How to Invest in the Internet of Things

Data-driven technology is becoming more attractive to investors as everything becomes more connected.

By Dawn Reiss | Contributor

April 13, 2016, at 9:00 a.m.

As the conversion of big data and analytics continues to grow, business are ramping up their involvement in the Internet of Things to hyper-personalize and customize every aspect of their companies. At the same time, the growth of this nebulous network that connects anything digital is attracting investors who are increasingly aware of growing opportunities.

Companies are either using the Internet of Things to become more efficient and productive or using the data to create new value. Cisco Systems (ticker: CSCO) estimates over the next decade $14.4 trillion in potential bottom-line value will be created and "up for grabs" for private-sector businesses, globally via the Internet of Everything. At the same time, a McKinsey Global Institute report says IoT technology could generate up to

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"The strategies and the choices companies are making right now will absolutely decide winners and losers in marketplaces," says Nick Kramer, senior director, data and analytics who specializes in IoT at SSA & Company, a consulting firm in New York. "It's important to care about the Internet of Things and care about the company's strategy when you are considering an investment."

Here are a few IoT investing trends to keep on your radar.

IoT affects all verticals of the global economy. There are certain segments that are moving more rapidly into this space. Manufacturing, health care, logistics and consumer electronics are all big players. Several experts point to manufacturing as the biggest. "It's less glamorous, but they are probably taking greater advantage of it than anybody else," says Kramer, who was in Hanover, Germany, helping a manufacturing client implement Internet of Things technology and strategy into its supply chain, logistics and product development.

A lot of Internet of Things technology sets are also coming from the business-to-consumer market, says Fred Guelen, CFO and president of North American operations of Planon Software in Boston. "Look at what companies are paying attention to the technologies used by consumers in their ordinary lives that are communicating with each other," he says.

Implement the black swan strategy. Make a lot of small bets and spread them out to make sure you have representation in multiple industries, big and small companies, Kramer says. "It's the black swan strategy," Kramer says. "So the losers aren't going to damage your investment portfolio and the winners could win big."

Consider what makes up the Internet of Everything. There are plenty of players in the IoT (or IoE) industry, including companies who are manufacturing the devices and sensors, businesses that are collecting the data or analyzing it, the systems that protect the security of the data, wireless networks, the companies that are using or storing the data and so much more.

All Internet of Thing devices need chipsets, so look at different players like ARM Holdings (ARMH), Atmel or Texas Instruments Incorporated (TXN), says Luke Burns, general partner for Ascent Venture Partners. Although Burns invests in private, not public, equities, he suggests investors look at smaller companies that are making big bets on the Internet of Things. One example is PTC (PTC), which won IoT Innovation Vendor of the Year award at the 2016 Consumer Electronics Show in Las Vegas and has purchased companies such as ColdLight ($105 million), ThingWorx ($112 million) and Axeda ($170 million).

[See: The 10 Best ETFs for Value Investors.]

Invest on a progressive platform. Paul Asel, managing partner at Nokia Growth Partners, which announced a $350 million fund for investments in Internet of Things companies in February, suggests looking at device-led hardware strategies, like Fitbit (FIT), as an early-stage investment. Over time once there's a critical mass of devices and the hardware becomes a commodity, he says to look for companies that can move into the software space and eventually pivot into the broader services and data once the industry gets established.

Forget what you've learned about blue-chip stocks. Big companies are having trouble replicating IoT success stories with new products. One example Kramer points to is Nest, which produces smart-home devices and was purchased by Alphabet (GOOG, GOOGL). "Even if a company has early success, has a lot of financial backing by a really successful company like Google, that still gives you no assurance they are going to be the right bet to make," Kramer says. "We've never been in a time like this where you can rely less on somebody's blue-chip history to make a forward-looking prognostication."

It's not like the old days when an investor could readily buy a blue-chip stalwart and rely on it. "There's no good tips like that anymore because we've seen these big companies go down fast and hard," he says. "We've seen the volatility of their stocks."

Be aware of valuations. "IoT is no longer a secret and the prices of some of these companies have ramped up," says Peter Krull, president of Krull & Company, a socially and environmentally responsible investment firm in Asheville, North Carolina. "Just because they do something great doesn't mean that their stock is a great buy."

For smaller investors, Krull says it might make more sense to buy into a diversified technology mutual fund since most will have some IoT investments. The most important aspect is for investors to make sure their investments are diversified not only by size, but industry and location.

Keep in mind, because the industry is changing rapidly life cycles of a new trend or technology are being measured in months rather than years, says David Karpook, a strategic business consultant for Planon Software, a global integrated workplace management system.

[Read: What Investors Really Want From the Fiduciary Rule.]

Do your research in the quarterly and annual reports. Peruse the quarterly 10-Q which must be filed to the Securities and Exchange Commission 35 days after each of the first three fiscal quarters, followed by the yearly 10-K, which must be filed within 60 days after the end of the fiscal year. "You really have to see what's happening on a quarter-by-quarter basis with these companies," Kramer says.

First, look at the company's strategy and see if it seems to makes sense, says Andrew Miller, executive vice president and CFO at PTC. When the market is taking off, the most important thing to review is the product-market fit, he says. "That means someone should be able to explain the value and the average person should get it," Miller says.

Secondly, check to see if the company is giving specific milestones to monitor over time and then delivering on those promises. "The greater the specificity in the investor documents it means they have a real solution," Miller says. "The less they disclose the more they are just waving their arms in the air. They should be able to tell real customer use cases on how they brought value."

Look at who initially funded the company. Look at which venture capitalist firms are behind the original investors, the track record of the companies they have invested in and the track record of the CEOs, Kramer says. "Venture capitalists are some of the experts we can rely on," he says. Kramer recommends looking at Kleiner Perkins and Andreessen Horowitz, who have "a very good track record for making wise bets." "It's not that CEOs get it right every time," Kramer says. "But the track record of the money behind them are much better indicators of future success than a lot of typical measures we've relied on in the past."

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