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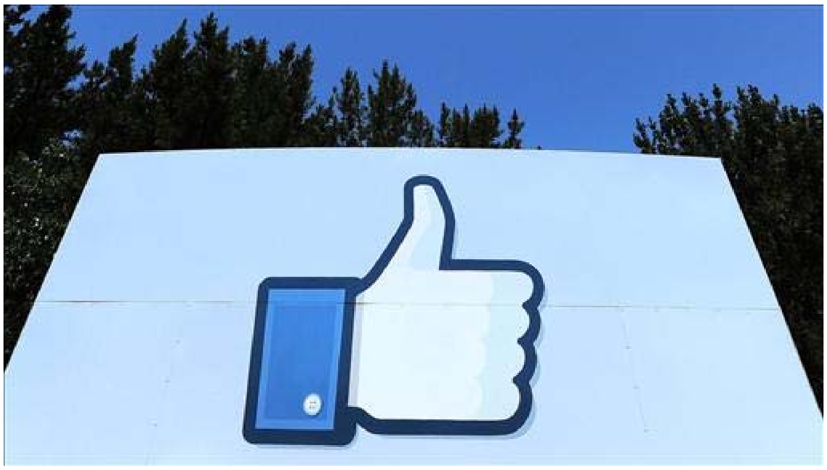
Is 'You' a Good Investment?

By JASON ZWEIG



WSJ's 'Intelligent Investor' Jason Zweig visits Mean Street and looks at the unique way in which Facebook is intertwined with the lives of its customers and asks 'How much is too much to pay for a piece of yourself?' Photo: Getty Images.

How much is too much to pay for a piece of yourself?

That was the question that went largely unasked in the run-up to Facebook's initial public offering. In seesaw trading amid record first-day volume for a U.S. stock, the shares opened up 11%, then ended the day just 23 cents above their debut price of $38. Although the Nasdaq market, where Facebook listed its stock, dropped 1.2%, investors were underwhelmed by Facebook's launch; expectations had been far higher.

Christophe Vorlet for The Wall Street Journal

But those who expect Facebook's shares to collapse quickly from here should realize that this isn't your garden-variety overvalued stock.

Regardless of the shares' short-term performance, Facebook may well remain a hot company for the foreseeable future. Rarely—if ever—has any other big corporation been so inextricably intertwined with the lives of its customers.

"When you buy most other companies' products, it's private," says George Akerlof, a Nobel Prize-winning economist at the University of California, Berkeley, and co-author of the book "Identity Economics." Even with an iconic brand like Coca-Cola, you often consume it in private; some of your friends and family might not even know whether you like it. But Facebook, he says, "enhances your identity" and is "an advertisement to the wider world of how you are defining yourself."

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He adds, "Identifying with that group [of users] can block out your rational judgments of what the stock might be worth." For the many Facebook users who also have just become owners of the company, to take a negative view on the shares would literally be to sell themselves short.

One past example of how identifying intensely with a company can muddle investors' objectivity: In March 2000, 3Com sold a minority stake in its Palm subsidiary to the public. Investors—many of them professional money managers fanatically devoted to their Palm Pilots and the company's other "personal digital assistants"—priced the Palm shares at more than 1,350 times net earnings after a first-day return of more

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than 150%. Meanwhile, shares in 3Com—whose majority holdings in Palm were diluted by other, less glamorous assets—went down. (Over the next two years, Palm shares fell by more than 90%.)

To some extent, investors always have identified with companies' products. Drive a Ford car and you might well end up owning Ford Motor's stock. Liking the car can make you more attached to the stock, and vice versa. Fans of the iPad and the iPhone are more likely to love Apple stock, as well. One recent study, for example, found that investors who admire a company's brands tend to form overly optimistic assumptions about its stock returns, to be overconfident about how likely those high returns are to be realized and to become more unwilling to sell the stock.

But Facebook is an extreme case, says Robert Shiller, the Yale University economist who correctly predicted that both the Internet-stock and real-estate bubbles would burst. For many users, he says, "Facebook is your ally in your quest to project [yourself] onto the wider world." That strong bond isn't likely to fade anytime soon—although it could ultimately set up the stock for a steeper fall.

Furthermore, a social network functions as a financial echo chamber. "Users are networked into other people electronically, rather than through direct personal contact," says David Hirshleifer, a finance professor at the University of California, Irvine. That exposes them to much greater potential reinforcement and "may make them much more aggressive in their trading."

For evidence of that, just consider the unidentified investor who, according to Knight Capital Group, put in a buy order for Facebook on the first day of trading for any price up to $4,000 a share.

"It sounds like the setup for a colossal bubble," Prof. Shiller says. "Price increases generate talk, and when people talk about it, the stories get amplified and that feedback leads to more of a price increase. Bubbles come to an end because they can't be sustained unless the price keeps growing. As the price falters, the talk turns negative and then the price goes down further."

The hordes of users-turned-investors might view Facebook differently once they own a piece of the company, says Brian Uzzi, an expert on social networks at Northwestern University. Some of these people, many of whom may never have owned a stock before, might realize that the firm's enormous value is derived from the information about them that it resells.

"That could make people a lot more sensitive to the importance of their own data," Prof. Uzzi says, "and they could become unwilling to share as much with Facebook free of charge and move to lock their data down."

That isn't likely to happen right away, and any slowdown in the company's growth will take time to unfold. At least for now, betting against Facebook is no slam dunk.

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