## CANALYST NEWSLETTER: ACTIVE MANAGEMENT & UNDERCOVERED NAMES

The summer trading doldrums are over, so it's time to start finding that next big winning stock idea. In this edition, we bring you a piece on active management, under-covered names, a screener contest, and a few exciting Canalyst product updates. Read on...

## **ACTIVE MANAGEMENT**

In a world obsessed with alternative strategies, recommending individual stockpicking sadly qualifies as a contrarian idea unto itself. The sentiment about this as an outdated approach is well captured by the following tongue-in-cheek quote by a popular financial columnist:

"Who buys individual stocks? It has become an old-timey hobby for the modestly wealthy and eccentric, like model railroading."

- Matt Levine, Bloomberg Money Stuff

The reasons for this view are actually fairly logical, given the steady deterioration in alpha captured by equity hedge funds over the last 15 years. As measured by the Credit Suisse Equity Long/Short "Skill" Index, the 5-year annualized rolling outperformance steadily fell from 6%/year in the early 2000s to 0% now, with most of the degradation occurring since 2008.

While many reasons have been put forward for why this occurred, the "abnormal markets" explanation appears to fit the chart best. From the 2008 period until just recently, the average pair-wise correlation of stocks was extremely high, over 50%, vs. 30% historically. If you recall hearing your active manager complaining about everything moving together (remember those Europecrisis terms of "risk-on" and "risk-off" days), this is what they meant. This phenomenon was exacerbated by central bank policy pinning rates near zero, rendering most tactical asset allocation models temporarily worthless vs. the non-stop injection of liquidity.

as in Canada. Last November's US election sparked massive sector rotation, and though some of those trades are unwinding now, it has at least reminded the market that stocks don't always move together. Additionally, any discussion of active stockpicking can't ignore the passive elephant in the room, the rise of indexing. Almost

Looking at the world today, these trends appear to finally be abating. Central bank policy is normalizing, both in the US as well

30% of US investments are now passively run, a figure that is expected to cross the 50% threshold sometime in the next 5-7 years. While this creates obvious challenges for the active management industry, the medium-term opportunities for fundamental stockpickers are striking:

- As passive benchmarks become all-important, the value gap between larger, well-followed index names, and small/midcap overlooked firms will increase. Though it may require patience to "arb" this gap (eg. waiting for quality smaller names to qualify for inclusion and re-rate higher), this seems like a winning fundamental strategy for stockpickers.
- 2. Sellside firms are, and will continue to, drop coverage of smaller companies as cost pressures mount, creating more opportunities for investors willing to do the legwork. If some of the performance decline from equity hedge funds since 2000 is attributable to the "pool of alpha" theory, in
- which there are just too many funds chasing the same trades, forcing some of the weaker players out of the market may improve returns over time.

Overall, while it is always difficult to draw a line in the sand and call for the end of a two-decade-long trend, this article is meant to illustrate that many of the factors that have led to the current overall sentiment towards active management may be set to reverse.

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## **UNDERCOVERED NAMES**

If now really is "Active Management's Time to Shine," this begs the question: how do you best position yourself for this potential reversal?

Canalyst provides the absolute deepest coverage of North American companies, especially those with little to no coverage by the Street. Out of our universe of 3600 companies, the following table shows how Canalyst's breadth is especially powerful in the small/midcap universe:

# OF SELLSIDE ANALYSI	# OF CANALYST MODELS
RECOMMENDATIONS	AVAILABLE FOR DOWNLOAD
0	131
1	131
2	133
3	156
4	212
Total:	763
Source: Canalyst models, Thompson	

Want additional help finding your next hidden gem among these 750 under-analyzed names? Stay tuned for screening and analytics launching on our portal soon!

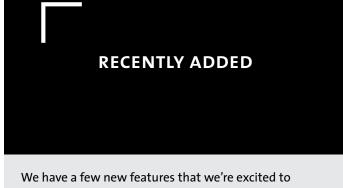


valuable is a screening tool to you and what would you like screened using fundamental data that you can't do today? We will draw one lucky respondent's name and award them for their efforts with a good bottle of wine. Send

marketing@canalyst.com your ideas, and we'll choose a

winner at the end of October.

ideas going, but want to hear from you. Simply put, how



announce and a potential game changer currently in development. Canalyst's IPO models are now more convenient than

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'click to request'. This change reduces the turnaround time for IPO model delivery from 48 hours to less than a minute. Additionally, we've expanded our international coverage with 300+ 'click to request' models for US listed foreign

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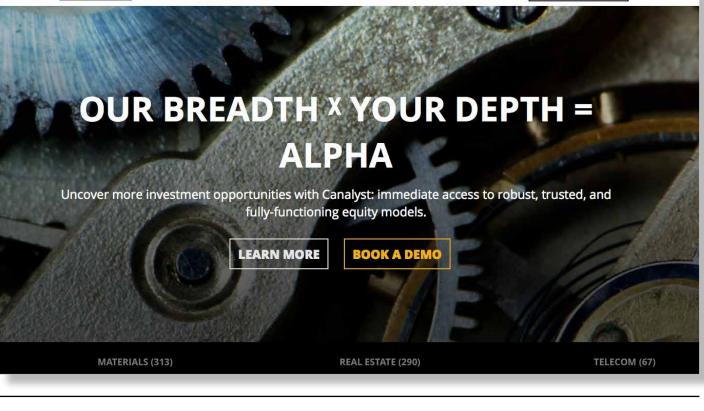
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Canalyst, Head of Equities

James Rife

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