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Falling for the leader of the pack

By Lauren Foster in New York
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When three Harley-Davidson executives, including James Ziemer, vice-president and chief financial officer, sold shares in the company this month, some investors may have wondered whether they should too. After all, many studies have shown corporate executives have an uncanny knack for timing the market when it comes to their own company's shares.

Mr Ziemer sold his shares in the US motorcycle company at \$50. Over the past year, the shares have traded between \$35 and \$55.

Harley-Davidson's executives are not the only insiders selling. Insider trades - when officers and directors buy and sell stocks in their own companies - show high levels of selling, suggesting sentiment is increasingly bearish. Analysts say investors should take heed.

Early estimates from Thomson Financial, the data provider, suggest August will be the fourth consecutive month with a bearish sell-to-buy ratio.

So far this month, the ratio, which is calculated by dividing the total number of dollars in stock sold by the total number of dollars in stock bought, is \$45.42 to \$1 - the highest ever. Typically it is about \$14.50 to \$1. When the ratio rises above \$20 it is considered a bearish signal and a drop below about \$12 is seen as bullish.

July marked the first three-month bearish stretch since 2000. Six months after the 2000 stretch, the S&P 500 was down 19 per cent.

August's figures will show the first four-month bearish period in more than 10 years. That could be onerous for the markets' performance in coming months.

In June, Michael Painchaud, director of research at Market Profile Theorems, an independent research firm, advised his clients that they "would not be advantaged by staying in equities" and should move into cash. "Insiders are very bearish in the aggregate," said Mr Painchaud, who has been studying insider trades for 31 years.

Similarly, David Coleman, editor of Vickers Weekly Insider Report, a newsletter that tracks insider trades, said his indicators started turning bearish in June. The firm moved its model portfolios into cash.

With corporate executives apparently uncertain about a recovery and bearish on their own companies' prospects, should investors follow suit?

"There is definitely a correlation between the high sell-buy ratio and what the S&P does," said Kevin Schwenger, insider research analyst at Thomson Financial.

"The historic trend has been on average some degree of decline in the general market following this sort of bearish indication."

"It is a commonsense approach to investing to follow the lead of investors who know more about the company than anybody else," he said.

"Corporate executives are the most knowledgeable [about the company] and are long-term, opportunistic investors who are driving the fortunes of the company and not

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subject to the market and falling victim to fear and greed."

Over the past decade Thomson Financial's sell-buy ratio has only risen above the bearish \$20 level about 15 times, and on 10 of those occasions the S&P subsequently fell, with an average six-month loss of 6 per cent and an average one-year loss of 9 per cent, Mr Schwenger said.

Selling by insiders is not always negative, however. Executives may sell stock for portfolio diversification, tax reasons, estate planning or cash needs.

Also, the driver behind the bearish sentiment is not so much insider selling, but rather a lack of buying, said Mr Schwenger. "The story is not that selling is out of control, it is that buying is so anaemic."

The current sell-buy ratio signals "a lack of confidence on the part of executives. They are not really putting money on the table and showing confidence in the recovery".



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