

The IPOs are coming!

Blog

It's fair to say that public interest in IPOs (initial public offerings) hasn't been this high since the dotcom era of the late 1990s. I say this with some experience, and perhaps bias, as I wrote my Ph.D. dissertation on IPOs and then wrote a book on the topic.

The reason IPOs are under the spotlight again is that after years of anticipation many "unicorns"—privately-financed start-ups valued at over USD 1 billion—could go public in 2019, raising close to USD 100 billion. It also helps that many of these companies are well-known household names, including Uber, Airbnb, and Pinterest.

Back in the day I examined IPOs through an academic research lens. Today I do so as an investment strategist. In our report *2019: The year of the "unicorn" IPO?* published 2 April, we applied both perspectives, first to serve as a primer on IPOs and how they've performed as investments in general. Then we examined the prospects of the IPO market this year and the broader equity market implications. Some of the main conclusions are:

- Since 1980 the average first trading-day return is 18%, with relatively few negative returns. In the six months after the first day IPOs performed roughly in-line with risk-adjusted market returns, but after five years about 60% of all IPOs had negative total returns and a small percentage had exceptional returns. In short, IPOs can be attractive investments if you can get an allocation in the offering, but much less so when buying in the secondary market.
- These average returns mask huge variation between the winners and losers, and certain factors (e.g., age, size, and funding sources) help explain the return dispersion. Thus, security selection matters a great deal when investing in IPOs.
- While there are legitimate concerns about high valuations and earnings potential for some companies, these are not dotcom IPOs. The unicorns that could go public today are larger, older, and more established than those early Internet companies, attributes which have historically correlated with better long-term returns.
- A strong performance by IPOs this year would likely positively impact overall equity market performance by lifting investor sentiment and attracting additional investors to the market who've sat out the rally.

The "year of the unicorn" IPO may come to pass if economic and market conditions stay favorable. But the ultimate deciding factor will be whether these companies actually live up to expectations. That won't be determined on the first trading day.

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