INSIDER MONKEY

Monthly Mini Newsletter
June 2013 Issue:1

Inside This Issue

Insider Monkey's mission is pretty straightforward. We try to outperform the market by imitating the stock picks of smart money managers and corporate insiders. We have been sharing the stock picks of our small-cap hedge fund strategy in our newsletter since the end of August 2012 and our picks have returned **48.9% through the end of May**. The S&P 500 Index, by comparison, gained 17.8% including dividend payments during the same period.

With that being said, we decided to launch this monthly mini newsletter to focus on a single hedge fund to determine if we could come up with new investment strategies. In the first issue of this newsletter we will analyze Greenlight Capital's historical 13F filings.

In the second part of this monthly newsletter, we will be sharing 2 stock picks by an up-and-coming hedge fund manager, Michael Castor of Sio Capital. Dr. Castor is an expert on healthcare stocks and his small-cap stock pick from our February interview returned more than 100% in a little over 3 months.

This first issue of our monthly mini newsletter will be free for all subscribers. All of our premium subscribers who subscribed before June 15th, 2013 will have **FREE** access to all future issues of this newsletter as long as they remain subscribed to our Quarterly Hedge Fund Newsletter. The monthly subscription price of this monthly mini newsletter will be $29.99 and we will offer a significant discount ($249 per 12 issues) if you opt in for an annual membership.

Don't pay hedge funds hefty fees when you can buy the best stock picks of best hedge fund managers at a fraction of what they charge

Can We Make Money By Imitating David Einhorn's Greenlight Capital?

David Einhorn, the manager of Greenlight Capital, is one of the most popular hedge fund managers overseeing around $9 billion. His returns have been spectacular in the past but not so much in recent years; this is a very common pattern we see with hedge funds.

Generally speaking, hedge fund managers tend to deliver strong returns when they are small and nimble, but their alpha goes down as they become bigger. This natural evolution, then, is why it is important to scrutinize their recent returns as well as their entire track record. We will focus on one subset of Einhorn's picks at a time and decide whether we should imitate these stock picks.

Imitating David Einhorn's all stock holdings that are disclosed in historical 13F filings would have yielded a monthly return of 1.23% between 1999 and 2012.

1. Subset: All Stock Picks
Average Monthly Return (1999-2012): 1.23%
Average Monthly Return of S&P 500 Total Return Index (1999-2012): 0.32%
Monthly Four-Factor Alpha (1999-2012): 0.40%

Average Monthly Return (2008-2012): **0.89%**
Average Monthly Return of S&P 500 Total Return Index (2008-2012): **0.29%**
Monthly Four-Factor Alpha (1999-2012): **0.14%**

Imitating Einhorn's entire stock picks may seem like a good idea but our analysis shows that the outperformance was mainly due to exposure to well-known factors. We used Carhart's four factor model to measure Einhorn's alpha. Our analysis showed that his alpha is 14 basis points per month between 2008 and 2012.

2. Subset: Top 10 Stock Picks
Average Monthly Return (1999-2012): 1.16%
Average Monthly Return of S&P 500 Total Return Index (1999-2012): 0.32%
Monthly Four-Factor Alpha (1999-2012): 0.47%

Average Monthly Return (2008-2012): **-0.05%**
Average Monthly Return of S&P 500 Total Return Index (2008-2012): **0.29%**
Monthly Four-Factor Alpha (1999-2012): **-0.57%**

Surprising results! Imitating Einhorn's top 10 holdings would have been a terrible experience between 2008 and 2012.

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3. Subset: Top 5 Stock Picks
Average Monthly Return (1999-2012): 1.20%
Average Monthly Return of S&P 500 Total Return Index (1999-2012): 0.32%
Monthly Four-Factor Alpha (1999-2012): 0.42%

Average Monthly Return (2008-2012): **-0.29%**
Average Monthly Return of S&P 500 Total Return Index (2008-2012): **0.29%**
Monthly Four-Factor Alpha (1999-2012): **-0.89%**

Imitating Einhorn's top 5 holdings would also have been a terrible experience between 2008 and 2012.

Imitating David Einhorn's largest 5 holdings that are disclosed in historical 13F filings would have been a disaster between 2008 and 2012.

4. Subset: Large Cap Stock Picks (above $20 billion in market cap)
Average Monthly Return (1999-2012): 0.75%
Average Monthly Return of S&P 500 Total Return Index (1999-2012): 0.39%
Monthly Four-Factor Alpha (1999-2012): 0.33%

Average Monthly Return (2008-2012): **0.40%**
Average Monthly Return of S&P 500 Total Return Index (2008-2012): **0.29%**
Monthly Four-Factor Alpha (1999-2012): **-0.06%**

Einhorn didn't have any large cap picks in the earlier years of his career. The first time he had a large cap pick in our database was the first quarter of 2002. As you can see his large cap picks have performed worse than his other picks.

5. Subset: Mid Cap Stock Picks (Between $10-20 billion in market cap)
Average Monthly Return (1999-2012): -0.12%
Average Monthly Return of S&P 500 Total Return Index (1999-2012): 0.34%
Monthly Four-Factor Alpha (1999-2012): -0.56%

Average Monthly Return (2008-2012): **1.05%**
Average Monthly Return of S&P 500 Total Return Index (2008-2012): **0.29%**
Monthly Four-Factor Alpha (1999-2012): **-0.01%**

These picks performed well relative to the market recently but that was purely because of exposure to well-known factors.

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6. Subset: SMid Cap Stock Picks (Between $5-10 billion in market cap)
Average Monthly Return (1999-2012): 1.31%
Average Monthly Return of S&P 500 Total Return Index (1999-2012): 0.53%
Monthly Four-Factor Alpha (1999-2012): 0.42%

Average Monthly Return (2008-2012): **-0.02%**
Average Monthly Return of S&P 500 Total Return Index (2008-2012): **0.35%**
Monthly Four-Factor Alpha (1999-2012): **-0.89%**

Imitating David Einhorn's small-cap holdings that are disclosed in historical 13F filings would have returned 1.35% per month between 2008 and 2012.

7. Subset: Small Cap Stock Picks (Between $1-5 billion in market cap)
Average Monthly Return (1999-2012): 1.49%
Average Monthly Return of S&P 500 Total Return Index (1999-2012): 0.32%
Monthly Four-Factor Alpha (1999-2012): 0.77%

Average Monthly Return (2008-2012): **1.35%**
Average Monthly Return of S&P 500 Total Return Index (2008-2012): **0.29%**
Monthly Four-Factor Alpha (1999-2012): **0.66%**

We finally found what we were looking for. Einhorn's small-cap picks seem to outperform the market in all phases of his career. More recently these stock picks outperformed the market by more than a percentage point per month and this strategy's monthly alpha was 0.66%. These are very respectable returns.

8. Subset: Top 5 Small Cap Stock Picks (Between $1-5 billion in market cap)
Average Monthly Return (1999-2012): 1.13%
Average Monthly Return of S&P 500 Total Return Index (1999-2012): 0.32%
Monthly Four-Factor Alpha (1999-2012): 0.46%

Average Monthly Return (2008-2012): **0.88%**
Average Monthly Return of S&P 500 Total Return Index (2008-2012): **0.29%**
Monthly Four-Factor Alpha (1999-2012): **0.26%**

The purpose of this last analysis is to discover if there is a relationship between the size of Einhorn's small-cap positions and their returns. It seems like there isn't a positive relationship.

Can We Make Money By Imitating David Einhorn's Greenlight Capital?

Conclusion:
Einhorn has been an amazing investor over his career but it is obvious to us that his alpha declined significantly as he started investing in larger cap stocks. When he has 1-2 good investment ideas each year, he typically shares them at high profile investment conferences.

This is a brilliant marketing strategy as people think that they have to hand over their hard earned dollars to Greenlight Capital to benefit from Einhorn's stock picking ability.

We disagree. Our analysis shows that Einhorn's best stock picks are small-cap stocks and investors may be able to experience much better returns by imitating Einhorn's small-cap stock picks. These stock picks returned 78.7% between 2008 and 2012. During the same 5 year period, the S&P 500 ETF (SPY) returned only 8.6%.

Based on the latest 13F filings (for the first quarter of 2013), here are David Einhorn's small-cap picks:

Company Name	Ticker	SH/PRN	Option	Value (x1000)	Activity	% in Portfolio	Market Cap (Billions)
MARKET VECTORS E T F TRUST	GDX	SH	N	227289	0%	3.5%	4.9
OIL STATES INTERNATIONAL INC	OIS	SH	N	220239	New	3.4%	4.5
N C R CORP NEW	NCR	SH	N	257956	-9%	3.9%	4.4
LEGG MASON INC	LM	SH	N	81626	-25%	1.2%	4.1
IAC INTERACTIVECORP	IACI	SH	N	19512	New	0.3%	3.8
A E C O M TECHNOLOGY CORP	ACM	SH	N	38479	0%	0.6%	3.4
BABCOCK & WILCOX CO NEW	BWC	SH	N	115311	0%	1.8%	3.2
D S T SYSTEMS INC DEL	DST	SH	N	160002	0%	2.4%	3.2
SPIRIT AEROSYSTEMS HOLDINGS INC	SPR	SH	N	31390	New	0.5%	2.7
ASPEN INSURANCE HOLDINGS LTD	AHL	SH	N	189612	0%	2.9%	2.7

Click to see Einhorn's entire portfolio and historical holdings.

Two Stock Picks from the "Next David Einhorn"

In the second part of this monthly newsletter, we will be sharing 1-2 stock picks made by either our team or by up-and-coming hedge fund managers who aren't particularly well known yet.

Michael Castor of Sio Capital is one of these hedge fund managers. We interviewed Dr. Castor at the end of February and published [this article on Marketwatch] at the end of March. Here is what we said in our article:

"Michael Castor of Sio Capital Management, LLC is a medical doctor (he used to be a surgeon) by training, but switched to finance in mid 2000. He worked as a health-care analyst at JPMorgan and Bernstein Investment Research and Management until he launched Sio Capital in 2006. Sio Capital returned 10.4% a year since its inception vs. 3.8% average annual gain for the S&P 500 Total Return Index during the same period. But this isn't why we like Sio Capital. We like Sio Capital because they achieved a 6.6 percentage-point outperformance with a nearly market neutral portfolio. Its beta was 0.15 since inception. Sio Capital was also 12% net short in 2012, yet it returned 14.9% after fees and expenses."

Sio Capital returned 10.4% a year since its inception in 2006, outperforming the S&P 500 Total Return Index by 6.6 percentage points per year.

We went on to discuss a trio of stock picks by Michael Castor. The first one was Cardinal Health (CAH), which returned 3.6% since our interview. Cardinal Health is a $16 billion market cap company. It isn't surprising that Michael's large-cap pick didn't perform as well as his small-cap pick. NPS Pharmaceuticals (NPSP) was trading below $8 when Michael recommended the stock in our interview. By the time we published the Marketwatch article the stock was up 25%. Currently NPSP trades at $15.76 and it returned 103% since our interview. We were pretty accurate by calling him the "Next David Einhorn" in our Marketwatch article. We believe Michael is a great hedge fund manager who has a nose for picking under-the-radar healthcare stocks.

So we knocked on Michael Castor's door again last week and he shared the following two small-cap ideas with us. Here is his note:

"A favorite quote of mine is by Peter Lynch: "Never invest in any idea you can't illustrate with a crayon." With that in mind, I present two small cap ideas. The investment stories are simple and the valuations compelling. While no investment is without risk, the risk of these investments seems low and is outweighed, if not dwarfed, by the returns that I expect.

Two Stock Picks from the “Next David Einhorn”

Rockwell Medical (RMTI)
Current Price: $4.09
Market Cap: $106 Million
52-Week Change: -57%

Rockwell Medical [RMTI]: Current Price=$4.09

Rockwell is focused on developing products for dialysis (kidney-failure) patients. Rockwell currently has a single product on the market: dialysate (the solution that ‘detoxifies’ the blood during the dialysis process). Dialysate is a relatively low gross-margin product, but Rockwell is a leading manufacturer with a market-leading product and growing share. Economies of scale should result in manufacturing efficiencies. More importantly, Rockwell has an existing commercial infrastructure and established relationships with customers. Accordingly, if Rockwell has any other products to sell to dialysis clinics, these will require very little incremental spending, and the resulting revenues should largely fall right to the bottom line. Indeed, this is exactly Rockwell’s story.

Rockwell has two products in late stage development. Both of these are geared towards sales to dialysis clinics. Both of these products are versions of already-existing drugs, thus making development risk extremely low.
The first of these products is calcitriol (vitamin D). Vitamin D is normally produced in the kidneys and is essential for healthy bone growth and for maintaining normal levels of calcium in the body. Rockwell submitted their application for FDA approval. We expect approval in the fall of 2013.

The second product is iron, which the body uses to produce red blood cells. Rockwell’s iron product, formally known as soluble ferric pyrophosphate (SFP), is in late stage clinical trials called CRUISE 1 and CRUISE 2. Data from these is due in July and September. Given solid early stage data coupled with the established benefit of IV iron, we think these are low-risk programs. Rockwell’s SFP is arguably superior to other commercial iron products, but we believe that Rockwell’s real advantage is the ability to bundle several products while selling to dialysis clinics.

Dialysis is paid for by Medicare. The current paradigm is referred to as ‘bundled’ payments, in which clinics receive a fixed amount for caring for dialysis patients. If clinics are able to purchase lower-cost goods in caring for their patients, they keep the savings as incremental profits. RMTI has articulated that it’s plan is to sell its vitamin D and iron products at a modest discount in order to take some share.

Two Stock Picks from the "Next David Einhorn"

From a financial perspective, Rockwell is winding down its R&D program as the SFP clinical trials are almost over. R&D spending, which is currently running at about $50m/year, should fall by half. The commercial infrastructure is in place with little incremental spending needed to support these two new products. We estimate that the combined R&D and SG&A spending will be approximately $50m at steady state. If Rockwell is able to capture 20% market share of its new products using modest discounting, we estimate that the company should generate incremental revenues in excess of $150m.

The main risk to investing in Rockwell is commercial execution. Rockwell need to be successful at gaining market share and doing so with attention to controlling costs. There is also clinical trial risk, as no clinical trial is a sure thing, but the risk there is low given that IV iron products are already established to be important in caring for dialysis patients. If however, Rockwell is able to navigate these risks and perform as we expect, this should yield earnings power in excess of $1.50 per share by 2017. With the stock trading at $4.00, this is compelling in our opinion.

Mazor Robotics (MZRTF) (MZOR)
Current Price (MZRTF): $5.54
Current Price (MZOR): $11.34
Market Cap: $165 Million

Mazor Robotics (OTC:MZRTF) (NASDAQ:MZOR):
Current Price (MZRTF)=$5.54,
Current Price (MZOR)=$11.34

Mazor robotics is an even simpler investment story than Rockwell. Mazor has built a robotic platform known as "Renaissance" to assist surgeons performing operations on the spine. Mazor's robot allows for shorter operations, higher accuracy, and less blood loss. It allows for easier minimally invasive surgery in an area of the body with very complex anatomy. The result should be better patient care and greater patient satisfaction. Our initial checks suggest excellent feedback on the Renaissance robotic platform. Mazor is in the early stage of launching its robot. We believe the launch will accelerate. The concept of Robotic surgery has been validated by Intuitive Surgical [ISRG], which has a market cap of $20 bn. Mako [MAKO], a smaller company with a robotic platform designed for orthopedic surgeons has had less positive feedback from physicians and slow uptake. Despite this, Mako's market cap is approximately $600m. Mazor currently has a market cap of approximately $160m.

Two Stock Picks from the "Next David Einhorn"

Mazor has been under the radar screen of many investors in part because, despite being headquartered in Florida, the company's shares traded only on the Tel Aviv stock exchange in Israel. On May 29, MZOR shares began trading on the Nasdaq. This should not only help drive awareness of the company, it will allow US investors to own MZOR. The main risk for investing in Mazor is commercial execution. Even with a great product, the company needs to generate physician awareness and demand for its products. We think this will come and will be monitoring this closely over time. We think that MZOR has a great product and a bright future. We believe that the current stock price offers a compelling entry point for investors."

Michael Castor's small-cap stock pick from our February interview returned more than 100% in a little over 3 months.

Michael Castor is one of the hedge fund managers we endorsed. We really like him because of his track record, and we should also note that it isn't possible to imitate his stock picks by following his 13F filings. Sio Capital doesn't have to disclose its stock holdings because it manages less than the $100 million threshold. Sio Capital is based in New York and its website is siocapital.com.