Securities Finance Report

Is There Safety in Size?

Companies armed with huge balance sheets can strengthen their market positions by funding issues such as regulatory changes, pension deficits, law suits, union battles etc. Has this view become too crowded and what is the impact of the Dodd/Frank Bill?

A current investment theme is that large companies can use their huge balance sheets to strengthen their position within their marketplace, thereby providing a safe haven for investors. Such firms have spare money to fund issues that some cannot in the form of regulatory changes, pension deficits, lawsuits, union battles etc. Is any one cynical of this view? Has this view become too crowded and what is the impact of the Dodd/Frank Bill?

On one end of the spectrum, owning relatively small companies with a concentrated reliance on too few large contracts is not the place to play right now. Witness the recent collapse of 3 UK travel companies, the price fall from a bank note printer over reliant on India - De La Rue, and Connnaught’s reliance on Government spending which caused a profit warning and so it goes on.

But, megalith BP (short interest is under 2% and falling) almost halved in price after a single incident. Not many companies take the kind of risk that BP took in drilling for oil a mile beneath the surface of the ocean. However, other big companies are vulnerable now that corporate risk is being redefined. This is coming to the fore as transparency continues its onward march.

US Senators, Chris Dodd and Barney Frank have included some interesting provisions in their recent bill. Manufacturers will have to reveal from where they are getting their industrial metals. I have not suddenly become a member of Greenpeace – panic not. However, I do suspect that many very large companies are prone to some uncomfortable headlines if this is enacted.

Socially responsible investing (or SRI) is no longer an exercise in nodding to the politically correct gallery since the BP crisis. Perhaps the biggest companies can afford to ride out a storm relating to, for example, child labor, palm oil, dangerous working conditions etc. Having said that, what if citizen action groups harness the internet to mobilize a protest campaign?

Short sellers are tentatively borrowing some shares in the large cap Unilever (UNA). Stock on loan went from 4.5% to 7% of total shares in July and then retreated again. UNA’s main exposure to negative headlines seems to be its use of palm oil. RepRisk (www.reprisk.com) track and assess companies exposed to environmental, social and reputational risks and picked out BP last year. Their proprietary “score” for Unilever is 23 out of 100 having been at a peak of 66 in November 2008 meaning they are not currently cropping up in too many damaging stories.

On the other hand, Apple Inc (AAPL) has a score of 61 being its highest for 3 years. This mainly relates to the kickbacks scandal and is yet to reflect any disclosures of sourcing metals from unsustainable sources which may or may not affect them.

BP is an interesting case of short selling over the past 2 weeks with a small very recent rise. Walmart* (WMT) has seen a small rise in short selling over the past week to 0.5% of total shares. This is likely to be in relation to their results and little to do with the reported controversy surrounding working conditions at some of their suppliers (http://labourrights.org/creating-a-sweatfree-world/sweatshops/news/12383) or the source of their blueberries (http://www.independent.co.uk/news/world/americas/us-blueberry-farms-accused-of-using-children-as-pickers-1813193.html) – but these stories are still out there nonetheless.

The big unknown is which type of investor will react to negative publicity and in what measure. If you are one of the world’s largest fund managers who own a stake in most large companies do you immediately cut your ownership or instead talk to management and be patient? Will short sellers opportunistically react first? This is the reaction one would anticipate and fits with recent history if our data is anything to go by.

The top 3 current issues according to RepRisk are Fraud, Tax Evasion and Anti-Competitive practices. Who would have thought that these issues were suddenly rather closer to the worlds large cap companies than previously thought?

Will Duff Gordon

For more information on any of the stocks mentioned in this article, please contact news@dataexplorers.com

For more breaking news about people, events and companies, visit:

www.longshortreport.com

Stock of the Day: Vestas Wind Systems

The share price for Vestas Wind Systems A/S (VWS) fell to an all-year low. Short interest in the stock has more than doubled over the past 6 months to over 9% shares outstanding.

Long Short Ratio: All

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 the securities lending programs and divides this by what has been put out on loan.
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 a common scale but rather shows the trend over the past 22 trading days.

For more information please contact Data Explorers.