



Philequity Corner (May 27, 2019)

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Heard it through the grapevine

The eponymous song is from the late sixties, part of the Motown sound of Gladys Knight and the Pips which laments hearing bad news from the grapevine of gossip. This one is about a heart broken by the news, involving third parties, not of the corporate kind.

Does the grapevine also influence investment decisions?

Some investors get their news secondhand, by hearing it from somebody else. Seldom do they bother to read the papers or watch Bloomberg, at least to mouth the clichés and get the buzz words right. And even then, media sometimes present stories based on unconfirmed reports and unnamed sources, like the story of the boardroom erupting into a near fistfight, and the exit afterwards of a senior executive.

This “ear-relevant” approach of keeping up to date feeds our penchant for conspiracy theories. Anybody at a party can concoct a scenario; say on the impact of the incursion of China investors in a yet undisclosed project. There is no need to specify the source of the rumors or cite the basis of the scenario.

We need only follow the information pipeline of a listed company to see how hearsay (or fake news) easily substitutes for research. Some insider or “senior executive” may be the source of unconfirmed reports of a buy-in by a strategic investor, the undisclosed loss from internal fraud, or the exit of the CEO due to unacceptable behavior.

The official narrative and financial information are communicated to research analysts and investors through the Investor Relations of the company concerned. The evaluation thereafter may then rate the company as a “buy”, “hold”, “buy on weakness”, or “sell”. There may be other intermediary ratings (don’t touch it with your children’s tuition money; only if you can afford to lose a fortune) which the research departments give their clients.

The information chain does not end here as the “heard” mentality kicks in. Without delving into or even understanding the details of the research and the caveats on the underlying assumptions, intermediaries will pass on to other bit players their flawed interpretation of the findings.

The “hearsay effect” is particularly fertile in new listings. One has yet to meet anyone who has completely read the prospectus on the IPO. The simple question of what the equity float will be used for (to make existing stockholders richer?) and the PE ratios obtaining have led to short-lived up-ticks of new listings.

While hype is frowned upon, the admonition by regulators is limited to the unread prospectus. Hearsay is not covered by any rules and can propound undocumented claims of how the pre-listing price is doing (clue: it is not lower than the IPO price).

Legitimate research organizations disclose the assumptions for their recommendations. They can even question official projections of next year's revenues used as basis for the PE ratios justifying the IPO price.

The problem with relying on aural information lies with the reliability and objectivity of the source and more important, an appropriate context for his conclusions.

It is no accident then that business reporting suffers from a form of hearing impairment. It is the more accessible and easily understood (and heard) parts of a business story that tend to be highlighted. These are the human angles of rivalry and falls from power, cadged from ambush interviews after the formal report to stockholders and investors.

It is easy to test the grapevine theory. One must list down the news of the day he has gathered. They will easily fall into the following categories: 1) It was a topic in a breakfast meeting where somebody overheard something significant; 2) It was heard on the radio with the commentator having strong feelings about it, pounding the table several times; or 3) It was Topic A at the gym from somebody's personal trainer.

Even if one surfs the net, what he finds there is not always based on documentary sources. The authority cited is unnamed, with a quote not made for attribution (a person close to this official). Even then, reading habits indicate that most people only scan headlines and maybe the first few paragraphs of the story. Seldom do they chase details into the jump pages.

In checking if a story is true, most are content with the ultimate test for accuracy: "That's what I heard". Strange as it may seem, some are willing to put their money on what they hear, as they later become the subject of gossip—do you know how much he lost?

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