

# Market News

**June 2010**

A monthly review of IR developments for our clients and friends. . .

## **Report card on 2010 proxy disclosures a mixed bag**

The SEC's Division of Corporation Finance is still plowing through this season's proxy filings, but its deputy director sees signs that some companies are still missing the point about requirements for executive comp disclosure. Shelley Parratt said the SEC is still finding insufficient information on the decisions around compensation, versus the framework for making those decisions. That means more disclosure about the actual performance targets, if material. A comp committee decision to abandon a target and award a discretionary bonus, or pay no bonus at all, doesn't mean that companies can avoid disclosing what the target actually was, she said.

## **It's a buyers market for auditors**

Audit fees are dropping as companies feel free to shop around to find the best deal. It's a complete change from the days immediately following the passage of Sarbanes-Oxley, when audit firms fired over a third of their clients and fees rose rapidly thanks to "value-added" services. According to research firm Audit Analytics, last year 82 percent of the 1,331 auditor changes were client initiated. They also point out that the average annual audit expense for a public company having revenues of \$250 to \$500 million dropped eight percent. For companies with revenues over \$500 million, fees dropped five percent.

## **Social media survey show CFOs are divided**

The German technology firm SAP asked CFOs of American public companies about their organization's social media policies and came away with mixed results. Over a third said their company doesn't use social media, and some have gone so far as to have a firewall to ensure employees aren't using social media while on the job. A quarter of those responding say they dabble in social media and have recently hired a full-time social-media professional. Seventeen percent said their company has leveraged the power of Facebook, LinkedIn and Twitter and have a blog, while eight percent said that they are working on a social media strategy and hope to have it executed within the year. Sixteen percent of the participants had no clue where their company was headed as far as social media was concerned.

## **Insider trading schemes often less than brilliant**

You probably won't hear Jay Leno calling attention to this stupid criminal episode, but it's somewhat amusing nonetheless: The SEC says that an administrative assistant to a top executive at Walt Disney Co. was involved in a scheme to sell confidential information about Disney's quarterly earnings to hedge funds. The woman and her boyfriend mailed "anonymous" letters to more than 20 hedge funds offering to leak, for a price, Disney's second quarter 2010 earnings before release. Some of the funds immediately alerted the SEC, which worked with the FBI to set up a sting operation. The hapless boyfriend then allegedly offered the inside info to FBI agents posing as investment managers for as little as \$15,000.

## **Hedge Funds bet on a snitch: IRS whistle-blowers**

Three years ago, the Internal Revenue Service began to offer larger rewards to whistle-blowers—15 percent to 30 percent of the money the government recovers. The increased rewards worked, with a surge of tips flowing in and claim amounts rising dramatically. But with the increased rewards came a year wait for the money, allowing the IRS to thoroughly investigate each charge. This opened up an opportunity for hedge funds to offer whistle-blowers an alternative. In exchange for an immediate payoff to the whistle-blower, the investor buys a hefty percentage of the future payout and shares the risk that the final amount may be smaller if the IRS fails to agree on all of the whistle-blower's claims. Last month the first of these payouts occurred, involving an overseas multinational corporation that had underpaid its taxes by billions of dollars. The whistle-blower received a \$4 million payment upfront from a hedge fund that will have to wait for its payday and hope it is what they thought it would be.

## **Has the May 6 crash done in the individual investor?**

Individual investors were finally starting to feel confident enough to dip their toe back into the investment waters when the "flash crash" whacked them May 6<sup>th</sup>. Though the recovery was quick, almost a month later regulators are still trying to figure out what happened. The SEC is proposing a central database for consolidating all trading activities to better keep track of them. Most investors are amazed that wasn't already the case, and are showing signs they have had it. The "flash crash" might have been the final straw. Individual investors withdrew a total of \$11.5 billion from U.S. equity mutual funds and placed \$506 billion into lower-yielding bond funds while the market was rebounding from its March 9, 2009 bottom, according to TrimTabs Investment Research. More recently, individual investors had just started to venture back into equities, placing \$13.9 billion into domestic mutual and ETF funds in March and \$6.9 billion in April. But the trend changed after the flash crash, with investor sentiment jumping to 36 percent bearish from 28 percent the week before the flash crash. Individuals withdrew \$29.3 billion from U.S. equities and mutual funds, and poured an additional \$8.2 billion into bonds since May 6th, according to an American Association of Individual Investors survey.

## **Filings show hedge-fund groupthink increasingly common**

Hedge fund managers like to brag about their unique investment strategies and models, and how greater disclosure requirements will harm them. But their actions suggest that they may really fear that more disclosure will reveal that their strategies produce quite common results. First-quarter SEC filings show that Apple was the number one or number two holding among 15 of the top hedge funds in the first quarter, which explains why Apple is up about 17 percent this year, compared with a flat market overall. D.E. Shaw, the sixth largest hedge fund, increased its stake in Apple by more than one-third in the first quarter, making it the firm's largest holding. Other top-100 hedgies with Apple as their largest holding include Duquesne Capital, Shumway Partners, Kingdon Capital Management, Raiff Partners, Jennison Associates, and Kleinheinz Capital Partners.

## **Multi-agency force will probe financial fraud**

Richmond, Virginia will be the home of a new multi-agency federal task force focused on financial fraud cases - with a priority on securities cases. The US Attorney's Office in Richmond will direct it, with SEC, CFTC, FBI, US Postal Service and IRS support. The location is significant. Jurors in Virginia tend to support government's view in complex cases, and the courts there are notably speedy in handling cases, with little sympathy for delaying tactics.



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