

## **Do Fund Managers Identify and Share Profitable Ideas?<sup>1</sup>**

by

Steven S. Crawford,<sup>2</sup> Wesley R. Gray,<sup>3</sup> and Andrew E. Kern<sup>4</sup>

### **ABSTRACT**

We study data from an organization in which fund managers privately share and discuss detailed investment recommendations. Buy recommendations generate positive abnormal returns, and sell recommendations result in negative abnormal returns. In the context of these results, we explore an important economic question: Why do skilled investors share their profitable ideas with other investors? Evidence suggests that the managers in our sample share ideas to receive constructive feedback and to attract additional arbitrageur capital to the securities they recommend. These findings are consistent with the theoretical predictions of Stein (2008) and Dow and Gorton (1994).

Key words: Networks, Hedge Funds, Market Efficiency, and Financial Statement Analysis

---

<sup>1</sup>We would like to thank Daniel Bergstresser, Dave Carlson, Hui Chen, John Cochrane, Lauren Cohen, Cliff Gray, Eugene Fama, Ron Howren, Carl Luft, Stavros Panageas, Shastri Sandy, Gil Sadka, Amir Sufi, Pietro Veronesi, and Rob Vishny. We would also like to thank seminar participants at the University of Chicago Booth School of Business, Texas A&M, Southern Methodist University, Drexel, Ohio State, University of Virginia, University of Washington, and Boston College. We also thank an anonymous referee for helpful suggestions.

<sup>2</sup> Rice University, 343 McNair Hall--MS 531 6100 Main Street Houston, TX 77005, E-mail: steven.s.crawford@rice.edu.

<sup>3</sup> Drexel University, Lebow College of Business, Philadelphia, PA 19104, Phone: 773-230-4727, Fax: 888-517-5529, E-mail: wgray@drexel.edu.

<sup>4</sup> Guggenheim Partners, E-mail: andrewkern@gmail.com

# **Do Fund Managers Identify and Share Profitable Ideas?**

## **ABSTRACT**

We study data from an organization in which fund managers privately share and discuss detailed investment recommendations. Buy recommendations generate positive abnormal returns, and sell recommendations result in negative abnormal returns. In the context of these results, we explore an important economic question: Why do skilled investors share their profitable ideas with other investors? Evidence suggests that the managers in our sample share ideas to receive constructive feedback and to attract additional arbitrageur capital to the securities they recommend. These findings are consistent with the theoretical predictions of Stein (2008) and Dow and Gorton (1994).

Key words: Financial Statement Analysis, Networks, Hedge Funds, and Market Efficiency.

## 1. Introduction

Fundamentals-based investors play a key role in the price discovery process. A professional investor's job is to research a firm's management, business, and future prospects and determine if the company's market valuation is different from its intrinsic value. If the manager believes a security to be inexpensive relative to its intrinsic value, he will buy the security, driving its price towards intrinsic value. If he believes it to be expensive, he will either sell the security or sell the security short, thereby putting downward pressure on the price and driving its price toward its intrinsic value. This logic is the basis for the market efficiency hypothesis (Freidman, 1953). However, Grossman and Stiglitz (1980) argue that market prices can never be perfectly efficient: If prices were always efficient, skilled investors who acquire private information would never be rewarded.

In the first part of this paper, we test the Grossman and Stiglitz prediction that price discovery agents' compensation comes in the form of abnormal returns generated by inefficient market prices. Specifically, we study a group of specialized market participants (predominantly small hedge fund managers focused on identifying firm values deviating from intrinsic value) who share detailed investment recommendations on the private website Valueinvestorsclub.com (VIC). We find evidence of stock-picking skill among VIC members. Specifically, we show that VIC buy and sell recommendations generate significant returns. However, the abnormal returns are restricted to small securities. For example, the average one-year value-weight calendar-time portfolio alpha estimate is 0.73% for buy recommendations and -3.11% for sell recommendations in the smallest quintile of firms. In addition to abnormal returns, we also show that trading volume increases for securities recommended by VIC members.

These results stand in stark contrast to a handful of papers in the literature that examine whether “expert” money managers and other investment professionals have stock picking skill. For example, Desai and Jain (1995) examine the recommendations of superstar money managers at the Barron’s Annual Roundtable and find no evidence of superior stock-picking skill. In a related paper, Metrick (1999) also finds no evidence of stock-picking ability among investment newsletters that publish stock recommendations. In addition to these papers, a large literature examining the performance of mutual fund managers shows that they do not outperform their benchmarks (e.g., Carhart, 1997; Malkiel, 1995; Daniel, Grinblatt, Titman, and Wermers, 1997). Our paper is unique because we provide evidence that a select group of money managers have stock-picking skill, but we are careful to point out that this result cannot be generalized to all money managers.

The empirical evidence suggesting that VIC members are talented stock-pickers is interesting on its own merits. However, the unique organizational structure of VIC, which is explicitly designed to facilitate private information exchange among professional investors, allows us to contribute to the literature by empirically addressing a question about investor behavior that has largely been ignored: Why would an investor with valuable private information share the information with others? Traditional theories suggest the process of how information flows into asset prices is straightforward. First, an arbitrageur identifies a temporary mispricing. Next, the investor acts on the price discrepancy with all available resources, which causes asset prices to move towards intrinsic value (e.g., Friedman, 1953). Bearing in mind this efficient pricing process, why a fund manager would share information about a profitable trading opportunity with other investors is unclear.

There are two central reasons why an investor might rationally share valuable private information. Stein (2008) proposes that fund managers could share private information because they gain valuable feedback from the person with whom they are sharing and that the most valuable ideas are shared among smaller groups of agents (collaboration argument). Another reason for information sharing is to attract additional capital into a stock to push prices to fundamental value (awareness argument). Additional capital may be necessary because a manager has already taken a capacity position in the stock or because holding costs cause the manager to limit his position in the stock (Pontiff, 2006).

We confirm many of the predictions from the collaboration and awareness sharing theories. With respect to the collaboration theory's predictions, we find evidence that investors share ideas to receive constructive feedback and limit the extent of sharing when ideas are perceived to be particularly valuable. For the awareness theory's prediction, we find evidence that VIC members share ideas to attract additional arbitrageurs to their asset market (i.e., talk their book). Specifically, institutional ownership (for buy recommendations), and short interest (for sell recommendations) all change in the predicted direction after VIC members submit a recommendation on a security.

Our collective findings suggest that sharing networks facilitate information flows into security prices. In the context of smaller firms, these results indicate a more nuanced view of market efficiency than traditional asset pricing models, which assume a single agent with private information can *instantly* drive a security to intrinsic value. The evidence suggests that small-cap securities eventually do reach intrinsic value as traditional models suggest, but proper price formation takes time.

The remainder of the paper is organized as follows. Section 2 discusses relevant research. Section 3 describes the data. Section 4 tests for stock-picking skill. Section 5 addresses why skilled fund managers share profitable trading opportunities. Section 6 concludes.

## **2. Related literature on the stock-picking hypothesis**

Several papers examine the stock-picking hypothesis by analyzing individual recommendations from “superstar” managers and other investment professionals. These studies show little evidence in support of the stock-picking-skill hypothesis. Desai and Jain (1995) examine the performance of recommendations made by “superstar” money managers at the Barron’s Annual Roundtable and find little evidence of superior stock-picking skill. Metrick (1999) also finds no evidence for the stock-picking hypothesis among stock recommendations contained in investment newsletters. In addition, studies of mutual fund managers have found that mutual funds do not outperform their benchmarks (e.g., Carhart, 1997; Malkiel, 1995; Daniel, et al. 1997).<sup>1</sup>

Another method of testing the stock-picking skill hypothesis is to study the performance of alternative asset managers (i.e., hedge fund managers). Research in this area often involves analysis of hedge fund return databases, but several data pitfalls plague this research. For example, much of the work in this area focuses on broad portfolio returns to test for the presence of stock-picking skill. Cohen, Polk, and Silli (2009) argue that analyzing portfolio returns is not a test of stock-picking skill because portfolio returns could disguise a fund manager’s true stock-

---

<sup>1</sup> Research has also shown that fund managers are biased forecasters. For example, Willis (2001) shows that mutual fund managers’ earnings forecasts systematically overstate earnings. Willis (2001) attributes this to the managers’ optimism. Groysberg, Healey, and Chapman (2008) confirm these findings and show that buy-side analysts issue more optimistic and less accurate earnings forecasts than sell-side analysts.

picking ability because managers have incentives to hold diversified portfolios that consist of their “best ideas” along with other positions to “round out” their portfolios. Other problems with hedge fund databases have been documented by Fung and Hsieh (2000, 2001), Liang (2003), Asness, Krail, and Liew (2001), and Getmansky, Lo, and Makarov (2004).

To avoid these problems we directly test manager stock-picking skill by studying detailed individual stock recommendations shared on VIC. Moreover, VIC is a unique setting in which managers have incentives to share profitable ideas (see the discussion in Section 5). Further, the detailed information embedded in the investment recommendations submitted by VIC members can be verified by the club’s sophisticated membership; thereby, mitigating the incentive for the promotion of efficiently priced recommendations.

Our database is not a panacea. VIC participants are pre-screened and thus represent a very select group of money managers. Our finding that VIC participants have stock-picking skill cannot be generalized to the larger population of money managers. Furthermore, the ideas in our sample are the simplest, most straightforward common equity recommendations submitted to VIC and are limited to those with data available on CRSP/Compustat. The exclusion of the many complicated arbitrage trades and special situation scenarios submitted to VIC, but not analyzed due to data and analysis constraints, could bias the evidence. These sophisticated trades require advanced knowledge and understanding of niche securities and/or access to expensive resources such as lawyers, industry specialists, or tax experts. These ideas could have higher gross returns than the remainder of the sample if, as Grossman and Stiglitz (1980) suggest, arbitrageurs are compensated for their information discovery efforts. If this is the case, our sample will likely be biased in favor of the null hypothesis that VIC members have no stock-picking skill. In general,

our data offer a rare opportunity to test a group of specialized managers for stock-picking skill in a relatively clean setting.

### **3. Data**

#### *3.1. Value Investors Club*

We collect our data from a private internet community called Valueinvestorsclub.com (VIC). VIC is a website restricted to 250 professional investors who share investment ideas with one another. To become a member of the club applicants submit an investment idea that is evaluated by VIC management to determine if the member has significant stock-picking ability. Once admitted, members are required to share investment ideas and to rate other members' ideas to maintain access to the website. Furthermore, members are encouraged to post comments and questions on investment ideas.

The identities of VIC members are not disclosed to the general public or to the other members of the site. Because membership data is confidential, we are unable to provide a statistical summary of VIC member characteristics. However, the management of VIC agreed to disclose that members are predominantly long-biased, value-focused hedge fund managers who typically have assets under management of between \$50 million and \$250 million. The small asset base that characterizes the investors we investigate could have important implications for the tests we perform. For instance, these funds are likely to invest in smaller and more illiquid firms relative to larger hedge funds (i.e., scale is not an issue). Details of the VIC website are included in the Appendix.

#### *3.2. Data description*

We analyze all investment reports submitted to VIC from the time of the club's founding on January 1, 2000 through December 31, 2011. Reports containing what ultimately prove to be poor recommendations are not deleted from the website and therefore our database does not suffer from an ex-post selection bias. In total, we examine 4,911 investment submissions. Report length ranges from several hundred to a few thousand words. Investment ideas are wide-ranging with respect to the security type, trading location of the asset, and the complexity of the strategy employed. For each investment report analyzed, we record various data: date and time of submission, symbol, price at time of submission, market(s) traded, security(s) traded, and strategy recommended (long, short, or long/short). Table 1 presents a summary of the sample's descriptive characteristics. Most of the VIC recommendations are for U.S. assets (4,155 of 4,911 total reports), and the majority of these U.S. recommendations are for common stocks. Across all asset types and market locations, long recommendations are the most common.

[Insert Table 1]

We only analyze U.S. exchange-traded long and short common stock recommendations with sufficient data from CRSP/Compustat. We do not analyze U.S. common equity investment recommendations that have payoffs one could consider non-linear or inappropriate to analyze with linear factor asset pricing models because they could bias our results (Fung and Hsieh, 2001). Specifically, we eliminate all recommendations classified as merger arbitrage, stub arbitrage, pair-trade, liquidation, long/short pair-trade recommendations, and non-common-equity ideas such as options or preferred stock. Of the 4,911 observations in the original sample, 3,220 reports remain after imposing these selection criteria. For these 3,220 reports we match the recommendation to accounting and stock return data from CRSP/Compustat. We require the

firm being recommended to have return data for at least one month following the posting date and further require the firm to have market value of equity in the month preceding the recommendation. These data restrictions leave us with a total of 3,175 reports to analyze.

Panel A and Panel B of Table 2 tabulate descriptive statistics for the long and short recommendations used in our tests. MVE is the market value of equity in thousands of dollars at the end of the month prior to recommendation month. B/M is the book value of equity scaled by MVE. Data on book value of equity is taken from Compustat using data from the firm's most recent annual report.<sup>2</sup> Past1 Return is the buy-and-hold return during the one month preceding the recommendation month, and Past12 Return is the buy-and-hold return during the 12 months preceding the recommendation month excluding month  $t-1$ . Illiquidity is the Amihud (2002) measure of illiquidity defined as the average ratio of the daily absolute return to the dollar trading volume, measured over a twelve-month period prior to the VIC recommendation.

Recommended investments on the long side are typically small with a tilt toward "value" as the median market capitalization is \$385 million and the median book-to-market ratio is 0.63. For short recommendations, VIC members bet on larger firms as the median market capitalization for these firms is \$854 million. However, the firms recommended short are still small in terms of the distribution of all publicly listed firms: a market capitalization of \$845 million would place a firm in the Russell 2000 small cap index for every year in the sample.<sup>3</sup> The median book-to-market ratio for short recommendations is smaller than the corresponding median for long recommendation at 0.32. To quantify liquidity we present Amihud's illiquidity measure for our sample. Long recommendation stocks are more illiquid than short

---

<sup>2</sup> For Compustat data we require the recommendation date to follow the fiscal year end by at least 90 days.

<sup>3</sup> See <http://www.russell.com/indexes/tools-resources/reconstitution/us-capitalization-ranges.asp>.

recommendation stocks, which is not surprising given that these firms' market capitalizations are smaller. With respect to momentum, long recommendations are generally poor recent performers relative to short-recommended firms. The median Past1 return is -1.1% for long recommendations and 3.9% for short recommendations. The median Past12 return is 0.0% for long recommendations and 14.3% for short recommendations. Table 2 also presents summary statistics for the ratings assigned to recommendations by VIC members. Of note is the fact that not all recommendations are rated; we discuss ratings in further detail in Section 4. Panel C of Table 2 shows the distribution of reports for long and short recommendations across the sample years. The number of long reports issued each year grew steadily until 2007, and then declined in 2008 and 2009. The decline could be a result of the economic slowdown during the same time period. Consistent with this, the number of short recommendations issued grew steadily in 2008 and 2009.

[Insert Table 2]

#### **4. Performance analysis**

In this section, we examine the performance of VIC recommendations. VIC members often state in their recommendation thesis that their ideas should be considered long-term investments and not short-term trades.<sup>4</sup> To capture this notion of long-term performance, we perform detailed calculations on investment periods ranging from one year to three years. We incorporate CRSP delisting return data using the technique of Beaver, McNichols, and Price (2007). For recommendations that become event firms intra-month we incorporate the "stub" return for the recommendation by compounding daily returns from the day after the

---

<sup>4</sup> We base this on a reading of all 4,911 reports submitted to Valueinvestorsclub.com.

recommendation is posted until the end of the month.

#### *4.1. Calendar-time portfolio regressions*

We analyze the data using the calendar-time portfolio regression approach advocated by Mitchell and Stafford (2000) and Fama (1998). This procedure involves forming portfolios consisting of all firms that were recommended in the current month  $t$ , and within the last  $x$  months ( $x$  is the length of the holding period). We then calculate the monthly returns to the event-firm portfolio in excess of the risk-free rate and regress this variable on a variety of linear asset pricing models, which include the following variables: MKT (excess value-weighted market index return), SMB (small minus big), HML (high book-to-market minus low book-to-market), and MOM (high momentum minus low momentum).<sup>5</sup>

The estimated alphas from our calendar-time portfolio regressions are presented in Table 3. The estimates in Table 3 represent the mean monthly abnormal return over the calendar-time horizon for all recommendations and for recommendations separated on NYSE size breakpoints. The alpha estimates for the long recommendations as a group are positive and statistically significant for both equal-weight and value-weight portfolios. The estimates degrade with time horizon, suggesting the information in VIC recommendations is incorporated into prices over time. The alpha estimates for long recommendations based on size quintiles reveal that alphas generally decline across size quintiles. We test whether the returns in the smallest and largest size quintiles are statistically different from one another by creating a portfolio that buys the firms in the smallest size quintile and sells firms in the largest size quintile (labeled “1-5” in Table 3). However, we find no evidence for a statistically different alpha between the smallest

---

<sup>5</sup> See Fama and French (1993) and Carhart (1997). Factors obtained from Ken French’s website [http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data\\_library.html](http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html).

and largest firms. Overall, the evidence with respect to long recommendations in Table 3 suggests VIC members have stock-picking skills, but the ability to pick winning stocks appears to be concentrated in smaller firms.

[Insert Table 3]

Moving to the results for short recommendations, we observe that alpha estimates are negative and significant for equal-weight portfolios, but generally not significant for value-weight portfolios. This result, in conjunction with the results showing that alphas are monotonically less negative across the size quintiles, demonstrates that only sell recommendations on small firms generate negative returns. We confirm this statistically and find that returns to the smallest size quintile of sell recommendations are more negative than those in the largest quintile. In summary, VIC members appear to be able to identify small, overpriced stocks.

By construction, calendar-time portfolios contain differing number of securities over time. The portfolios start with a few firm observations and slowly build over time. For a calendar-time portfolio observation to be included in the results in Table 3 we require that five observations from each of the size quintiles be present in a particular calendar month; results without this restriction are similar. The long recommendation portfolios are well-populated, but the short recommendation portfolios for the top three size quintiles can contain few securities. We conduct robustness tests where we combine the top three size quintiles into one portfolio partition and there is no change in conclusions. In addition, we conduct our analysis of calendar-time portfolios requiring a minimum of 10 securities in a month to be considered an observation. Our findings from this analysis are qualitatively similar to those shown in Table 3.

As further robustness tests, we create restricted-weight portfolios following Savor and Lu (2009) who restrict each stock's weight in a portfolio to a maximum of 25%. We conduct this analysis because value-weight portfolios may be dominated by a single recommendation that is a magnitude larger than the other recommendations in the calendar-time portfolio. We also calculate results using weighted least squares (WLS) calendar-time portfolio regressions by weighting observations by the market capitalization of the portfolios. Results using these different methodologies provide similar inferences to those in Table 3.

#### 4.1.1. *Performance and VIC ratings*

When a report is posted to VIC, members are given the opportunity to rate the idea on a scale of 1 (bad) to 10 (good). Ratings are recorded if five or more members rate the idea, and the rating period is open for only two weeks to ensure members do not rate ideas based on ex-post performance.<sup>6</sup> Since 2007, which is when data on the time of rating became available, 60% of ratings were submitted within 72 hours of posting.<sup>7</sup> The club's guidance to the community regarding how ratings should be assigned is that ratings should be objective and based on the expected performance of the investment thesis. Moreover, to encourage active participation, the club requires that members rate at least 20 ideas per year. The club also requests that extremely high (9 or 10) or extremely low (1 or 2) ratings be accompanied by specific commentary about the investment thesis in the discussion section affiliated with the recommendation.

Our analysis of the ratings data is important in the context of an organization designed to facilitate the sharing of profitable ideas among skilled managers. A conjecture from critics of idea sharing theories is that portfolio managers do not actually share *good* ideas with other

---

<sup>6</sup> VIC management provides no explicit indication of why they only record ratings if five or more members rate the idea, but we speculate that it minimizes skewness caused by one or two extreme ratings.

<sup>7</sup> Per email correspondence with VIC management.

managers, rather, they “pump” stocks with false information in hopes of driving the stock price away from intrinsic value. The ratings data allow us to test whether the VIC community has the ability to evaluate the ex-ante performance of investment recommendations posted by other investors. Specifically, we test whether VIC members can identify the best and worst recommendations within their universe of ideas.

For our tests on ratings, we exclude the first two weeks of return data because a VIC rating could be endogenously determined should an idea perform exceptionally well during the two-week rating period after submission, inducing members to rate it very highly. We also perform all of our empirical tests on ratings with the inclusion of the two week rating period and find slightly stronger results.

To assess if ratings can predict future performance, we run calendar-time portfolio regressions after dividing our sample universe into five ratings quintiles based on the distribution of ratings in our sample. The estimated alphas from our calendar-time portfolio regressions are presented in Table 4. As with our analysis in Table 3, for a calendar-time portfolio observation to be included in the results in Table 4 we require that five observations from each of the ratings quintiles be present in a particular calendar month; results without this restriction are similar.

Alpha estimates increase roughly monotonically across rating quintiles. For example, the low rated one-year equal weight portfolio of long recommendations has statistically insignificant alpha of -25bps a month. In contrast, the high rated one-year equal-weight portfolio has positive and statistically significant alpha of 125bps a month. The difference in alphas between the lowest and highest rated long recommendations is statistically significant for the one-year equal-weighted returns but none of the value-weighted returns. To examine why this is the case, we

calculate the mean MVE for each of the ratings portfolios and find that the mean MVE of the firms included in the highest (lowest) rating portfolio is \$3.5 (\$2.9) billion. Combined with the results from Table 3, the fact that firms rated more favorably are also larger explains why the difference in value-weighted returns between the two ratings categories is insignificant. On the short side, the evidence is similar to the long recommendation results. For example, the lowest rated one-year equal-weight portfolio has a positive, but insignificant alpha of 19bps a month, whereas the highest rated short ideas have statistically significant alpha of -202bps a month. The difference in returns between the lowest and highest rated stocks is significant for both equal- and value-weight portfolios. Overall, the evidence in Table 4 suggests that the VIC community has the capability to assess the relative quality of ideas submitted to the organization particularly for ideas on small firms.<sup>8</sup>

[Insert Table 4]

## **5. Why do managers share profitable ideas?**

VIC is an organization explicitly designed to facilitate the sharing of private information among fund managers. Two straightforward reasons for why skilled investors might share valuable information with others are 1) to signal their skill, or 2) to garner direct monetary benefits. With respect to signaling, there is no reason to think VIC members benefit from highlighting their skill to the marketplace because the VIC organization requires anonymity, which makes signaling ineffective. The second reason sharing may be economically feasible is if the value of a monetary award for the information is greater than the expected costs of sharing

---

<sup>8</sup> We also conduct an abnormal volume analysis and find strong evidence that VIC recommendations are associated with significant abnormal volumes.

the information and losing out on a profitable trading opportunity. As discussed in the Appendix, twice each month \$5,000 is awarded to the best idea submitted to VIC. In the context of the asset management business, the potential for a \$5,000 award is likely negligible with respect to a manager's incentive to share a profitable investment opportunity.

The sharing of valuable private information by VIC members is puzzling given that signaling and direct monetary incentives appear not to explain this behavior. Furthermore, traditional theories (Friedman, 1953) suggest that arbitrageurs with valuable private information should take full advantage of the information until prices reflect intrinsic values. Moreover, in a market with efficient funds allocation, competing arbitrageurs should keep their valued information private so they can outperform their competition and attract more investor capital (Stein, 2008).

Such theories compellingly suggest that rational agents will not share private information, but few theories explain why rational agents *do* share private information in the asset management industry. Stein (2008) suggests managers might share information because they can get valuable feedback that improves their ideas (collaboration argument). Dow and Gorton (1994) suggest arbitrageurs will only make investments if they believe subsequent arbitrageur demand will push the asset price higher. In the Dow and Gorton model, arbitrageurs are unable to reliably expect another arbitrageur to push asset prices further, and market prices end up being inefficiently priced. One intuitive way arbitrageurs can help ensure other arbitrageurs will take a position in an asset is by sharing private information (awareness argument). Practitioners often refer to this practice as “talking your book.”

### *5.1. Collaboration argument*

Stein's theory of information exchange between competitors suggests that an asset manager will share his idea if it gives him access to constructive feedback that will make his idea more valuable. For example, fund manager *X* has developed a promising investment thesis, but his information set is incomplete so his idea is not worth much; however, by sharing his thesis with fund manager *Y* and receiving feedback, his investment thesis will become more valuable. As long as this give-and-take relationship is valuable for both parties involved, information exchange will occur between competitors. Stein's theory provides two basic predictions: managers will share ideas in situations in which they can receive constructive feedback, and the most valuable ideas will remain localized within a small group.

To quantitatively assess Stein's primary hypotheses we analyze the comments attached to VIC recommendations. VIC has a robust infrastructure to facilitate collaboration and comments on individual ideas. Whenever an idea is posted to VIC, members receive an idea alert and are able to share their comments on the investment thesis. In addition, VIC members can mark comments as "private." Private comments are only visible to the VIC community and are not accessible by the general public. (Anyone can sign up for guest access to VIC, but access comes with a 45-day delay.) For example, if a VIC member posts an idea on January 1, 2008 and a VIC member makes a comment on the idea that he designates as private, then after February 14, 2008 anyone from the general public who is reading the investment thesis and following the comments will not have access to the comment designated as private.

We analyze the comments on VIC using data from January 1, 2004 through November 21, 2009. We begin our analysis of comment data on January 1, 2004 because the option to label

comments private was rarely used prior to this date (13.44% of ideas had at least one private comment prior to 2004 versus 74.45% after January 1, 2004).<sup>9</sup> Furthermore, we are unable to access comments after November 21, 2009 because of website restrictions.

Table 5 provides a detailed description of the comments from VIC. We analyze the comments for the sample of recommendations with at least one comment and that have MVE available in the month prior to being posted to VIC.<sup>10</sup> In total, we examine the comments on 1,499 recommendations: 1,271 long recommendations, and 228 short recommendations. The sample is smaller than the original sample used for the abnormal return analysis because not all recommendations receive comments and because of the website restriction mentioned above. We tabulate the total number of comments submitted (Comments), the number of unique VIC members involved in a particular conversation (Members), the number of comments that are designated as private (#Private), the number of comments that are author submitted (Author), and the number of comments that are submitted within 45 days of the recommendation's posting (<45 Days). We also report the percentage of comments marked private (%Private), submitted by the author (%Author), and submitted within 45 days of posting (%<45 Days).

[Insert Table 5]

Summary statistics certainly suggest that ideas submitted to VIC receive extensive feedback. Long and short recommendations receive 11.35 and 13.13 comments, respectively, and approximately five different VIC users comment on each recommendation (i.e., average

---

<sup>9</sup> We were unable to determine the reason for the significant shift in the number of comments marked private beginning in 2004. The results in this section are subject to the caveat that they might not apply to the broader VIC sample and that something beyond our control may be spuriously causing the association between ratings and the percentage of comments marked as private.

<sup>10</sup> Over 90% of VIC recommendations we examine receive at least one comment. In unreported analysis, we find ideas that receive ratings are more likely to be commented on.

Members is 4.77 and 5.20 for long and short recommendations, respectively). In addition, many of the comments are provided by the author. The mean %Author is 38.06% for long ideas and 34.07% for short ideas, which suggests there is a conversational, give-and-take nature of the comments between the recommendation's author and VIC members. These results fit the primary prediction of Stein's collaboration theory that fund managers share their ideas to receive feedback from other smart investors. However, a direct test of Stein's prediction that VIC managers submit ideas to receive feedback is beyond the reach of our data.

Other interesting results from the comment analysis are the percentage of comments that are labeled as private (%Private) and the percentage of comments that are submitted within 45 days of the recommendation posting (%<45 Days). These two data parameters are important because private posts remain restricted to the VIC community after the 45-day lock-up period. For the sample of long and short recommendations 29.69% and 31.32% of comments are marked private, respectively. 65.51% of all long comments and 63.95% of all short comments occur within the 45-day window around the recommendation. These results suggest that VIC members limit some of their conversations to the VIC community and focus their discussion efforts in the 45-day window before comment and recommendation data become accessible by the public.

We next test Stein's hypothesis that more valuable ideas will be shared among a smaller group of agents. To assess this hypothesis we use the number of private comments (#Private) and the percentage of total comments marked private (%Private) as proxies for the size of the collaboration group. For example, if idea *X* has 20 comments and 15 are private, the collaboration information for idea *X* will be primarily limited to VIC members; whereas, if idea *Y* has 20 comments and 0 are private, the feedback information is available to VIC members and

the general public after 45 days.

We calculate the univariate relation between ratings and number of comments marked private or the percentage of comments marked private (untabulated). This analysis serves as a preliminary investigation of the hypothesis that higher quality ideas will be shared among a smaller group. For long recommendations the lowest-rated ideas have a mean (median) #Private of 2.41 (1.00) and a %Private of 26.48% (20.00%), but the highest-rated ideas have a mean (median) #Private of 6.23 (3.00) and a %Private of 32.38% (26.49%). Statistical tests for differences in means and medians reveal that the differences are significant. Short recommendations show a similar pattern: low-rated ideas have lower #Private and %Private than the high-rated ideas. The mean and median differences are all statistically significant except for the difference in means for short recommendations.

To investigate Stein's hypothesis in a multivariate setting, we regress #Private and %Private on ratings variables and several other controls. For the analysis on #Private, we focus on results from a Poisson regression because the data are bound from zero to infinity. We also conduct our tests using standard OLS regressions and a negative binomial regression technique; all results are qualitatively similar. For the analysis on %Private we use the fractional logit model estimated using a quasi-likelihood approach developed by Papke and Wooldridge (1996) because %Private is bound between zero and one. For robustness, we also regress %Private on our ratings variables and controls using OLS and logit regression models and find similar results. Table 6 presents the results for our fractional logit analysis on %Private and our Poisson regression results for #Private.

For long recommendations, the estimated coefficient on Rating is positive and significant

in all of our estimations suggesting a robust association between ratings and the number and percentage of comments marked private. These results suggest that VIC members want to limit their discussions on the best ideas to the VIC community. For example, the coefficient on Rating in the fractional logit model with month fixed effects is 0.146. The marginal effect of Rating evaluated at the means of the independent variables is approximately 3%. Thus, all else equal, an increase in the ratings variable increases %Private by approximately 3%.<sup>11</sup> We document a similar relation between private comments and ratings for short recommendations, but the results are not as strong. Specifically, the estimated coefficient on Rating is always positive but only statistically significant in the Poisson regressions. The relation between whether a stock is rated (Rated) and our private comment variables is mixed. The coefficient on Rated is only positive and statistically significant for long recommendations when #Private is the dependent variable. In fact, for short recommendations the coefficient on Rated is negative and statistically significant when %Private is the dependent variable. These results suggest that a stock must be rated well by VIC members in order for them to limit their comments to the VIC community – simply being rated is not enough. Overall, the regression estimates provide evidence that is generally in support of Stein’s hypotheses: a positive relation exists between the perceived quality of an idea (as proxied by the idea’s rating) and how widely information is shared in the market (as proxied by the percentage and number of private comments).

[Insert Table 6]

## 5.2. Awareness argument

A key insight of the Dow and Gorton (1994) analysis of arbitrage chains is that short-

---

<sup>11</sup> We lose observations when estimating the fixed effect logit model because in a few months all (none) of the comments for all observations are marked (not marked) as private.

horizon arbitrageurs will only make investments if the probability of another arbitrageur subsequently entering the market ( $\delta$ ) is high enough. If  $\delta$  is too low, arbitrageurs will not take an immediate position in a long-horizon arbitrage because the price will not be supported in subsequent periods and the arbitrageur will be exposed to various transaction and holding costs. Although  $\delta$  is fundamental to the analysis of arbitrage chains, Dow and Gorton (1994) don't discuss the origins of  $\delta$  and it is assumed to be exogenous. However, arbitrageurs might endogenously increase the chances of future arbitrageurs coming into the market. One way arbitrageurs can help ensure other arbitrageurs take a position in an asset is by providing awareness of their investment thesis, i.e., talking their book. The ratings analysis from Section 4 suggests that stock promotion on the basis of no information is unlikely to convince other smart investors to take a position in a particular asset; however, if investors share valuable information, which can subsequently be verified by another arbitrageur, the sharing can convince others the idea is profitable. Arbitrageurs with the new information will presumably purchase the asset and move the price closer to intrinsic value. This argument is particularly compelling in cases where managers are resource constrained (e.g., limited capital or research capability), which prevents them from pushing prices to intrinsic value.

In addition to extending the arguments in Dow and Gorton (1994) we also utilize the framework in Pontiff (2006) to motivate why managers would "talk their book". Pontiff (2006) argues that holding costs force an arbitrage trader to take a limited position in a mispriced security which allows the mispricing to persist. He shows that this problem is particularly acute for firms with high idiosyncratic risk. We follow Pontiff's reasoning and suggest that the arbitrageur can share information about the mispriced security to induce other arbitrageurs to

commit capital and push price to fundamental value. The benefits of sharing are greater for securities with high idiosyncratic risk (e.g., for small firms as those in our sample). In summary, the arguments in Pontiff (1996) suggest that even though arbitrageurs may not be capacity constrained they limit their positions in mispriced securities. We argue that managers can share their ideas with other traders to mitigate the mispricing.

### *5.2.1. Institutional ownership*

The awareness hypothesis suggests that investors who talk their book hope to convince other investors to purchase the undervalued securities they currently own. A testable prediction of this hypothesis is that institutional ownership should increase upon the release of price-relevant information released by an informed trader so we examine how broad institutional ownership changes surrounding a VIC recommendation. Ideally, the tests would isolate changes in ownership for the VIC members in the sample; unfortunately, data on the identity of VIC members and their employers is unavailable.

To calculate institutional ownership information, we use data from the Thomson Reuters Institutional (13F) Holdings database, which provides quarterly data on the institutional holdings of managers subject to SEC Form 13F filings (i.e., those with assets under management of at least \$100 million). For each quarter, the database reports the securities and number of shares held by each institution. We examine how total institutional ownership changes before and after the release of the report.

Holdings data are only available on a quarterly basis, so for each firm in the sample we observe the institutional ownership in the quarter in which the recommendation is made, as well as the quarters prior to and the quarters after the recommendation. Because these individual

changes could be noisy due to the periodic nature of the 13F reporting, we calculate the change from quarter t-1 to quarter t+1 and the change from quarter t-2 to t+2 to capture any effect the VIC recommendations have on institutional ownership. We aggregate holdings across institutions for a given quarter to calculate total institutional ownership as a percentage of total shares outstanding for each firm quarter. We also calculate the change in the number of institutions holding positions in VIC long recommendations before and after an event. The distinction between increases in the percentage of shares held by institutions and the number of institutions holding shares is important. Awareness theory does not necessarily predict an increase in ownership across institutions that already own the stock; however, the theory does predict an increase in the number of owners. In other words, talking your book may not affect investors who already own the stock in their portfolio, but talking your book should encourage new investors to initiate positions in recommended firms to their portfolio.

Panels A and B of Table 7 present summary statistics for the percentage of shares held by institutions and for the number of institutions holding shares, respectively. For all long recommendations, total institutional ownership increases from 55.99% in quarter t-1 to 56.84% in quarter t+1. The increase of 0.85% is significantly different from zero at the 5% level. Using data from two quarters before to two quarters after shows a larger increase in total institutional ownership of 1.63%. The average number of institutions owning the recommended stock from quarter t-1 to quarter t+1 goes from 138.98 to 140.08, a statistically significant change of 1.09. The change in the number of institutional owners between quarter t-2 to quarter t+2 increases by 1.67. These results suggest that, on average, institutions are net buyers of stocks recommended long by VIC members and the increase in institutional ownership is being driven (at least in part)

by new institutional owners initiating positions in VIC recommended stocks. This evidence is consistent with the hypothesis that recommendations on VIC are related to increases in institutional ownership and ownership breadth. These results are consistent with the prediction from awareness theory that investors share private information in order to convince other investors to invest in their holdings.

We further investigate the institutional ownership data by dividing our sample into rating quintiles. We expect higher rated ideas to experience larger changes in institutional ownership than lower rated ideas, all else equal. Table 8 shows that stocks in the lowest ratings quintile experience a statistically significant decline in the number of institutions owning a recommended stock. The percentage ownership also decreases, but the decline is not significant. In contrast, the highest rated ideas experience an increase in the percentage of shares held by institutions. Furthermore, the number of institutions holding these stocks increases by 8.30, on average, from quarter t-2 to quarter t+2. The increase is much smaller when measured from quarter t-1 to quarter t+1. Tests for differences in the means of the institutional ownership variables between the highest and lowest rating quintiles show that these differences are statistically significant.

The results on ratings and institutional ownership suggest that talking your book can be an effective approach for a manager looking to increase institutional interest in their current holdings; however, the recommendations have to be of high quality in order for this strategy to be effective. A strategy resembling a “pump-and-dump,” or talking up stocks that are low quality, is ineffective, and could end up causing investors to exit a position.

[Insert Table 7]

### 5.2.2. *Short-interest tests*

Our analysis of institutional holdings for long recommendations suggests that recommended firms see an increase in institutional ownership and breadth, which is in line with the predictions from awareness theory. Unfortunately, we are unable to test the implications of the awareness theory using institutional holdings data for short recommendations because institutions are not required to report short positions. However, in this section we look at changes in short interest as a proxy for increased institutional trading interest in VIC sell recommendations. We divide our sample into rating quintiles to highlight effects associated with ratings. We hypothesize that the highest-rated short recommendations will experience the largest shocks in short interest because they are expected to be the most profitable VIC recommendations.

Because short interest data is available on a monthly basis, we examine the data two months before and after the VIC short recommendation. Table 8 presents the short interest results for the short recommendations in our sample. Short interest increases by 1.77% two months after a short recommendation is posted to VIC compared to two months before posting. Furthermore, the change in short interest increases almost monotonically from low rated ideas to high rated ideas from month  $t-2$  to month  $t+2$ . Specifically, short interest for the highest rated recommendations increases by 3.15% while the lowest rated stocks experience a decrease of -0.30%. The difference, 3.45%, is statistically significant. The results comparing month  $t-1$  to month  $t+1$  are similar. These results suggest that talking your book can be an effective approach for VIC members trying to attract attention to securities they believe are overvalued, but as with long recommendations, short recommendations have to be perceived as high quality to be

effective in attracting investor attention.

[Insert Table 8]

## 6. Conclusion

We explore two basic economic questions: 1) Do fund managers that share recommendations on a private website have stock-picking skill? 2) Why do these managers share good ideas with their competition? With respect to the first question, the evidence suggests the fund managers in our sample have significant stock-picking skills, but their skill is concentrated in small firms. The fact that abnormal return results are concentrated in small firms is not surprising for two reasons: 1) the managers we analyze have relatively low assets under management, which implies fewer liquidity constraints; 2) smaller firms are more likely to be inefficiently priced relative to larger firms, all else equal. In equilibrium, skilled investors should be compensated for their efforts in accurately analyzing firms and driving assets to intrinsic value.

To address the second question, we test basic predictions from the collaboration and awareness theories of idea exchange. We find that the investors in our sample share profitable ideas to collaborate with other sophisticated investors. We also find evidence that VIC members attract attention to their investments by talking their book: recommended firms earn abnormal returns, volumes increases, institutional investors increase ownership in long recommended securities, and short interest increases for short recommendations.

## Appendix

Valueinvestorsclub.com (VIC) is an “exclusive online investment club in which top investors share their best ideas.”<sup>12</sup> Many business publications have heralded the site as a top-quality resource for those who can attain membership (e.g., *Financial Times*, *Barron’s*, *BusinessWeek*, and *Forbes*).<sup>13</sup> Joel Greenblatt and John Petry, managers of a large hedge fund, Gotham Capital, founded the site in 2000 with \$400,000 of start-up capital. Their goal was for VIC to be a place for “the best-quality ideas on the Web” (Barker, 2001). The investment ideas submitted on the club’s site are broad but are best described as fundamentals-based. VIC states that it is open to any well thought out investment recommendation, but that it has particular focus on long or short equity or bond-based recommendations, traditional asset undervaluation situations, such as high book-to-market, low price-to-earnings, liquidations, etc., and investment ideas based on the notion of value as articulated by Warren Buffett (firms selling at a discount to their intrinsic value irrespective of common valuation ratios).

VIC managers try to ensure that only members with significant “investment ability” are admitted to the club.<sup>14</sup> Accordingly, membership in the club is capped at 250 and the approximate acceptance rate is 6%.<sup>15</sup> As a result of the low acceptance rate, membership started at 90 members in 2000 and did not reach the 250 cap until 2007. Admittance is based solely on a detailed write-up of an investment idea (typically 1000 to 2000 words). Employer background and prior portfolio returns are not part of the application process. If the quality of the independent research is satisfactory and the aspiring member deemed a credible contributor to

---

<sup>12</sup> <http://www.valueinvestorsclub.com/Value2/Guests/Info.aspx>

<sup>13</sup> Ibid.

<sup>14</sup> <http://www.valueinvestorsclub.com/value2/Home/MoreInfo> accessed April 1, 2012.

<sup>15</sup> Per email correspondence with VIC management.

the club, he is admitted. Once admitted, members are required to submit at least two “high-quality” investment ideas per year to continue as members and receive unrestricted access to the ideas and comments posted by the VIC community.<sup>16</sup>

VIC management doesn’t explicitly define what constitutes a high-quality idea, but the quality of the reports submitted by VIC members is encouraged and monitored in several different ways. First, members can only submit a maximum of six ideas per year to elicit the submission of their best ideas. Second, VIC management reserves the right to remove reports they deem to fall short of the quality standards. VIC management describes this process as follows: “Occasionally members post ideas that have not been presented in nearly enough detail to meet the standards of the board. VIC will take down ideas that clearly do not meet the quality levels of the other members’ ideas. Fortunately, this is an uncommon event.”<sup>17</sup> Third, reports submitted within a month of the one-year deadline are subject to a member vote to determine whether the idea should count toward the two-idea requirement. Fourth, repeat ideas (a member submitting an idea on a security he has previously submitted an idea on) are not counted toward the membership requirement. However, ideas on securities that have been submitted by other members can count toward the membership requirement but only if the work is original and substantially updated, or if it includes a different recommendation from the previous member’s submission. VIC management determines whether a write-up on a security recommended in the past counts toward the two-idea requirement.

---

<sup>16</sup> <http://www.valueinvestorsclub.com/value2/Home/FAQ> accessed April 1, 2012. Initially, all members were required to submit ideas by December 31<sup>st</sup> to fulfill their membership requirement. “This led to a flood of ideas being posted each year from December 15 to 31” (ibid) so VIC changed the requirement so that ideas must be submitted each year by the member’s “Anniversary Date” or the date they were initially admitted to VIC. VIC management states “that Members will benefit from a more even flow of ideas through the year” (ibid).

<sup>17</sup>Ibid.

Members who don't submit at least two qualifying reports are placed on "Re-Activation" status resulting in the loss of real-time access to the ideas submitted to VIC. To be reactivated, the member must submit a new idea, and then VIC members are allowed to vote to determine whether the idea qualifies the member for reactivation. Two-thirds of the votes must be in the affirmative for reactivation to occur.

A few other aspects of the site are worth mentioning. First, VIC members must rate the quality of at least 20 ideas each year, and they are encouraged to post comments and questions on individual ideas. These policies encourage quality submissions by allowing other members to flag and comment on both high- and low-quality reports. Second, twice each month \$5,000 is awarded to the best idea submitted (\$120,000 in prize money per year).<sup>18</sup> Prizes are solely determined by management, and VIC members can win the award multiple times. Management does not disclose their explicit criteria for determining winners, except to mention that "Management will determine the best idea, solely at its own discretion. Management will judge ideas based upon the quality of the analysis and Management's perception of the attractiveness of the idea."<sup>19</sup> VIC management explicitly states that member ratings do not affect the selection of award winners.<sup>20</sup>

Finally, VIC members' identities are not disclosed to the general public or to the other members of the club. The intent of the policy is to keep individual VIC members from forming outside sharing syndicates with other members, who could then take their valuable research and comments away from the broader VIC community. The anonymity requirement also ensures the

---

<sup>18</sup> At some point VIC management changed the frequency of the award from once a week to two times a month without stating a reason for the switch.

<sup>19</sup> <http://www.valueinvestorsclub.com/value2/Home/WeeklyContest> accessed April 1, 2012.

<sup>20</sup> <http://www.valueinvestorsclub.com/value2/Home/FAQ> accessed April 1, 2012.

message board does not become a place for hedge fund managers to signal to potential investors or market their services to the general public.<sup>21</sup> Finally, by keeping identifying information private, members can speak truthfully and without consequence about conversations with management, proxy situations, and other sensitive situations in which identity disclosure could lead to legal or relationship repercussions.

Because membership of VIC is confidential, we are unable to tabulate statistics on VIC members' profiles. However, the management of VIC agreed to disclose that VIC members are predominantly long-biased, value-focused hedge fund managers who typically have assets under management of between \$50 million and \$250 million. A simple extrapolation exercise suggests the organization has discretionary control of between \$12.5 billion ( $\$50\text{million} \times 250$ ) and \$62.5 billion ( $\$250\text{million} \times 250$ ) in assets. These numbers reflect a substantial amount of capital, but only represent a fraction of the entire asset management industry.

The small asset base that characterizes the investors we investigate has important implications for the tests we perform. For instance, these funds are likely to invest in smaller and more illiquid firms relative to larger hedge funds (i.e., scale is not an issue). The fact that VIC recommendations tend to focus on smaller firms is actually one of the selling points of the website. In the "More Info" section of VIC website it states: "most analysts ignore smaller capitalization stocks, out-of-favor opportunities, and companies undergoing restructurings, recapitalizations, [etc.] that can be extremely lucrative for individuals who do their own research."<sup>22</sup>

---

<sup>21</sup> This would create a legal predicament for hedge fund managers who rely on Rule 506 of Regulation D in the Securities Act of 1933 to exempt them from registering their security offerings with the SEC.

<sup>22</sup> <http://www.valueinvestorsclub.com/value2/Home/MoreInfo> accessed April 1, 2012.

## References

- Amihud, Y., 2002. Illiquidity and stock returns: cross-section and time-series effects. *Journal of Financial Markets* 5, 32-56.
- Asness C., Krail, R., Liew, J., 2001. Do hedge funds hedge? Be cautious in analyzing monthly returns. *Journal of Portfolio Management* 28, 6-19.
- Barker, R., 2001. This message board may really light up. *Businessweek*, <http://www.businessweek.com/archives/2001/b3722161.arc.htm>, accessed October 30, 2008.
- Beaver, W., McNichols, M., Price, R., 2007. Delisting returns and their effect on accounting-based market anomalies. *Journal of Accounting and Economics* 43, 341-368.
- Carhart, M., 1997. On persistence in mutual fund performance. *The Journal of Finance* 52, 57-82.
- Cohen, R., Polk, C., Silli, B., 2009. Best ideas. Unpublished working paper. Harvard University.
- Daniel, K., Grinblatt, M., Titman, S., Wermers, R., 1997. Measuring mutual fund performance with characteristics based benchmarks. *The Journal of Finance* 52, 1257-1274.
- Desai, H., Jain, P., 1995. An analysis of the recommendations of the superstar money managers at Barron's annual roundtable. *The Journal of Finance* 50, 1257-1273.
- Dow, J., Gorton, G., 1994. Arbitrage chains. *The Journal of Finance* 49, 819-849.
- Fama, E., 1998. Market efficiency, long-term returns, and behavioral finance. *The Journal of Financial Economics* 49, 283-306.
- Fama, E., French, K., 1993. Common risk factors in the returns on stocks and bonds. *The Journal of Financial Economics* 33, 3-56.
- Friedman, M., 1953. The case for flexible exchange rates, in: *Essays in Positive Economics*. University of Chicago Press, pp. 157-203.
- Fung, W., Hsieh, D., 2000. Performance characteristics of hedge funds and commodity funds: Natural vs. spurious biases. *Journal of Financial and Quantitative Analysis* 35, 291-307.
- Fung, W., and Hsieh, D., 2001. The risk in hedge fund strategies: Theory and evidence from trend followers. *Review of Financial Studies* 14, 313-341.
- Getmansky, M., Lo, A., Makarov, I., 2004. An econometric model of serial correlation and

- illiquidity in hedge fund returns. *Journal of Financial Economics* 74, 529–609.
- Grossman, S., Stiglitz, J., 1980. On the impossibility of informationally efficient markets. *American Economic Review* 70, 393-408.
- Groysberg, B., Healy, P., Chapman, C., 2008. Buy-side vs. sell-side analysts' earnings forecasts. *Financial Analysts Journal* 64, 25-39.
- Liang, B., 2003. The accuracy of hedge fund returns. *The Journal of Portfolio Management* 29, 111-122.
- Malkiel, B., 1995. Returns from investing in mutual funds 1971-1991. *The Journal of Finance* 50, 549-572.
- Mitchell, M., Stafford, E., 2000. Managerial decisions and long-term stock performance. *Journal of Business* 73, 287-329.
- Metrick, A. 1999. Performance evaluation with transactions data: the stock selection of investment newsletters. *The Journal of Finance* 54, 1743-1775
- Papke, L., Wooldridge, J., 1996. Econometric methods for fractional response variables with an application to 401(k) plan participation rates. *Journal of Applied Econometrics* 11, 619-632.
- Pontiff, J. 2006. Costly arbitrage and the myth of idiosyncratic risk. *Journal of Accounting and Economics* 42, 35-52.
- Savor, P., Lu, Q., 2009. Do stock mergers create value for acquirers? *The Journal of Finance* 64, 1061-1097.
- Stein, J., 2008. Conversations among competitors. *American Economic Review* 98, 2150-2162.
- Willis, R., 2001. Mutual fund manager forecasting behavior. *Journal of Accounting Research* 39, 707-725.

**Table 1: Recommendation Summary Data**

This table reports descriptive characteristics for investment recommendations submitted to Valueinvestorsclub.com (VIC) from January 1, 2000 through December 31, 2011. Panel A reports where assets are traded and the asset type recommended. Panel B reports the number of each long, short, and long/short recommendation by the type of asset. Panel C reports the number of each long, short, and long/short recommendation by trading location.

*Panel A: Asset type and trading location*

Market	Common Stock	Bonds	Preferred Stock	Convertible Securities	Warrants	Options	Other	Total
US	3,908	68	50	19	12	17	81	4,155
Canada	259	2	2	1	0	0	3	267
UK/Europe	262	9	4	1	0	0	1	277
Japan	31	0	0	0	0	0	2	33
Hong Kong	38	0	0	0	0	0	0	38
Korea	21	0	0	0	0	0	0	21
Other	117	1	0	0	0	0	2	120
Total	4,636	80	56	21	12	17	89	4,911

*Panel B: Recommendation by asset type*

	Common Stock	Bonds	Preferred Stock	Convertible Securities	Warrants	Options	Other	Total
Long	4,093	73	46	21	12	13	17	4,275
Short	503	2	3	0	0	3	7	518
Long/Short	40	5	7	0	0	1	65	118
Total	4,636	80	56	21	12	17	89	4,911

*Panel C: Recommendation and market location*

	US	Canada	UK/ Europe	Japan	Hong Kong	Korea	Other	Total
Long	3,573	258	256	29	33	20	106	4,275
Short	484	5	14	3	3	0	9	518
Long/Short	98	4	7	1	2	1	5	118
Total	4,155	267	277	33	38	21	120	4,911

**Table 2: Recommendation Summary Statistics**

This table reports summary statistics for VIC recommendations submitted from January 1, 2000 to December 31, 2011. Panels A and B show the characteristics of long and short investment ideas, respectively. Panel C shows the frequency of recommendations by calendar year. The sample consists of all firms that have at least one monthly return observation and data for MVE in the month preceding the recommendation. MVE is the market value of equity in thousands of dollars at the end of the month prior to recommendation month. B/M is the book value of equity scaled by MVE. Past1 Return is the buy-and-hold return during the one month preceding the recommendation month, and Past12 Return is the buy-and-hold return during the 12 months preceding the recommendation month excluding month t-1. Illiquidity is the Amihud (2002) measure of illiquidity defined as the average ratio of the daily absolute return to the dollar trading volume, measured over 12 months preceding the recommendation month. Rating is the average rating (on a scale of 1 to 10) assigned to a recommendation by VIC members.

<i>Panel A: Long recommendation characteristics</i>								
	N	Mean	Median	Std. Dev.	Min.	Q1	Q3	Max
MVE	2,761	4,540,605	385,205	21,509,568	845	115,854	1,730,550	350,760,253
B/M	2,713	1.118	0.626	4.570	-9.406	0.340	1.123	149.405
Past1 Return	2,728	-0.011	-0.011	0.159	-0.781	-0.085	0.061	1.768
Past12 Return	2,704	0.100	0.000	0.678	-0.969	-0.252	0.254	8.324
Illiquidity	2,760	1.267	0.010	11.077	0.000	0.001	0.113	381.905
Rating	2,355	5.02	5.10	0.73	1.30	4.60	5.50	7.50
<i>Panel B: Short recommendation characteristics</i>								
	N	Mean	Median	Std. Dev.	Min.	Q1	Q3	Max
MVE	414	3,265,551	854,657	10,585,317	7,195	353,032	2,056,566	159,614,765
B/M	404	0.580	0.322	1.862	-15.660	0.124	0.656	20.265
Past1 Return	410	0.039	0.017	0.192	-0.515	-0.058	0.105	1.286
Past12 Return	403	0.471	0.143	1.396	-0.964	-0.168	0.591	17.139
Illiquidity	414	0.318	0.004	4.085	0.000	0.001	0.014	78.935
Rating	365	5.27	5.40	0.74	2.60	4.90	5.80	6.90

**Table 2: Recommendation Summary Statistics (Continued)**

---

*Panel C: Time-series distribution of recommendations*

---

	Long	Short
2000	103	1
2001	185	2
2002	200	11
2003	208	29
2004	224	29
2005	206	42
2006	228	31
2007	298	34
2008	276	49
2009	221	65
2010	311	73
2011	301	48

---

**Table 3: Calendar-Time Portfolio Regressions by NYSE Size Breakpoints**

This table reports calendar-time portfolio regression alphas to VIC long and short recommendations submitted from January 1, 2000 to December 31, 2011. At the beginning of every calendar month, all event firms are assigned to one of five quintiles based on NYSE size breakpoints. Each month, the quintile portfolios consist of all firms that were recommended in month  $t$ , and within the last  $x$  months ( $x$  is the length of the holding period). Portfolios are rebalanced monthly. The independent variables are the monthly excess value-weight market index returns and returns from the Fama and French factors (1993) and the Carhart (1997) momentum factor. Alphas are in monthly percent, p-values are shown below the coefficient estimates, and 5% statistical significance is indicated in bold.

	Long Recommendations						Short Recommendations					
	Equal-weight portfolio			Value-weight portfolio			Equal-weight portfolio			Value-weight portfolio		
	One-year	Two-year	Three-year	One-year	Two-year	Three-year	One-year	Two-year	Three-year	One-year	Two-year	Three-year
All	<b>0.76%</b>	<b>0.63%</b>	<b>0.54%</b>	<b>0.58%</b>	<b>0.49%</b>	<b>0.39%</b>	<b>-1.44%</b>	<b>-1.03%</b>	<b>-0.96%</b>	-0.10%	-0.06%	-0.20%
	0.000	0.000	0.000	0.013	0.015	0.047	0.000	0.000	0.000	0.851	0.863	0.484
1	<b>0.69%</b>	<b>0.55%</b>	<b>0.47%</b>	<b>0.73%</b>	<b>0.53%</b>	<b>0.42%</b>	<b>-3.28%</b>	<b>-2.29%</b>	<b>-1.73%</b>	<b>-3.11%</b>	<b>-2.04%</b>	<b>-1.58%</b>
(Small)	0.002	0.016	0.036	0.001	0.010	0.044	0.000	0.000	0.000	0.000	0.000	0.000
2	<b>0.94%</b>	<b>0.74%</b>	<b>0.58%</b>	<b>1.00%</b>	<b>0.71%</b>	<b>0.70%</b>	-0.58%	-0.34%	-0.29%	-0.45%	-0.33%	0.01%
	0.001	0.003	0.019	0.000	0.008	0.005	0.289	0.351	0.419	0.436	0.378	0.966
3	<b>0.88%</b>	<b>0.74%</b>	<b>0.77%</b>	<b>0.76%</b>	<b>0.59%</b>	<b>0.70%</b>	-0.43%	-0.40%	<b>-1.04%</b>	-0.41%	-0.47%	-0.61%
	0.002	0.003	0.001	0.006	0.008	0.001	0.508	0.375	0.013	0.480	0.239	0.088
4	<b>0.77%</b>	<b>0.70%</b>	<b>0.58%</b>	<b>0.71%</b>	<b>0.80%</b>	<b>0.69%</b>	-0.19%	-0.15%	-0.09%	0.03%	0.10%	0.10%
	0.004	0.002	0.004	0.007	0.001	0.003	0.799	0.719	0.833	0.964	0.848	0.829
5	0.41%	0.42%	0.32%	0.46%	0.38%	0.23%	0.54%	0.15%	-0.14%	0.51%	0.23%	0.03%
(Large)	0.154	0.090	0.192	0.131	0.129	0.318	0.577	0.792	0.771	0.538	0.649	0.949
1-5	0.27%	0.12%	0.15%	0.26%	0.15%	0.19%	<b>-3.83%</b>	<b>-2.44%</b>	<b>-1.59%</b>	<b>-3.62%</b>	<b>-2.28%</b>	<b>-1.61%</b>
	0.377	0.683	0.604	0.427	0.611	0.502	0.001	0.003	0.024	0.002	0.003	0.015

**Table 4: Calendar-Time Portfolio Regressions by Ratings**

This table reports calendar-time portfolio regression alphas to VIC long and short recommendations submitted from January 1, 2000 to December 31, 2011. The samples consist of all firms that have at least one monthly return observation and a rating. At the beginning of every calendar month, all event firms are assigned to one of five quintiles based on their rating. Each month, the quintile portfolios consist of all firms that were recommended in month  $t$ , and within the last  $x$  months ( $x$  is the length of the holding period). Portfolios are rebalanced monthly. The independent variables are the monthly excess value-weight market index returns and returns from the Fama and French factors (1993) and the Carhart (1997) momentum factor. Alphas are in monthly percent, p-values are shown below the coefficient estimates, and 5% statistical significance is indicated in bold.

	Long Recommendations						Short Recommendations					
	Equal-weight portfolio			Value-weight portfolio			Equal-weight portfolio			Value-weight portfolio		
	One-year	Two-year	Three-year	One-year	Two-year	Three-year	One-year	Two-year	Three-year	One-year	Two-year	Three-year
All	<b>0.51%</b> 0.001	<b>0.42%</b> 0.003	<b>0.35%</b> 0.0117	0.38% 0.078	0.25% 0.122	0.14% 0.319	<b>-1.10%</b> 0.000	<b>-0.84%</b> 0.000	<b>-0.80%</b> 0.0000	0.41% 0.350	0.13% 0.705	-0.02% 0.931
1 (Low Rating)	-0.25% 0.369	-0.10% 0.668	-0.22% 0.3182	0.01% 0.988	-0.02% 0.944	-0.13% 0.695	0.19% 0.771	-0.14% 0.810	-0.02% 0.9663	0.31% 0.663	-0.21% 0.682	-0.13% 0.793
2	0.34% 0.156	0.13% 0.543	0.08% 0.7037	0.03% 0.909	-0.03% 0.927	-0.03% 0.926	-0.14% 0.846	-0.28% 0.621	-0.22% 0.6586	-0.50% 0.472	-0.27% 0.585	-0.60% 0.197
3	0.37% 0.110	0.40% 0.061	<b>0.43%</b> 0.0300	0.22% 0.389	0.29% 0.205	0.27% 0.195	0.22% 0.707	-0.10% 0.833	-0.26% 0.5460	<b>2.61%</b> 0.002	1.59% 0.054	<b>1.57%</b> 0.042
4	<b>0.80%</b> 0.000	<b>0.69%</b> 0.001	<b>0.69%</b> 0.0006	<b>0.99%</b> 0.005	<b>0.73%</b> 0.023	<b>0.64%</b> 0.040	<b>-2.05%</b> 0.000	<b>-1.60%</b> 0.000	<b>-1.25%</b> 0.0011	-0.64% 0.303	-0.66% 0.175	-0.72% 0.105
5 (High Rating)	<b>1.25%</b> 0.000	<b>0.69%</b> 0.001	<b>0.48%</b> 0.0106	0.68% 0.071	0.40% 0.160	0.20% 0.424	<b>-2.02%</b> 0.000	<b>-1.39%</b> 0.000	<b>-1.41%</b> 0.0001	<b>-1.51%</b> 0.010	<b>-1.21%</b> 0.006	<b>-1.14%</b> 0.004
5-1	<b>1.50%</b> 0.000	<b>0.79%</b> 0.004	<b>0.69%</b> 0.007	0.68% 0.152	0.43% 0.314	0.33% 0.404	<b>-2.21%</b> 0.014	-1.25% 0.070	<b>-1.39%</b> 0.030	<b>-1.82%</b> 0.031	-0.99% 0.102	-1.01% 0.086

**Table 5: Comments Summary Statistics**

This table reports summary statistics for the comments associated with VIC recommendations submitted from January 1, 2004 to November 20, 2009. Panels A and B show the characteristics of long and short investment ideas, respectively. The sample consists of all firms that have at least one monthly return observation, data for MVE in the month preceding the recommendation, and at least one comment. Comments represent the number of comments. Members represent the number of unique members commenting. #Private (%Private) represents the number (percentage) of comments that are private. Author (%Author) represents the number (percentage) of comments from the author. < 45 days (%<45 Days) represents the number (percentage) of comments submitted within 45 days of the recommendation date.

*Panel A: Long Recommendations*

Variable	N	Mean	Median	Std. Dev.	Min.	Q1	Q3	Max
Comments	1,271	11.35	8.00	12.90	1.00	4.00	14.00	138.00
Members	1,271	4.77	4.00	3.29	1.00	3.00	6.00	28.00
#Private	1,271	3.53	2.00	5.66	0.00	0.00	4.00	82.00
%Private	1,271	29.69%	25.00%	27.67%	0.00%	0.00%	50.00%	100.00%
Author	1,271	4.15	3.00	5.28	0.00	1.00	6.00	57.00
% Author	1,271	38.06%	42.86%	25.53%	0.00%	20.00%	50.00%	100.00%
<45 Days	1,271	6.50	4.00	7.61	0.00	2.00	9.00	91.00
% <45 Days	1,271	65.51%	77.78%	37.50%	0.00%	40.00%	100.00%	100.00%

*Panel B: Short Recommendations*

Comments	228	13.13	8.50	15.01	1.00	4.00	17.50	147.00
Members	228	5.20	5.00	3.27	1.00	3.00	7.00	24.00
#Private	228	4.37	2.00	7.21	0.00	1.00	5.00	73.00
%Private	228	31.32%	26.67%	27.18%	0.00%	7.85%	50.00%	100.00%
Author	228	4.44	2.50	5.77	0.00	0.00	6.00	40.00
% Author	228	34.07%	40.00%	23.90%	0.00%	0.00%	50.00%	100.00%
<45 Days	228	6.66	5.00	7.04	0.00	1.50	10.00	47.00
% <45 Days	228	63.95%	76.79%	38.09%	0.00%	36.13%	100.00%	100.00%

**Table 6: Relationship between Private Comments and Idea Value**

This table presents the results of regressing the number of comments marked private (#Private) and the percentage of comments marked private (%Private) on Rated, Rating and several control variables for VIC recommendations submitted from January 1, 2004 to November 20, 2009. The sample for each regression consists of all firms that have data for each of the variables used in the regression. Columns 1-3 (7-8) are quasi-likelihood estimates from a fractional logit regression for long (short) recommendations; columns 4-6 (10-12) are maximum likelihood estimates from a Poisson regression for long (short) recommendations. Rated is an indicator variable set to one if the firm has a rating, zero otherwise; Rating is the average rating assigned by the VIC community. Log MVE is the natural log of MVE; Log B/M is the natural log of one plus B/M; Log Illiq is the log of one plus the Amihud (2002) measure of illiquidity measured over a twelve-month period prior to the VIC recommendation; Past1 Return is the buy-and-hold return during the one month prior to the VIC recommendation. Past12 Return is the buy-and-hold return during the 12 months preceding the recommendation excluding month t-1. Month fixed effects are included where indicated. Standard errors are clustered at the firm level. p-values are shown below the coefficient estimates, and 5% statistical significance is indicated in bold.

	Long Recommendations						Short Recommendations					
	Fractional Logit (% Private)			Poisson (# Private)			Fractional Logit (% Private)			Poisson (# Private)		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
Rated	0.031			<b>0.647</b>			<b>-0.592</b>			0.594		
	0.843			0.000			0.038			0.080		
Rating		<b>0.184</b>	<b>0.146</b>		<b>0.437</b>	<b>0.426</b>		0.231	0.165		<b>0.946</b>	<b>0.839</b>
		0.002	0.017		0.000	0.000		0.135	0.375		0.000	0.001
Log MVE	<b>-0.058</b>	-0.029	<b>-0.058</b>	-0.027	<b>-0.027</b>	-0.027	0.075	0.116	0.065	0.043	0.051	0.044
	0.014	0.218	0.017	0.280	0.006	0.274	0.344	0.078	0.421	0.613	0.059	0.582
Log B/M	-0.059	-0.026	-0.031	0.022	-0.026	0.024	0.477	0.299	0.429	0.096	0.077	0.412
	0.520	0.756	0.736	0.850	0.501	0.828	0.230	0.379	0.327	0.800	0.571	0.170
Log Illiq	-0.013	0.091	-0.013	0.027	-0.065	-0.025	0.018	0.323	0.106	-0.473	-0.415	-0.057
	0.879	0.312	0.894	0.739	0.070	0.761	0.984	0.643	0.902	0.451	0.065	0.889
Past1 Return	-0.451	<b>-0.875</b>	-0.420	-0.461	<b>-0.685</b>	<b>-0.639</b>	-0.075	-0.210	-0.049	-0.320	0.011	-0.026
	0.100	0.004	0.160	0.105	0.000	0.034	0.904	<b>0.670</b>	0.939	0.636	0.954	0.960
Past12 Return	-0.024	<b>-0.237</b>	-0.029	0.115	<b>0.118</b>	0.106	0.078	0.026	0.059	<b>0.173</b>	<b>0.193</b>	<b>0.135</b>
	0.706	0.003	0.645	0.089	0.000	0.081	0.374	0.700	0.519	0.013	0.000	0.041
Constant	<b>-1.019</b>	<b>-1.474</b>	<b>-1.689</b>	0.222	<b>-0.647</b>	<b>-1.089</b>	-2.674	<b>-3.814</b>	<b>-4.489</b>	0.572	<b>-4.491</b>	<b>-6.000</b>
	0.042	0.002	0.003	0.651	0.001	0.043	0.078	0.004	0.009	0.743	0.000	0.000
Fixed Effect	Month		Month	Month		Month	Month		Month	Month		Month
Observations	1,166	1,065	1,065	1,166	1,065	1,065	210	196	196	210	196	196
Pseudo R <sup>2</sup>	0.152	0.031	0.161	0.091	0.042	0.115	0.380	0.031	0.358	0.346	0.185	0.424

**Table 7: Institutional Ownership Summary Statistics**

This table shows the % institutional ownership (Panel A) and the number of institutions holding shares (Panel B) for long recommendations from January 1, 2000 to December 31, 2011. Observations are divided into quintiles based on rating. Mean change refers to the difference in institutional ownership between the two quarters listed. Two-sided p-values for a paired t-test are shown in the final two columns, and 5% statistical significance is indicated in bold. The line labeled 5-1 presents the difference in the means of % Institutional Ownership (Panel A) and # of Institutions (Panel B) between firms in the highest and lowest quintiles of VIC ratings. We test for differences in means using a two-tailed t-test assuming equal variances. p-values are shown in the final two columns, and 5% statistical significance is indicated in bold.

Panel A: % Institutional Ownership											
	N (t-2 to t+2)	N (t-1 to t+1)	Quarter t-2	Quarter t-1	Quarter t	Quarter t+1	Quarter t+2	Mean Change t-1 to t+1	Mean change t-2 to t+2	p-value t-1 to t+1	p-value t-2 to t+2
All	2,302	2,485	55.86%	55.99%	56.72%	56.84%	57.49%	<b>0.85%</b>	<b>1.63%</b>	0.000	0.000
No rating	324	348	54.49%	53.83%	54.49%	54.16%	54.39%	0.34%	-0.10%	0.464	0.883
1	413	448	61.49%	61.13%	60.93%	60.67%	60.36%	-0.46%	-1.12%	0.469	0.154
2	404	441	57.24%	56.86%	57.80%	57.71%	59.16%	0.84%	<b>1.92%</b>	0.117	0.006
3	359	388	56.36%	55.94%	56.71%	57.17%	58.89%	<b>1.22%</b>	<b>2.54%</b>	0.018	0.000
4	451	474	53.10%	54.35%	55.45%	55.26%	55.42%	<b>0.90%</b>	<b>2.32%</b>	0.049	0.000
5	351	386	51.94%	53.06%	54.16%	55.46%	56.28%	<b>2.40%</b>	<b>4.34%</b>	0.000	0.000
5-1								<b>2.86%</b>	<b>5.46%</b>	0.001	0.000
Panel B: # of Institutions											
All	2,302	2,485	140.56	138.98	139.29	140.08	142.23	<b>1.09</b>	<b>1.67</b>	0.047	0.041
No rating	324	348	118.13	115.05	116.06	116.50	119.85	1.45	1.73	0.179	0.393
1	413	448	149.96	146.95	144.67	142.15	142.46	<b>-4.80</b>	<b>-7.50</b>	0.003	0.001
2	404	441	149.09	148.77	149.90	151.52	152.32	2.75	3.23	0.051	0.106
3	359	388	147.11	142.46	145.15	146.85	152.99	<b>4.40</b>	<b>5.88</b>	0.001	0.002
4	451	474	149.72	149.40	149.35	151.19	149.84	1.79	0.12	0.083	0.948
5	351	386	121.89	123.84	123.59	125.39	130.20	1.55	<b>8.30</b>	0.304	0.000
5-1								<b>6.36</b>	<b>15.80</b>	0.004	0.000

**Table 8: Short Interest and Short Recommendations**

This table shows the levels of short interest % (shares short divided by shares outstanding) for short recommendations from January 1, 2000 to December 31, 2011. Observations are divided into quintiles based on rating. Mean change refers to the difference in short interest % between the two months listed. Two-sided p-values for a paired t-test are shown in the final two columns, and 5% statistical significance is indicated in bold. The line labeled 5-1 presents the difference in the means of short interest between firms in the highest and lowest quintiles of VIC ratings. We test for differences in means using a two-tailed t-test assuming equal variances. p-values are shown in the final two columns, and 5% statistical significance is indicated in bold.

Rating	N (t-2 to t+2)	N (t-1 to t+1)	Month t-2	Month t-1	Month t	Month t+1	Month t+2	Mean Change t-1 to t+1	Mean change t-2 to t+2	p-value t-1 to t+1	p-value t-2 to t+2
All	381	384	10.14%	10.39%	11.00%	11.64%	11.91%	<b>1.25%</b>	<b>1.77%</b>	0.000	0.000
No rating	44	44	7.79%	8.15%	8.18%	8.73%	9.04%	0.58%	1.24%	0.308	0.069
1	48	49	9.36%	9.38%	10.00%	9.68%	9.06%	0.30%	-0.30%	0.532	0.629
2	48	48	8.44%	8.88%	9.48%	10.14%	10.13%	<b>1.27%</b>	<b>1.69%</b>	0.013	0.012
3	55	56	10.00%	10.20%	10.55%	11.41%	11.01%	<b>1.21%</b>	1.01%	0.02	0.069
4	79	79	12.38%	12.73%	13.28%	13.67%	14.41%	0.94%	<b>2.03%</b>	0.059	0.008
5	107	108	10.63%	10.82%	11.83%	13.01%	13.78%	<b>2.18%</b>	<b>3.15%</b>	0.000	0.000
5-1								<b>1.89%</b>	<b>3.45%</b>	0.005	0.001