

Securities Finance Report



Why are European ADRs increasingly in demand?

As cited in this week's Barron's magazine (August 30th, *Two Different Worlds*), the popularity of short selling European companies via their US listing (ADR) tells us of the differing views being held by investors on either side of the Atlantic. The current rise in demand to borrow European ADRs contradicts the two-year trend in which we've seen a reduction in demand to borrow US and European equities for short covering purposes.

The episode that alerted us to this trend was the Gulf of Mexico oil spill. There was a strong divergence of views as to how this disaster would impact BP's share price. European investors showed their confidence in the company's ability to afford the fall out by not shorting any of BP's ordinary shares until early June, and even then this did not exceed 2% of total shares. This was after the price had fallen in half. In stark contrast, BP's American Depositary receipt saw demand to borrow peak as early as late April when the price was only just beginning to fall. One could speculate that US investors had a better idea of the scale of wrath that such an environmental disaster would engender.

To find out if this was an isolated incident or a wider trend we took a quarterly snapshot of the number of open securities lending transactions (a proxy for the number of short selling trades) over the past two years across US equities (via the Russell 2000), all European equities and European ADRs. By counting the transactions we are able to remove the effects of price changes to gauge the true scale of demand.

There is more than a 50% (966k to 442k) reduction in Russell 2000 stock loan trades between early 2008 and the present, and just under a 40% (224k to 149k)

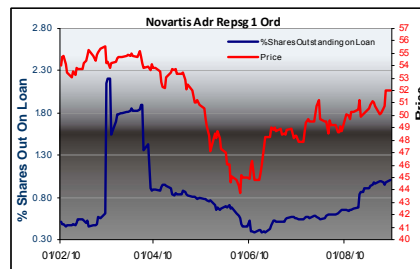
reduction for Euro equities. On the other hand, there is a rise in the number of securities lending transactions across European companies with a USD listing via an ADR (9.5k to 11k). Part of the reason we see fewer trades in the main equity listings reflects the deleveraging taking place since 2008. But that doesn't explain why demand to borrow ADRs is rising.

Take European pharmaceutical companies as a current example of diverging views on either side of the pond. Demand to borrow the main Swiss listing of Novartis (NOVN) is low at less than 1% of shares outstanding and hasn't changed in months. However, USD investors are betting against the price rebound and have doubled their ADR borrowing since early June. Shire (SHP) is another name where investors disagree depending upon their location. Dollar investors are covering their ADR shorts whereas demand to borrow the UK listing is at a 6 month high of 1.5% of issued shares.

Given the various trials, tribulations and regulatory changes experienced by short sellers over the past 2 years, it pays to check investor sentiment across the range of listed instruments from ordinary equities to corporate bonds to ADRs. Detecting investor pessimism has become harder, not easier! A more objec-

tive view of a company's health may best be found by checking the trading behavior of investors who are physically removed and thereby less influenced by local bias.

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Stock of the Day: Saks(SKS)
This is in response to the big jump today. Large short base with this name, having increased to 28% SOOL lately from a low of 22% four months ago.

% Total Shares Outstanding on Loan

Long Short Ratio: All Global Securities

30 Aug 10	Chg	% Chg	Week % Chg	52 Week High	52 Week Low
7.14	-0.00	+0.06%	+1.06%	7.34 (10-Aug-10)	6.26 (07-May-10)

This is a very simple way to understand whether the market is getting more or less short. It is derived by taking the institutional longs that are made available to borrow through

DXI Global 50



The DXI™ Data Explorers family of indices tracks the change in securities lending, a proxy for short selling, in relation to shares outstanding of the largest companies in each region. The advantage of the DXI™ methodology is that it is not impacted by changes in price or by changes in trade volume so securities lending activity is not obscured by cash market movements.

The region-specific DXI™ US, UK, Europe (ex UK), Japan, and Asia (ex Japan) 30 each cover the securities lending loan base for the 30 largest market capitalised companies in each region, respectively.

The DXI Global 50 is made up of the 50 largest companies from the five regional indices.

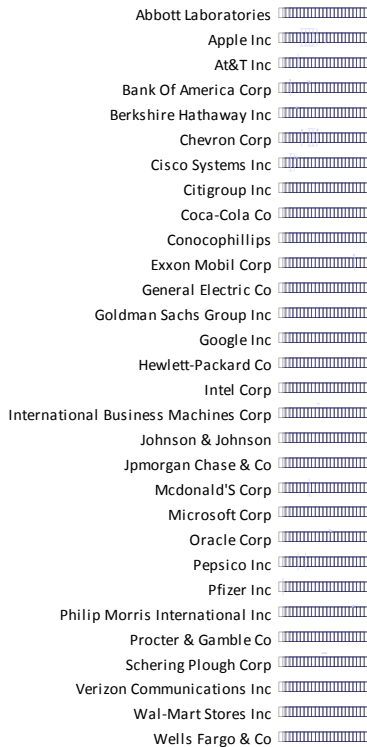
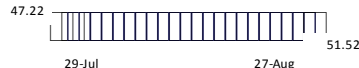
A rising DXI™ index represents a relative increase in quantity on loan (i.e. short selling) while a falling index highlights a decrease in the quantity on loan (i.e. short covering).

Each index has a base as of 6 January 2010 and is rebalanced quarterly. The indices are not weighted.

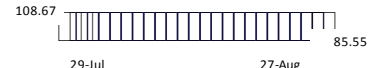
The chart for each index component shows the percent shares outstanding on loan for each company. *Note: this is not to a common scale but rather shows the trend over the past 22 trading days.*

For more information please contact Data Explorers.

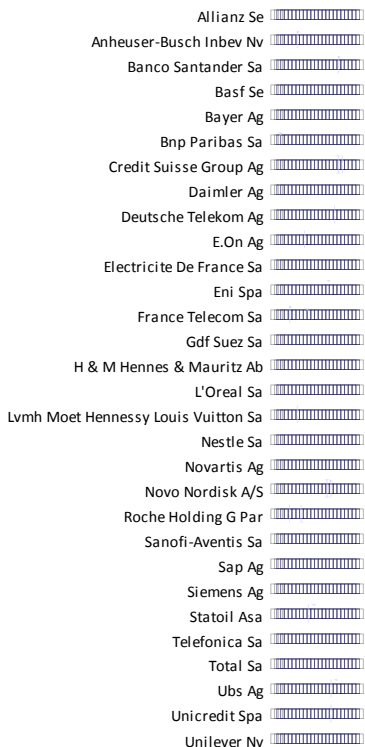
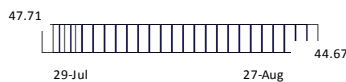
DXI US 30



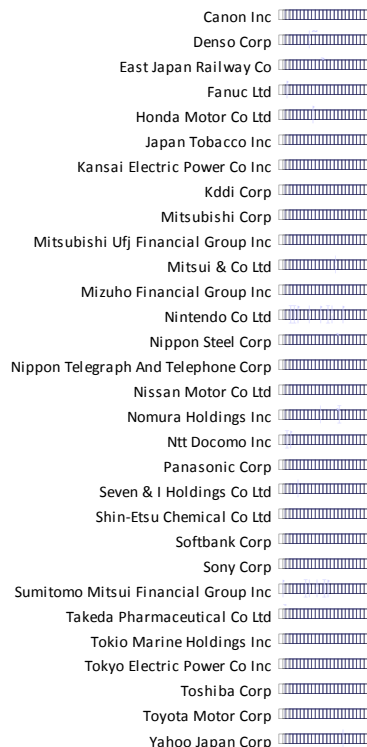
DXI UK 30



DXI EU xUK 30



DXI Japan 30



DXI Asia xJP 30



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