The Better IR Newsletter

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What's inside...

Across the Border

International Investments in US Equities

By: Sudarshan Setlur, Chris Stroh, and Matt Davis

A TEN-YEAR GROWTH STORY

Given the sheer size and depth of the institutional investment community, the size of the US capital markets and the prevalence of the S&P 500 as a key performance benchmark, it shouldn't come as a surprise that US institutions have dominated and still dominate the ownership profile of US companies. However, about ten years ago we saw an uptick in questions about their international shareholder base. Until then, for all but a pioneering few, "international outreach" typically meant visits to neighbors to the north and an occasional widening of scope at an international industry conference, to meet investors one-on-one in that city. One might argue the "chicken-or-the-egg" question on whether the increase in outreach in these past ten years was spurred by the increase in international investment, or vice versa. Either way, the continued growth in both the proportion of international shareholding and the number of our US issuer clients with a structured approach to international outreach is striking.

Over the past 10 years the proportion of non-US investment in S&P 500 stocks has more than doubled, from 7.2% of the institutional shareholding to 15.3%. Ipreo's bespoke identification exercises for US clients show that this number is actually about 25% higher when accounted for non-filers and incomplete and outdated filings. This puts the average international shareholding above 19% of the total institutional shareholder base.

Figure 1 – Average international (ex-US) shareholding in S&P 500 - historical

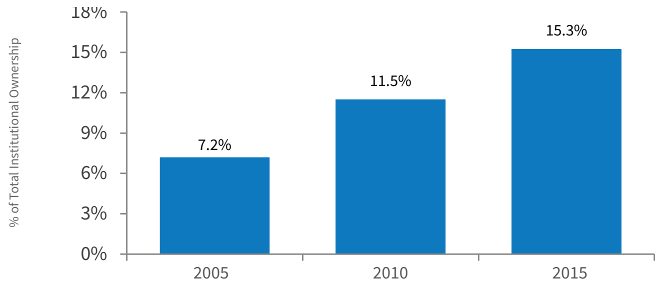
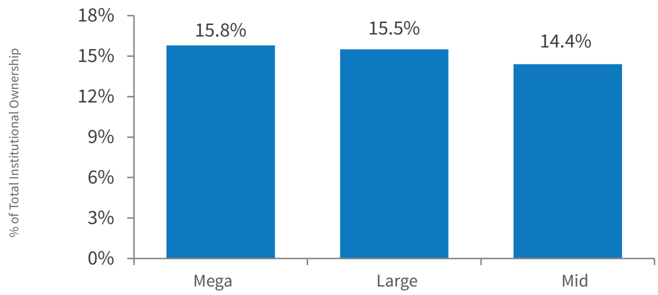


Figure 2 – 2015 average international (ex-US) shareholding in S&P 500 – by market cap



Source: Ipreo

Mega caps, with 15.8% of total institutional shareholding in international hands, are marginally higher than what we see for large caps (15.5%) and mid caps (14.4%). This suggests that the ten-year growth is seen across all three market-cap segments in the S&P 500.

The average number of international shareholders in S&P 500 companies has seen a substantial jump over the last ten years. The number in Europe has almost doubled, from 118 per issuer to 230 today. The jump in Asia-Pacific is even more impressive, albeit from a low base of 14 per issuer in 2005 to 62 today. It must be noted that a part of this is explained by increased mutual fund disclosures and more international investors coming under the purview of disclosure regulations such as 13Fs.

However, in our estimation, most of the increase has come from organic growth in international investing in the US.

Figure 3 – Average number of holders in an S&P 500 stock

	2015	2005	Change
Europe	230	118	112
Asia-Pacific	62	14	48
United Kingdom	57	31	26
Canada	27	20	7
Switzerland	25	11	14
Japan	23	12	11
Germany	19	12	7
France	18	10	8
Sweden	17	8	9
Australia	11	3	8
Netherlands	11	6	5
Denmark	19	6	4

BUT 2015 WAS A MIXED YEAR

Though the long-term growth has been exceptional, the most recent picture has been less than stellar. International investors pulled an aggregate of $50B out of US equities in calendar year 2015. Given the upheaval and volatility of the global markets in 2015, the significant level of outflows shouldn't be treated as a trend.

Investors in Switzerland and Norway top the list of the biggest buyers of US equities in 2015. However, the buying power, while significant, belies a lack of depth of international institutional interest in US equities this past year.

Driving the increase in Switzerland was significant buying of US equities by the Swiss National Bank (SNB). Yes, this is the same SNB that controls Switzerland's monetary policy as its central bank. SNB puts a portion of its foreign currency reserves to work by investing in the equities of developed and emerging markets. SNB uses passive, index replication to execute its investments, so don't put them on your target list. In 2015, SNB was a buyer of more than $13B in US equities. Norway's buying of US equities was driven largely by Norges Bank Investment Management. Oil prices may have taken a nose-dive in 2015, but the oil-rich country's SWF continued to buy US equities in 2015 to the tune of $12B in net buys. Investors in several of the most popular destinations for companies seeking foreign capital pulled a material amount of assets from US equities in 2015. London, Toronto and Edinburgh experienced aggregate outflows of $60B.

Metros- Top Inflows

	Metros	2015 Net Activity ($M)
1	Zürich	11,385
2	Oslo	11,176
3	Tokyo	8,924
4	Seoul	5,003
5	Frankfurt	4,937
6	Geneva	1,999
7	Cologne	1,899
8	Sydney	944
9	Copenhagen	886
10	Tel Aviv	751

Countries- Top inflows

	Countries	2015 Net Activity ($M)
1	Switzerland	13,097
2	Norway	10,745
3	Japan	8,924
4	Germany	6,794
5	South Korea	5,004
6	Israel	754
7	Denmark	712
8	Luxembourg	522
9	Italy	130
10	India	47

Metros- Top outflows

	Metros	2015 Net Activity ($M)
1	London	-28,372
2	Toronto	-14,161
3	Edinburgh	-13,021
4	Amsterdam	-5,352
5	Montréal	-4,009
6	Paris	-3,046
7	Singapore	-2,818
8	Hamilton	-2,688
9	Brussels	-1,879
10	Melbourne	-1,400

Countries- Top outflows

	Countries	2015 Net Activity ($M)
1	United Kingdom	-46,741
2	Canada	-21,364
3	Netherlands	-12,147
4	France	-3,049
5	Singapore	-2,818
6	Bermuda	-2,688
7	Belgium	-1,491
8	Brazil	-1,429
9	South Africa	-976
10	Sweden	-968

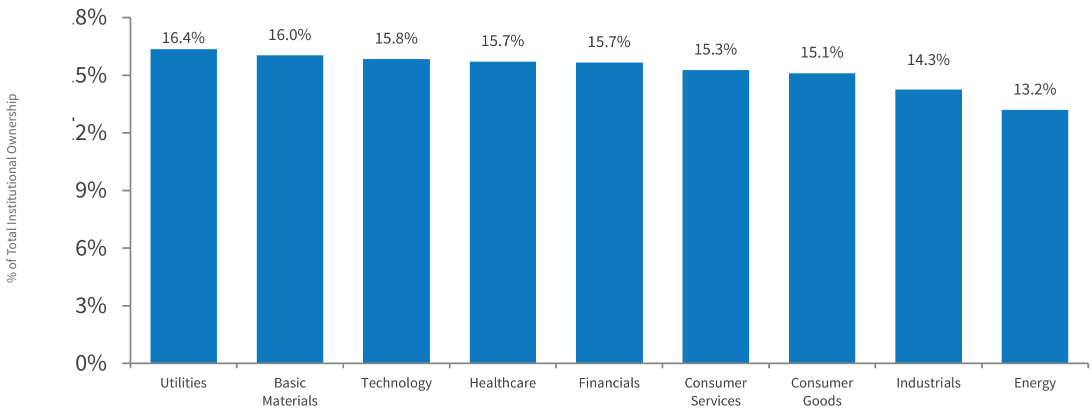
Figure 4 – % of value held by international shareholders in S&P 500 stocks

	S&P Weighting	2015	2005	Change
Technology	20.4%	21.1%	19.5%	1.6%
Financials	17.4%	19.6%	19.4%	0.2%
Consumer Services	14.5%	15.2%	12.9%	2.3%
Healthcare	14.7%	16.0%	14.4%	1.6%
Industrials	9.3%	7.7%	9.7%	-1.9%
Energy	7.1%	5.2%	9.0%	-3.7%
Consumer Goods	10.9%	10.3%	9.1%	1.1%
Utilities	3.4%	2.8%	2.9%	-0.1%
Basic Materials	2.3%	2.0%	3.1%	-1.0%

Though the Utilities sector is the second-to-last in terms of total international investment dollars, its constituent companies rank as the #1 sector when it comes to the proportion of institutional investment in international hands. In our consulting experience we have seen even mid-cap regional utilities, with zero revenue exposure outside the home state, garner interest from international investors.

The secret? Dividend yield and regulated protection of the businesses, a combination that is attractive to conservative yield seekers like pensions.

Figure 5 – % of value held by international shareholders in S&P 500 stocks



LAND OF THE FREE, HOME TO THE BEST OPPORTUNITIES

A striking feature of international shareholding in S&P 500 stocks is the proportion that is actively managed. At the end of last year, 83.8% of the total international equity investment was held by active managers. This stands in stark contrast to recent discussions in the US which was well-summarized by one active manager we spoke with - "the passives are eating our lunch." We are inclined to throw in "breakfast and dinner" for good measure.

While we have to admit that some of the largest active international managers such as Norges Bank, run portfolios whose final investments are heavily determined by top-down allocations, most are relatively concentrated portfolios. Of the 1,871 international investors in this study, 70% own 50 stocks in the S&P 500, or fewer. Driving these active managers is the lack of comparable opportunities. There is simply no other country that offers as many well-run companies, with excellent trading liquidity, across sectors, in a transparent, well-governed economy, as the US does.

Despite the reversal of 2015 the future of international investments in US equities is strong. As you set out on your quest to grow this segment in your stock, it's important that you set achievable (not CEO-driven) goals. Eschew unrealistic or even spurious goals such as matching your international investment levels with the proportion of revenues earned overseas. Instead choose ones that are based on relevant data, like the current make-up of your and your peers' shareholder bases and investment trends and capital flows into and out of US equities.

Institutional Shareholders' Voice in the Boardroom

More than just a whisper

By: Brian Matt, CFA

JUST AS BOARD MEMBERS TAKE THE STEWARDSHIP OF SHAREHOLDER INTERESTS SERIOUSLY IN THEIR ACTIVITIES, INVESTORS ACTING ON BEHALF OF THEIR BENEFICIAL OWNERS ALSO HAVE A STEWARDSHIP DUTY AND OBLIGATION. SCRUTINIZING CURRENT AND POTENTIAL INVESTMENTS UNDER A LENS OF EFFECTIVE GOVERNANCE IS ONE COMPONENT OF STEWARDSHIP.

Some investors take this duty to the level of operational engagement, such as publicly seeking to change governance practices at a company or filing shareholder proposals; a much larger contingent of the investment community simply seeks to speak its mind once per year through the proxy voting process. The growth of index investing, which is naturally scalable and concentrated, has led to a larger percentage of all shares held by shareholders who are unable to "vote with their feet" by selling shares of companies with unacceptable governance risks. These are the investors who may speak softly 364 days a year, but carry a big stick on the date of the AGM.

Figure 1 – Major US Passive Investors Voting by Proposal Category – 2015

	BLACKROCK FUND ADVISORS			THE VANGUARD GROUP			STATE STREET GLOBAL (SSGA)		
Proposal Category	With	Against	Abstain	With	Against	Abstain	With	Against	Abstain
Audit	99.9%	0.0%	0.0%	99.4%	0.6%	0.0%	99.3%	0.7%	0.0%
Capitalization	93.4%	6.6%	0.0%	77.3%	22.3%	0.3%	84.3%	15.7%	0.0%
Compensation	92.9%	7.1%	0.0%	92.1%	7.8%	0.1%	90.3%	9.6%	0.1%
Director Election	95.5%	4.5%	0.0%	95.1%	4.9%	0.0%	91.9%	8.0%	0.1%
Environmental/Social	99.6%	0.4%	0.0%	56.3%	0.1%	43.7%	83.1%	11.2%	5.7%
Governance	72.4%	27.6%	0.0%	87.7%	11.7%	0.6%	78.0%	21.8%	0.2%
Routine / Other	89.9%	10.1%	0.0%	89.3%	9.3%	1.4%	69.6%	29.9%	0.6%
Strategic	81.3%	18.7%	0.0%	75.8%	18.2%	6.1%	51.5%	46.1%	2.4%

Source: Ipreo BD Corporate Governance

Investors' most direct voice in the boardroom is effected through the vote on director elections, and it's incumbent on every management team and board to listen to these aforementioned whispers, particularly before they turn into shouts. Knowing the composition of the shareholder base and the voting decision-makers from each major institutional investor is a first step in the process, but listening to what investors are expressing through their votes iseven more important. The statement at the annual meeting may be "director X received only 70% support from investors," but the message may be more specific and identifiable: "Investor Y and Z own 13% of the stock and believe our compensation practices aren't aligned with shareholder value."

INVESTORS' APPROACH TO DIRECTOR ELECTIONS

This thought process is valid globally, but the US market offers us the ability to read investors' minds through voting data that is released annually, albeit on a delayed basis. US mutual funds are required to disclose all of their votes cast in both annual and special meetings during the period from July 1 through June 30 via SEC Form N-PX, which is made available by August 31. Additionally, most large investors disclose their voting guidelines publicly, and the guidelines for proxy advisory firms may also serve as a way to view the broad "standard" for making director election voting decisions.

Figures 2 & 3 give a view of major US investors' broad voting policies with respect to directors; votes from the top 50 US investors by equities under management average 92.7% support for directors on the whole, with some investors even more likely to support the company. Grantham Mayo Van Otterloo, for example, has a stated policy of supporting directors across the board, though following ISS recommendations on nearly any other type of vote.

Figure 2 – Firms in Top-50 US EAUM with Highest % Support on Director Elections, 2014-15

			2015 Voting			2014 Voting			
EAUM Rank	Investor Name	# Securities	With	Against	Abstain	With	Against	Abstain	Chg % Support
46	Fisher Investments	28	100.0%	0.0%	0.0%	99.2%	0.8%	0.0%	0.8%
44	Grantham Mayo Van Otterloo	258	99.8%	0.2%	0.0%	99.9%	0.1%	0.0%	-0.1%
25	Harris Associates	84	99.7%	0.3%	0.0%	99.6%	0.4%	0.0%	0.2%
19	Dodge & Cox	43	99.6%	0.4%	0.0%	99.6%	0.4%	0.0%	-0.1%
8	Capital Research Global Investors	466	99.2%	0.8%	0.1%	98.8%	1.1%	0.1%	0.4%
5	Capital World Investors	359	99.1%	0.8%	0.0%	99.6%	0.4%	0.0%	-0.5%
24	Jennison Associates	642	99.0%	0.9%	0.0%	99.6%	0.4%	0.0%	-0.6%
4	Fidelity Management & Research Company	1555	98.0%	2.0%	0.0%	97.8%	2.2%	0.0%	0.2%
43	Franklin Mutual Advisers	448	97.9%	2.1%	0.0%	96.4%	3.6%	0.0%	1.5%
37	First Eagle Investment Management	436	97.8%	2.2%	0.0%	97.6%	2.4%	0.0%	0.2%

Figure 3 – Firms in Top-50 US EAUM with Lowest % Support on Director Elections, 2014-15

			2015 Voting			2014 Voting			
EAUM Rank	Investor Name	# Securities	With	Against	Abstain	With	Against	Abstain	Chg % Support
29	TD Asset Management	252	88.8%	11.2%	0.0%	90.8%	9.2%	0.0%	-2.0%
10	Dimensional Fund Advisors	2349	89.9%	10.1%	0.0%	90.3%	9.7%	0.0%	-0.4%
15	Geode Capital Management	2923	90.6%	9.4%	0.0%	90.8%	9.1%	0.0%	-0.3%
48	Putnam Investment Management	1082	91.4%	7.9%	0.7%	91.4%	8.3%	0.3%	0.0%
39	AQR Capital Management	2408	91.6%	8.2%	0.3%	93.5%	6.5%	0.0%	-1.9%
3	State Street Global Advisors	2391	91.9%	8.0%	0.1%	91.4%	8.6%	0.0%	0.5%
17	Mellon Capital Management	2387	92.0%	7.9%	0.1%	95.2%	4.7%	0.1%	-3.2%
28	Charles Schwab Investment Mgmt.	2487	92.7%	6.8%	0.5%	92.2%	7.5%	0.3%	0.5%
33	Principal Global Investors	2250	92.7%	7.2%	0.1%	95.1%	4.8%	0.1%	-2.4%
30	Janus Capital Management	386	92.7%	7.2%	0.1%	93.7%	6.3%	0.0%	-1.0%

Why do investors vote against directors broadly? There's a whole series of issues that investors raise when reviewing companies' policies .

Rarely do investors express the full blunt force of a vote against a full (non-classified) board – but the fact that these occasions aren't common is what makes them strong statements when used. Figure 4 highlights the set of issuers that saw at least one of the Top 50 US investors by EAUM withhold 100% of their votes for the entire board.

DIRECTOR VOTING DECISION

Outside of the relatively uncommon vote against the entire board, most investors withhold a vote for a director for a specific reason. On the surface it may appear difficult to identify the specific reason that Investor X is withholding from Director Y, as these reasons may overlap – but viewed in context with other votes the investor files, it may be possible to discern the message. For example, if Director Y chairs the Nominating Committee, and Investor X is well-known for voting against nominating committee chairs, it's more likely that Investor X's vote on Director Y is related to committee membership, as opposed to person-specific.

TYPICALLY THREE CATEGORIES OF OBJECTION ARISE:

01

CONDUCT FROM THE BOARD MEMBER

ISS and Glass Lewis's standards have pushed companies toward stronger disclosure on the first category – while not necessarily eradicated, situations of board members missing large numbers of board meetings during a given year have decreased to historically low numbers, and companies are disclosing greater information on directors' conduct to make sure they meet independence standards.

02

THE MEMBER'S SPECIFIC QUALIFICATIONS

Overboarding is a common concern in the second category – in a January 2016 study, Ipreo noted previously that investors Blackrock Advisors / Blackrock Fund Advisors, J.P. Morgan Investment Management, and AllianceBernstein had supported less than 35% of directors that were in the "overboarded" range (6+ boards) in 2015. TIAA-CREF, Security Investors, Fidelity Management, and GAMCO Investors were among those appearing to assign little concern to these situations, with above-average (90%+) support for these candidates. As with the first category above, investors have forced companies over time to disclose more information about directors' qualifications, giving more tools to scrutinize the "why" behind investor voting here as well.

03

MEMBER'S STANDING ON A PARTICULAR BOARD COMMITTEE

The third category, committee membership, may be a bit easier to isolate. Any board committee structure will generally have committees serve at least three basic functions: 1) overseeing management and its compensation packages; 2) providing an independent voice in the audit function; and 3) protecting effective governance by nominating board candidates that will produce an informed and knowledgeable board. Investors will often express their displeasure at how the company is performing any of these functions through a "withhold" vote on either all members of the appropriate board committee, or against the chairperson of that board committee specifically.

Compensation Committee

Mandatory say-on-pay voting in the US and UK has already given shareholders the ability to publicly oppose the company's pay practices – often investors will make similar decisions on the say-on-pay vote and on compensation committee nominees. However, say-on-pay voting is not a requirement for every company, and for some companies it may be a biennial or triennial vote instead of annual. Investors in these cases often express their displeasure through withhold votes on the compensation committee chair or the full committee; Federated Investments, Loomis Sayles, Columbia Management, TD Asset Management, and Charles Schwab Investment Management are a few of the large investors with 10 or more withhold votes on S&P 500 comp committee chairs in 2015.

Audit Committee

Given the public standing of the company's relationship with an auditor and the auditor's requirements, an against vote, while rare, also sends what should be an obvious message. Most issuers have moved on from the Enron-era conflicted practices of paying high consulting fees to companies associated with their auditors, but despite regulator disclosure rules, this practice still exists occasionally and attracts withhold votes for those associated with the audit. Separately, material weakness disclosures will often coincide with "no" votes. European investors have taken further steps toward reviewing the independence of the auditor relationship, suggesting that auditors that have conducted the audit for a particular company over a long period of time may have lost their independence; we're also likely to see this review practice coming to the US in the next few years.

Figure 4 – S&P 500 Audit Committee Chairs Receiving Lowest % Support, 2015 Proxy Season

Issuer	Support	Major Investors Opposing
Bank of America Corporation	71.6	Invesco, Cap World, Manulife
Ball Corporation	73.1	T. Rowe, Mellon, Nicholas Co.
First Solar, Inc.	79.0	DFA, Geode, Northern Trust
Lowe's Companies, Inc.	79.5	BlackRock, J.P. Morgan, Invesco
L-3 Communications Holdings, Inc.	81.1	Mellon, Charles Schwab, LSV

Nominating / Governance Committee

In contrast with the audit committee, the withhold vote for the governance committee member is usually a bit more difficult to isolate causation. Investors may have a whole range of reasons to oppose a change to the structure of the board (for example, insufficiently independent, diverse, or qualified boards) and will vote their displeasure on any one of these in a manner that's tough to isolate. This is when the relationship between the company and the investor can be leveraged. Investors are often willing to engage with the company both inside and outside of proxy season, and are usually very open in telling companies the issues they have with governance practices. As of 2015, more than half of the S&P 500 disclosed some type of shareholder engagement process in their proxy statements – knowing in advance what practices investors want the company to follow in structuring governance may help the company connect the dots from a no vote to a reason why.

Figure 5 – S&P 500 Gov / Nominating Committee Chairs Receiving Lowest % Support, 2015 Proxy Season

Issuer	Support	Major Investors Opposing
Costco Wholesale Corporation	52.8	BlackRock, Northern Trust, American Century
First Solar, Inc.	73.1	Wellington, DFA, Geode
Urban Outfitters, Inc.	79.3	Vanguard, BlackRock, TIAA-CREF
Motorola Solutions, Inc.	80.8	Charles Schwab, River Road, Loomis Sayles
Regions Financial	81.8	LSV, Ceredex, Brown Advisory

WHISPERS TO SHOUTS

Shareholders more frequently exercising their rights in the boardroom may have implications far beyond just a few percentage points in an election of an already majority-winning director. As one example, T. Rowe Price Associates, often a top 10 holder of many of its positions, made a splash recently in stating that it would withhold votes for governance committee members of US companies with multiple share classes, an increasingly common structure in both the founder-owned and sponsor-backed worlds. While it stopped short of saying it wouldn't invest in such companies, T. Rowe is also a significant participant in the IPO market, and companies with such a structure may at minimum be starting their public-company lives with a built-in disadvantage on a shareholder vote. T. Rowe owns 2.65% of well-known dual-class issuer Facebook's common shares outstanding today, not to mention a greater-than-10% stake in the common shares of more than 135 companies.

While it single-handedly may not be able to raise the cost of capital for companies seeking to sell equity, it's not hard to see how wider adoption of this approach to governance may start to have a direct and quantifiable impact on the bottom lines of companies in the capital-raising process. The decision to maintain multiple share classes could mean a difference in the IPO price, and boards of public companies may need to pay attention to fulfill their fiduciary duties to both sponsors and founders in dollar terms too.

All voting data in this piece was sourced from Ipreo's BD Corporate Governance tool, which provides a robust set of institutional voting data corporate governance decision makers to support Corporate Secretaries and IROs interact with their voting shareholders.

Understanding Options Activity and Strategies

A GUIDE FOR AN IRO

By: Rob Perle

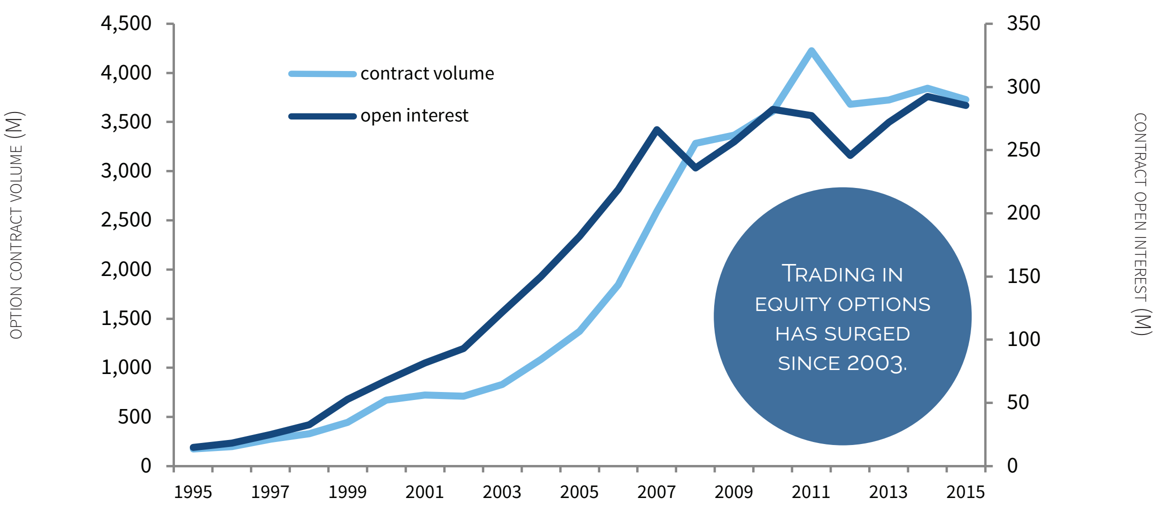
The following article is an excerpt from a Special Report of the same name that was published on June 12, 2016 and released at the 2016 Annual NIRI Conference.
The full report can be found here.

THE WORLD OF EQUITY OPTIONS

The intricate world of equity options is vast and can be difficult to digest, but it offers valuable insight for IROs and their executive teams who are equipped to properly interpret the data. This paper is a guide to understanding the relevance of options activity.

Proper analysis of options trading can give IROs and management additional insight into current sentiment and the strategies of a stock's investors. As trading volume in equity options has surged since 2003 [FIGURE 1 below], issuers need to understand how analysis of options activity can provide awareness about how investors are thinking about present and future performance of the stock, and how investors are using options to hedge their current equity exposure. Effective analysis of options activity requires consideration of the primary elements of the contracts being traded, which include price of the underlying stock, contract strike price, time until expiration, volatility, interest rates, and dividends. By examining these components, we can formulate reasonable conclusions about the motivations, expectations, and consequences behind certain patterns of options activity.

Figure 1 – Equity Options Contract Volume and Open Interest



Source: Options Clearing Corp.

KEY FINDINGS

An IRO can classify the intelligence to be gained from any specific options activity into several categories:

01
Sentiment and outlook on the underlying stock

02
Specific connections between options contracts and equity stock trades by investors, which are typically hedge funds

03
High-frequency options contract trading and short-term hedging noise that is less relevant to the IRO

The second category above is particularly noteworthy for the IRO, as investors can use the leverage that options offer to quickly build equity exposure. A few common options activity scenarios will demonstrate the insights available to an IRO.

We also discuss the value of data from commonly observed aggregated options activity. Metrics such as the put/call ratio and implied volatility may provide some clues about sentiment in a stock. However, their value for the IRO can be limited and possibly misleading under certain circumstances. We will explore some scenarios that show potential pitfalls associated with aggregated options metrics.

As we explore this topic, it is important to think about options in their proper context, as only a subset of the buy side is actually engaged in options activity. (See the Appendix for list of leading options contract holders.) Options trading typically does not figure into the modus operandi of the traditional institutional giants and mutual fund managers that most concern IROs. As such, analysis of options activity may not be a top priority for an IRO if Cap World, Fidelity, T. Rowe Price, Wellington, et al are not involved. However, analysis of options activity is an important data point in understanding the overall picture of what is happening in equity trading.

DO INVESTORS USE LISTED OPTIONS TO BUILD LONG EQUITY POSITIONS?

Investors are capable of accumulating equity positions over a period of time by using long-dated call options known as LEAPS (Long-Term Equity Anticipation Securities), which typically have expiration dates of a year or more. If XYZ in March 2016 is trading at $10, an investor can claim the right to purchase 1 million shares of exposure by buying 10,000 January $15 2018 LEAPS contracts, an investment that requires a much lower capital commitment than purchasing the stock outright. Investors can also buy long-term downside insurance with put LEAPS. Issuers can monitor increases in open interest of LEAPS for clues if an investor is building a call position, or if an existing equity investor appears to be settling in for the long haul with puts.

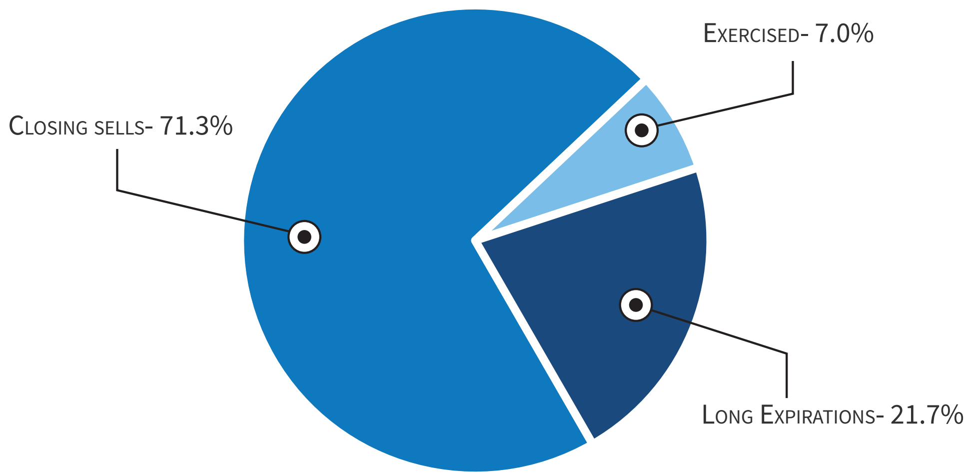
Many IROs are concerned about activist investors building a position through options. Note, however, that many recent activist moves with derivatives have been executed in the OTC market and cannot be observed in open trading of listed contracts. For example, over the period 10/28 – 11/20 in 2015, activist hedge fund Elliott Management accumulated 35.97m shares of Alcoa (AA) via physically settled swaps in the OTC market, representing almost half of the shares it eventually disclosed on its Form 13D. This type of OTC activity is not disclosed until the filing comes out and cannot be observed in open trading.

Some known activists use options contracts to buy equity, but this kind of trade may be only a small part of a broader strategy. For example, activist investor Bill Ackman said on Pershing Square's Q116 earnings call that while the firm has "used options over a long period of time, options have generally been a relatively small percentage of our overall capital." It appears that at least some of the firm's well-publicized 9% Valeant stake is hedged with options, but was not built by converting calls. Instead, Pershing Square wrote puts to buy the stock cheap.

"Valeant options where we debated, do we buy the stock outright, or is it more sensible in light of volatility to sell puts and buy calls?... Our ultimate view here is the January $60 strike put options we've sold to finance the calls we purchased, in this case, are likely to expire out of the money, or we're acquiring the stock at a price that, in our view, is a very, very low valuation for the business."

-Pershing Square Q116 earnings call Q&A

Figure 2 – What Happened to Options Contracts in 2015?



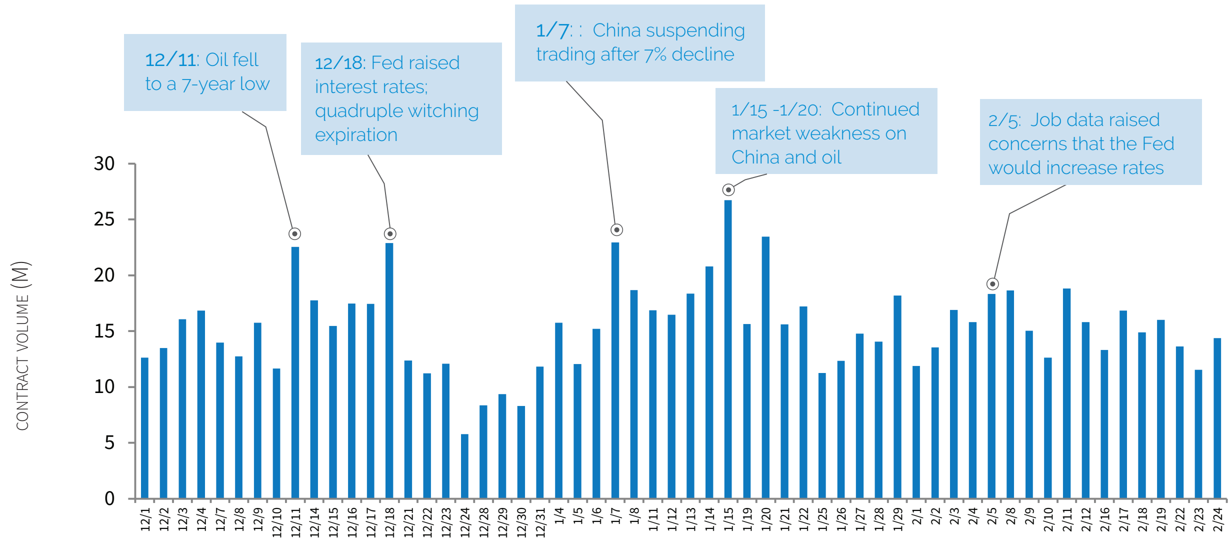
Source: Options Clearing Corp.

Note that only a small percentage of listed options volume gets converted to an equity position [FIGURE 2]. Data from Options Clearing Corp. show that in 2015, 93% of options contracts were not exercised and were traded back and forth in the run-up of trading volume to almost 4 billion contracts. Most contracts (71.3%) actually end up being closed by brokers before expiration, while 21.7% expire and are not converted to equity via puts or calls. Last year, only 7% of all contracts were actually exercised.

Moreover, we typically observe most options contract volume is traded in near-term expiration contracts and during periods when stocks tend to be volatile, like around earnings calls or market-wide announcements that induce short-term shocks to trading. Note that spikes in contract volume during recent trading sessions appear to have been prompted by broadbased market sentiment amid higher volatility, as investors rushed to place bets on future stock performance.

Much of this volume increase is represented by contracts being tossed back and forth over and over again within milliseconds. Note the surges in options contract volume over the volatile Dec. 2015 – Feb. 2016 period when oil prices, interest rates, and concerns about growth in China were dominating the headlines [FIGURE 3].

Figure 3 – Equity Options Contract Volume Dec 2015 - Feb 2016



Source: FactSet

Outside of the near-term volatility trades, some options activity is connected to investors exercising contracts to equity in advance of contract expiration. The primary reason for exercising a contract early is to capture the stock's dividend, using near-expiration contracts that meet the criteria below. An investor can use call options to secure the dividend for a profit when the dividend is greater than the interest expense of converting the contracts and buying the shares early. These contracts are typically executed the day before the stock's ex-dividend date. Dividend stocks in the telecom, utilities, energy, and banking sectors tend to see this activity frequently.

Call Option	Put Option	Exercise occurs when...
In-the-money	zero value	dividend > interest expense of buying shares early
In-the-money	value > 0	dividend > put price + interest expense of buying shares early

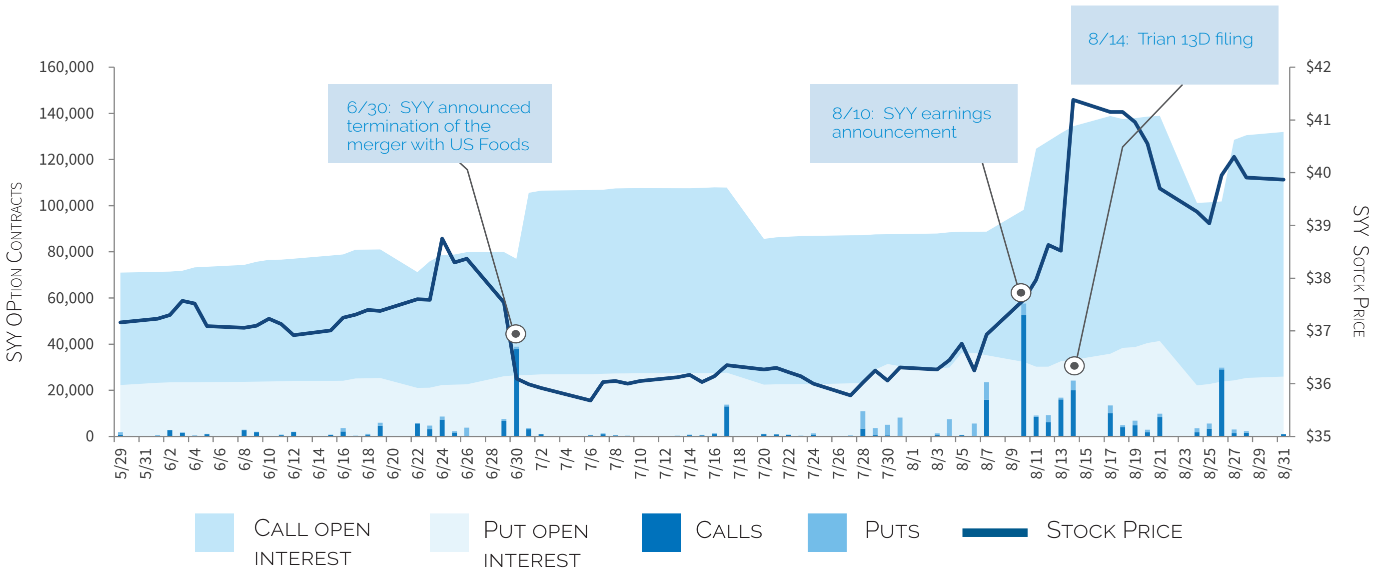
OPTIONS INSIGHT IN CONTEXT

Analysis of options activity can provide valuable insight for the IRO, provided that the context is meaningful and specific, and not based on vague metrics or opaque methodologies. Some options market observers may inflate the relevance of a sudden increase in options activity. For example, a surge of 100,000 call options traded might prompt a claim that an activist hedge fund now has potential exposure to a 10-million share position in the stock. While theoretically possible, this premature conclusion does not consider the myriad of possible alternative scenarios. Are the calls long-dated? What is the delta? Are there corresponding puts, indicating a market-neutral volatility hedge? Is a bearishoptions trader simply collecting premiums by writing naked calls? While the activist scenario is conceivable on paper, we cannot be confident in the narrative without appropriately researching the primary elements of the contract activity.

Consider the case of SYSCO (SYY) in 2015 [FIGURE 3]. On 6/30, the company announced that its much anticipated mega-merger with US Foods was canceled, and options volume spiked on the news as investors prepared for volatile trading. Six weeks later, hedge fund Trian filed a 13D disclosing a 7.1% activist stake. An untrained or speculative analyst might have drawn a straight line connecting the options volume surge with an activist position. Understanding what actually happened, on the other hand, requires analysis of the both the options and equity trading. The bulk of the 6/30 options traded were new November $39 calls, possibly being written by SYY-holding hedge funds and brokerages like Citadel and/or Susquehanna who were expecting a negative reaction to the announcement. These investors wanted to remain long in the equity, but saw the opportunity to hedge the position in the short term by writing calls and gaining income from the contract premium (see Scenario 3). Options activity also showed short-term speculators trading near-the-money July $38 calls, looking to generate small and quick profits (see Scenario 1). As it turned out, these strategies turned out to be prescient, as the stock consolidated throughout July and into August. What options analysis did not illuminate, in this case, was the actual accumulation by Trian. In fact, the hedge fund's 13D filing explicitly stated that its use of hedging with options came from "privately negotiated back-to-back call and put transactions," i.e., the firm was not using listed contracts that could be observed in trading by options analysts. On the other hand, a hedge-fund accumulation representing a dominant ownership stake like this one would be fairly easy to pick up through stock surveillance. Intelligence analysts can monitor aggressive inflows into the accounts where activist hedge funds typically hold shares in custody.

Options trading analysis also provided intelligence around the trading landscape after SYY's earnings announcement (8/10) and when Trian's 13D was published (8/14), as contract volume and open interest spiked once again. On the 8/10 earnings announcement, SYY's quarterly revenue missed estimates, and the company said that "the go-forward trajectory for the industry growth" was "unclear." Investors reacted with a near-term bearish strategy by writing out-of-the-money September $38 and November $39 calls. However, sentiment turned bullish on 8/14 when August $41, $42, and $43 calls were active following the activist's 13D filing.

FIGURE 3 – EQUITY OPTIONS CONTRACT VOLUME DEC 2015 - FEB 2016



Source: FactSet

These examples show how analysis of options activity can provide an effective narrative for what is happening in trading. Listed options contract volume may be driven by short-term options traders and electronic churn by quant shops seeking thin margins on momentum, and these players have little to do with the investor base IROs and their management teams care about. The high-frequency trading trend that has come to dominate equity markets also thrives in the options market. However, the examples described in this paper show that identifying certain explicit patterns through proper analysis can provide IROs with actionable intelligence about sentiment in a stock and hedged moves by equity investors.

An IRO should understand what insights can and cannot be gleaned from options activity alone, because options analysis represent only one piece of the intelligence puzzle regarding a stock's trading and its institutional investors. This paper shows that options activity analysis plays an important complementary role, but not necessarily a comprehensive one, as these insights taken in conjunction with equity stock surveillance provide the IRO with the best actionable intelligence. Data from options trading are just one of many signals the IRO should look to for actionable information. Because traditional investment managers who dominate shareholder lists generally do not participate in trading options, the intelligence obtained from what happens in equity trading is the preferred driver of IR strategy.

Ipreo's Corporate Access Survey

2016

By: Brendan Fitzpatrick and Geoffery Suen

The following article is an excerpt from Ipreo's 2016 Corporate Access Survey. The survey, which is in its sixth year, measures corporate issuers' activity levels and management participation, sell-side sponsor strengths and weaknesses and overall satisfaction with the corporate access experience. The full report can be found here.

KEY FINDINGS

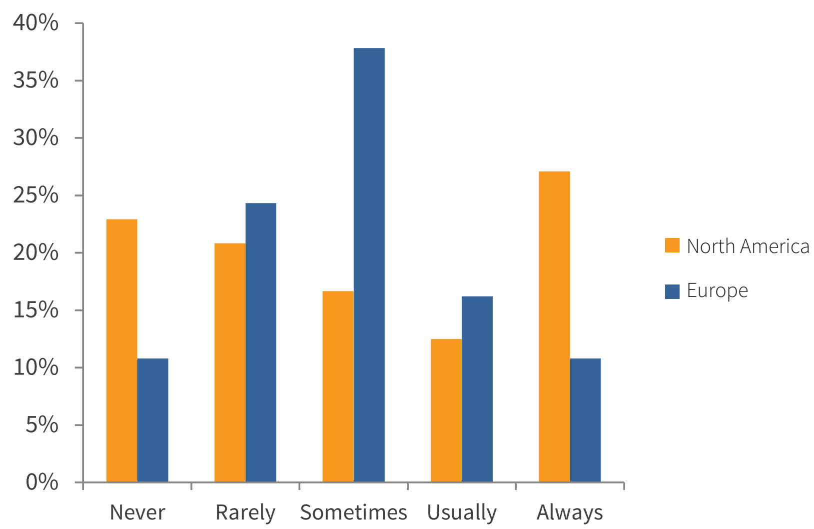
- The overall number of one-on-one meetings decreased for both U.S. and non-U.S. companies across all market-cap groups.
- Participation by companies in investor conferences organized by the sell side was down across the board. For large caps, there was no bounce off last year's decline (and even a small but likely not statistically significant decline). Last year's slip in conference participation by mid-cap companies snowballed, while small-cap companies reversed last year's bump with participation moving down to 2013 levels.
- Large-cap companies reported an increase in non-deal roadshow activity, while activity by mid and small caps held steady.
- Management participation in investor events declined broadly and significantly (corollary: reliance on IROs to lead investor events increased broadly and significantly).
- Just under one-third of respondents report participating in virtual events, split evenly between teleconferences arranged by corporate access and meetings arranged by issuers.

VIRTUAL MEETINGS

Demographics

31% of respondents participated in at least one virtual investor meeting in 2015, including nearl y half of large-cap companies,but only one in five small-cap companies. European issuers leverage the technology more frequently than U.S. issuers (40% vs 27%).

Figure 1 – Virtual Meeting Organizers



Frequency

Virtual meetings have established a beachhead, but have yet to set up base camp. N early 9 o f 10 issuers report participating in 5 or fewer virtual meetings during 2015, while 1 in 5 c ompanies conducted more than 5 virtual meetings over the period. While corporate access plays an important role in leveraging virtual meetings to connect issuers and investors across all caps and markets, compared to in-person meetings, issuers are more likely to independently arrange virtual investor meetings. North America shows a greater tendency to independently organize virtual meetings (always or usually 40%) compared to Europe (always or usually 27%), but these per centages far exceed the per centage of issuers who "always" or "usually" organize their own road shows (12% across all regions).

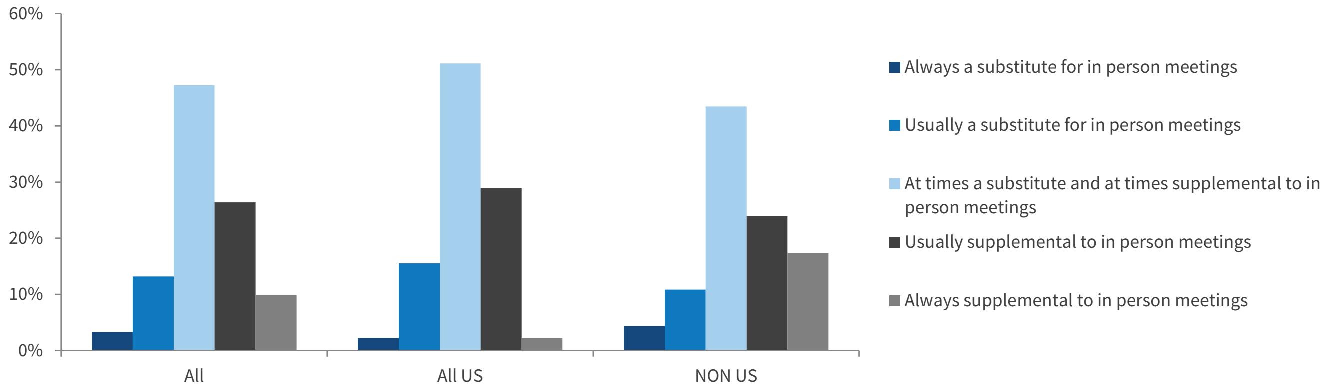
"Virtual meetings are a great way to get to investors who are located in out of the way places where there is insufficient an concentration of investors to make a half day of meetings. It is also a very efficient way to stay in touch in between personal visits."

-North American Mid-cap Technology Company

THE ROLE OF VIRTUAL MEETINGS

Virtual meetings hold the promise of increasing the frequency of communication by bringing parties together that do not have the opportunity to meet in person, typically due to a lack of proximity. In an era where we often lament that electronic communication has replaced in-person communication, a natural question to ask is whether virtual meetings are a replacement of or supplement to in-person meetings. The answer is…yes.

Figure 2 – Role of Virtual Meetings



In the chart above, we see a balance between virtual meetings acting as substitute and virtual meetings acting as supplement, with a significant skew toward the role of supplement. The skew indicates that virtual meetings, on balance, increase the overall frequency of interaction between investors and issuers.

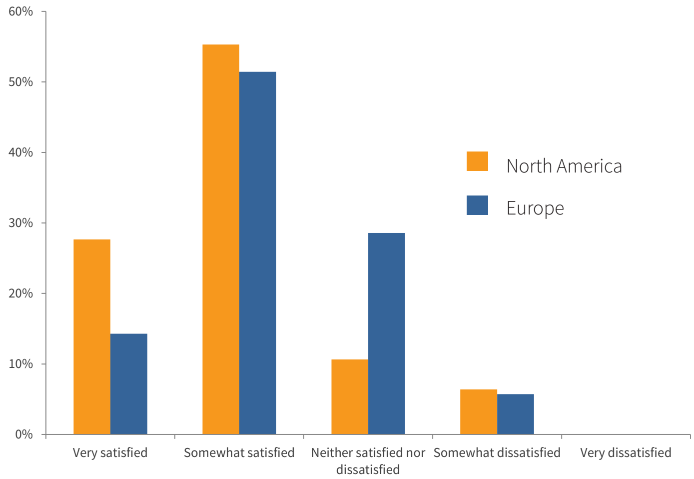
ADDITIONAL HIGHLIGHTS ON VIRTUAL MEETINGS

Concerned that an investor will cancel or forget to attend a virtual meeting? Rest assured, 81% of respondents were very or somewhat satisfied with the attendance and punctuality of participants.

Virtual meeting usage forecast:

- Plans to use/not use virtual meetings in 2016 is split 51/49% (use/not use).
- 94% of respondents who used virtual meetings during 2015 plan to increase or maintain their level of activity.
- 38% of respondents who did not use virtual meetings during 2015 do not plan to use virtual meetings during 2016.

Figure 3 – Virtual Meeting Organizers



ADDITIONAL HIGHLIGHTS ON VIRTUAL MEETINGS

74%

of respondents reported that they were at least somewhat satisfied with virtual meetings. No one reported that they were very dissatisfied.

72%

of respondents reported that they were at least somewhat satisfied with the quality of the interaction during virtual meetings. No one reported that they were very dissatisfied.

85%

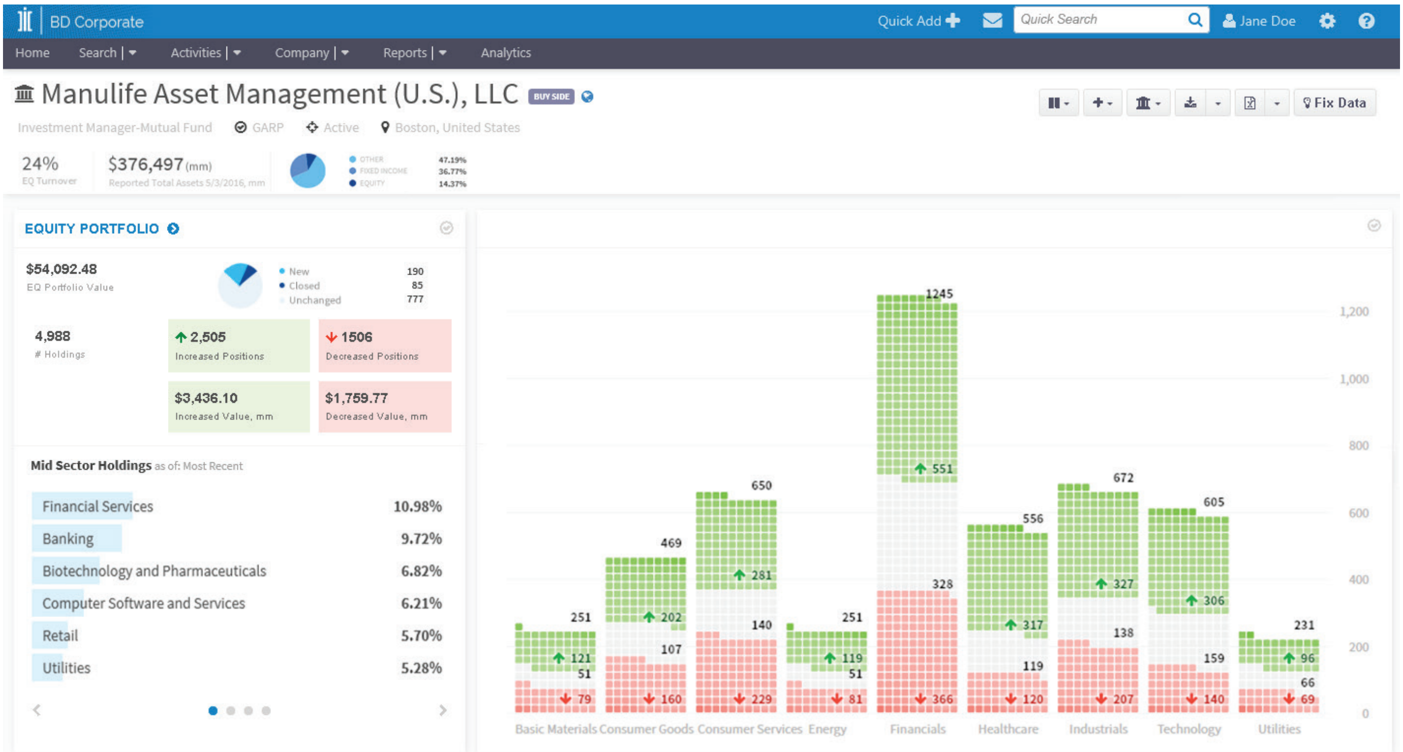
of respondents reported that they were at least somewhat satisfied with the quality of participants. No one reported that they were very dissatisfied. Of note, 26% reported that they were very satisfied with the suitability of investors, compared to 14% who reported they were very satisfied by at in-person events.

Firm Snapshot

Target Firm:
Manulife Asset Management (U.S.) LLC

Targeting Profile:

The U.S. branch of Manulife was born out of Canadian insurance company Manulife Financial's acquisition of Boston-based John Hancock Financial in 2004. The John Hancock brand has been a respected name in the industry since 1862, and as such lives on as a subsidiary focused on Manulife's investments in U.S. equities. John Hancock currently manages $54B in disclosed equity assets, with 82.5% of the portfolio allocated to U.S. securities and 12.2% allocated to European securities. This Boston branch of the greater Manulife organization doesn't manage many Canadian equities- those are managed out of the Toronto office by Manulife Asset Management, LTD. Despite widespread concerns over a British exit from the European Union, Manulife plans to increase its investments in the region. In Q1 of 2016 John Hancock displayed this willingness to participate in the European market by upping its stake in securities such as Novartis AG (+$64M), Diageo plc (+$19M), and Unilever NV (+$15M). The John Hancock family of funds favors stocks that already have dominant positions in their respective markets; at the small and mid-cap levels it tends to seek out stocks that trade below intrinsic value, and thus have a margin of safety at entry. Its largest mid-cap investment is in Ralph Lauren Corporation, which it rotated an additional $79M into during Q1 2016 for a total holding of $488M. John Hancock Investments frequently meets with issuers, and the majority of meetings are taken out of the firm's headquarters in Boston.



Source: Ipreo's BD Corporate

Fund Snapshot

Target Fund:
Vanguard Wellesley Income Fund

The Vanguard Wellesley Income Fund is managed by John Keogh and Mike Reckmeyer at Wellington Management Company via capital provided by the Vanguard Group. Keogh and Reckmeyer have managed the fund together since 2007, with Reckmeyer managing equities and Keogh in charge of the fund's fixed income strategies. The Boston-based fund manages $44B in assets, allocating roughly two-thirds of its portfolio to bonds and the remaining one-third to stocks, in order to strategically reduce its exposure to volatility risk. Though equities only account for a portion of the fund, the reported equity assets add up to $16.2B. Equity assets are deployed across a fairly concentrated portfolio of 59 securities, enabling the fund to take noteworthy positions in issuers. Though the fund can invest up to 25% of its assets globally, capital is currently allocated only to North America (89%) and Europe (11%).

All of the fund's equity investments are in either large or mega-cap securities (25% and 75%, respectively) that pay a dividend. Its holdings are diversified across sectors, exemplified by the fund's top three holdings: Microsoft ($817M), Wells Fargo ($606M), and Johnson & Johnson ($603M). Notably, at 12% the fund is overweight the Energy sector and has taken meaningful positions in Exxon Mobil ($536M), Chevron ($400M), Suncor Energy ($335M), and Occidental Petroleum ($306M); during Q1 of 2016 it also initiated a $75M position in Oil & Gas Storage and Transportation company TransCanada. Issuers looking to set up a meeting can reach out to Mike Reckmeyer, who is known to frequently meet with issuers from all industries.

TOP INDUSTRY BUYS

Industry	Chg*	% Port
Biotechnology and Pharmaceutical	72.3	13.73
Oil, Gas and Coal	117.4	12.23
Utilities	38.8	10.32
Food, Beverage, and Tobacco	167.1	11.53
Utilities	38.8	10.32
Telecommunications	72.9	7.98
Computer Software and Service	(58.2)	6.34
Banking	12.6	5.61
Financial Services	11.5	5.14
Semiconductors	11.6	5.17
Conglomerates	59.1	4.68

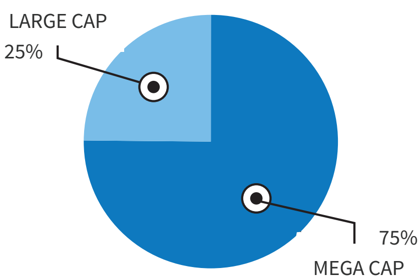
TOP INDUSTRY BUYS

Industry	Chg*	% Port
Transportation	175.0	1.98
Food, Beverage, and Tobacco	167.1	11.53
Oil, Gas and Coal	117.4	12.23
Telecommunications	72.9	7.98
Biotechnology and Pharmaceutical	72.3	13.73

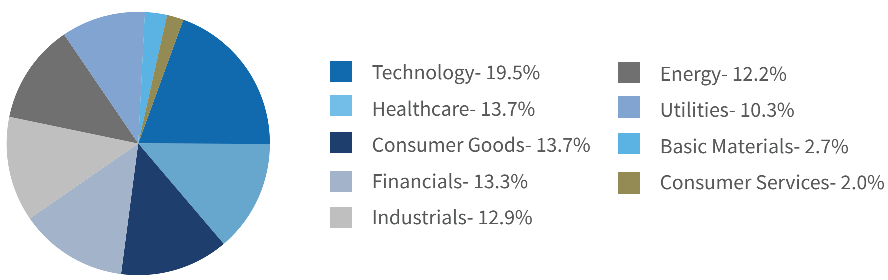
TOP INDUSTRY SELLS

Industry	Chg*	% Port
Wholesale	(166.6)	0.00
Industrial Equipment	(134.8)	3.20
Computer Software and Service	(58.2)	6.34
Metals and Mining	(56.1)	0.47
Insurance	(0.4)	2.54

MARKET CAP



SECTOR ALLOCATION



Metro Area Targeting Focus

Tokyo, Japan

MONEY CENTER STATISTICS

Reported Equity Assets ($B)	$567.1
Number of Institutions:	128
Top Sector Weighting:	Financials
Financials Weighting:	23.4%
Top Country Weighting:	Japan
Canada Weighting:	58.2%
North America Weighting	35.2%
Total Net Buying ($B):	$26.2
Total Net Selling ($B):	-$18.0
Total Net Activity ($B):	$8.2

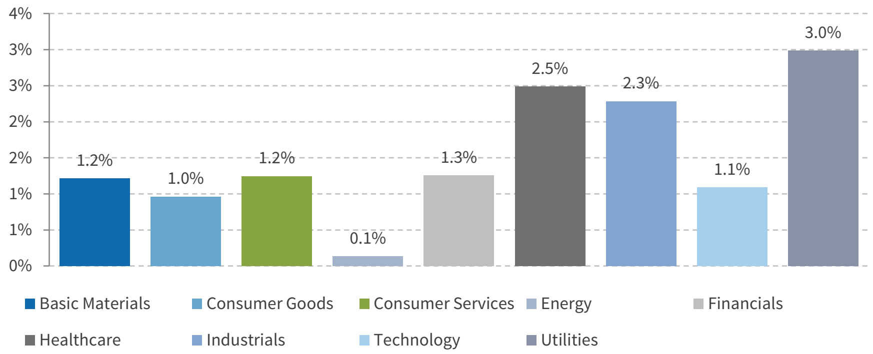
Ownership changes as of most recent public filings since 12/31/2015

SUMMARY NOTES

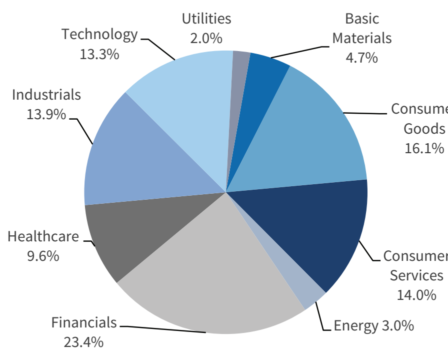
For issuers looking to extend their outreach efforts to Asia, Japan is a worthwhile destination. Investors in the Tokyo metropolitan area manage a combined $567.1B in disclosed equity assets, which is by far the largest pool of assets in Asia and accounts for almost a quarter of its capital. So far in 2016 Japanese investors have added $8.2B to the global equities market. The biggest beneficiary was North America, which drew $5.4B of the capital. The city is home to 128 asset managers, largely growth-oriented in style, though Japanese investors are also known to favor stocks that pay a dividend. For a visiting IRO, meetings with the asset management arms of some of Japan's most prominent banks such as Nomura Asset Management Company ($92.0B EAUM), Sumitomo Mitsui Trust Asset Management Company ($72.6B EAUM), Daiwa Asset Management Company ($55.8B EAUM) and Mitsubishi UFJ Trust & Banking Corporation ($44.5B EAUM) are a must.

While investors in Tokyo naturally allocate the majority of capital (58.2%) to Japan's domestic market, at a 35.2% allocation North American investment isn't far behind. Investment in European equities, however, is less of a focus with a 4.1% allocation. Industry-wise, investors in the city favor Financials (23.4% of capital invested), followed by Consumer Goods (16.1%), and Consumer Services (14.0%), all of which they've continued to rotate capital into at the start of 2016. Nomura rotated $225M into the U.S. Consumer space during Q1 of 2016, upping its stake in household names such as PepsiCo, Wal-Mart, Tiffany & Company, and Whole Foods Market. Sumitomo Trust allocates 77.6% of its portfolio to North American securities, with notable positions in Apple ($1.8B), Microsoft ($1.2B), and Exxon Mobil ($1.0B).

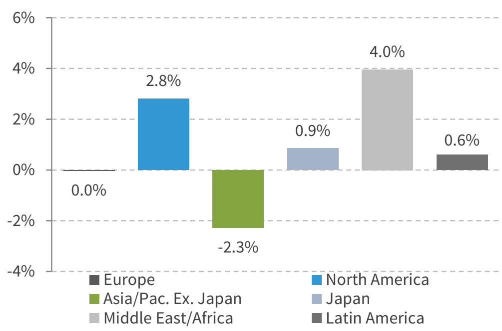
MOST RECENT SECTOR NET ACTIVITY (%)



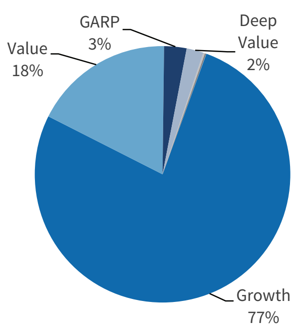
SECTOR ALLOCATION



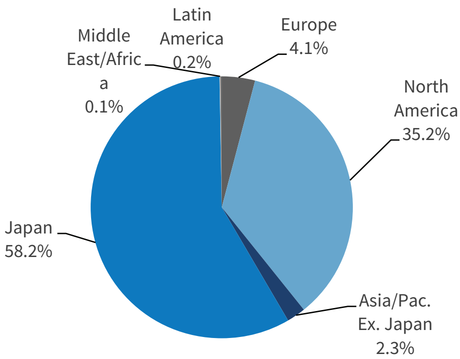
MOST RECENT REGIONAL NET ACTIVITY (%)



INVESTMENT STYLE



GEOGRAPHICAL ALLOCATION



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