New Methods For Large Dealings

Renaissance On The Bourse?

It seems we may have something of a sharemarket Renaissance—a new thinking or reform of the methods of dealing in what may be termed large parcels of securities.

Already we have talk of a new Stock Exchange having restrictions on its members marrying, or crossing, parcels of securities away from the market place—and we have an existing Stock Exchange now reporting its off-market trading.

It would seem inconsistent that the direction of the reform is away from centralisation with the attendant high cost of the resulting duplication.

With all this air of reform, perhaps it is appropriate to look even further into methods of trading: In particular to investigate the way the professionals operate, and specifically, to the way some of them trade in large parcels of shares off-market at prices based on the market for small parcels.

The obvious action, if it is considered that this off-market activity is undesirable, is to bring all trading back to an open market place. How is this to be done, so that all parties may be treated fairly? Perhaps it might be useful to investigate some overseas practices.

Procedures said to be adopted in New York reveal ideas with a good measure of local application. Three methods used for the handling of large placements include:

- Specialist block purchase, or sale.
- Exchange Distribution, or acquisition.
- Special Offering, or bid.

**SPECIALIST BLOCK PURCHASE OR SALE**

If an investor wishes to sell a substantial block (1,000 to 10,000 shares) of stock quickly, he may instruct his broker to obtain a specialist's block bid.

The specialist in the issue, after considering his position, the current quotation in the market, and his estimate of what may be expected in the near future, usually will make a bid. The bid will be somewhat below the bid then current in the regular auction market. The seller will pay a commission on his sale to his broker as usual.

In practice, the overall cost to the seller of a large block is equivalent to two or three times the normal commission rate paid on smaller orders in the same stock at that time.

The specialist's bid must be reviewed by a Floor Governor of the Exchange before it becomes effective. The Floor Governor will consider the "depth" of the market in that stock, the relation of the specialist's bid to the current market quotation, and the reasonableness of the transaction in terms of the flow of stock through the Exchange.

The transaction is not reported on the ticker; it is a private transaction. The specialist, presumably, will sell the stock in the normal course of his activity within a few days after buying the block. He will buy, of course, with the expectation that he can sell at a profit, but he has no guarantee of profit.

A specialist may also be willing to make a block offering to an investor seeking to obtain a substantial block of an issue. The costs, relative to the market for one or two round lots, would probably be nearly three times the commission on stock of that price. The specialist would sell from inventory or on the expectation that he would have the opportunity to cover the sale in the course of his ordinary activity in a few days.

**EXCHANGE DISTRIBUTION OR ACQUISITION**

For somewhat larger blocks (5,000 to 50,000 shares) another procedure often has usefulness. An Exchange Distribution is accomplished by obtaining sufficient buy orders from customers beforehand to permit a cross of the buy and sell orders on the floor in the usual auction market.

Interest in buying is stimulated by offering the stock within the current quotation free of commission. The seller may pay a special commission to his broker to add to the incentive to obtain the buy orders.

Success for the distribution depends on the ability of members' firms to obtain these buy orders in sufficient quantity in a fairly short period of time.

An Exchange Distribution, or Acquisition, like the Specialist Block Bid, or Offer, must be approved by Exchange authorities before it is executed to assure conformance to trading practice. Notice of execution is given on the tape only after the orders have been obtained and they are crossed on the floor in the auction market.

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atting income, a reduction in the dividend has occurred in a number of cases.

No one ratio will assess a company's merits and at this stage of the development of security analysis we can probably count ourselves lucky if we are right in 60 per cent. of cases after taking a number of factors into account.

The main purpose of this article is to provoke some thinking on this subject. It may well be that the basis outlined is not the best one and in this connection it is worth noting that in an N.A.A. Bulletin of February, 1962, at least 12 different methods as used by U.S.A. companies were listed. These companies used this ratio to assess management performance within their various divisions.

Another factor which is also of importance is that, so far as it is possible to tell, Australian managements' thinking up-to-date has been concentrated on earnings to ordinary capital. Earnings can be varied quite extensively by changes in various provisions such as depreciation provisions, stock provisions, so that a short down run in profitability can be disguised just as a company can pay out in dividends more than it has apparently earned.

With the spectacular growth of the 'fifties behind us and the possibility of lower growth rates in the future, we may well find that the trends in the return of capital employed will become a better indication of future profitability.

--- MEMBERS ---

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The Editor,
Australian Society of Security Analysts,
Box 5085, G.P.O.,
Sydney.

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SPECIAL OFFERING OR BID

Still larger blocks (25,000 to 100,000 shares) of stock may be sold through the Special Offering procedure. In this instance, a price for the shares is predetermined, taking into account the current quotation in the auction market.

For the buyer, the price is net. He obtains stock at the offering price without paying the usual commission. He may also obtain stock at a price slightly below the best offer in the auction market at the time of the offering. Selling brokers are offered a special, incentive commission, perhaps two to two and one-half times the usual commission on a sale.

The offering must remain open for at least fifteen minutes after its announcement, unless the announcement is made at least one hour before the offering becomes effective. When buy orders have been received on the floor, they are filled at the offering price until the entire block has been sold. A Special Offering must be approved by Exchange authorities before it is announced.

A Special Bid may be made by an investor seeking to acquire a large block of stock of an issue.

There is little purpose in the piecemeal additions of new ideas to a system perhaps troubled by the inadequacies of growing empirically. It would seem that not only must the method of marketing large parcels but the operation of the whole market must be re-thought and re-planned to remove what anomalies still exist and prevent more developing.

LEGAL RESPONSIBILITY OF INVESTMENT ADVISERS

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attempt to ensure that this does not occur by issuing a policy on condition that the assured bears a predetermined percentage of the risk (normally 10 per cent.).

The policy also provides that the insurer will take over complete defence of any action for alleged libel but should the assured insist on defending or resisting a case where the insurer has a legal opinion from counsel of standing that the matter should be compromised, the insurer will not in that case be liable for costs, damages or expenses incurred from the date of refusal to compromise. Subject to this the insurer undertakes to pay all damages, costs or legal expenses incurred as a result of such an action.

Whilst it is understood as mentioned above that libel insurance policies are taken out in connection with periodically issued trade publications and by the country Press, there is apparently no known occasion as yet where such a policy has been taken out by a member of a Stock Exchange and because of this it is assumed that in the absence of a loss history, premium charges might be relatively minor.

If this article serves to reduce the number of investment advisers who are prepared to suggest that a given share is over-valued and to support their proposition in a detailed way, it would be most unfortunate, because it is probable that in the public interest there are too few people at the moment who are prepared to issue circulars of this kind.

As a practical matter, moreover, it would be unlikely that libel proceedings would be initiated against an investment adviser unless there had been fairly considerable provocation and if responsible circulars are prepared with due regard to the facts, and in the ordinary course of business, there should be little risk.