

T H E

# Better IIR

N E W S L E T T E R

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## Buyback Trends

### Now that I Can Afford to Pay the Bills, What do I do with All This Extra Money?

According to Standard & Poor's, the value of share buybacks by S&P 500 companies rose a staggering 221% from the second quarter of 2009 to the second quarter of 2010. This also marks a sequential increase of 41% over buyback volume during the first quarter of 2010, and represents the fourth consecutive quarter that buyback activity has increased<sup>1</sup>. The increase in buyback activity has been highlighted in the media and added to the popular debate of how best to use excess cash, and specifically, how best to provide value to shareholders? Adding to the complexity of this issue is the new trend of companies turning to historically cheap credit markets to raise cash to buy back shares at theoretically cheap valuations. At face value this seems to make a lot of sense; however, it will be interesting to see how this strategy plays out over time, and if it has any negative effects on the operations or financial stability of these companies.

As a quick review, the pros and cons of a buyback program from a shareholder perspective are fairly straightforward. The benefit is that buybacks serve as a tax-free method of returning cash back to shareholders. Shareholder value should be created by improving certain financial ratios, boosting EPS by reducing the shares outstanding and limiting dilution in addition to sending a positive signal. The counter argument mostly revolves around the timing of buybacks, as companies are often criticized as historically buying back stock at unfavorable periods in time. The dynamic that drives this, is that companies often buy back stock at market highs when a company is performing well, and halt these programs when they would be most impactful - as in when a company is at a lower valuation and not performing well.

### Historic Buyback Trends

During the third quarter of 2007, S&P 500 companies reached a peak in terms of the amount of cash spent on buying back stock, though this activity quickly declined as corporate earnings plunged going into the financial crisis. Corporate spending on company stock did not bottom until the second quarter of 2009, fueling investor concern about how buyback programs are executed. In 2010, with companies posting their first two consecutive quarters of increased earnings, companies are beginning to feel pressure to return value to shareholders. Despite buybacks being a variable cost, companies are often slow to make changes as the operational environment changes. In terms of dividend policy, payouts, in aggregate, remained relatively stable even during the midst of the financial crisis. Companies made an effort to maintain their dividend programs at all costs despite the difficult operating environment. Dividend programs are viewed as more of a fixed commitment, making them difficult to cut. In contrast to dividend programs, buybacks can be suspended without a public announcement and often are not tracked as closely as dividend payouts.

During the height of company buybacks (the third quarter of 2007) industries such as Consumer Discretionary, Financials and Technology led the buying, as illustrated by the green columns in Figure 2 below. While every industry experienced a severe cutback in buybacks by the second quarter of 2009, Consumer Discretionary and Financial companies had the most significant net difference. While most sectors have rebounded significantly since the low, Technology, Healthcare, and Consumer Staples are the only industries to return to levels approaching that of the third quarter of 2007.

Figure 1

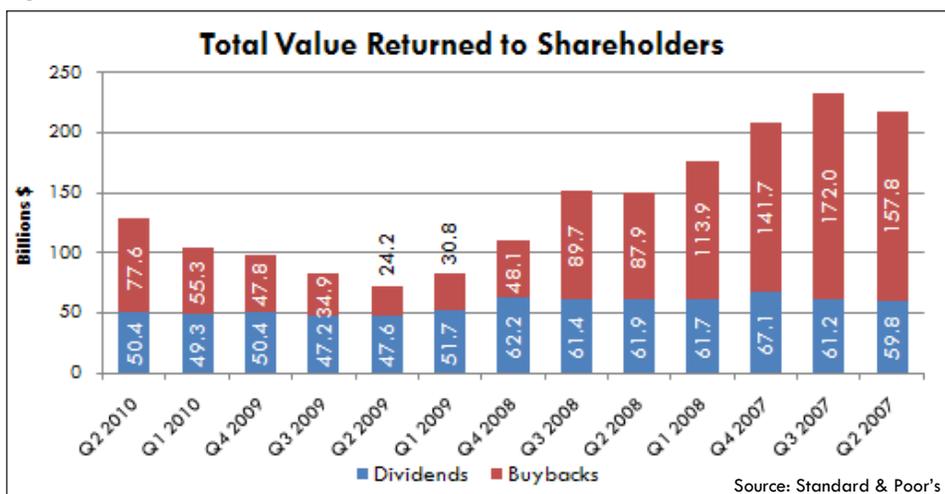
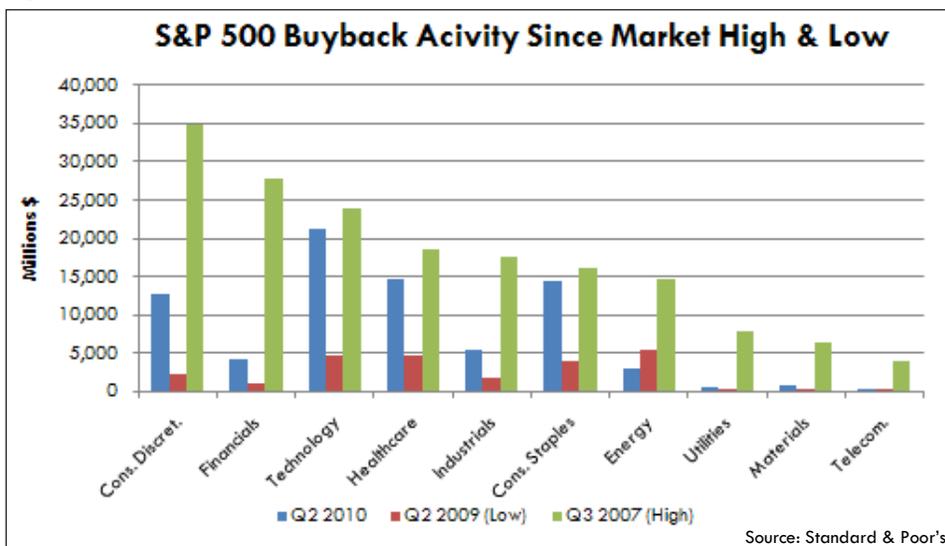


Figure 2



### What Are Companies Signaling for the Future?

As economies stabilize and balance sheet strength improves, buyback activity is expected to expand as evidenced by the announcements of new, or updates to existing, buyback programs. To provide some insight into the future of buybacks, as well as the market reaction to these announcements, Ipreo analyzed buyback announcements made by S&P 500 constituents within the last 2 quarters, in terms of the size of the buyback announcement in dollars and its equivalent as a % of shares outstanding.

Figure 3

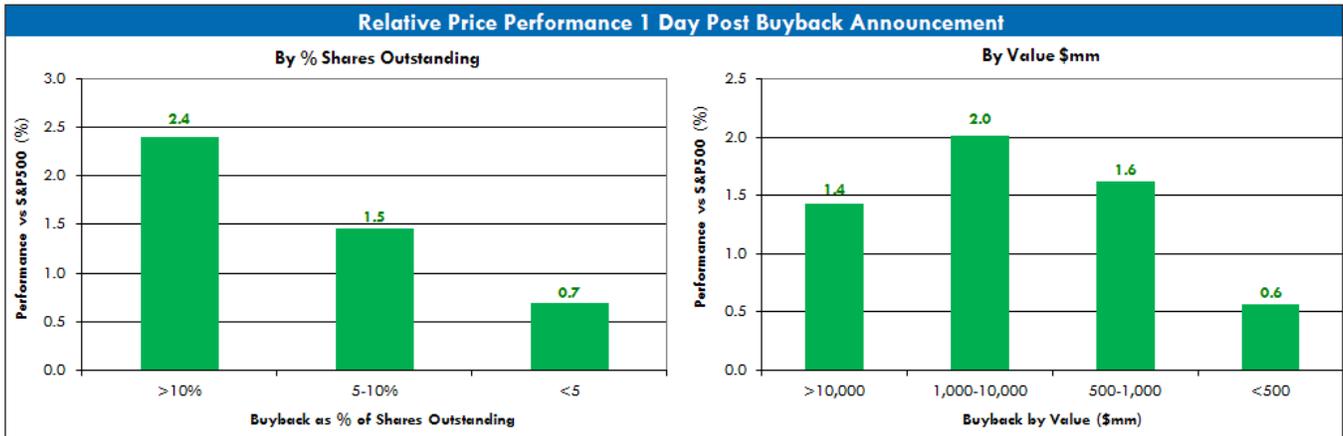


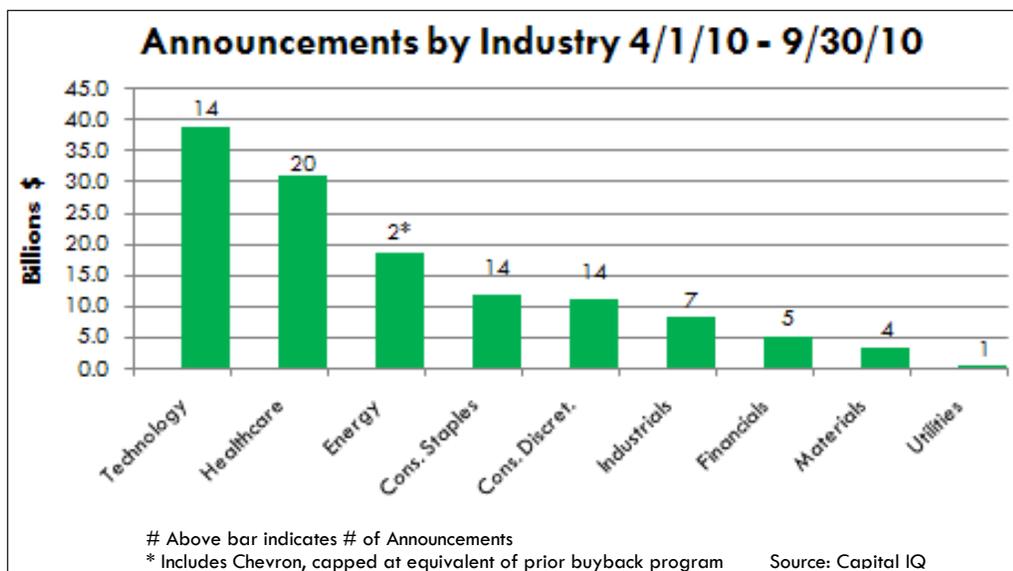
Figure 3 shows the average 1 day price performance relative to the S&P 500 based on the size of the buyback announcement in terms of percentage of shares outstanding and dollar value expressed in millions. Across the board, issuers that announce buyback programs show outperformance relative to the S&P 500 in the 1-day period following the announcement, with larger announcements generally having a more profound impact. While this trend seems fairly consistent, it is important to consider buyback announcements are often announced concurrently with other events such as an earnings release, so it can be difficult to determine how much price performance is driven solely by the effect of the buyback announcement.

Figure 4



As illustrated in Figure 4, the 7 and 30 day price performance is still favorable for the most part; however, smaller announcements do not demonstrate superior longer-term price performance. In all cases, an issue is that the terms of the buyback period can vary drastically. Companies are not beholden to complete the buyback in full, which can also determine the period that benefits financial reporting, if at all. The demonstrated market performance highlights the common criticism that buyback programs are short-term focused.

In terms of announcements by industry over the past 2 quarters, Technology and Healthcare continue to lead the group, with large announcements by IBM (\$8Bn), Texas Instruments (\$7.5Bn), Pfizer (\$5Bn) and Gilead (\$5Bn). On the heels of relatively little buyback activity from the Energy sector the past quarter, 2 companies, Devon Energy and Chevron, have announced additional repurchase programs. Chevron's July 30th announcement was unique in the respect that it has no set term or monetary limits. The Consumer Staples and Discretionary sectors have traditionally returned considerable value to shareholders in general, both in terms of dividends and buybacks, however, there seems to be an overall trepidation to return to prior levels.



### Takeaways for the IRO

Though companies are experiencing pressure from investors to return value and buy back shares it is important to not just automatically institute a buyback program without reviewing a few considerations:

1. What are all of your potential uses of cash?
2. How are your peers using their cash?
3. Review your shareholder base and determine if a particular use of cash is favored. For example, yield- and value-oriented investors may favor raising the dividend instead of buying back shares.
4. What message are you sending your shareholders by proceeding with a particular use of cash strategy?
5. Is now the best time to buy shares, or is this only a consideration because there is excess cash on the balance sheet? In particular, this is important for companies that have been criticized for buying excessively during prior market highs.

As with most elements of life, it is often difficult to please everyone; however when developing a strategy to return cash to shareholders, it is vital to keep in mind how all current and potential shareholders will view the decision. Additionally, these types of decisions should always be considered an opportunity to craft a message that reinforces company goals.

**Author:** Justin Vieira

*Justin Vieira is the Director of Corporate Analytics at Ipreo*

<sup>1</sup> Standard & Poor's Press Release "S&P 500 Second Quarter Buybacks Soar 221% From Q2 2009", September 22, 2010

## ETFs, Futures, and Portfolio Hedging

Since the onset of the securities analysis process, portfolio managers have sought ways to hedge against potential losses, either seeking easy methods of diversification or assets that have low correlation with the rest of the manager's portfolio. With a number of innovations that have taken place in the securities market over the last two decades, dozens of new instruments are now available to portfolio managers to help them lower risk, and hedge funds and other alternative asset managers have been able to use these instruments as a significant portion of their portfolios. Mutual funds, pension funds, and other more traditional asset managers have generally built into their mandates that the subadvisor should invest in just a particular type of securities in line with the goals of the pension fund, with limitations on the usage of derivatives and most other asset classes save cash. After all, if you pay Marsico to manage a growth equity portfolio, generally you want the securities they select to be growth equities, not derivatives or real estate.

However, innovations such as ETFs and futures are no longer the sole property of individual investors and hedge fund managers; a wider range of portfolios, including many mutual funds and pension funds, have mandates that now allow them to hold more than just traditional equity securities, and use any number of instruments to transfer risk. The expansion of these mandates into two specific areas – futures and ETFs – may have significant implications for equity issuers and the investor relations process, not just the portfolio managers themselves. It's important for the IR professional to understand how the portfolio manager across the table is viewing the equity investment in context with the other investment vehicles available.

### Futures

There's a reason you see 24-hour coverage of index futures on CNBC – index futures are among the most liquid securities available to any portfolio manager, and are generally traded in sufficient amounts to be liquid at any time of day.

One increasingly popular type of futures contract is called an "e-mini". E-mini futures, which are traded on the Chicago Mercantile Exchange's electronic Globex system, give investors the liquidity they desire, along with the portfolio diversity that comes with holding a large number of stocks. They mirror exchange-traded funds in their composition and use; however they are priced much lower than ETF contracts, affording more investors the ability to purchase the futures contracts. Additionally, e-mini futures are comparable to ETFs in that they both offer far more liquidity than the individual stocks of which they are comprised, and in the case of the major index futures, usually have significantly lower transaction costs than even the ETFs that replicate the index.

Futures trading appears to have played a significant role in the "flash crash" in May 2010. The Ivy Asset Strategy Fund has frequently been cited as the party responsible for triggering the flash crash. The fund, which is managed by Waddell & Reed Investment Management Company, is unique in that it is allowed to trade in various asset classes. It is not limited to traditional equity and fixed income trades and "is well-known for hedging with equity index futures".<sup>1</sup> Funds such as Ivy Asset Strategy Fund, which have the ability to use a variety of strategies unavailable to traditional mutual funds, are becoming more and more prevalent. "As a group, these kinds of funds have received more than \$100 billion in net new money in the past six years, according to Morningstar. Of the 99 such funds counted by Morningstar, 28% were founded in the past year."<sup>2</sup>

In April, the Ivy Asset Strategy fund had a bullish stance on the market, holding "87% of its assets in stocks." However, the portfolio managers "became concerned about the impact on European banks of the region's growing debt problems," and the effect that it could have on the U.S. economy, so "the fund began hedging, notably by selling futures." Waddell & Reed sold "\$4.1 billion of futures contracts linked to the Standard & Poor's 500 Index as the market wobbled," as a hedge against its equity holdings.<sup>2</sup>

The Globex system, which is used to trade e-mini futures, is an electronic trading platform that allows investors to trade at exceedingly fast rates. This "high-frequency" trading can be a useful tool for taking advantage of short-lived opportunities in the market. However, the speed with which trades are executed, in addition to the use of complex algorithms as a hedge makes it incredibly difficult for portfolio managers to actively keep track of their trades. According to the SEC, Waddell's "trades were initiated by a computer algorithm and were sold into a falling market without regard to time or price. Rather than scaling back its orders in response to that day's volatility, the algorithm accelerated its trading." The trades which it made would normally take around "five hours, [but instead] these contracts were dumped in just 20 minutes."<sup>3</sup> It seems as though Waddell & Reed's algorithm used trading volume as a measure of liquidity, without accounting for other factors involved in trades. There was not sufficient demand in the market, driving down prices, and causing a snowball effect of stock devaluation. The speed with which the trades were performed, as well as the e-mini futures' correlation with the S&P 500, (which generally indicates the health of the market) created a panic among already bearish investors, leading to the massive sales.

To the issuer, one of the takeaways of the flash crash involves the impact that futures trading can have on equity trading. If your issue is significantly less liquid than most of the issues in an index, any building of index arbitrage positions (buy all the securities in the index / sell the index future) will have an outsized effect on trading in your stock relative to others.

However, the more overarching takeaway for the IRO is that in an increasing number of portfolios, gaining macro exposure to an asset class (equities), sub-class (small-cap equities), industry (US technology equities), or other diverse group is very often now far cheaper and lower-risk

for a portfolio manager than holding a particular equity or small group of equities. To put it another way, if you're a large-cap US consumer stock, it may now be cheaper and easier for more investors to gain exposure to the large-cap US consumer equities through futures instead of owning your stock.

Make sure you're aware of the ability of the investor across the table to hold non-equity securities – if so, selling your story as a macro play may be much tougher, as you may have more competition than just peer stocks.

## ETFs

Exchange-traded funds (ETFs), also offer prodigious liquidity which cannot usually be matched by the purchases of individual securities. In addition to replicating the major S&P and Russell indices, investors looking to gain exposure to a specific sector have become more and more likely to hold an ETF, rather than investing in a set of securities, given the speed with which they can turnover their ETF positions.

The growth of commission-free trading of ETFs through online brokerage firms has helped boost interest and enhance the appeal of these relatively new investment vehicles. Fidelity, with 26 currently-available ETFs, Charles Schwab (11 ETFs), and Vanguard (62 ETFs) were among the first firms to offer the service, and TD Ameritrade announced last month that it will soon be offering well over 100 commission-free ETFs.<sup>4</sup>

As ETFs have grown in popularity and liquidity, fund managers have become some of the top users of these products. In fact, institutions are often the largest long holders of ETFs. Table 1 shows the top ten ETFs by percent of shares held institutionally. The SPDR S&P 500 ETF (Ticker: SPY) has one of the highest trading volumes of any U.S. security.

*Table 1: Top 10 ETFs by % Institutionally Held*

Top 10 Securities	Value Institutionally Held (\$M)	% of Security Institutionally Held
SPDR S&P 500 ETF Trust TR UNIT	65,612.0	80.3%
SPDR Gold Trust GOLD SHS	23,325.8	41.5%
iShares Trust MSCI EMERG MKT	19,776.1	51.4%
iShares Trust MSCI EAFE IDX	18,704.5	58.5%
Vanguard International Equity Index Funds EMR MKT ETF	13,528.8	36.5%
iShares Trust S&P 500 INDEX	9,233.9	40.0%
iShares Trust BARCLYS TIPS BD	7,553.4	36.6%
PowerShares QQQ Trust, Series 1 (ETF) UNIT SER 1	7,412.2	33.3%
iShares Trust IBOXX INV CPBD	6,039.8	40.8%
iShares Trust BARCLY USAGG B	5,599.0	44.3%
<b>Total:</b>	<b>176,785.6</b>	

Data Provided by Ipreo Holdings LLC

Long investment by institutions in ETFs has doubled in the last four years to \$345 billion in Q2 2010. In addition to the growth of aggregate investment of institutions in ETFs, some well-known investors and mutual funds now have more than 20% of their equity assets invested in ETFs rather than individual companies. Bridgewater Associates, for example, has half of its equity assets invested in ETFs. Even ETF allocations of greater than 5% may be considered high for a mutual fund that is paid fees for actively managing its investors' money. The Old Westbury Global Small & Mid Cap Fund, as seen in Table 2 below, holds 7.4% of its equity assets in ETFs.

*Tables 2 & 3: Sample of Investors with High % of Equity Assets in ETFs*

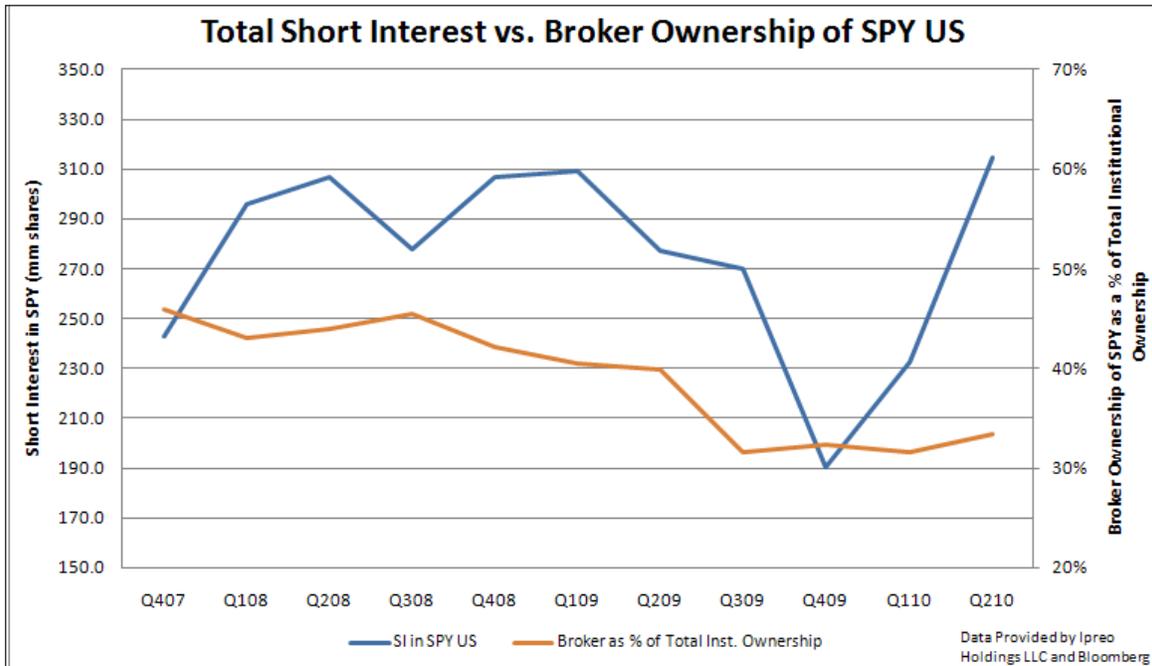
Firm	Equity Assets (\$mm)	% of Equity Assets in ETFs
Windward Investment Management, Inc.	3,965.5	99.2%
Harvard Management Company, Inc.	1,304.9	83.6%
Jane Street Capital, LLC	4,165.3	66.6%
Susquehanna Investment Group, LLC	4,506.9	52.1%
Bridgewater Associates, Inc.	5,677.0	50.6%
Sun Capital Advisers, LLC	1,883.4	48.7%
Virtus Investment Advisers, Inc.	1,214.6	41.7%
Morgan Stanley Smith Barney, LLC	50,521.7	39.0%
Robert W. Baird & Company, Inc. Private Wealth Management	2,712.5	25.4%

ETFs also give large investors the chance to take short positions in sectors in which their presence itself might otherwise move the price of securities. Roughly one-third of institutionally owned ETF shares are held by 13-F filing brokers, many of whom hold these ETF shares in relationship with prime brokerage units to loan out to short sellers. Anecdotally, it has been said that a majority of ETF shares held in a broker's inventory are loaned out to clients for shorting. However, as short interest in the SPDR S&P 500 ETF climbed in the first half of 2010, after a low of 190.5mm shares in Q4 2009, the number of shares held in ETFs by brokers as a percentage of total institutional ownership of this security type has remained near recent lows. (See Figure 1 below). The average percent held by brokers over the four quarters ended Q2 2010 was 32.2%, well below the 45.9% held in Q4 2007. By contrast, investors were short a total of 314.4mm shares of the SPDR S&P 500 ETF at the end of the Q2 2010, surpassing the prior recent peak of 306.8mm shares.

Fund	Equity Assets (\$mm)	% of Equity Assets in ETFs
PIMCO Global Multi-Asset Fund	1,706.2	25.0%
USAA Cornerstone Strategy Fund	1,151.1	21.5%
EQ/Mid Cap Value PLUS Portfolio	1,456.1	13.4%
EQ/Large Cap Growth PLUS Portfolio	1,149.1	11.4%
Old Westbury Global Small & Mid Cap Fund	3,612.3	7.4%
Metropolitan Series-Artio International Stock Portfolio	1,008.4	7.0%
BlackRock Global Allocation Fund	24,147.6	6.1%

Data Provided by Ipreo Holdings LLC and FactSet

Chart 1: Total Short Interest vs. Broker Ownership of SPDR S&P 500 ETF



Looking back with a slightly wider lens, the percentage of institutionally-held shares held by brokers was as high as 52.9% in Q2 2007, but it has declined as other institutional holders have grown their ownership of ETFs more rapidly.

It has become increasingly important for IROs to communicate to investors, especially those with significant ETF holdings, the distinct advantages of holding their security over granular ETFs, whether from a sector, regional, or market cap perspective. A manager with limited expertise and a wide mandate that can invest in ETFs in addition to equities may choose to pay the small transaction and expense ratio involved with an ETF investment instead of holding one or several equities in order to achieve higher diversification and liquidity. Another possibility is that investors with strategies directing them to place capital in small-cap or niche areas may opt to take advantage of the high liquidity of ETFs rather than risk being one of the biggest players in a company.

At the moment, broader-based ETFs replicating diversified indices have very high liquidity and are easy for investors to use. Sector-focused ETFs, however, are earlier in their life cycle, with some sector ETFs reaching very high volumes while others have languished. Although some securities, such as those held by the S&P North American Natural Resources Sector Index Fund, may be in more “direct competition” with individual equities for investors, the lack of sufficient liquidity in many other ETFs, such as the iShares funds listed below indicate that they may not have reached the minimum liquidity thresholds needed to attract institutional investment. For now, these ETFs may not constitute significant competition for an issuer, but as they become more popular, and thus more liquid, issuers will need to be more aware of their characteristics and may have less ability to pitch their story as a “macro” industry play relative to the ETF.

Table 3: Average Daily Volume of iShares Sector ETFs

Ticker	iShares Fund Name	Average Daily Volume (past year)	Total Net Assets
IGE	S&P North American Natural Resources Sector Index Fund	364,263	1,741.3
IXC	S&P Global Energy Sector Index Fund	183,960	1,213.1
MXI	S&P Global Materials Sector Index Fund	106,866	939.3
IGN	S&P North American Technology-Multimedia Networking Index Fund	99,670	182.2
IGF	S&P Global Infrastructure Index Fund	83,741	478.8
IGV	S&P North American Technology-Software Index Fund	82,823	340.5
IGM	S&P North American Technology Sector Index Fund	75,079	412.1
IXJ	S&P Global Healthcare Sector Index Fund	70,144	484.2
IXN	S&P Global Technology Sector Index Fund	68,975	564.4
IXG	S&P Global Financials Sector Index Fund	68,672	288.7

Data Provided by FactSet

One possible benefit for issuers may be indirect. On the short side of the transaction, the liquidity available for ETFs helps lower borrowing costs for short-sellers, which may lead to it being easier for an investor to sell short an ETF instead of the securities underlying the ETF.

**Authors:** Alex Weissman, Deirdre Tomlinson, and Brian C. Matt, CFA

*Alex Weissman is an Analyst with Ipreo's Corporate Analytics Group. Deirdre Tomlinson is an Analyst with Ipreo's Capital Markets Analytics Group. Brian C. Matt, CFA, is Director of Data Strategy & Analytics at Ipreo.*

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## Managing the Sell Side: Coverage & Liquidity

Managing contact with sell-side analysts is always on the minds of investor relations professionals. While all IR teams follow new research notes and must handle communications with analysts, there are significantly different challenges for IR teams at small- and large-cap issuers. At small-cap issuers, the teams are tasked with the difficult undertaking of attracting new coverage. However, at large-cap issuers, the IR teams often must allocate limited resources between many sell-side analysts. These professionals must at some point wonder if there is a point where they have too much coverage. This paper looks at each of these issues in a quantitative manner by analyzing the tradeoff between liquidity and sell-side coverage, as well as some of the determining factors that correlate with expansion of sell-side coverage.

### Small-Caps: Attracting New Coverage

The IR teams of small-cap stocks tend to focus on increasing sell-side coverage as a method to gain more exposure and attract liquidity. However, this task often becomes a "chicken before the egg" issue, as the sell-side often has minimum liquidity requirements needed to initiate coverage. Due to this dynamic, gaining sell-side coverage can be difficult and is consistently a priority for any small-cap IRO.

The securities in the S&P 600, by definition of the index, are all small-cap companies, some of which will face liquidity issues. To understand which small-cap companies gained the most new analyst coverage over the past year, Ipreo grouped the S&P 600 constituents into six tiers relative to certain metrics. Table 1 below displays the findings.

**Table 1: S&P 600 Constituents: Average # Analyst Recommendations Added, 9/09 – 9/10**

		Top 100	101-200	201-300	301-400	401-500	510-600
Volume	Components by Avg Daily Value Traded	1.79	0.94	0.88	0.46	0.52	0.03
	Components by % Change in Avg Daily Value Traded	1.02	1.04	0.86	0.75	0.38	0.57
Revenue	Components by Revenue	1.14	0.81	0.59	0.75	0.62	0.71
	Components by % Chg in Revenue last 4Q's	0.74	0.8	0.99	1.1	0.79	0.2

Source: FactSet

According to our findings the top 200 companies by average daily value traded, percent change in average daily value traded, and revenue saw the greatest increase in analyst coverage. However, of the factors analyzed, revenue growth appears to have less correlation to attracting sell-side coverage.

These findings are somewhat intuitive. Companies with higher volume and revenue have more notoriety, and therefore, have a greater ability to gain the attention of sell-side analysts. It is apparent that sell-side analysts initiate coverage on stocks with more liquidity and strong operational performance. While these two figures cannot be directly affected by IR teams, IR teams can do their part in raising the profile of their stock and proactive outreach can assist in this goal. In addition to providing liquidity, regular marketing to prospective buy-side investors can help increase sell-side coverage, as investors reach out to brokers and request research. Anecdotally, sell-side analysts will often mention that hearing a name often enough from buy-side clients is likely to help push them towards adding coverage.

Similarly, providing access to management at sell-side conferences could lead to the same result. As a principle benefit that the sell-side provides the buy-side, management access is a carrot that companies should strategically use to their advantage.

### Large Caps: How much coverage is too much?

While the IR teams at small-cap stocks are trying to figure out just how to gain new coverage their large-cap IR friends are grappling with a very different problem. For every new sell-side analyst that covers a company, an IR team must devote scarce additional time to these analysts. Additional sell-side coverage clearly has its benefits for public relations and general market knowledge, but there can also be a negative externality from increasing coverage beyond a certain amount.

When analyzing the amount of coverage a certain security receives, it is important to observe who is providing initial research. In many cases the first few estimates will be made after detailed analyses of a company; however, the following estimates will be generated using the first estimates as context. These “follower” analysts may be adding significant amounts of additional, but little new, data. However, they will also take a significant amount of time away from IROs.

*Chart 1: S&P 500 Analyst Coverage vs. Average Daily Value Traded (\$M)*

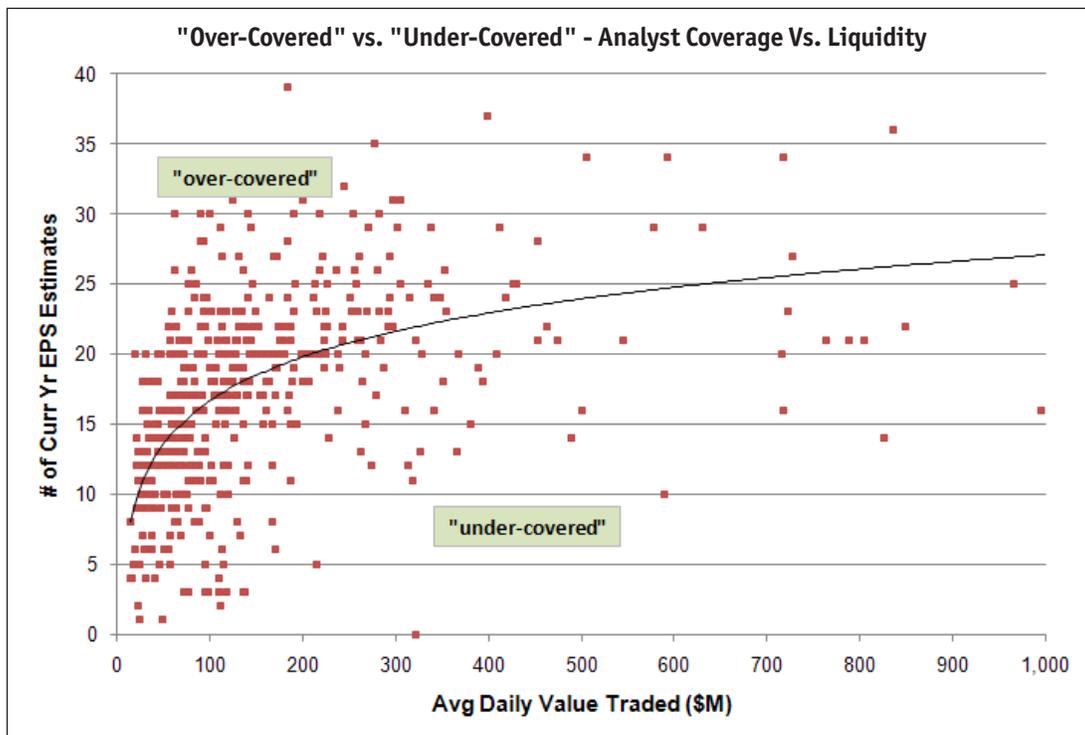


Chart 1 above shows the analyst coverage for the S&P 500 against the average daily value traded of each of its securities. From an IR perspective, the Y-axis equates somewhat with “amount of time spent with the sell-side”, as any company with 30 coverage analysts will spend significantly more hours working with brokers than one with 20 coverage analysts.

While there is a positive correlation between ADV and analyst coverage, at some point increased liquidity produces diminishing returns in terms of additional analyst coverage. The companies at the top left of the chart have analyst coverage exceeding their expected liquidity; these issuers may see brokers more in direct competition with each other for limited trading dollars, while taking more time with issuer IR as part of that competitive process. Conversely, issuers on the lower right side of the chart may have less coverage than their liquidity might suggest.

While large-cap companies have little ability to limit the number of analysts covering the stock, the best piece of advice is to simply manage your time as effectively as possible. All sectors have their star analysts. Return calls to highly ranked analysts and analysts that IR and management feel are particularly insightful first. Additionally, focus on conferences organized by firms that provide the best coverage, or have deep relationships with the buy-side to schedule the meetings you want. The same goes for roadshows, where you should work with corporate access teams that have a particular niche or have demonstrated an ability to schedule quality meetings.

IR has no direct control over the operational functions of a company, and over the long-run companies with strong operational performance will show higher liquidity and increased sell-side coverage. However, IR teams at both small- and large-cap companies must manage their interactions with the sell-side effectively. There is likely no exact method of handling sell-side that will work for every company. However, in general, IR teams of small-caps stand to gain from being proactive in their outreach to both the sell-side and buy-side community. Separately, IR teams at large-cap stocks must balance being open with the entire sell-side community while not expending all of their scarce resources responding to sell-side requests

**Authors:** Robert Romanow, Alexander Knote, and Brian C. Matt, CFA

*Robert Romanow is an Analyst with Ipreo's Corporate Analytics Group. Alexander Knote is an Associate with Ipreo's Corporate Analytics Group. Brian C. Matt, CFA, is Director of Data Strategy & Analytics with Ipreo.*

## BetterIR - Firm Snapshot

**Targeted Firm:** Fred Alger Management, Inc. (\$10,910.49mm)

### Targeting Profile:

Fred Alger Management, Inc., which has \$10.9Bn in equity assets, manages the Alger family of mutual funds. The firm, which Ipreo classifies as an aggressive-growth investor, invests the majority of its portfolio (88.8%) in U.S. stocks. The institution's portfolio is most heavily weighted in Technology stocks, which account for roughly 30.3% of its holdings. While the firm is overweight relative to the market average portfolio weighting in the Technology, Healthcare (17.3%) and Industrial (14%) sectors, it is highly underweight Financials (8.8%). Holdings are relatively evenly distributed among small- (27.9%), mid- (29.4%), large- (21.8%), and mega-cap (19.9%) securities, with just 0.3% residing in micro-caps.

Fred Alger's top five holdings are all in the Technology sector. In Q210, the firm made purchases of Hewlett-Packard Company (+\$52.2mm) and Marvell Technology Group (+\$65.6mm), augmenting its positions to \$227mm and \$183.8mm, respectively. It also sold \$58.7mm of its largest holding, Apple, Inc., and now holds \$266.3mm. The firm's most significant sector buying activity was in Industrial stocks. It made considerable additions to several holdings in which it had previously held nominal positions, including purchases of 3M Company (+\$51.2mm) and Fedex Corporation (+\$26mm). Fred Alger also initiated new positions in numerous Industrial securities, including Ingersoll-Rand Company, LTD CL A (+\$46.2mm) and Clean Harbors, Inc. (+\$38.5mm). The industry which saw the most selling activity was Consumer Services, which currently occupies 12.9% of Fred Alger's portfolio. The firm was a net seller of Travel Services and Leisure stocks, and also made notable sales in retail, selling \$35.9mm of Target Corporation, \$32.4mm of eBay, Inc., and \$24.8mm of J. Crew Group, Inc.

### How to Approach:

The majority of the funds which Fred Alger manages are primarily growth-focused, as the firm seeks to invest in companies which will achieve long-term capital appreciation. Companies which consistently generate above average growth rates, as well as those which are undergoing organizational, structural, or financial changes, (potentially leading to future above-average growth) are the most likely to gain entry into the firm's portfolio. Fred Alger has also recently shown an

interest in certain cyclical stocks, as evidenced by its rotation into the Industrials sector, which saw its portfolio weighting increase by 17.6%. Securities in the Technology and Healthcare industries, the firm's two most heavily weighted sectors, may continue to attract the attention of Fred Alger's Portfolio Managers.

### How not to Approach:

Low-growth companies domiciled outside of North America would have a difficult time procuring significant investments from the firm. Although Fred Alger holds 69 European and 109 Asian stocks, the values of its holdings in the two regions amount to just \$310.7mm and \$212.8mm, respectively. Additionally, given the diminutive portfolio weighting that the firm allocates to micro-cap stocks (0.3%), companies under \$250mm in market cap are not likely to garner much interest. At the industry level, the firm has recently been a major seller of Consumer Services stocks, indicating concerns over the impact of a weak consumer spending environment on the health of the industry. Fred Alger has also allotted a very low percentage of its portfolio to Basic Materials and Utilities securities, (2.7% and 0.7%, respectively) and has been a net seller in each.

### Largest Funds Managed:

- Alger Small Cap Growth Institutional Fund (\$1,081.66mm); Jill Greenwald
- Alger Capital Appreciation Institutional fund (\$845.08mm); Patrick Kelly
- Alger Midcap Growth Institutional Fund (\$778.75mm); Daniel Chung

### Portfolio Fundamentals:

- TTM Price/Earnings: 23.0x
- Avg. 3 Yr. Revenue Growth: 11.6%
- Dividend Yield: 0.8%
- Price/Book: 3.7x

**Average Equity Holding Period:** 1.22 years

## BetterIR - Fund Snapshot

**Targeted Fund:** American Funds SMALLCAP World Fund (\$15,083.72mm)

### Targeting Profile:

The \$15B American Funds SMALLCAP World Fund, advised by Capital Research and Management Company, is the tenth-largest out of the thirty total American family of funds. The fund, as well as Capital Research and Management Company, utilize a multiple portfolio counselor system led by Gordon Crawford. The portfolio is divided into segments which are managed by eleven individual counselors who decide, along with analyst recommendations, how their respective segments will be invested. The fund typically allocates its assets in at least 80% of companies with market caps of \$3.5B or less globally with above average growth potential. As a result, mid-large caps constituted only 5.4% of holdings this past period. As implied by its name, the fund seeks diversity across geographic regions with more than half its assets invested outside the U.S and over 50 issuing countries represented within the portfolio.

The fund does not exhibit any evident sector bias as managers tend to select securities using a bottom up approach with an emphasis on above average valuation multiples relative to growth potential. In addition, the portfolio managers and analysts typically specialize in company research and are inclined to discount macroeconomic and sector forces. Management's lack of sector and geographic partiality is exemplified by the funds largest diverse purchases this recent quarter including Irish travel & leisure company, Paddy Power Plc (+\$56.3mm,) Indian transportation company Pipavav Shipyard, LTD (+\$53.3mm), U.S. media firm, John Wiley & Sons (+\$51.5mm), and U.S. education and training Services company, Strayer Education, Inc. (+\$43.7mm). Holdings of as much as 10% of shares outstanding are common though no security constitutes more than 1.2% of the portfolio.

Furthermore, the fund has been recently shifting its long term focus to emerging markets, specifically that of Asian countries as illustrated by PM Brady Enright; "You look at Asia, and you see some very good growth prospects that likely aren't going to go away any time soon." Accordingly the fund has increased its exposure to India, China and Singapore by +\$135.2mm combined while decreasing its positions in U.S. holdings by -\$341.1mm (-5.6% change since prior period) this past quarter exemplifying the funds focus towards companies whose growth is driven by dynamics outside the U.S. According to

recent filings, investments in Asia represented 22.5% of the total portfolio (+1.2% change from last period) in comparison to 40.6% in U.S. (-5.3% change) and 19.3% in European assets (-2.7% change).

### How to Approach:

Currently, management overwhelmingly seeks small cap companies (defined as <\$3.5B) with a diverse global presence outside of the U.S. Attractive targets include those with above average P/E multiples relative to growth potential regardless of sector performance. In addition, ideal targets should have increasing revenue exposure to emerging markets, most notably, Asian markets. Accordingly, small cap companies with geographically diverse revenue streams should be at an advantage and within the portfolio managers' spectrum. Furthermore, in meeting with management, issuers should emphasize individual growth potential irrespective of sector performance in light of management's lack of focus on top down research.

### How not to Approach:

Granted the theme of the fund is geared towards small cap companies with large exposure to international markets, mid-large cap issuers with a large portion of revenues concentrated in the U.S. are likely to be excluded from the portfolio managers' periphery. In addition, due to management's bottom up research approach, companies within favorable sectors that lack strong fundamentals and growth prospects should seek investment from elsewhere.

### Portfolio Fundamentals:

- TTM Price/Earnings: 24.1x
- 5 Year Projected Growth: 17.6%
- PEG: 1.2x
- Price/Sales: 3.5x

**Average Equity Holding Period:** 2 years

## Metro Area Targeting Focus - Edinburgh, United Kingdom

Money Center Statistics	Summary Notes
Reported Equity Assets (\$B): \$234.0	<p>The city that Adam Smith, the famous philosopher and the world's "first economist", called home for many years is now one of the largest institutional investment centers in Europe. Based on disclosed equity holdings, Edinburgh ranks 17th in the world and 5th in Europe with over \$234Bn in equities held. The top three investors, <b>Scottish Widows Investment Partnership</b>, <b>Aberdeen Asset Managers</b>, and <b>Baillie Gifford &amp; Company</b> account for roughly 63% of all equity assets in Edinburgh, totaling \$147.3Bn. Investors in Edinburgh have strong exposure across all regions; however, recently a strong bullish trend has shifted towards Japan, which saw \$1.6Bn in net inflows over the quarter. Typically, investors in Edinburgh tend to hold investments for a longer time than some of the neighboring UK metros, and certainly longer than US investors. The weighted average turnover rate for Edinburgh investors is 34%, compared to 49.9% for all US investors. In general, Edinburgh favors Financials more than any other sector (19.6%), and investors continued to add exposure to the space, as the metro recorded +\$3.34Bn in net activity over the 2Q period. Utilities was another active sector, having the largest percentage increase in net activity, although the sector still remains only 2% of the metros aggregated overall sector allocation. During 2Q, Energy was the only sector with negative net activity after <b>Baillie Gifford &amp; Company</b> sold -\$356mm in the space, yet Energy still ranks as the second largest (13.8%) sector allocation for investors in Edinburgh. North American issuers in the Technology space should also consider a visit with <b>Walter Scott &amp; Partners</b>, as the firm not only invests over 53% of its portfolio in US stocks, but it also recently purchased \$337mm in the Tech space within North America alone, notably buying \$268mm in Google Inc. The firm also holds other notable US stocks such as Nike (\$395mm), Intel (\$374mm), Wal-Mart (\$360mm), and Abbott Labs (\$355mm).</p>
Number of Institutions: 37	
World Rank: 54/184	
Top Sector Weighting: Financials	
Financials Weighting: 19.6%	
Top Region Weighting: Europe	
Europe Weighting: 63.4%	
Total Net Buying (\$B): \$13.7	
Total Net Selling (\$B): -\$5.5	
Total Net Activity (\$B): \$8.2	

