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(Updated note: In October 2009, IPOX Capital Management LLC, a SEC registered investment advisor, was formed by Dr. Josef Schuster. Under its first mandate, IPOX® Capital Management LLC will provide sub-advisory services to the innovative "Direxion IPOX® Global Long/Short Strategy Fund", a US-based alternative equity fund scheduled for launch in December 2009.)

By Gerard Al-Fin

Mr. Schuster, what is the main business of IPOX Schuster?

IPOX Schuster LLC is an innovative financial services firm specialized in Financial Products Design related to global IPOs and spin-offs. Our underlying philosophy involves classifying IPOs and spin-offs into a separate asset class for a substantial, yet limited time in aftermarket trading. Our main product is the series of IPOX® Indexes, 50 Indexes which allow for scalable exposure to the aftermarket performance of global IPOs and spin-offs. The index series precisely measures the impact of IPOs and spin-offs to benefit from the potential asset allocated benefits of IPOs and spin-offs, which share unique empirical dynamics.

Is the global IPO market economically significant?

The market for global IPOs is economically significant. Around USD 600bn p.a. has been created through global IPOs over the past decade. Due to the unique impact of the 'going public' event, the aftermarket performance of global IPOs may diverge substantially from the performance of the benchmarks indexes. From an asset allocation perspective, it is therefore important to track IPOs separately from the market.

Who are our clients?

Ever since the launch of our first product in July 2005, the IPOX Indexes have managed to establish themselves as an alternative vehicle to gain exposure to growth companies and have been applied in various ways. More than 50 separate financial products representing approximately USD 3bn have been benchmarked to IPOX since 2005. These are, amongst others, fund products in the U.S. launched by Morgan Stanley's Van Kampen Investments or First Trust Advisors. Other products include structured products launched by Banco Santander, ABN Amro/RBS, UBS Bank Sarasin Alpen in Europe or non-branded index replication funds offered by Macquarie in Hong Kong or DBS in Singapore. Moreover, domestic Chinese Banks such as China Minsheng or China Everbright have used IPOX to gain access to the large- and mega-cap stocks pooled in the IPOX-30 Global (All Markets) Index. These structures were arranged by Banks such as Goldman Sachs, Barclays Capital, Deutsche Bank, Merrill Lynch or JP Morgan.

Has there been enough business in 2009? The number of IPOs has declined dramatically.

Amongst our three sectors Funds, Structured Products and Data Services, we have seen strong declines in structured products as banks have sharply reduced headcount in or shut entire divisions. On the other hand, the business with investment funds and pension fund has increased lately, mostly due to the positive performance record of the IPOX Indexes, which efficiently capture the performance of an underrepresented sector. We are also in the process of launching a product line less susceptible to declining equity markets, such as the IPOX Global Long/Short portfolios, which have market neutral characteristics.

“Since our first product in 2005, the IPOX Indexes have managed to establish themselves as an alternative form to capture the dynamics of global growth companies and have been applied in various forms globally.”

What about the declining number of IPOs?

Because IPOX is taking at least a four-year perspective to the performance of global IPOs and spin-offs, we are less affected by the current decline in the number of IPOs. I want to note that even last year, a number of large IPOs and spin-offs took place, e.g. Philip Morris International, Visa, Lorillard, China Railways, Renhe Commercial, China Railways Construction or OGX.

What about the performance of IPOs in the world regions?

Over the long-run, an investment into IPOs versus the well known benchmark indexes is attractive. A reason is the solid portfolio construction methodology and index technology of the IPOX Indexes. For example, the IPOX-30 U.S. Index (IPXT), which measures the performance of the largest 30 U.S.-domiciled companies over a four-year rotational cycle, has outperformed the Russell 3000 Index by around 7500 basis points since going real-time five years ago. On the global level, the performance has been similarly positive. The performance in Asia-Pacific and Europe has been slightly more moderate. For example, the IPOX Europe has suffered over proportionately in 2008, mostly due to heavy exposure into the plunging mining sector. This year, however, the indexes have recorded strong outperformance again.

Can you provide us with a list of examples?

The relatively few IPOs during the past months have generally performed well. For example, Renhe Commercial, a Sequoia-capital backed developed of underground shopping centers in China has almost doubles since going public in November last year. Furthermore, I want to highlight US firms such as Philip Morris International, Lorillard, Dr. Pepper Snapple and Mead Johnson, US-traded consumer staples with high dividend yields, which have developed well on a risk-adjusted basis. I want to particularly stress Gree Inc., the first listed social networking firm in Japan and benchmark for a potential IPO of Twitter and Facebook. The stock has doubled since its IPO at the beginning of the year. All these stocks are included in IPOX.

What are the criteria for inclusion of IPOs into the IPOX Indexes?

For the start, we do only include offering of common stocks of IPOs and spin-offs and do not consider unit offerings, investment companies, real estate investment trusts (REITs) or similar offerings. Once we have identified the universe of companies, companies which do meet size, float and certain initial return restrictions, are included in the IPOX Global Composite Index (IPGLC). The IPOX Global Composite Index measures are a fully market-cap weighted index that measures the performance of IPOs and spin-offs over an approximately four-year rotational cycle. The index currently captures 2100 companies and USD 2.5 trillion total market capitalizations. The respective IPOX Sub-Indexes, such as the IPOX China 20 Index (CNI), IPOX-30 U.S. Index (IPXT), IPOX-30 Europe Index (IXTE) or IPOX-30 Global Index (IPGL30), provide a quarterly snapshot of the respective universe in the underlying IPOX Global Composite Index and are optimized by applying liquidity and diversification rules. The result is a semi-passive, stable and scalable index group, which allows for a precise measurements and replication of the performance of the largest IPOs and spin-offs over a four-year rotational cycle. Interestingly, we find that hedge funds and active fund companies tend to overweight IPOX heavyweights, such as Visa, Mastercard, Philip Morris International or Lorillard.

IPOX organized a global IPO workshop at the DIFC in October 2009. Who are your clients in the UAE?

In the past year, Bank Sarasin Alpen and ABN Amro/RBS have structured IPOX-linked products for private clients in Dubai. Further, a number of active IPO funds have been launched in Saudi Arabia recently. I see good opportunities in the MENA region, because of the inherent advantages of using indexing vs. active management in the IPO space, combining lower cost and diversification.

Two large Saudi-Arabian domiciled IPOs have recently experienced large initial returns when going public on the Riyadh stock exchange, rising 400 and 700 percent, respectively: AXA Cooperative insurance and subsidiary of AXA Group, the French insurance giant, and competitor ACE Arabia Cooperative Insurance. To what degree do these companies play a role?

Companies with such large initial returns are principally excluded from IPOX Indexes membership. In markets such as Saudi-Arabia (or domestic China), high initial returns are common place, often experience by state-owned firms which have different motives to 'going public'. In these cases, IPO prices are set artificially low to compensate certain investors in the sense of a wealth transfer.

The experience with companies with extraordinarily high initial returns such as China-based Alibaba.com, U.S.-based VM Ware, Fortress, Las Vegas Sands etc. is negative, globally. The phenomenon of huge initial returns poses an underlying threat to the health of the domestic Chinese market, for example. AXA Cooperative Insurance and ACE already trade 30 percent below their first close, despite the strength in the local stock market.

You have recently celebrated the fifth anniversary of your company? What has motivated you in summer 2004 to start IPOX?

To find a scalable, systematic and positive solution to the large skewness in long-run IPO returns globally. Over cycles, a large number of companies go public globally. Many companies eventually will have performed poorly, while few will have performed very well, which describes the essence of the IPO market. Those that perform well, however, when holding combined in an asset allocation focused vehicle, can have substantial asset allocation benefits (such as CME, GOOG, MLP, Bank of China, Tencent, Kazakmys, Vedanta, Xstrata, Visa, Mastercard, etc.). IPOX is an efficient vehicle which uniquely replicates the effects of the 'going public' process on companies.

For future generations of investors, it will also be increasingly important to consider alternative indexing methodologies which have dynamic, rather than static properties, i.e. where companies such as General Electric, Microsoft, Siemens, Google, SAP or ICBC have a limited, not indefinite holding period. It is interesting to relate this to Chinese market, where the YTD performance difference between the IPOX China 20 Index (CNI) and the FTSE XINHUA 25 Index (XIN01) is due to the "old" index constituents in the FTSE XINHUA 25 Index.

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You have based the company in Chicago. Why didn't you choose New York and Wall Street?

Our first client is headquartered in the Chicago area. An important part of our research is done out of London and Beijing as well.

Chicago and Detroit are often referred to as "Metropolitan areas of decline" due to the decline in US carmakers? What can you contribute to the discussion?

I strongly believe in a renaissance of the US auto industry. The US governments mandate to run the automakers has already been bearing fruit in terms of consumer behavior and climate/environment protection. One can also see the strong cuts in distributions networks and the focus in developing smaller, more energy efficient cars. You can see the first positive signs as the US consumer seems to increasingly switch to smaller, more energy efficient cars. The IPO of GM and Chrysler next year could be interesting. Sometimes, the effect of a successful IPOs are jumps in innovation, GOOG is a good example. In any case, IPOX will track the developments and be involved.

Ben Bernanke, FED governor, is cautiously optimistic about worldwide economic recovery. When do you see a pick-up in European IPO activity?

Over the next few months, the recovery in global equity markets will have positive effects on European IPO activity. Upcoming deals include the IPO of Birdseye Iglo (frozen foods, Germany), New Look (fashion group, United Kingdom), Pets at Home (animal foods, United Kingdom), Phoenix Group (Pharma, Germany), Sisal (online betting, Italy) or Unity Media (cable TV, Germany). Over the long-run, companies such Deutsche Bahn (transportation, Germany) and Glencore (Materials, Switzerland) will be going public.

Thank you for the conversation !!!

(August 2009, update: October 2009).