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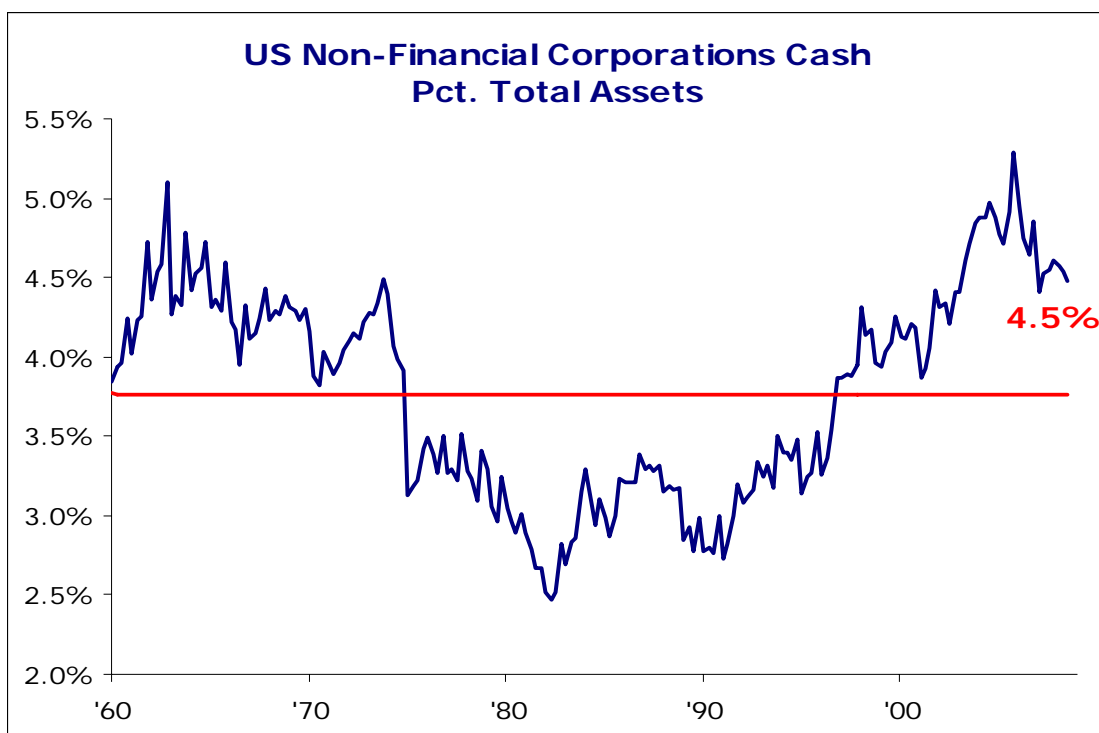
## THE SOCIOLOGY OF OWNERSHIP REVISITED

### Desperately Seeking The Marginal Buyer of Equities

Over the years, former Chairman of Furman Selz, serial Wall Street overachiever, client, and friend, Ed Hajim, has encouraged us to think frequently of the market's "sociology of ownership." His general thesis is that, at any given time, the market has an "alpha investor" that can tell you a lot about the way the market is trading and, perhaps more importantly, how market dynamics are likely to change. Over the last 50 years, the marginal buyer of equities has transitioned from trust departments at banks to hedge funds, bringing the average holding period for equities down from 8 years in 1960 to less than 7 months today.

In our current circumstances, defining the marginal buyer is no easy task, and we have been surprised at how often professional investors have asked us in recent weeks what would possess the various constituencies that make up the investment community to increase their exposure to equities. Given the perceived absence of public and private sector leadership to solve the myriad financial challenges facing the global economy, such a crisis of confidence shouldn't be all that surprising. Still, with the market hovering just above the November lows and pessimism ubiquitous, we thought it might be worthwhile to attempt to discern which market demographic might actually step into the breach and arrest, or at least slow down, the decline in the prices of common stocks. From most likely to least likely to emerge as the marginal buyer, here's how we handicap it:

- **Corporates.** Share buybacks and M&A have slowed predictably to a trickle in recent months. Still, we believe it's important to note that corporate balance sheets in the non-financial sectors of the economy are still strong. **We also note the tendency of companies throughout the years to buy earnings growth when earnings growth becomes scarce.** (On Monday we'll be publishing our list of potential buy-out candidates). Large well-capitalized companies might very well be able to take advantage of depressed equity valuations and limited availability of credit and consider all-cash acquisitions of small and medium sized companies with valuable strategic assets.



- **Sovereign Wealth Funds/Foreign Investors.** In the short-term, it is difficult to see this relatively new and important group of investors emerging as big marginal buyers of common stocks in the United States, especially in light of the relatively expensive lessons they were taught by dabbling in financial services companies last year. Still, over the long-term, most emerging sovereign wealth funds tend to be overweight natural resources and fixed income, and underweight common stocks. Some stabilization in the global economy and any rebound in commodity prices is likely to render this group an important part of the demand equation for equities in the next decade. More traditional foreign institutional investors could emerge as an important source of demand for equities if for no other reason than the idea that the U.S. is the best house in a bad neighborhood and, as the first to enter recession, likely the first to recover.
- **Hedge Funds.** Given the yoke of a high-water mark, most of our hedge fund clients are taking little solace in their relative outperformance last year, keeping both net and gross exposures tight, and seeking to add alpha in relatively small high-conviction ideas. The barriers to entry and cost of doing business in the industry have gone up dramatically in the last year, a trend that may contribute more to rationalizing the *number* of hedge funds rather than the industry's assets under management. Significant business risk for many hedge funds makes it difficult to see them as first-movers on the long side, relegating many to the bench until a more dominant market trend emerges.

- **Fiduciaries.** I sit on a couple of small boards and I think it's safe to say that we are in the early innings of a reevaluation of the last decade's love affair with alternative investments. Concerns about liquidity, governance, and, Ye Gods, fees are emerging as far more important issues than anyone could have thought possible even a year ago. In the short term, many institutions are now in the unenviable position of having to make a Hobson's choice between selling already-depressed public equity positions to fund commitments to private equity shops whose return assumptions now seem impossibly difficult to achieve. Over the long-term some redeployment of incremental funds to lower-fee "plain vanilla" equity and debt vehicles seems likely.
- **Private Equity.** As it says in the Good Book, the mind is willing but the flesh is weak. Sitting on nearly \$500 billion in untapped private equity commitments and what seemed to be an unlimited availability credit two years ago, we thought that there was a chance that public equities could benefit from a transition from long/short to leveraged long vehicles. Talk of taking Home Depot private only fueled such speculation. It seems clear now that private equity may wind up being far more important in the distressed debt markets than they will be for public equities.
- **Retail/Households/High Net Worth.** It's probably safe to say that a combination of two 50% declines in the broad indices in the last decade and an almost complete evaporation of public trust in "Wall Street" will make it difficult for the retail investor to "join the bid" for all but the most blue of blue-chip stocks anytime soon despite sub-1% money market rates. The speculative retail investor probably won't return to the market in a meaningful way for a generation. High net worth investors should prove to be more durable owners of equities but a widespread return to equities is unlikely until there is some sense that we have established a sustainable bottom.

The only good news in all this is that almost all investment constituencies are potential buyers of U.S. common stocks in the years to come. In 2009, our hopes seem likely to be centered on M&A and a Darwinian process of the strong taking share from the weak. For the long-term, some modicum of leadership from government and our own industry may be the only reliable way to regain confidence lost.

**Quarterly Net Purchases of Corporate Equities  
\$ Billions**

	1Q '08	2Q '08	3Q '08
Households	208.1	79.8	-139.3
State & Local Governments	43.7	-2.6	-8.4
Foreign	88.1	-32.3	41.8
Banks & Savings Institutions	1.9	-2.0	-13.3
Insurance Companies	67.8	76.7	79.3
Private Pensions	-250.9	-140.4	-121.2
Public Pensions	-68.2	22.7	-27.2
Mutual Funds	-74.4	134.3	-116.1
Close-End Funds	3.0	-18.5	-40.5
Exchange-Traded Funds	15.7	32.1	298.4
Brokers/Dealers	-91.4	49.2	-35.4

*Federal Reserve Flow of Funds, Next Release: 3/11/09*

**China Development Bank's Pivotal Role**

If you're going to splurge, it's handy to have a pliant bank ready to provide the funds.

In recent days, nearly \$60 billion has been slated for spending by Chinese entities on four resource deals, ranging from Chinalco's \$19.5 billion investment in Rio Tinto to a \$25 billion loans-for-oil tie-up with Russia

For now, though, funding China's resource grab is its number one priority.

*Wall Street Journal, 2/20/09*

← This still appears to be the current landscape.

*Jason DeSena Trennert*