



Fisher Funds Investor Education Centre

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Perceptions of value in eye of beholder

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In every share transaction there is a buyer and a seller. What makes the share market interesting is that every investor has a different perception of value. Sellers sell at what they perceive to be a good selling price while buyers buy at that same price perceiving it to be a good buying opportunity.

Generally buyers and sellers have access to the same information, so perceptions of value are determined largely by the investors' own investment conclusions.

The only time a buyer or seller might have an information advantage is if they are an insider.

The term insider is generally associated with the illegal kind of insider trading where someone inside a company trades based on material non-public information that can have an impact on the company's share price.

But there is a lot of insider trading that is legal, essentially the buying and selling transactions of executives, key employees, major shareholders, and directors of a company who because of their position have access to the most up-to-date information about the state of the business.

This inside information can be helpful, and investors can benefit from monitoring insiders' investing transactions.

In fact a University of Michigan study found that when executives bought shares in their own companies, the stocks tended to outperform the total market by 8.9% over the next 12 months. Conversely, when they sold shares, the stock underperformed by 5.4%.

Generally speaking, buying by insiders is a more useful indicator than selling because insiders often sell for reasons unrelated to the business. They may for instance want to reduce debt or diversify their investments. Insider buying on the other hand is relatively less common which is why the market often reacts immediately when a company implements a buyback programme. If a company considers the best use of its funds is to buy shares in itself, that's a pretty good indication that its future looks bright.

One type of insider selling that can be very instructive for investors is in an IPO situation, where existing owners sell all or part of a company through a share float. While it is not always the case, investors should be wary if existing shareholders are selling out completely.

If the future of a company is positive, why would existing owners want to sell right out?



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Two recent Australian IPOs have been terrible failures as the owners, who happened to be private equity firms in both cases, sold out completely. Department store Myer floated in late 2009 at \$4.10, a price it has never reached again, and currently trades around \$2.40. Collins Foods, which is Australia's largest KFC franchisee, had its IPO at \$2.50 in July and after an earnings downgrade last week, is now trading around \$1.20, representing a 50% loss in three months for IPO participants.

Thankfully in the case of the much-heralded Trade Me IPO, owners Fairfax will retain a significant shareholding so will experience the same upside and downside as new shareholders.

Monitoring those in the know is one way to get an information advantage in an otherwise opaque market environment.