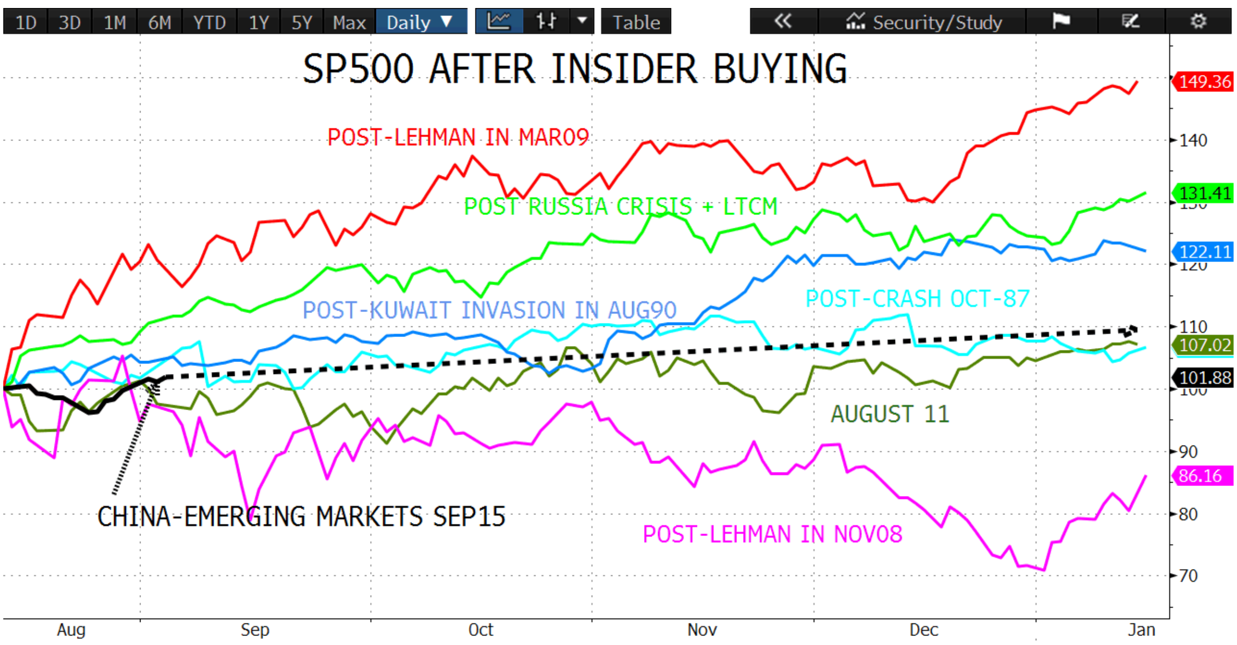
CHART OF THE MONTH

WHAT SHOULD WE DO WHEN U.S. INSIDERS BUY THEIR OWN STOCKS?



Source: 1 Vickers

WHAT SHOULD WE DO WHEN U.S. INSIDERS BUY THEIR OWN STOCKS?

Analysts, traders, portfolio managers, clients and companies tend to look at several data to draw informed conclusions about what should be done: buy, sell, or hold. Fundamental and technical data are the most typical indicators used.

Flows are also frequently looked at, but it is difficult to draw reasonable conclusions:

- ETF flows are available on a daily basis, but it is the perfect coincident indicator: when the markets go up, normally there are inflows into the ETFs; when the markets go down, normally there are outflows.
- Exposure to equities of balanced funds: also perfect coincident indicator, as asset allocators buy in bull markets and sell in bear markets.
- Net beta exposure of long/short equity funds: the data is available with a lag, but also a perfect coincident indicator.

Nevertheless, there are some flows with good historical predictive power: “legal insider trading”. "Insider trading" is a term that most investors have heard and usually associated with illegal conduct. But the term actually covers both a legal and an illegal conduct. The legal version is when corporate insiders—officers, directors, and employees—buy and sell stock of their own companies. When corporate insiders trade their own securities, they must report their transactions to the SEC with a delay of 10 days. Vickers Stock Research compiles the information and calculate the purchases and sales on a weekly basis, so a sell/buy ratio can be produced and analysed historically.

Two interesting conclusions can be drawn from past observations:

1) When they sold aggressively (2 standard deviations), the market did not show neither bullish nor a bear pattern. In many cases they sell because they need the money to diversify their exposure out of the shares of their own companies, so no useful information can be drawn.
2) When they bought aggressively (2 standard deviations), typically the market went up. This is a logical outcome: they know their company much better than anybody else, so they become buyers especially during big unjustified sell-offs. We could say that when retail and institutional investors are panicking, corporate insiders do buy. (Probably they have read Warren Buffet’s advice).

The graph shows 6 episodes when the insiders bought aggressively and how the SP500 performed afterwards. In 5 out of 6 situations, the indicator worked extremely well with 6 month performance between 7% and 49%. In one instance only, the indicator did not work. In Nov08, after the first leg of the Lehman crisis, they started to buy - only to see a second leg in 2009. All in all, the summary is quite encouraging as the average performance would have been +17% with 5 out of 6 times delivering positive returns.

What is it telling us today: the latest available information is that insiders in the US are buying but not at the aggressive levels as for the 6 previous situations shown in the graph. Today, the signal is 1.7 sigmas versus >2.0 historically. It is not a high compelling signal to buy the US equity market, but at least, with this level of insider activity we may conclude not to sell, despite the negative sentiment: Who knows better a company that their officers and directors?