

The Berkowitz Group, Incorporated

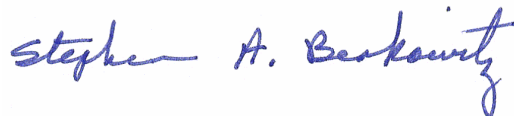
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We are reviving our periodic précis of the two articles crossing our desk this quarter that we believe will be of greatest interest to the securities industry and the litigation attorneys serving the industry. Should you have questions about the articles or the topic they cover please contact us and we will be delighted to chat with you.

Sincerely yours,



Stephen A. Berkowitz

“What Does Nasdaq’s High-Yield Bond Market Reveal About Bondholder-Stockholder Conflicts,”
Gordon J. Alexander, Amy K. Edwards, and Michael G. Ferri, *Financial Management* Spring 2000, pages 23-39.

Equity and debt have value because they represent claims on the expected cash flows of the issuer. As issuers become more risky, uncertainty increases regarding their ability to satisfy all claims on expected cash flows. This paper finds a general relationship between excess bond returns and excess stock returns when controlling for risks embedded in bond and stock indices. The authors lay the foundation to explore the impact of events that transfer wealth between bondholders and shareholders.

Data from 39 corporate issuers of high yield corporate bonds over the period October 3, 1994 to July 1, 1997 provide some support for the notion that excess returns in time proximity to events expected to transfer wealth between bondholders and shareholders are different from those observed during other periods. While the authors explore a cross section of issuers, we believe that the techniques offer insights into responses of securities markets to events affecting a single issuer.

Were the analysis to be confined to a single company, compliance reporting (and, in the context of litigation, discovery) can be used to determine accurately the dates when events may be expected to affect the markets for debt and equity securities. This removes a significant source of noise (read error) from the analysis. The authors have provided a much richer set of tools for demonstrating both liability and damages in matters involving alleged securities fraud than we currently see in general use. These tools lend themselves to analysis of matters that involve the reapportionment of bondholder and shareholder claims through the issuance of convertible bonds, warrants, and other forms of derivatives.

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“When the Underwriter is the Market Maker: An Examination of Trading in the IPO Aftermarket,”
Katrina Ellis, Roni Michaely, and Maureen O’Hara, *Journal of Finance*, Vol. LV, No. 3, June 2000.

This paper examines 306 Nasdaq initial public offerings (IPO’s) from September 1996 to July 1997. It builds a technical vocabulary for measuring the gross profitability of underwriter activities during the first three months of life for a publicly traded equity. The quote and transaction data reported in the paper are readily available from Nasdaq. Data regarding underwriting fees and related costs are available from the various compliance reports filed by broker/dealers and issuing companies.

The authors find that the lead underwriter not only becomes a market maker in the IPO issue, but also the most active dealer. They note that the intermediation activities of the lead underwriter (who accumulates significant inventory positions) contribute significant liquidity to the markets. Although it is counter-intuitive, they find that underwriting fees represent approximately three-quarters of the gross profits earned by the underwriter in the first three months of an issue’s trading life. The analysis confirms that IPO underpricing is directly linked to underwriting profits.

While the intent of the study is to explore the relative importance of various IPO related activities of the lead underwriter’s gross profitability, the data tabulations by the authors offer guidance regarding the range of economic costs that arise from the IPO process. Applying a similar analysis to a single underwriter or issue and incorporating such additional data as the registered representative payout files can reveal the business dynamics that create the direct selling costs incurred to move IPO inventory. These data are commonly retained by broker-dealers and are typically made available through the discovery process during securities litigation.