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Webinar May 2010

Securities lending flow data - a new equity market factor?

With analysis from Macquarie Research

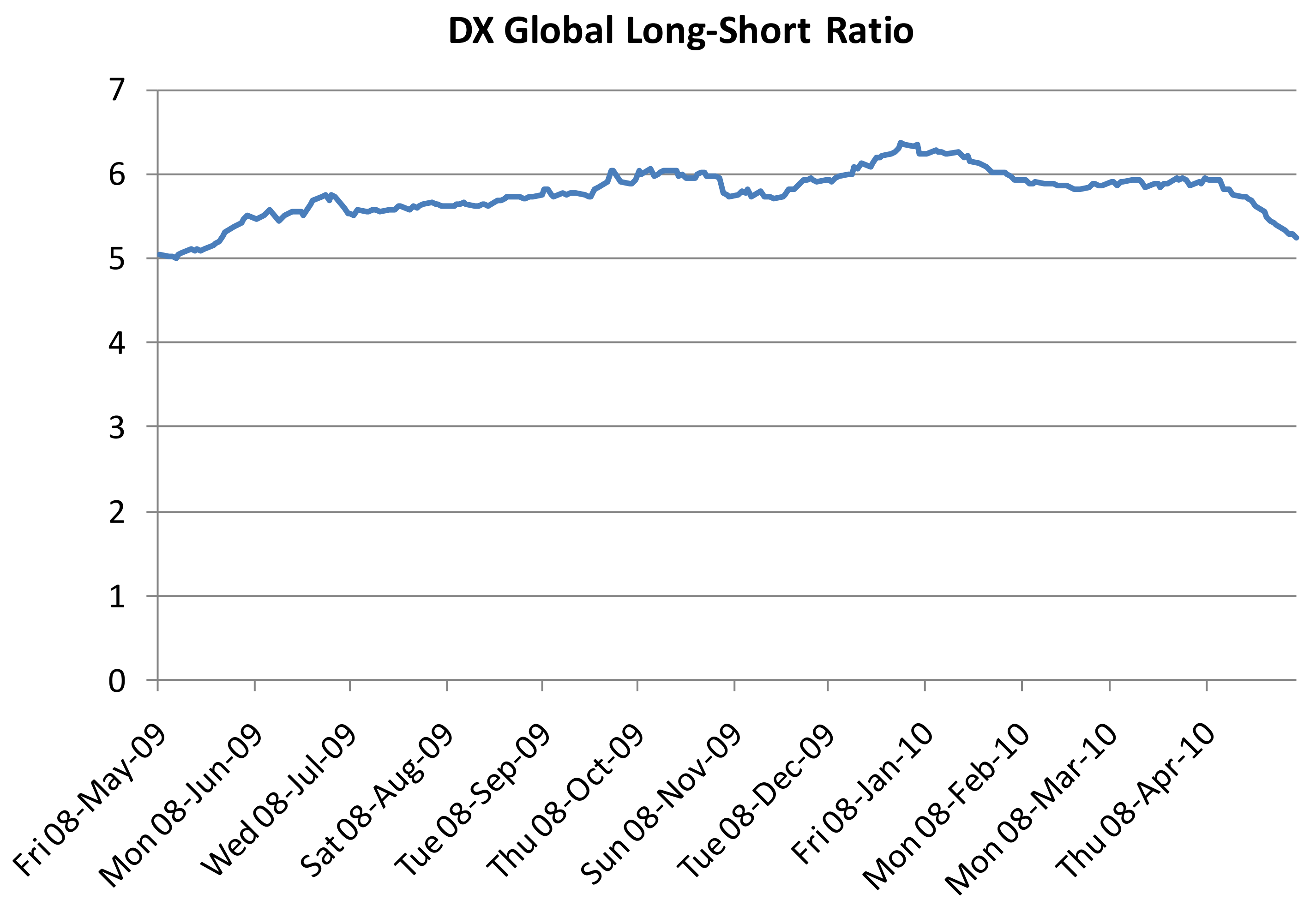
Macquarie Quant Research

Overview

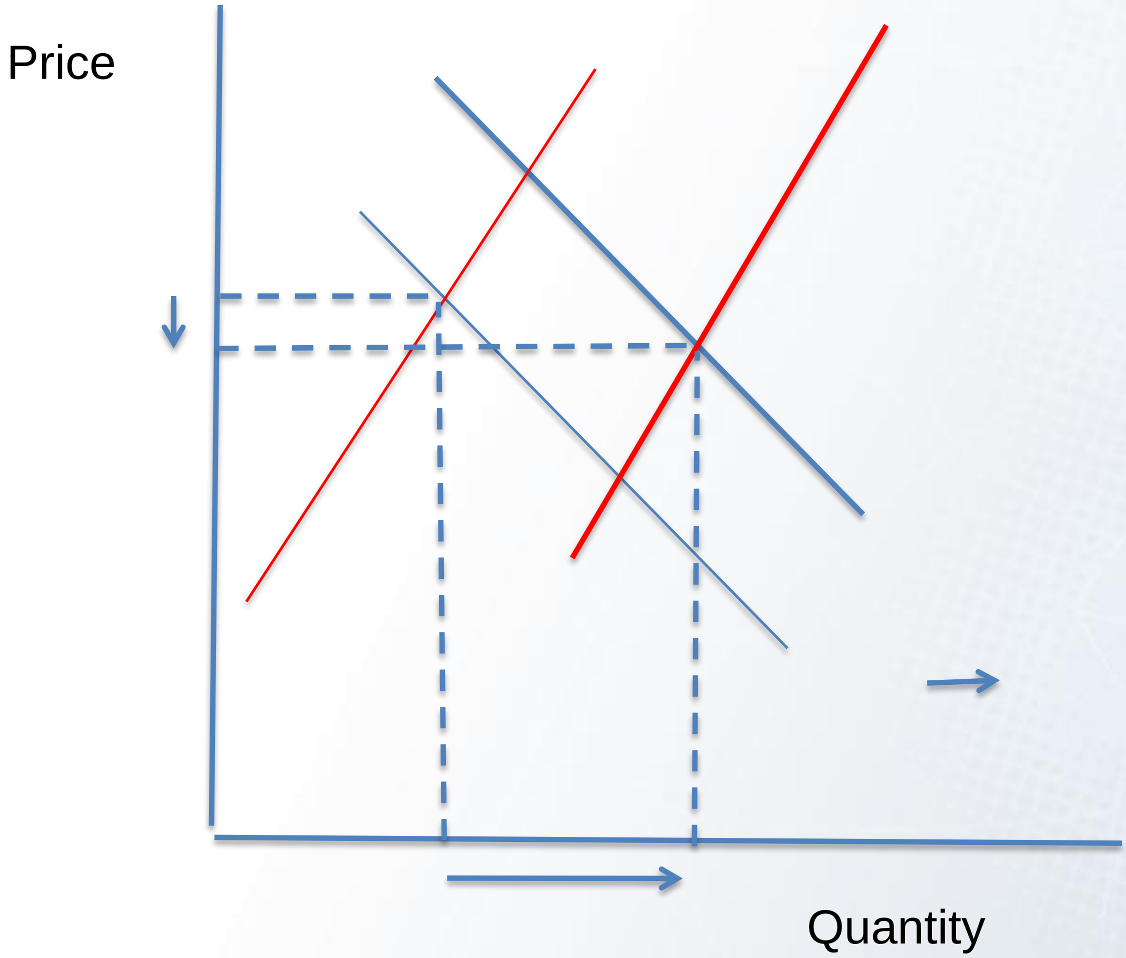
- Introduction – why is this important?
- Flow data
- Main market factors
- Identifying the value of flow data for
  - Fundamental managers
  - Momentum managers
  - Value managers
  - Event driven managers
  - Dealing desks
- A fifth market factor?

Introduction

- Investment decisions:
  - Macro – Asset allocation, Net long or short
  - Micro – sector and stock selection
  - Portfolio construction - scale of leverage, number of holdings
  - Dealing – time horizon, holding period, liquidity
  - Risk – diversification across risk fault lines
- Investor dilemma:
  - get these right – but not too early, and not too late
  - Is the market coming your way or moving away?
- or What is the state of the market tide?
  - Rising or Falling?
  - Smooth or Turbulent?


DX Global Long-Short Ratio
7
6
5
4
3
2
1
0
Fri 08-May-09
Mon 08-Jun-09
Wed 08-Jul-09
Sat 08-Aug-09
Tue 08-Sep-09
Thu 08-Oct-09
Sun 08-Nov-09
Tue 08-Dec-09
Fri 08-Jan-10
Mon 08-Feb-10
Mon 08-Mar-10
Thu 08-Apr-10

Swift recap



Typical Flow Summaries

Negative Sentiment (Short)	Long Flow (Supply Qty % Change)	Short Flow (Demand Qty % Change)	Fee (Change)	Price % Change	Loan Value (Million$)	SOOL %	Days to Cover	Active Utilization %
Kinder Morgan Energy Partner	-7.5%	24.2%	4(-5)	-7.4%	110.7	0.6	1	100.0
Clean Energy Fuels Corp.	-3.2%	2.9%	2(0)	-20.1%	85.5	8.7	2	87.4
Ezra Holdings Ltd.	-0.8%	1.3%	4(-1)	-7.7%	29.2	3.1	2	72.7
Alliance Oil Co. Ltd.	-2.9%	5.5%	2(-1)	-15.9%	121.6	5.0	10	58.8
Cheniere Energy Inc.	-4.4%	7.7%	2(0)	-19.0%	20.0	9.8	5	57.9
Petroplus Holdings AG	-4.4%	7.6%	1(0)	-13.2%	128.9	9.3	5	52.9
PA Resources AB	-4.9%	10.4%	4(1)	-22.8%	11.5	3.1	2	52.7
Uranium One Inc.	-2.0%	4.9%	2(0)	-5.1%	47.1	3.3	9	46.0
Total S.A.	-0.1%	13.1%	3(1)	-5.6%	10619.5	8.8	18	44.8
Oilsands Quest Inc.	-1.3%	1.8%	1(-1)	-9.7%	12.6	5.3	7	37.4

Changes over 7 days

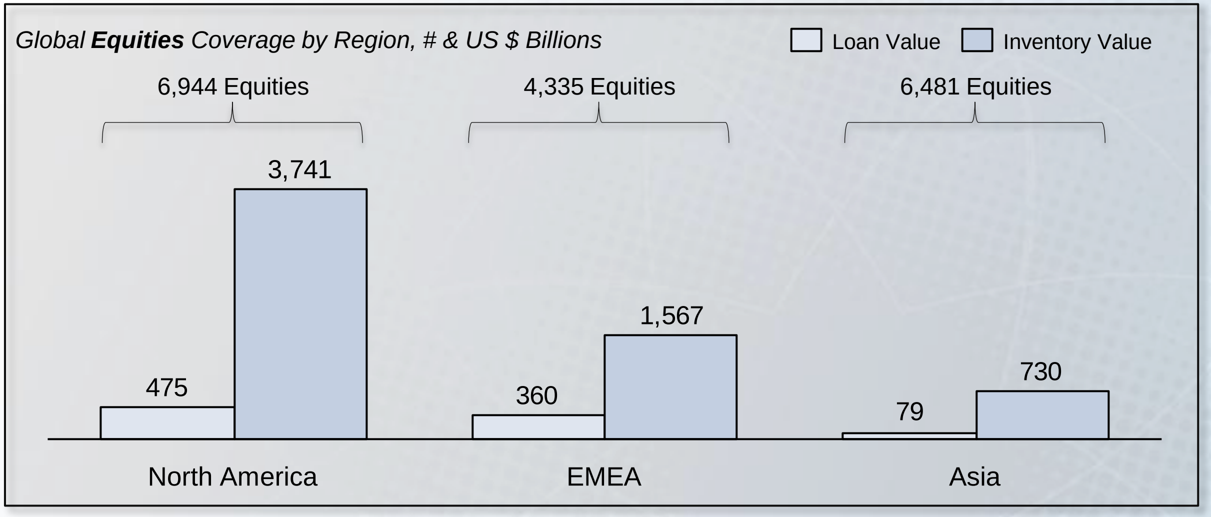
Flow Data

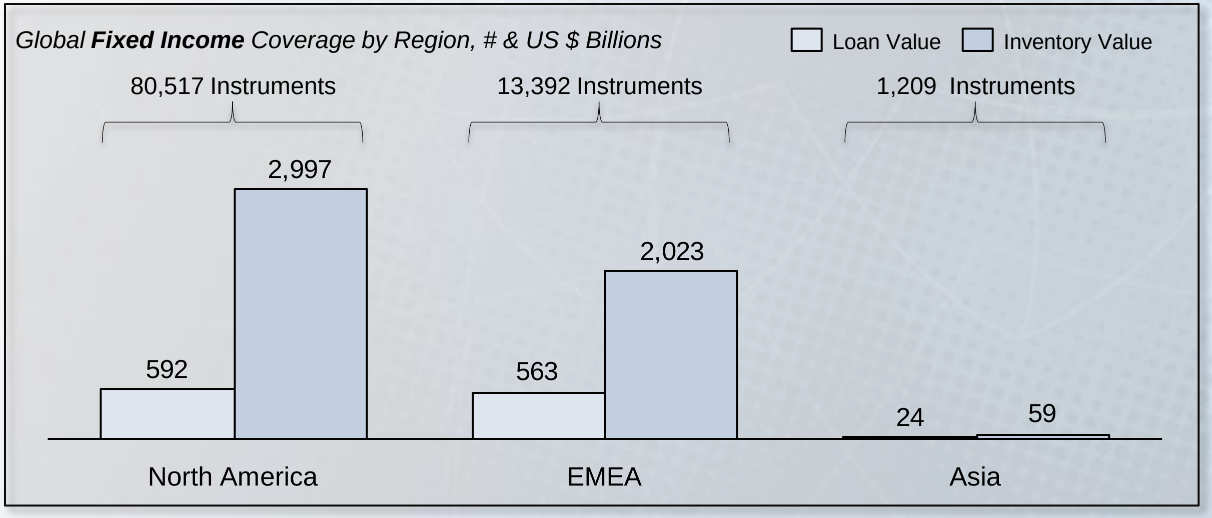
- Flow data gives a clear steer on:
  - Investors increasing and decreasing their holdings
    - Lendable inventory is a good proxy for institutional ownership changes
    - Institutional ownership data provides macro flow indications
  - Short sellers opening and closing their positions
    - Stock loans, Public data, Option open interest all form part of the overall short selling jigsaw puzzle
- From this simple set of data points, we can gain valuable insights into market dynamics
- Research by MacQuarie uses Flow data to uncover hidden value within the standard market factors look for this logo to show where we are quoting MacQuarie results →

DX Data

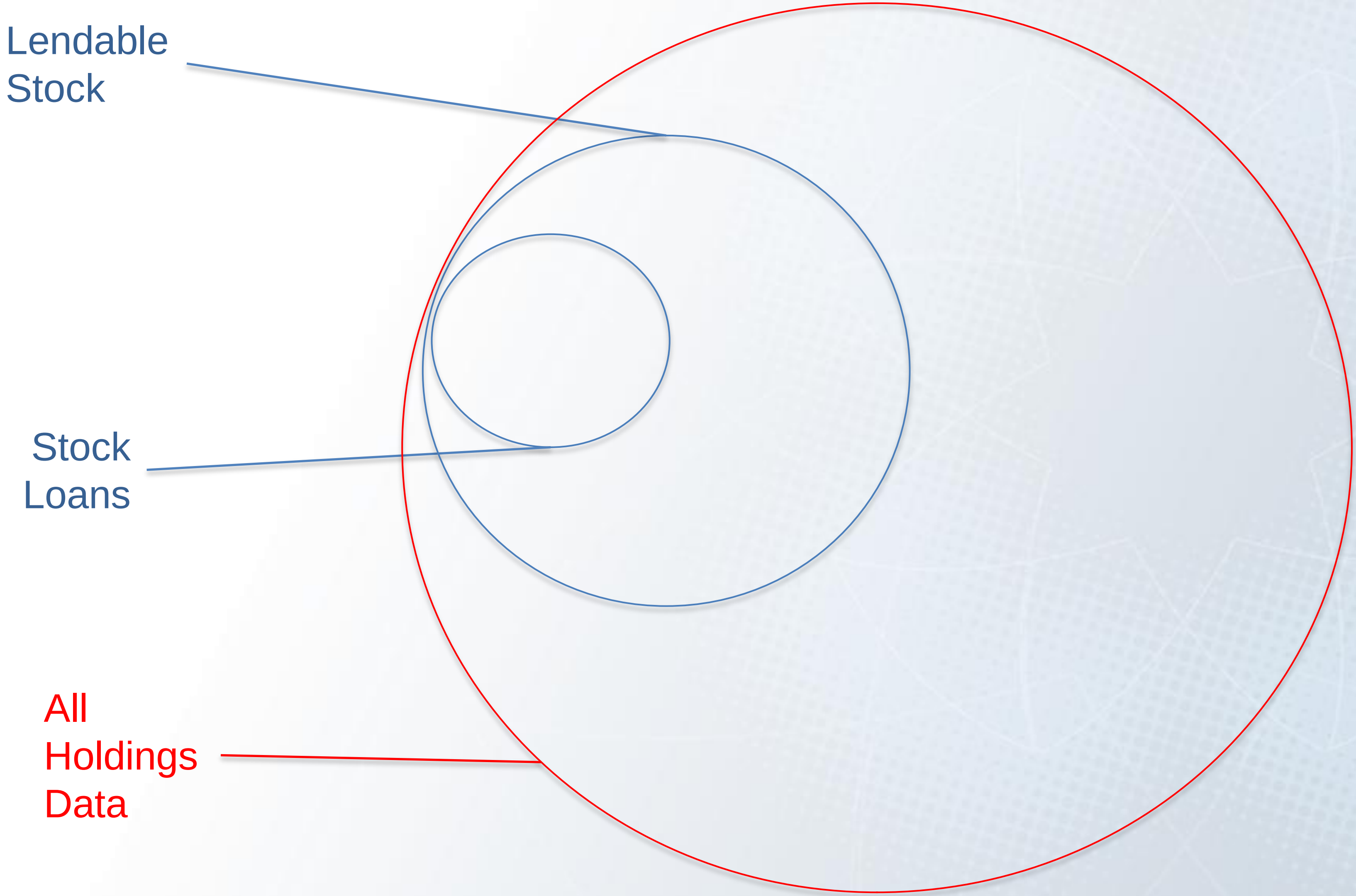
Data Explorers offer a unique insight into daily global aggregate changes in portfolio positions

- Unique data set of more than 3.5 million daily transactions
- US $11 trillion in inventory available to borrow
- US $2 trillion is out on loan
- 113,000 global equity and fixed income instruments
- Encompasses approximately 85% of global transactions
- 55% Equities and 45% Fixed Income
- 8 years of data history

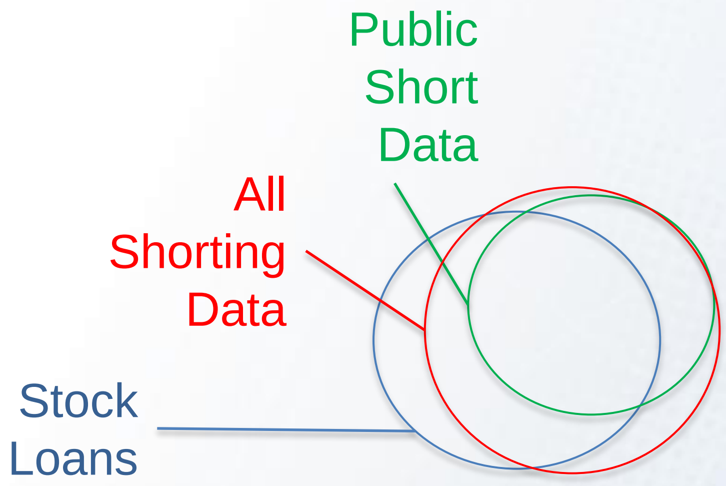




DX Flow Data



DX Flow Data



Recap of main market factors

- Standard Factors:
  - Equity Market (high and low beta)
  - Value vs Growth
  - Large vs Small
  - Positive vs Negative Momentum

Fama French

Carhart

- So is flow data just another way of capturing these?
  - Need to control for these standard factor effects

Basic Result

Stocks with low short interest

outperform

Stocks with high short interest

BUT

Stocks with very high short interest are at risk of a short squeeze

This is a result that we have confirmed in a number of studies, with various features:

-It is most noticeable in the extremes, and for large samples
-It is volatile
-It can be detected for various holding periods
- It can be detected at the stock as well as sector level
- It is stronger in bear markets
- It is strongest in the US
- It is country specific in Europe
- It needs to be filtered for squeezes, div arb and convert arb
-It is most robust in conjunction with other data:
>> earnings, events, value, momentum, fundamentals

Momentum Managers

Poor price momentum stocks with low short interest

outperform

Poor Price momentum stocks with high short interest

Good price momentum stocks with low short interest

outperform

Good Price momentum stocks with high short interest

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Value Managers

Good value stocks with low short interest

usually outperform

Good value stocks with high short interest

Poor value stocks with low short interest

often underperform

Poor value stocks with high short interest

Event Driven Managers

Short sellers avoid having large positions going into earnings announcements
Short sellers increase their positions after earnings announcements

Short sellers increase positions when earnings surprise is negative
Short sellers also increase positions in response to share prices which over-react to positive earnings surprises or positive product news

Companies with high loan fees *outperform in the 10 days prior to an earnings announcement, but then underperform in the 10 days following the earnings announcement*

Companies with high fees often have high short interest; the reverse is not always true.

Dealing Desks - Shorting Risk Control

If a stock is expensive to short (high DCBS), or difficult to short (Very high Utilization), then don’t short it – it may be due for a squeeze.

Triggers for a squeeze are:

- earnings surprises
- product surprises
- sharp drop in lendable
- major cash flow impact

- any of these can trigger short covering / rising stock prices.

Stocks with a high short base:

High Days to Cover likely to outperform +2.5% (due to a squeeze)
Low Days to Cover likely to underperform -0.8%

Actual squeezes are rare, but they result in an *average* outperformance of
+5.5%

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Dealing Desks - Shorting Risk Control 2

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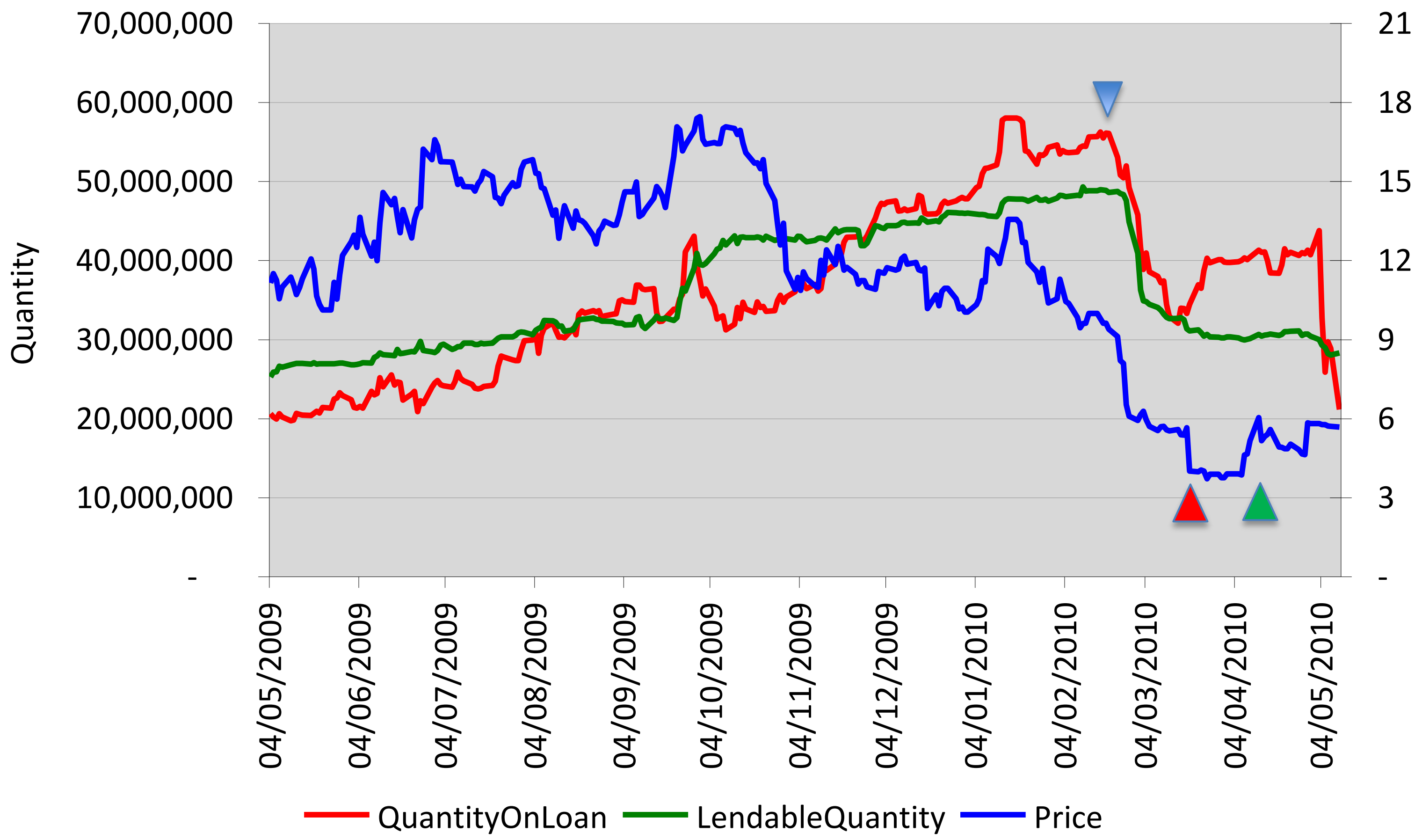
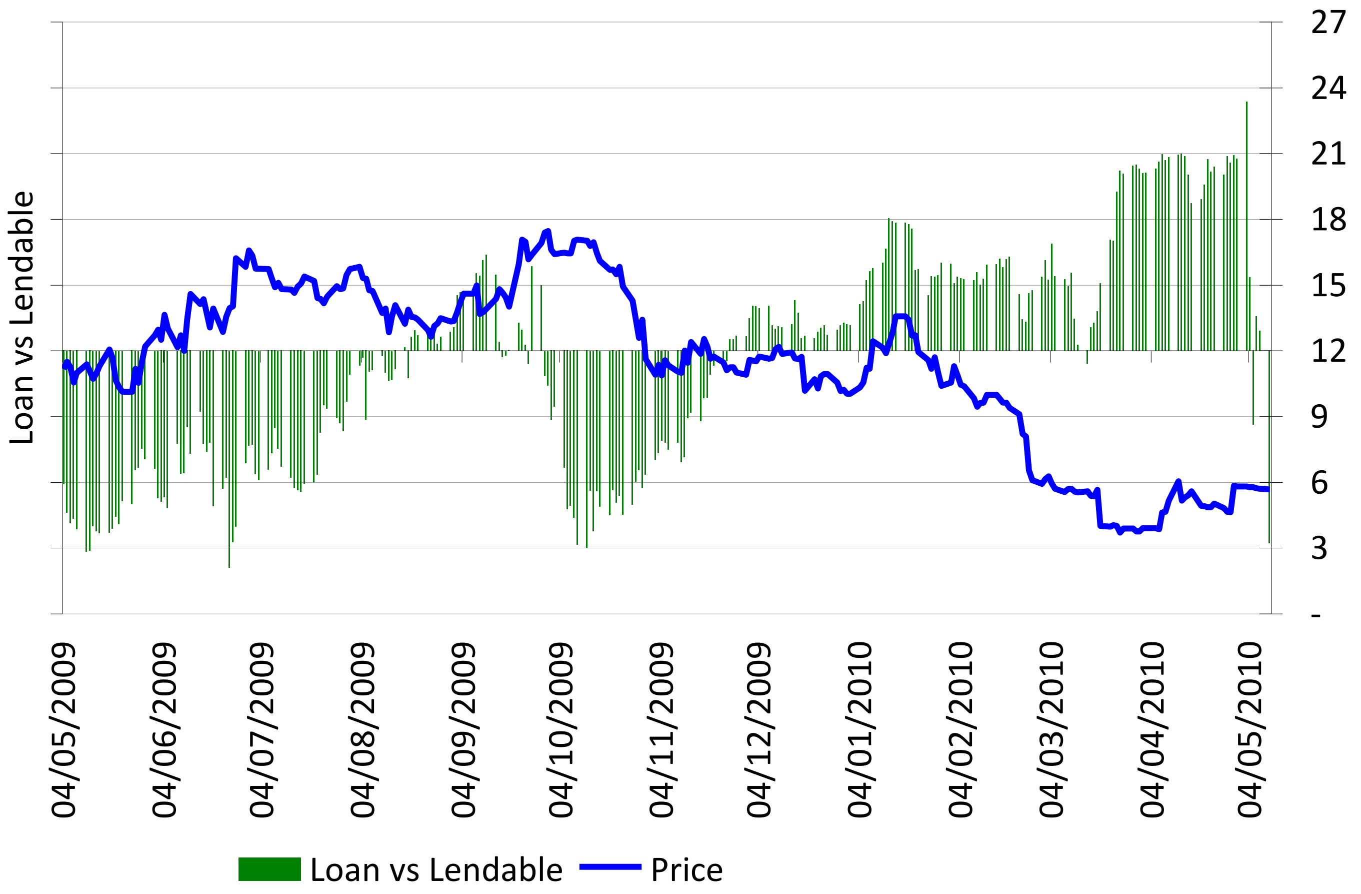
If a stock has a Loan balance that is close to, or exceeds the Lendable, then it may be at risk of a squeeze. If the excess is a large proportion of the traded volume then a squeeze is even more likely. Such stocks are often expensive to short.

Squeeze Risk	Long Flow (Supply Qty % Change)	Short Flow (Demand Qty % Change)	Fee (Change)	Price % Change	Loan Qty (Million)	Lendable Qty (Million)	Volume Traded (Million)	Active Utilization %
BP Prudhoe Bay Royalty Trust	-21.8%	-24.3%	2(-1)	-5.3%	0.1	0.0	0.3	100.0
Kinder Morgan Energy Partner	-7.5%	24.2%	4(-5)	-7.4%	1.7	0.8	1.4	100.0
Uranium Energy Corp.	-1.3%	3.7%	6(1)	-3.8%	6.2	6.6	0.4	93.5
Western Refining Inc.	3.6%	-1.9%	3(0)	-15.3%	11.7	11.4	2.3	92.6
Williams Partners L.P.	-0.1%	2.8%	5(3)	-11.2%	1.6	1.6	0.3	92.4
SandRidge Energy Inc.	18.8%	19.4%	6(1)	-16.8%	52.0	31.9	13.7	92.4
El Paso Pipeline Partners L.P.	0.5%	6.6%	3(0)	-1.8%	1.3	1.0	0.3	90.4
InterOil Corp.	-0.4%	0.6%	1(0)	-16.0%	2.4	1.9	1.0	63.9
Goodrich Petroleum Corp.	2.0%	2.6%	1(0)	-17.2%	9.0	9.6	1.4	61.9
Alliance Oil Co. Ltd.	-2.9%	5.5%	2(-1)	-15.9%	8.7	8.7	0.9	58.8

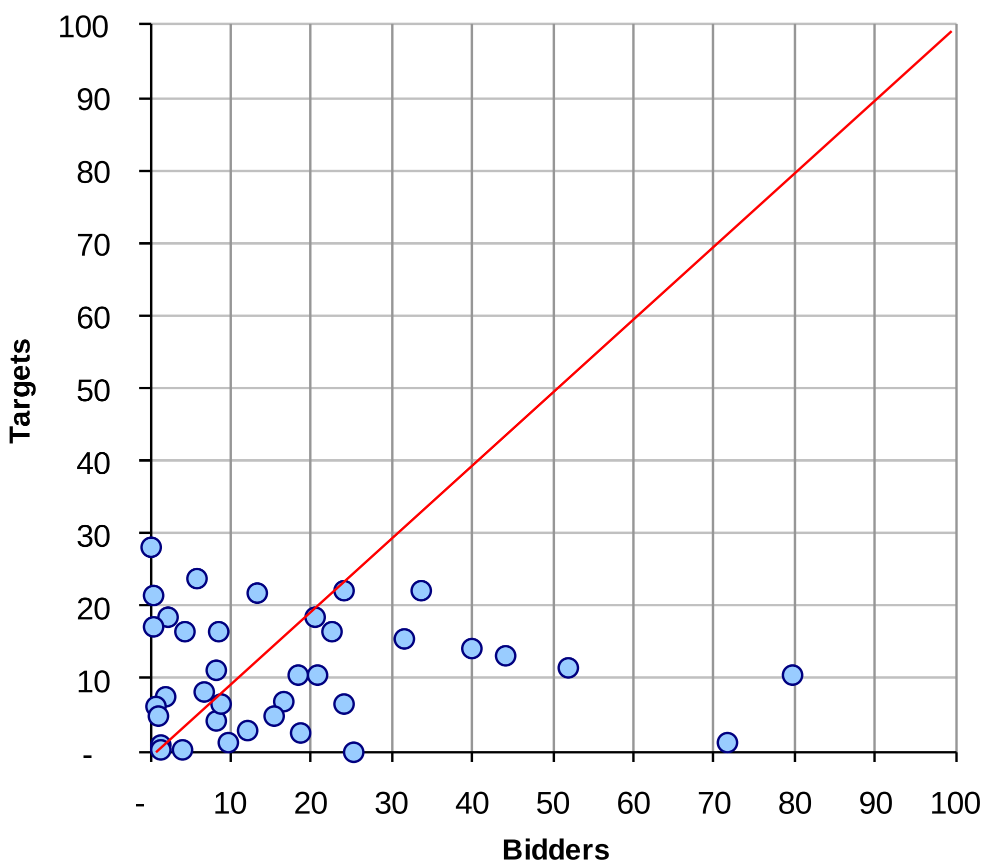
Case Study- PALM



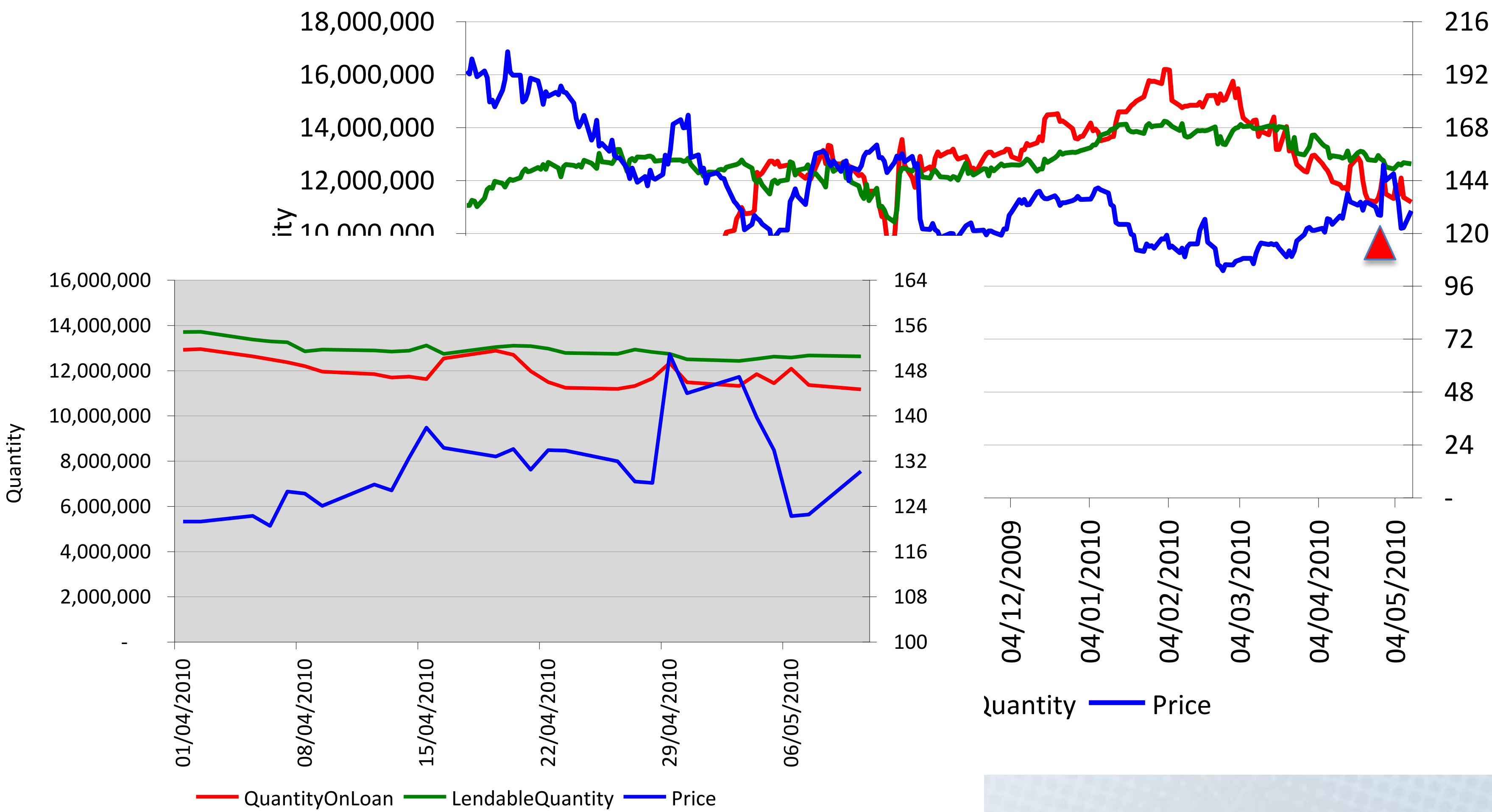
Case Study- PALM



Case Study: M&A Activity 26 April 2010



Case Study: First Solar Inc. (FSLR)



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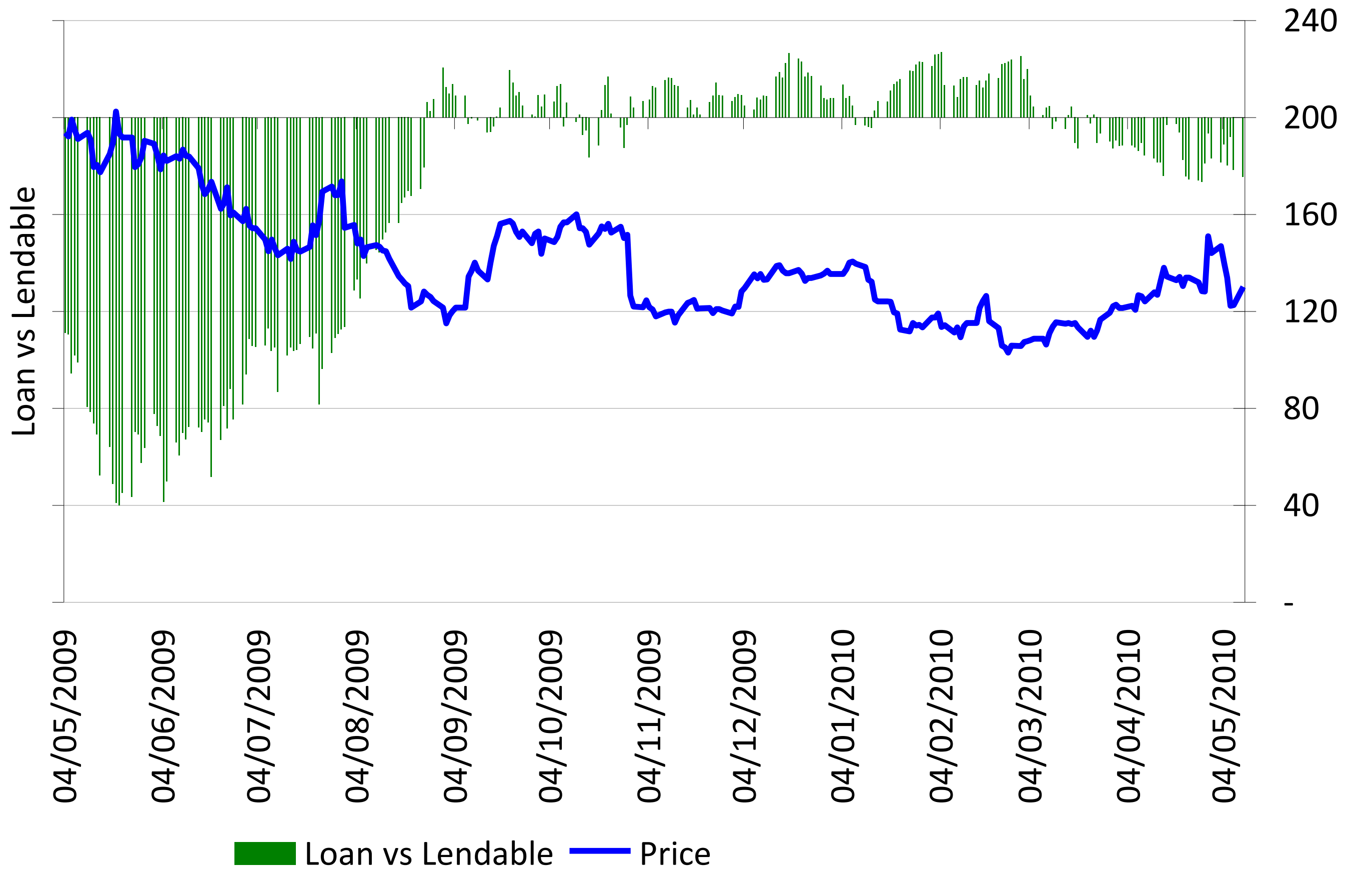
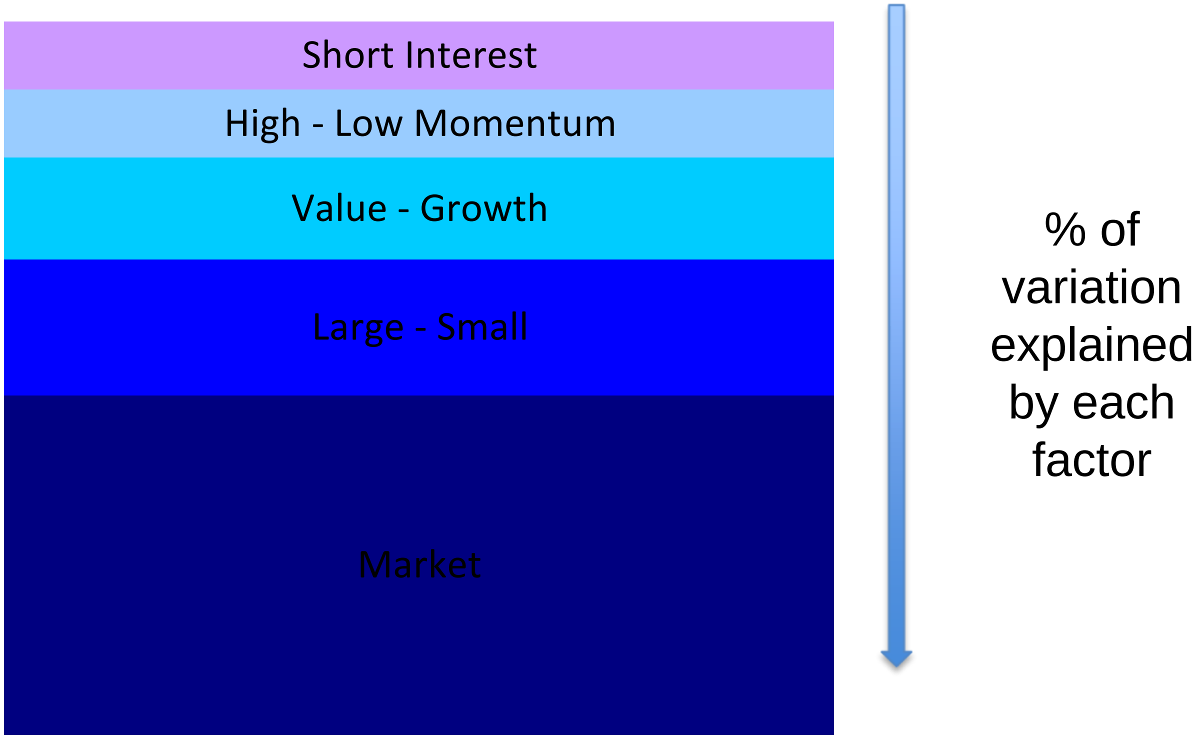


5 factors?


Short Interest
High - Low Momentum
Value - Growth
Large - Small
Market
% of variation explained by each factor

Conclusions

- Flow data:
  - provides the basis of a 5th market factor

    and is of use to

  - Traditional and Alternative Managers
  - Value and Momentum managers
  - Event driven managers
  - Dealing desks
  - And others…

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