

Director share trading



By Donald Hellyer, Open Director

Who beats the Australian share market — individuals, professionals or insiders?

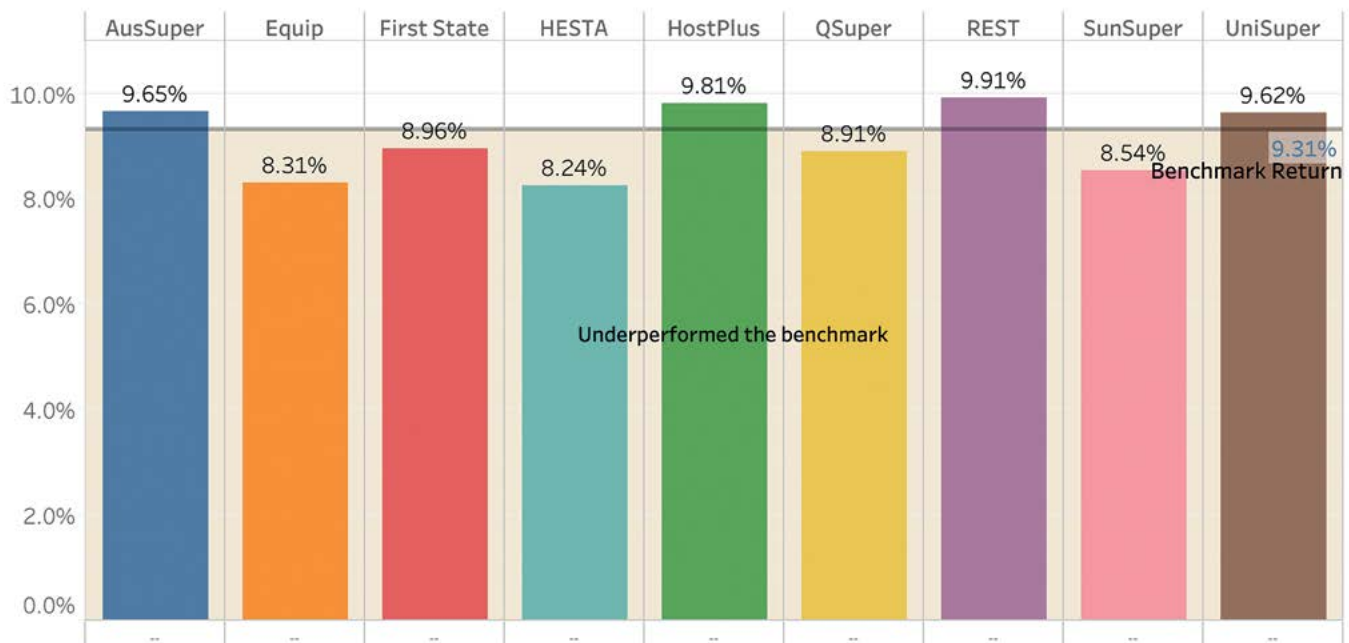
Individual investors could be outperforming the S&P/ASX 200 benchmark, but we will never know. The lack of valid data would make this statement challenging to justify.

Certainly, large Australian superfunds employing professional active fund managers are not. The chart below from OpenDirector¹

suggests superfunds at best break even against a passive benchmark, if they don't slightly underperform. Morningstar² reported 75% of Australian fund managers underperformed the benchmark for the full 2019 year. Similar results in the US published by S&P³ showed 89% of active equity managers underperformed their benchmarks.

Firstlinks⁴ first published this Australian share returns chart in an article written by me in July 2020.

Australian Share Returns - Pension - Ten Years Annualised Returns



But one group is different. Company directors do quite well in their share trading. Dr Dean Katselas from ANU studied how directors traded company shares after the release of good and bad company news.

Dr Katselas explains how directors bought shares on bad company news and sold shares on good news: “My results show these contrary trades were being made with non-public knowledge, privy only to company insiders, about the future performance of the firm. It was the exact opposite of what you'd expect to see after either kind of news. If the news had the potential to boost the share price, I found the directors were selling their shares, when normally this is the time you'd expect them to be buying.”

While Dr Katselas said these trades were against insider trading laws, ASIC's response was that Dr Katselas is relying on a “very different concept” of insider trading.

Dr Katselas findings back up the financial theory known as the “Semi-Strong” form of the Efficient Market Hypothesis (EMH).⁵ The Semi-Strong form states that public information is already reflected in a company's share price. An investment decision will not be helped by looking at public information (accounts, broker reports, etc.). However, non-public information, like the type held by directors, will help investment decisions.

If you were wondering, the “Strong” form of the EMH states that even insider information won't help with investment decisions. And the “Weak” form of the EMH says that while past share prices cannot help in determining future share prices, fundamental analysis may help.

We at Open Director believe directors do signal the likely future company prices and we have commenced a project to prove it. This is no task for the weak-hearted. Firstly, we need lots of data. Secondly, we need a method to filter a director's motivation for share transactions. Our study looks at three primary elements

1. Timing of share purchases to meet minimum board requirements. Directors of listed companies are often required to purchase a minimum value of shares. Frequently, directors are required to buy shares equal to their base annual director fee over three or five years. Our study analyses whether directors are leading or lagging the purchase of shares against an evenly spread percentage of the minimum requirement. For example, if directors were required to purchase \$100,000 of shares over five years, we would expect them to purchase \$20,000 per year.

2. Purchase or sales of shares above the minimum required shares. Do directors continue to buy shares when they are no longer required to purchase those shares and, horror, do they sell shares.

3. Directors on multiple boards. We look at directors' share transactions for one company versus what they are doing in relation to another company. If a director is on more than one board, do they favour one company over another when they buy or sell shares?

Director Name	Shares Owned	Estimated Purchase Value	Board Minimum	Ad. For Time on the Board	Over / Under	Purchases in 2000 FY
Polson ⁶	122,000	\$538,020	\$525,500	\$525,500	\$12,520	0
Green	10,000	\$44,100	\$179,000	\$92,483	-\$48,383	0
Gregg	14,000	\$61,740	\$179,000	\$179,000	-\$117,260	0
Kobayashi ⁷	0	0	0	0	0	0
Stephenson	17,000	\$74,970	\$179,000	\$179,000	-\$104,030	2000
West	18,957	\$83,600	\$179,000	\$62,650	\$20,950	0
Willis	149,892	\$661,024	\$179,000	\$92,483	\$568,541	0


Here are some examples. Please be cautious. This data is very preliminary and subject to verification.

1. Minimum board requirements. Challenger requires directors to own shares to the value of 100% of board fees within five years. If a director had no view on a company, a director would buy 20% per year in each of the five years. But we can see many directors are behind schedule. Numbers are at 30 June 2020, using a closing price for Challenger shares of \$4.41. Note: many companies calculate the value of shares held using the actual purchase value of the shares.

2. Transactions above minimum board requirements. Michael Carapiet, the Chairman of Link Administration, purchased 220,000 shares for \$979,746 in March 2020. There was no minimum board requirement for him to buy these shares. We found this purchase strange. The CEO, John McMurtrie, had taken a considerable reduction in remuneration the previous year and Link shares continued to fall. You would expect a director to be cautious, if not to sell the shares. Why was he buying? Perhaps because he knew that Link had started the process to replace the current CEO and this news would please institutional investors.

3. Directors on multiple boards. Tabcorp's now outgoing Chair, Paula Dwyer, sold 75,000 (about \$189,750) Tabcorp shares in March 2020. Dwyer is also on the board of ANZ. She sold Tabcorp shares but did not sell ANZ shares, although she could do so.

We are in the first stage of our analysis, and we have further work to do. Many of these signals will be false. The question is, does this analysis predict future share prices in aggregate?

With luck, the ASA will ask me back to share the results of our project with you. 

¹ <https://opendirector.com.au/>

² <https://www.morningstar.com.au/funds/article/moment-of-truth-for-active-funds/201895>

³ <https://us.spindices.com/indexology/core/spiva-us-year-end-2019>

⁴ <https://www.firstlinks.com.au/large-super-funds-struggle-match-index-aussie-equities>

⁵ <https://www.investopedia.com/ask/answers/032615/what-are-differences-between-weak-strong-and-semistrong-versions-efficient-market-hypothesis.asp>

⁶ Poslen purchased 6,944 (\$21,595) of shares in July 2020. At the current price of \$3.86 the value of his holdings is \$473,600

⁷ Board exempted Kobayashi for the minimum shareholder requirement.