

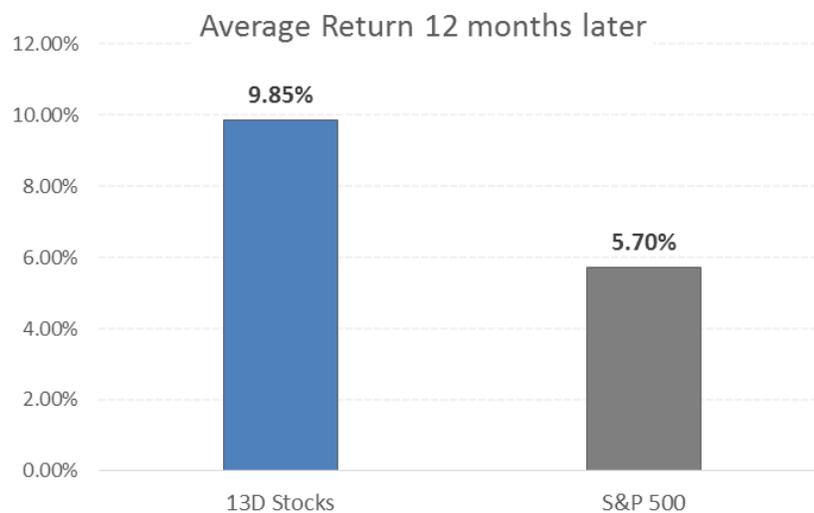
Alpha from Active Insights

Taking an Interest

13Ds provide a wealth of information for the investor who is willing, and able, to scour them systematically. IDXGlobal™ relieves the investor of this task and leverages our expertise and proprietary software to streamline this process. Our research shows that 13D filings provide a rich opportunity set for investors looking to systematically add value to a portfolio.

In the six years from 2008 to 2013, there were over 10,000 13D filings issued by various entities including: hedge funds, individual investors and corporations. We restrict this analysis to original 13D filings (and not 13D/A which are amended filings) in companies whose stocks were trading over \$5 at the time of filing. Activist campaigns in penny-stocks can be massively profitable but require much more careful analysis and will be the subject of subsequent analysis.

When we look at the average return on stocks 12 months after a 13D was filed, the outcomes are meaningful. Stocks in which a 13D was filed increased 9.85% over the following year vs. 5.70% for the S&P 500 over the same period:



This includes over 1400 separate 13D filings in over 1000 different companies over the six years from 2008 through the end of 2013. So, on average, the stocks of "Subject Companies" in 13D filings increased at almost twice the rate of the S&P over the next year.

When we drill down, we find that the averages above include examples such as:

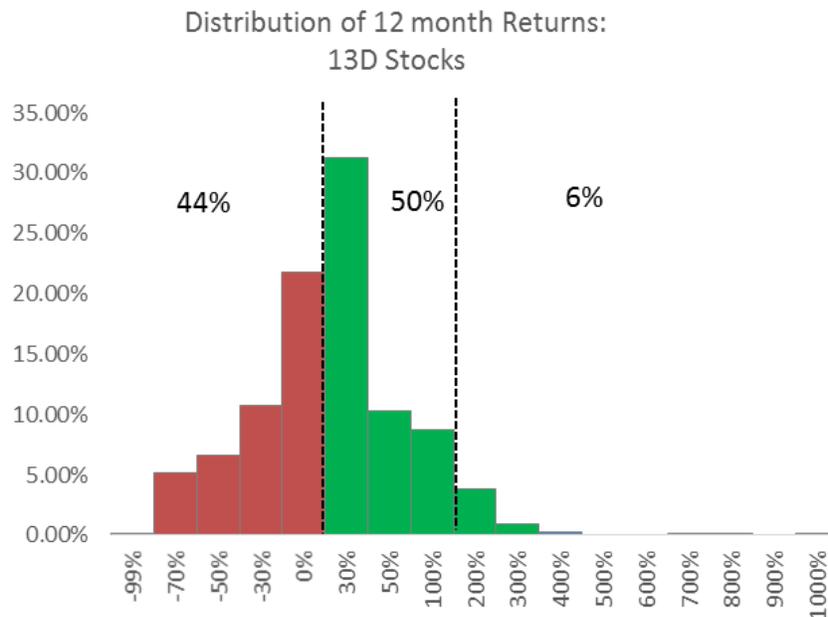
OncoGenex Pharmaceuticals which increased 556% in the 12 months after Canadian venture capital firm GrowthWorks Capital filed a 13D



...as well as Cliffs Natural Resources which lost 75% after Phil Falcone's much publicized 13D filing:



If we look at the distribution of all of these examples, we see that the 13D stocks earn a positive return over the subsequent 12 months about 56% of the time with 6% of those increasing by more than 200% and the largest increase over 10x.



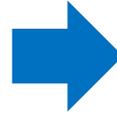
Not all Filers are Created Equal

Already one can see that a list of 13D stocks is not a bad opportunity set for an investor to consider. That said, there are many filings for which there is no structural reason to expect those stocks to outperform. For example, when Bank of America filed a 13D on Norwegian Cruise Line in 2011, it's not clear what value, if any that should contain. No information was given as to the Purpose of the Transaction which is not surprising given that such a position is simply part of the ordinary course of business for an enterprise so large. In this case, the 13D filing represents a perfunctory disclosure – and nothing more. This fact highlights an important concept when weighing the value of 13D (or any) filing which is the **conviction** of the information. This cannot be determined with quantitative analysis alone but needs to be overlaid with a qualitative understanding of the financial industry.

Consider the example just given. A filer such as Bank of America (with a market cap of \$150 billion engaged in multiple lines of business) disclosing a 5% position in a company such as Norwegian Cruise Lines (with a market cap of \$6.5 billion) doesn't represent the same level of conviction as say, Carl Icahn, disclosing a 5% position. At IDXGlobal, our research has revealed that the same 5% position carries much more weight when it's disclosed by a (relatively) small, singularly-focused filer.

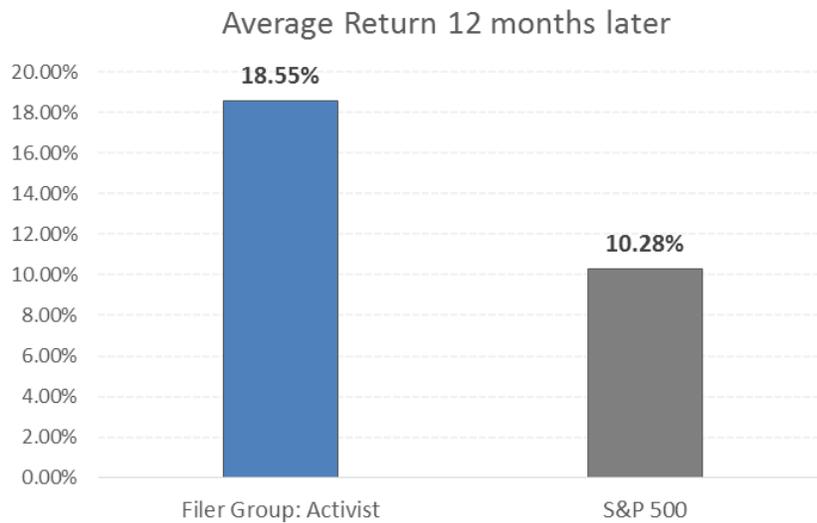
The **size** and more importantly the **type** of entity filing the 13D is crucial when considering the information.

For that reason, IDXGlobal™ classifies all 13D according to the type of filer with the aim of identifying homogeneous groups of filers from which we can expect similar behaviors. “Activists” will be employing a very different strategy on a very different group of companies as compared to a large mutual fund company or a biotechnology venture capital firm, for example.



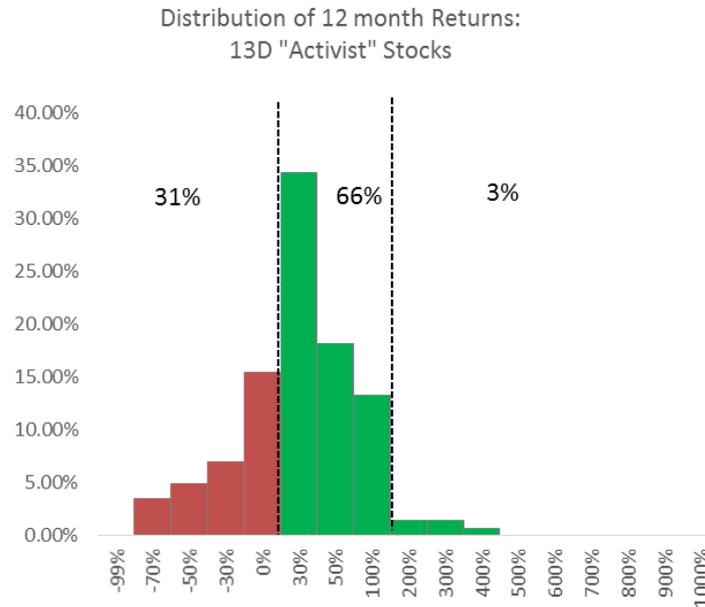
Filer Type
Activist
Hedge Fund
VC/PE Fund
Corporation
Individual
Large Asset Manager
- RIA
Specialist
- Biotech/Healthcare
- Cleantech
- Nat. Resources/Mining

Looking at the returns for 13D stocks for which the “Activists”¹ have disclosed a stake shows an average return over the next 12 months of almost 19% vs. just over 10% for the S&P 500. Narrowing in on the stocks being bought by this specific group of filers increases the average 12 month return by a full 10% over that shown by our original universe of 13D stocks:



¹ This group includes any entity or individual that exhibits an activist strategy as their primary course of business.

Looking at the distribution of the 12 month returns of the "Activist" stocks shows that they are positive a remarkable 69% of the time with the bulk of the 12 month returns between 0 and 30%:



Identifying Intent

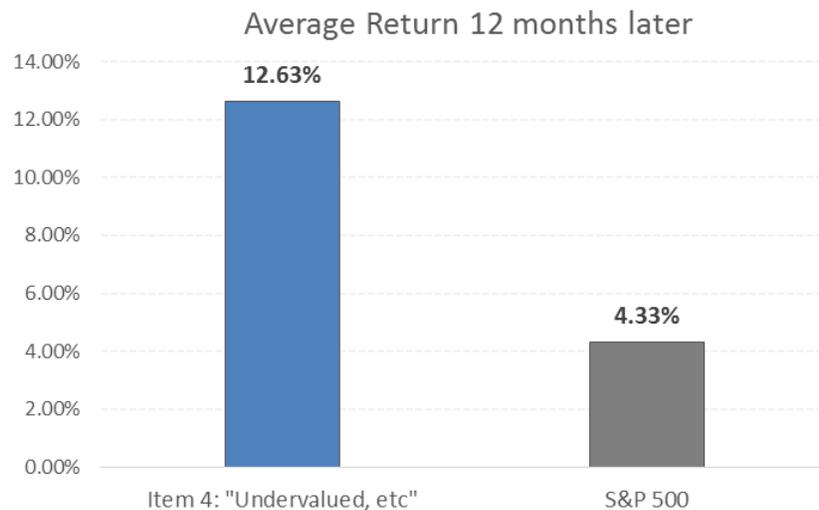
In addition to segmenting by the type of filer, IDXGlobal™ also categorizes the data according to the **intent** of the filer as well. Of specific interest is the "Item 4" section of the 13D filing in which the filer states the "Purpose of Transaction". There is a wealth of information to be mined from this section for those willing to look.

Using the information from the Item 4 field, we classify each filing into the following categories based on specific keyphrases:

Category	Sub Category	Key Phrase
Agreement	Investment	"undervalued" "attractive investment opportunity"
	General	"general course of business.."
Control	Board Control	"changing to the composition of the issuer's board"
	General Control	"acquire control of"
	Merger	"agreement and plan of merger"
Disagreement	general	"sent a letter"
Nothing	None	"no plans or proposals which relate to or would result in..."

IDXGlobal's™ goal is to leverage any forward-looking information as it relates to the intent of the 13D filer. When Starboard Value Fund files a 13D in TriQuint Semiconductor citing the fact that the stock is "undervalued", this conveys very different information than when Whippoorwill Associates files a 13D in Silicon Graphics International with the objective of "taking a control position". While the outcome may be favorable in either circumstance, the paths by which those outcomes is realized can be expected to be very different – and this represents valuable forward-looking information.

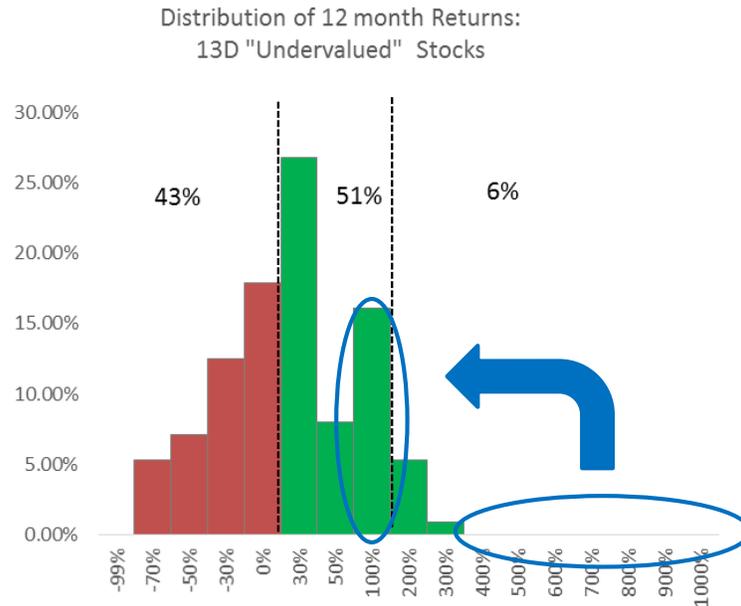
As next step, we will try to identify certain subsets of 13D filings that provide an even more fertile hunting ground for stocks. Specifically, we look at only those 13D stocks (that are over \$5) where the "Purpose of Transaction" contained keyphrases relating to the stock being "undervalued" ("price disparity", "attractive investment", etc.). Not surprisingly, filtering by this criteria improves the 12 month return of 13D stocks as demonstrated in the chart below:



Focusing on just those 13D stocks that are "undervalued" increases the average 12 month return from 9.85% up to an impressive 12.63% vs. only 4.33 for the S&P 500.² Clearly, our research shows that leveraging this information from the Item 4 field is appears to be a robust source of excess return.

² The ave. S&P 500 returns shown will be different for the sample of "Undervalued" 13D stocks vs. the original universe. This is due to the fact that the two samples contain filings at different times and in each case, the increase over the next 12 months, for each stock, is compared to the increase in the S&P over the same time period. This ensures the most statistically robust comparison.

The next chart looks at the distribution of 12 month returns for this group of "undervalued" 13D stocks:

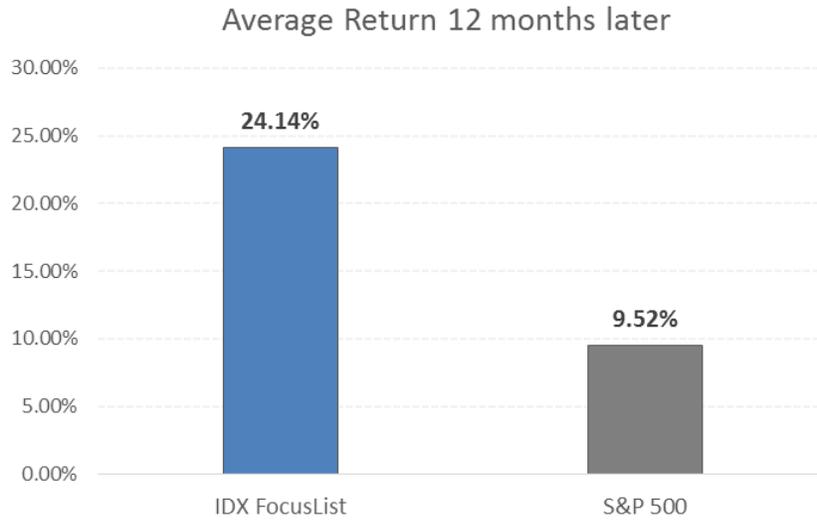


Interestingly, we find that there are no instances of these "undervalued" stocks increasing more than 400% over the next 12 months – which is consistent with the logic that the extremely large returns will be more likely the result of aggressive "control" positions and not just because the shares are "undervalued". As a result, there are noticeably more outcomes in the 50%-100% return buckets.

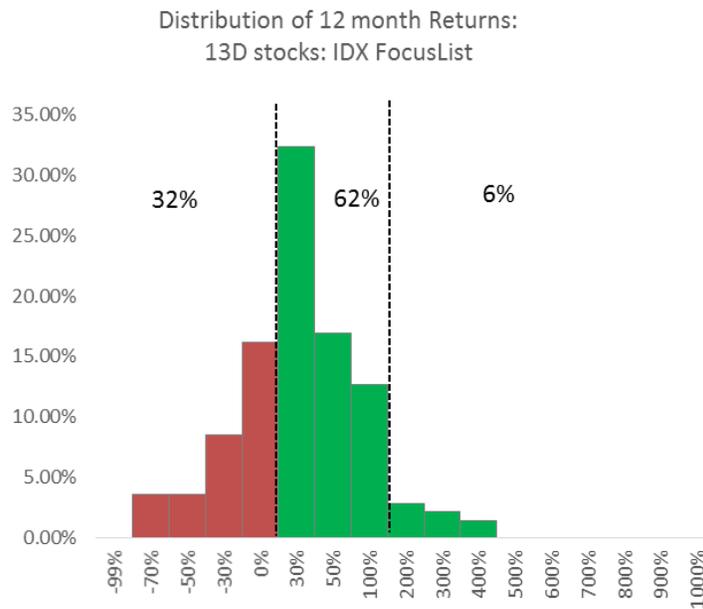
Follow the Leaders

With a comprehensive database of 13D filings, and the right variables, IDXGlobal™ believes there clearly exists an opportunity to combine multiple criteria to create a combination of filers & conditions that will yield a robust investment opportunity set going forward – and we will present such examples in subsequent analysis. As a final example, we present the results from our IDX Super group of filers with a real-world example of "cloning" these results. Specifically, we identify a group of 55 filers that comprise Activists (like Pershing Square and Carl Icahn), non-Activist hedge funds (like Scout Capital and Weiss Asset Mgmt), Individuals (like Elon Musk and Richard Rainwater), Corporations (like Leucadia) and VC/Private Equity groups (like TPG) that represent the best filers pursuing different strategies but with one common objective: absolute returns.

The result is a very compelling opportunity set from which IDXGlobal™ generates investment ideas:



The 12 month return to the stocks of these filers is a staggering 24% vs. 9.52% for the S&P 500 over the same time periods. Similar to the “Activists”, the distribution of 12 month returns for the IDX FocusList of filers is positive almost 70% of the time but with one notable difference – over 6% of the time, the 12 month return is over 200%. This is expected as the IDX FocusList includes VC funds, entrepreneurs and other entities that are specifically hunting for the “multi-baggers”

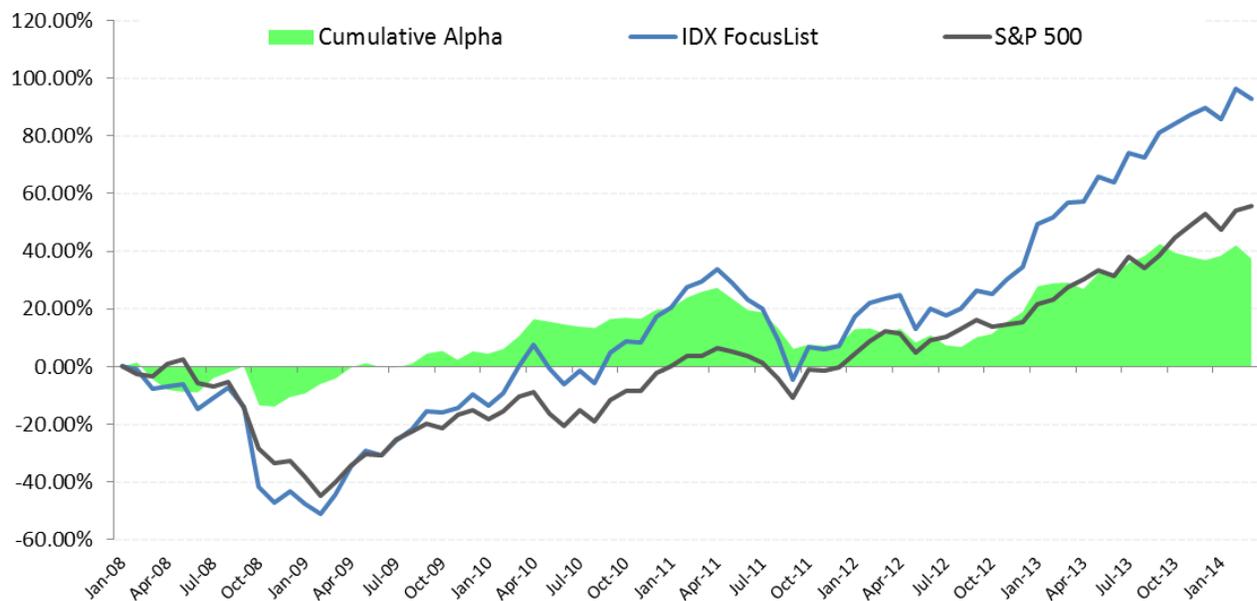


Off the Sidelines and Into the Game

The obvious question is: Can an investor realistically clone these returns by investing in a basket of these stocks. We've purposely focused the analyses above on only those stocks trading above \$5 with a horizon of 12 months to attempt to provide the most robust (and repeatable) insights that can be reliably expected to persist **going forward**. The goal of this exercise is to "look under the hood" of a known, durable and repeatable source of excess return and determine whether or not it can be systematically harvested in a rules-based fashion. The answer is "Yes". This is the epitome of what IDXGlobal™ identifies as "Advanced Beta".

So let's turn our attention back to the IDX FocusList of filers. Over the period from Jan'08 through Dec'13, these 55 filers filed about six new 13D disclosures each month. We construct a portfolio that establishes a position in each of these stocks at the beginning of the **next** month and holds it for 12 months³. Each month, at the beginning of the month, the portfolio is rebalanced equally among all the positions in the portfolio. Such a portfolio would hold about 35, equally weighted, positions each month with a maximum of 55 (in Feb'09) ensuring a well-diversified portfolio of stocks at all times.

Performance of IDX FocusList over time

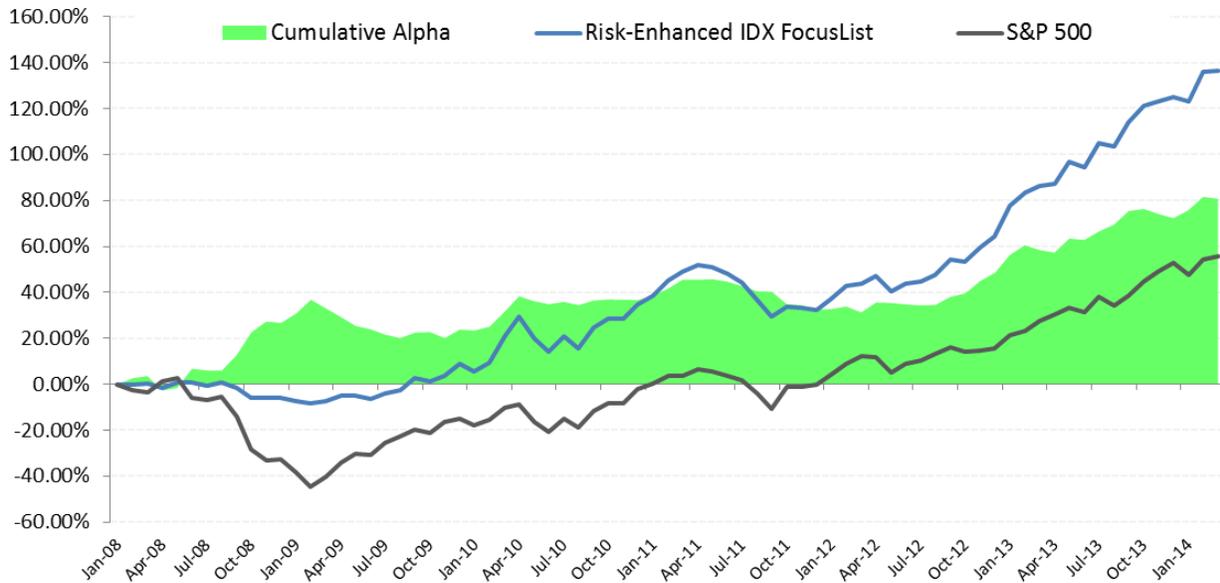


The result, as one might expect, is a portfolio of stocks that adds considerable "alpha" (i.e. "Advanced Beta") relative to the S&P 500 over time. So, the very simple methodology outlined above does a respectable job at beating the S&P 500 over time. The list of 13D stocks for the IDX FocusList of filers is clearly fertile hunting ground for stocks with large upside potential but can we do something to mitigate the risk of these stocks?

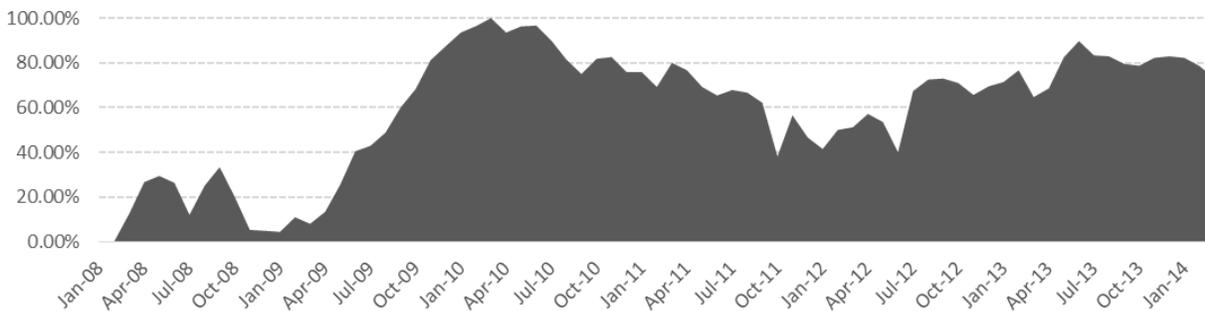
³ This is done to ensure a robust backtest and avoid any data biases associated with the well-documented "Activist bump" often seen in the days immediately after a 13D filing

As a simple refinement, we add a filter to our portfolio of 13D stocks which determines if each stock is in an uptrend at the beginning of each month (based on the trailing 12 months). If it is, then an equal-weight allocation is made according to the original methodology, however, if a stock is showing negative momentum, then that allocation is moved to cash. The result, is a simple, diversified portfolio that is able to systematically harvest the collective insights of the IDX FocusList while truncating downside risk:

Performance of Risk-Enhanced IDX FocusList over time



Portfolio Exposure



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