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Insider Action Flashes Buy on Tech

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While individual investors have bailed out of the **Nasdaq** recently and pundits have recommended steering clear of anything tech-related, corporate insiders have turned decidedly more bullish.

"Analysts have thrown in the towel [but] insiders are waving a new one," said Michael Painchaud, director of research and principal at Market Profile Theorems, which tracks insider activity for institutional clients like **Fidelity** and **Putnam Investments**.

According to Painchaud, the technology sector is displaying more positive insider action than at any time over the last 13 years, with companies like **Motorola** (MOT:NYSE - news - commentary) , **Electronic Arts** (ERTS:Nasdaq - news - commentary) , **McData** (MCDT:Nasdaq - news - commentary) , **MSC Software** (MNS:NYSE - news - commentary) , and even **Computer Associates** (CA:NYSE - news - commentary) all showing accelerated insider buying or an abatement of insider selling.

"Technology is a bad word, but insiders are heading in here very dramatically, and it's just the opposite to what they were doing in 1999 and 2000," he said.

Undecimated

Painchaud, who follows 2,517 stocks in 10 sectors, said the tech group has seen the most dramatic decile change over the last few months, going from 2 in March to 10 today, suggesting to him that some tech stocks may have hit bottom. "You rarely see tech, as a sector, move above 1 historically speaking," he said.

Market Profile's insider trading model works like this: The firm takes publicly available **SEC** filings on the companies it tracks and runs the data through a computer. Each company is then assigned an individual decile, or score, based on seven different factors, the most important of which is whether an insider actually bought or sold shares.

If the purchase or sale was particularly large, or if the individual conducting the transaction had been prescient in the past, the model gives extra weighting to those trades. The stock's historical inside trading pattern is another input that can affect the stock's final score, which ranges from 1 to 10, with 10 being the best.

Although the final number is significant, Painchaud said it is less important than the rate of change in the number. The technology sector, for example, has seen a very sharp positive change in a short period of time, indicating that insiders have turned more constructive.

Other sectors of the market, like financials and energy stocks, also have a high score, but Painchaud stops short of drawing any conclusions because the numbers haven't changed noticeably in the last few

months.

Because insider buying has historically preceded gains in individual stocks, the data suggest the tech sector could be poised to move higher. "Insider activity, modeled in the right way, does have predictive characteristics," Painchaud said.

In 2001, companies under his coverage that had seen positive insider activity rose 3.8% over a six-week holding period, while companies seeing negative insider activity were down 1.45% over the same time.

Wacked

One of Painchaud's best catches recently was **ImClone** (IMCL:Nasdaq - news - commentary) . On Nov. 17, 2001, his company issued a fax to clients saying that the stock had seen a 7-point drop in its score in one week, suggesting that insider activity had turned bearish. "Generally, the larger the drop in the insider model score, the greater the possibility that you're going to have price weakness," he said.

Upon further investigation, Painchaud found that almost every director had been selling stock Oct. 29, including William R. Miller, John Mendelsohn, David Kies, Richard Barth, Arnold Levine and Paul Kopperl.

Richard Barth again sold stock on Dec 12, leaving him with no shares in the company at all. That fact added weight to Painchaud's model, serving to keep ImClone's score at the lower end.

"All summer long, [ImClone] was scoring 9s and 7s. It had never scored under a 7 from Dec. 1, 2000 all the way through Nov. 16. So that's why it appeared on the list, because of the change in behavior," Painchaud said.

When Market Profile's fax went out on Nov. 17, Imclone was trading at \$63.31, but by February it had fallen to \$18. (The stock is now back on the firm's buy list, however, having seen an improvement in insider activity.)

In his most recent update to clients, Painchaud warned that homebuilders and hospital management firms have seen a pickup in insider selling recently. He also cited **Albany International** (AIN:NYSE - news - commentary) , which he said has seen some selling by formerly accurate inside buyers, and **Goodrich Petroleum** (GDP:NYSE - news - commentary) , which has seen some cluster selling.

Conversely, **Remec** (REMC:Nasdaq - news - commentary) has seen cluster buying while **Sigma Designs** (SIGM:Nasdaq - news - commentary) and **Computer Motion** (RBOT:Nasdaq - news - commentary) have also seen an increase in inside buying.

Profile Market Theorems uses its research on insider trading in combination with three other models to determine whether a stock is likely to trade higher or lower. The firm uses technical analysis and also has a style model to gauge what kind of company will benefit from the current environment, be it growth, value, large- or small-cap.

In addition, it examines changes to analysts' earnings expectations. Although analysts are currently bearish on technology (scoring a 2 on the firm's earnings model), Painchaud said they will likely turn more bullish in time.

"There is a natural informational hierarchy in the markets, that's our premise, and naturally the persons who run the companies should be aware of changes first," he said. "If our model is correct, analysts will follow the insiders."
