COMMENTARY

GLOBAL ALPHA

September 18, 2015

Dear clients and colleagues,

While studying corporate finance at university, we were taught that if your shares are expensive, issue shares. Most companies issuing shares do so because they consider their stock price to be expensive, i.e. they can raise cheap capital as someone is willing to overpay for their shares.

This brings us to our commentary this week - on companies that launch an Initial Public Offering (IPO). We rarely participate in IPOs. Why? A few reasons: firstly, companies are often too expensive at the IPO price. Additionally, we want to wait to see how the company will transition from a private to a publicly traded company. For instance, what will corporate governance be like?

If we find a company interesting, we will follow it after the IPO and may decide to buy at a later time if the risk-reward trade-off justifies it.

Evidence seems to be on our side reading from a Bloomberg article this week. Of the 35 companies that went public with a valuation larger than $1Billion in the last 12 months, only 40% have not fallen below their IPO price and worse, more than 75% now trade below their closing price on their first day of trading as a public company.

Unfortunately, the IPO market is still a market with few rules when it comes to pricing and allocating shares. Hedge Funds and large mutual funds get the majority of the share allocation, with smaller fund and individual investors having to purchase in the secondary market.

Most of these funds that get an allocation sell their shares immediately, often to individual investors who frequently will overpay for these shares.

Looking at the Bloomberg IPO Index, which tracks companies for a year after they go public, the index is down 20% since the start of the year.

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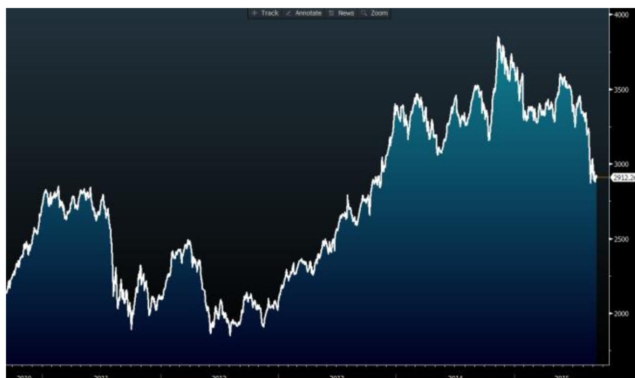
Bloomberg IPO Index



Source: Bloomberg

Now, on to our comment on the Fed. Recent events are not surprising, but disappointing nonetheless. The Fed, as expected, left its target rate unchanged. However, some of the comments made were much more bearish than expected. Statements issued by the Fed even alluded to negative rates as a policy tool - despite US data supporting a raise and the Fed's shift from being US data to Global data dependent. This is a clear departure from the Fed's mandate on employment and inflation, and likely to create a lot more confusion and volatility in Global markets.

If anyone a year ago had been told that unemployment would be at 5.1%, housing prices back to 2006 levels, GDP growth above 3%, and rates would still be at zero, they would have said it is impossible and you are crazy.

We think the Fed missed the opportunity to raise rates. This may well be viewed as a policy mistake looking back in a few years.

Have a nice weekend.

The Global Alpha Team

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