

Impact of Unit Trust Conversions

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Introduction

We take a look at unit trust conversions to corporations for the past two years and the impact it has had on their performance leading to and after the conversion date.

While this report is in no way an extensive statistical analysis, there does seem to be a correlation between an increase in price prior to the conversion (as equity only indexers buy the stock) and a reversion to mean shortly after the trade.

Conversion Demand

We estimate about 1% of the S&P/TSX Composite index (approx \$15 billion) to be benched by 'equity only' indexers. As unit trusts convert over to the corp, 'equity only' indexers buy the stock in order to add to their benchmark.

There is also some supply due to the unit trust being removed from the S&P/TSX Unit Trust index. However, the volume is insignificant given the relatively small amount of money benched to this index.

Trading Volumes around Conversion

In the past, we have seen the majority of conversion volume take place in the closing minutes of the conversion date so as to avoid slippage from the benchmark for the indexers. This is shown in the conversion date charts below with the gray volume bars skewed towards the close (normally we see the classic 'smiley' curve profile on an average trading day).

Market on Close (MOC) plays a big part in the trade in the last 20 minutes of trading and historically, we have seen imbalances that are in the same direction as indexers objectives (ie buy imbalances). However, in the case of PMT.UN and ALA.UN on July 5th, we note smaller than normal imbalances and as a result, the imbalances 'reversed' and the stocks closed lower. The primary reason for this was that July 5th happened to be a US holiday, which meant lower volumes in the Canadian markets. Anticipating this, most of the indexers had started to buy their positions earlier than normal resulting in reduced demand in the closing minutes of the index rebalance. July 5th was clearly a poor choice for conversion date.

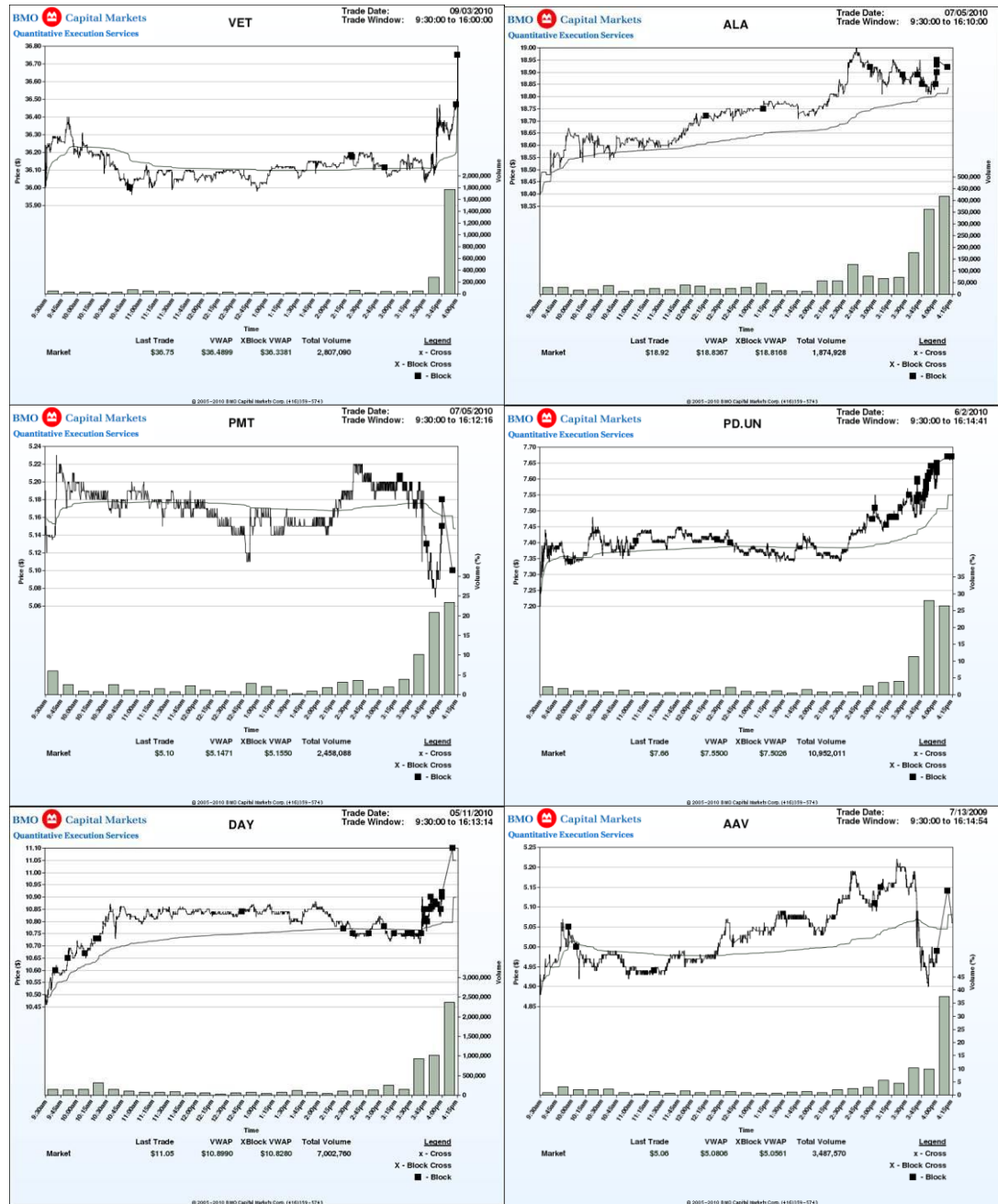
Price Movement around Conversion

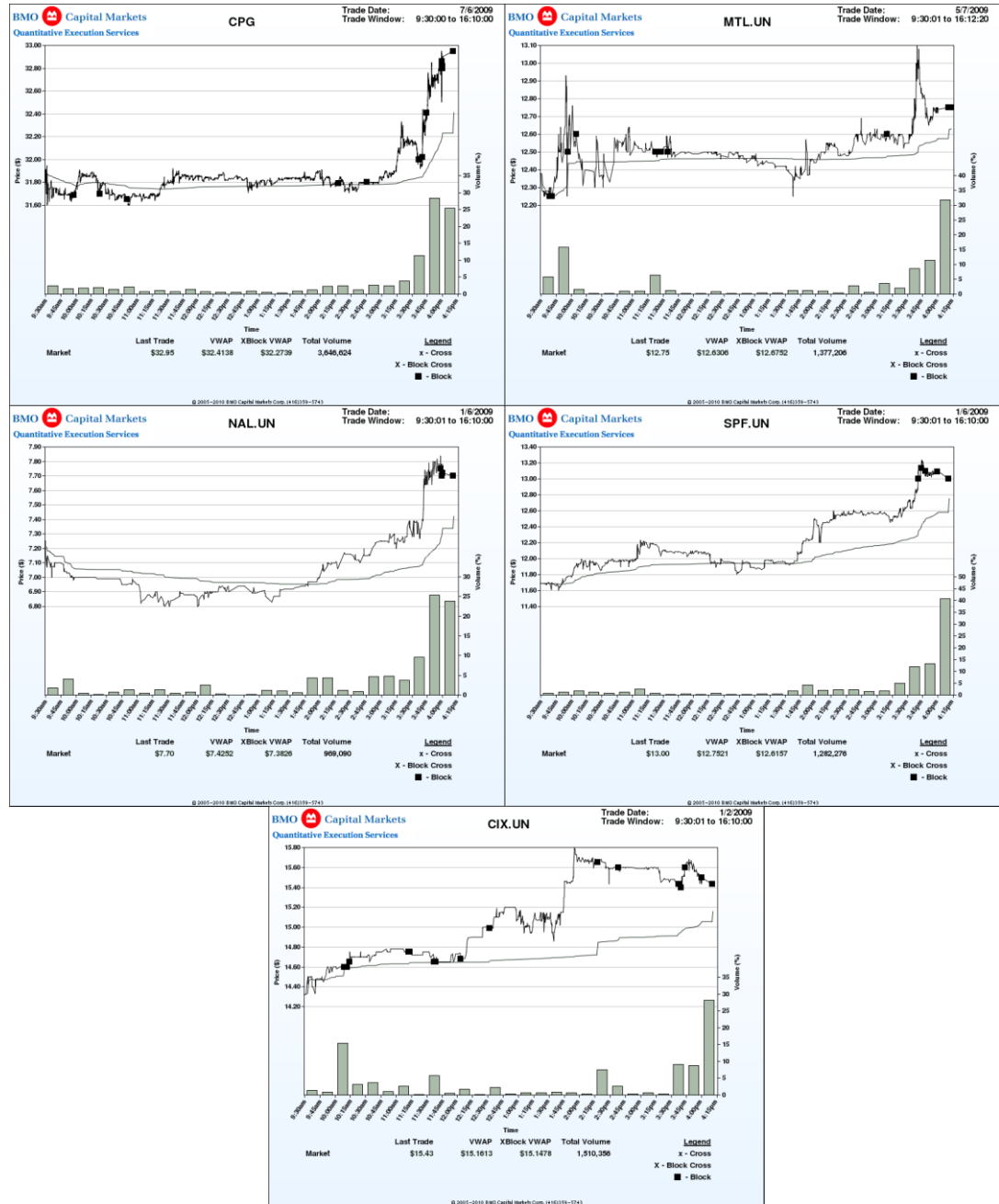
We note that on average, the units rally prior to the week of conversion and then sell off after the conversion has taken place as shown in this table (we have adjusted the % moves to take into account S&P/TSX index move to factor out market movements):

Price movements around conversion

Symbol	Conv Date	Imbalance	Price			% Change		
			T-7	T	T+7	T-7 to T	T to T+7	T-7 to T+7
VET	9/3/2010	918,000	34.87	36.75	36.31	3.2	(0.3)	2.8
ALA	7/5/2010	184,800	18.56	18.92	19.30	6.4	(2.3)	4.3
PMT	7/5/2010	70,500	5.17	5.10	5.08	3.1	(4.7)	(1.4)
PD	6/2/2010	1,188,000	6.26	7.67	7.26	20.5	(2.5)	16.8
DAY	5/11/2010	1,688,000	10.92	11.10	10.04	1.9	(7.6)	(5.8)
AAV	7/13/2009	(262,500)	4.61	5.14	5.66	12.8	3.6	17.7
CPG	7/6/2009	507,000	33.93	32.95	31.80	1.4	(2.1)	(0.7)
MTL	5/7/2009	258,100	12.06	12.75	13.15	(1.2)	4.3	3.4
NAL	1/6/2009	124,600	5.82	7.70	6.36	25.0	(12.0)	7.8
SPB	1/6/2009	230,400	10.35	13.00	11.25	18.3	(8.1)	7.2
CIX	1/2/2009	70,000	13.14	15.39	15.95	6.0	5.3	12.1
Average		452,445				8.9	(2.4)	5.8

Trade Graphs on Conversion Date





Conclusion

The empirical evidence suggests that the equity indexers have a temporary impact on the price of the unit trust around conversion time. This happens in the days leading up to the actual conversion date. We typically see buy-side imbalances on conversion date with the bulk of trading taking place in the last 20 minutes and MOC facility. The high is usually the closing price on conversion date and the price reverts back in the following week once the index buying pressure subsides.

We continue to follow these conversions and other index rebalances in our 'Index Effect' newsletter providing more colour around supply/demand numbers on the securities involved.

As always, your feedback and comments are appreciated!

Cheers,

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