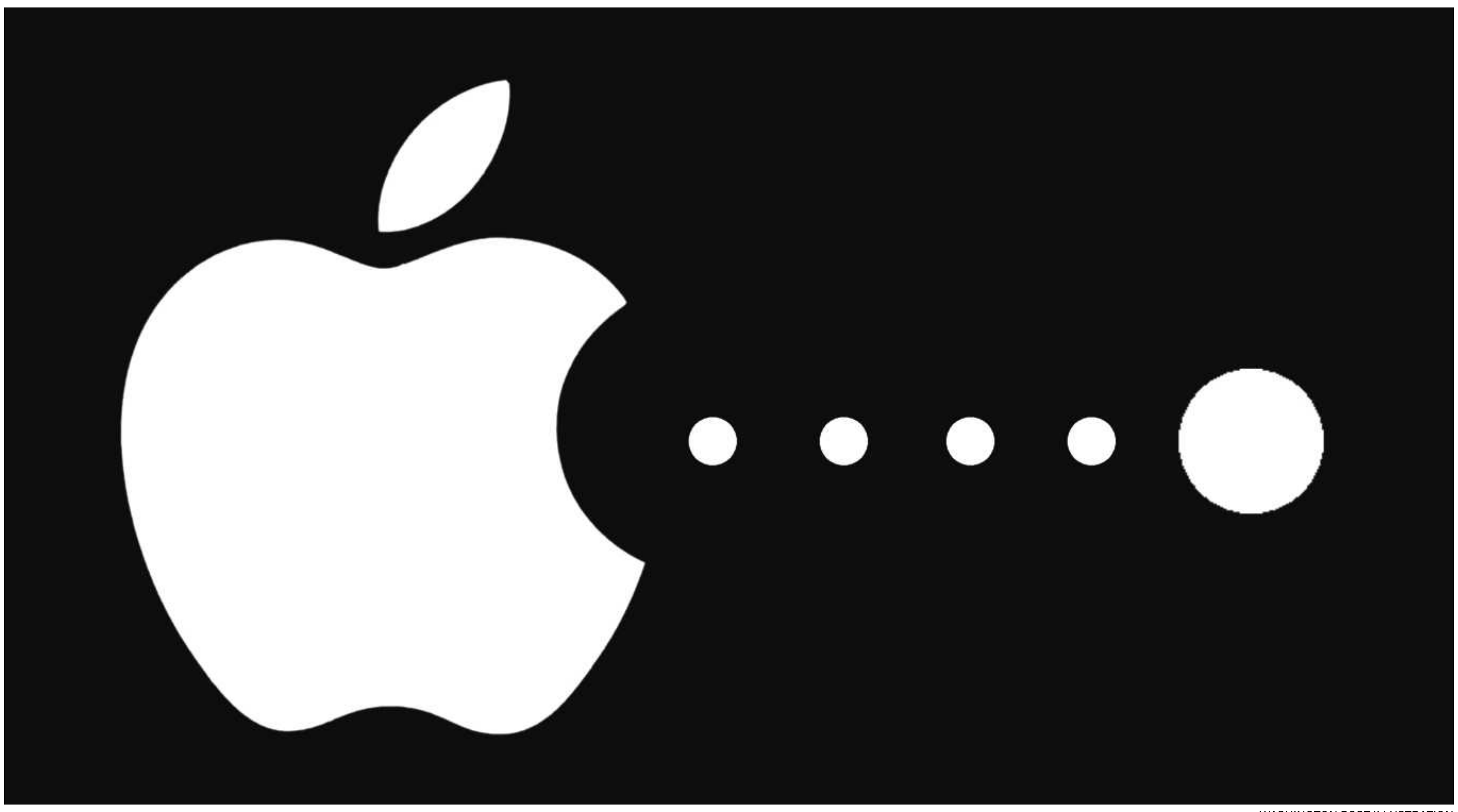
ON THE MONEY



WASHINGTON POST ILLUSTRATION

And then there were none: Apple's destruction of rivals

BARRY RITHOLTZ
On Investing

One thing that might have gotten lost in the avalanche of Steve Jobs coverage has been his impact on technology investors. Not the entire sector but rather the crushing effect that Apple has had on specific competitors. It is creative destruction writ large.¶ Jobs remade entire industries according to his unique vision. From music to film, mobile phones to media publishing, and now computing, his impact has been enormous. And rumors abound about the next new thing, Apple's remake of traditional television. ¶ While Apple 1.0 influenced how we think of the PC user interface, it was hardly the disruptive behemoth that Apple 2.0 became. The Cupertino PC maker hardly profited from its innovations — Apple was a marginal player with a tiny market share. Yes, we know the original Mac was hugely influential and mostly ripped off by Microsoft. Indeed, the Mac-maker was kept alive by a $150 million Microsoft investment in 1997. With that, Bill Gates could retain a weakened competitor and argue that his firm did not own a monopoly in operating systems. The irony is that lifeline allowed a competitor to recover to the point where it is now a threat. ¶ But it is much more than just Microsoft. Today, the triple threat of iPod/iPhone/iPad has left behind a wake of overwhelmed business models, confounded managements and bereft shareholders. Let's look at who has been hurt — and helped — by the perfectionist from Cupertino:

Destroyed

Hewlett-Packard: The printer business might still have some ink left in its cartridges, but its PC operations are hurting, gutted by sales of the iPad. HP is considering selling its $40 billion division and exiting the PC industry. HP's tablet entry, the $499 TouchPad, was an unmitigated disaster — Best Buy was sitting on more than 200,000 unsold units — until the price was slashed 80 percent, to $99.

The HP TouchPad

Dell: About Apple, founder Michael Dell once famously stated: "What would I do? I'd shut it down and give the money back to the shareholders." When Apple's market cap passed Dell's in 2006, Steve Jobs reminded employees of that barb via e-mail. Today, Apple's profit ($29 billion) alone is larger than Dell's entire market capitalization. And Dell seems to have no answers to the major challenges Apple has thrown at its traditional made-to-order PC business.

Motorola: See Google.

Research in Motion/BlackBerry: RIM is an instructive example of how a leader can get toppled by an innovative competitor. RIM long owned the enterprise market for mobile e-mail and text messaging via its "crackberry." Topping out at $144 per share in 2008, it now trades in the $20s and has no solid answer to the iPhone.

Nokia: Not long ago, Nokia had better than a 50 percent market share in the mobile phone market. Today? Just 15 percent and forced to abandon its own OS in favor of Microsoft's tame also-ran phone OS, Windows Mobile.

Ericsson: I'm sorry, but the name doesn't ring a bell.

Damaged

Microsoft: Once a vicious and hated monopolist, Mister Softee is currently run by Steve Ballmer. Under Ballmer, Microsoft has become vulnerable on multiple fronts. It has missed nearly every major trend in technology over the past decade, with the Kinect being the lone exception. Ballmer famously said he wouldn't let his kids use an iPod or Google, missing an entire computing shift. As recently as two years ago, he claimed Linux was a bigger competitor to Microsoft than Apple. Perhaps Ballmer's sale of 49.3 million shares in his Microsoft stock in late 2010 — that is $1.3 billion in cash — is a better tell than his foolish proclamations. Microsoft still has its cash cows Windows and Office, but I imagine it could see significant attenuation over the next decade.

Sony: Once owned the portable music space, but its Walkman was replaced by the iPod, and its well-regarded Vaio laptops are getting supplanted by iPads. It has a huge consumer electronics, film and television business but is being slapped by the Koreans below and Apple above.

Intel: A mixed bag, to say the least. Intel is powering Macs and has some chipsets in other Apple products, but its PC business appears to be potentially at risk.

Sony Ericsson's Walkman phone in 2007

Challenged

Google: A juggernaut in its own right, Google acquired Android and turned it into a legitimate competitor to the iPhone. But it doesn't sell the OS — it gives it away for free and retains the search rights (the bread and butter).

It was smart to expand into mobile so as to not get eclipsed in that space, but it also created another set of headaches: patent exposure. Apple not only dominates the space but also acquired a huge trove of Nortel patents so as to insulate itself and challenge all comers. This forced Google to pay up for a comparable portfolio, grabbing (former Apple partner) Motorola for $12.5 billion. The jury is still out as to whether this will insulate some of the obvious Apple-inspired tech on the Android.

AT&T: Was desperate enough to let Apple dictate terms for the iPhone, thereby transforming the industry. When iPhone calls got dropped in large numbers, Apple might have saved it from an ignominious demise.

Verizon: We could argue that the phone giant could be put into multiple categories: Challenged? Benefited? Perhaps a foot in each camp?

No doubt, the initial years of AT&T's iPhone sales took some market share from competitors. But Verizon's reputation for having reliable network coverage was enhanced. Its savvy advertising also limited the damage. As soon as AT&T's exclusivity ended, Verizon was right there to become an iPhone4/iPad2 seller. Both products sold well for the company. Verizon's Android sales meant they were also in a good negotiating position with Apple for contracts. That's something most other mobile phone companies cannot claim.

Benefited

Samsung: Similar to Verizon and Foxconn, Samsung benefits from Apple as a major supplier but is also a competitor in its own right. The Economist recently reported that Samsung makes 26 percent of the component cost of the iPhone. Indeed, there is litigation between the two firms over designs and patents, but so far, Samsung is a net winner in the new Apple econosphere.

Apple's iPhone 4

Sharp: Apple invested a billion dollars in Sharp to ensure a steady supply of laptop LCDs, and their ongoing relationship seems to be working well for the Japanese multinational.

Corning: "Gorilla" Touchscreen Glass is the supplier not only to the iPod Touch/iPhone/iPad but also to an entire industry. The i-line and its many competitive inspirations have been a boon to Corning.

Sprint: Will reportedly begin selling the iPhone 5 later this year.

Foxconn: Manufacturer of many Apple products continues to benefit from the relationship with Cupertino.

STMicroelectronics: Makes the Accelerometer and Gyroscope in iPods and iPhones.

Qualcomm: Produces the wireless baseband chips in iPhone4 and to be in iPhone 5.

One day, a new competitor will come along and do to Apple what Apple had done to others. It is the nature of creative destruction that these innovative firms are temporary, lasting a few years to a few decades. Survivors such as IBM and GE are the exception, not the rule. This is why investors must always remain vigilant against losses. There is no such thing as a forever stock holding.

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Mastering both fear and the market

Experts explain how to look at crises as investment opportunities

BY BOB FRICK

Nothing tests an investor's mettle like a disaster, whether natural or man-made. The fear prompted by, say, the swine flu outbreak, Japan's recent tsunami and nuclear disaster, or the Sept. 11, 2001, attacks can result in poor investing decisions. Understanding fear and its effect on markets — and on ourselves — can help us avoid panic selling. And mastering our fears may help us profit during troubled times.

If you have a hair-trigger reaction to danger, congratulations. You're wired to survive. Humans have evolved so that we respond to danger before we can process it intellectually, thanks in large part to the amygdala, a small, almond-shaped mass deep within the brain. When something scary appears — a coiled snake at our feet, a drawn gun or even the look of fear on the faces of others — the amygdala jolts our system with stress hormones.

Kiplinger

But sometimes our initial response is to underreact to a disaster, says Richard Peterson, a psychiatrist and managing partner of MarketPsych, a firm that measures market sentiment, including fear, trust and optimism. When we first try to understand the effect of a disaster, he says, we might go into denial or experience cognitive dissonance: holding conflicting ideas concurrently. "People have trouble processing new information that is out of their comfort zone," he says.

Once we incorporate the new facts, Peterson says, we react accordingly. For example, fund managers will sell stocks of companies that might be hurt by a disaster and buy those that may profit. This reaction stage might be followed by an overreaction stage, or panic, perhaps four to five days after the event.

"Inevitably, you'll get Chicken Little fears, such as worrying that a cloud of radiation will cover the world" in the case of the recent Japanese nuclear disaster. This fear could prompt you to sell risky assets and hoard safe ones.

Periods of panic give shrewd investors a chance to buy deeply discounted stocks. But it isn't easy to take that risk. "Even some of the most experienced investors get a stomachache investing in those situations," says Lauren Templeton, a hedge fund manager and the great-niece of the late Sir John Templeton. Uncle John, as she calls him, was one of the great investors of the 20th century and was well known for making steely decisions during a crisis. He famously borrowed $10,000 to invest in beaten-down U.S. stocks on the eve of World War II. He quadrupled his money.

Lauren Templeton says her first lesson in practicing what her uncle preached came in 2001, just months after she started her hedge fund. After the Sept. 11 attacks, with air traffic halted and the market plunging, her uncle had her place orders to buy top airline stocks selling at half their previous prices. They bought stock in American, Continental and US Airways; six months later, they sold it at profits of 61, 72 and 24 percent, respectively.

Templeton, who teaches a course in behavioral finance at the University of Tennessee at Chattanooga, says you can train your brain to profit from catastrophes. She has repeatedly invested during times of crisis and reaped the rewards afterward. For instance, her funds scored big during the Toyota recalls in 2009 by buying the stock near its nadir.

Templeton says you can learn to look forward to crises as opportunities and take fear out of the equation. Make a list of stocks you'd like to buy that are too expensive at the moment. Then place orders to buy the stocks if they fall, such as 30 percent below current prices. "In a crisis situation, when you're afraid to buy those stocks, it's too late; the decision has been made," she says.

Peterson thinks fear-proofing is possible to a point. "We can condition most of the fear out of us, but at some point the body will rebel against the brain," he says. "When the information flow gets too grisly, turn it off."

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