Would Reduced Corporate Disclosure Be Good for the TSX Index?

Description

As the U.S. considers reducing quarterly reports down to biannual reports, Canadian investors with exposure to the NYSE and NASDAQ may want to be prepared for such an eventuality. What would it mean for investors, and in particular Canadian investors with exposure to American companies, and could the introduction of reduced corporate disclosure have any direct effect on our own TSX index?

Pros

Some of the thinking behind reducing corporate disclosure is linked to improving the performing efficacy of companies, particularly by reducing compliance costs for smaller firms and their ability to manoeuvre through tough periods. In theory, company directors would be freer to try out long-term growth tactics without worrying unduly about frightening investors.

Technically, stocks would also be less volatile overall, and investment styles would change focus to the long-term. You may see more stability in REITs, such as **Morguard REIT** (TSX:MRT.UN), with less impact from fluctuations in the housing market. As a case in point, Morguard is discounted by 44% compared to its future cash flow value, despite offering a large dividend yield of 7.74%. A softening housing market may therefore lend itself to reduced corporate disclosure, since REITs would generally face less volatility through the year, helping to shore up their share prices.

Cons

Disappointed shareholders would likely still be a part of a post-reduced disclosure landscape, while corporations themselves wouldn’t necessarily change the way they operate. Markets could be skewed, with greater volatility around report releases, and the TSX index as a whole could potentially be depressed. Heavy trading either side of a release would be intensified if biannual reporting were to be brought in, leading to wilder swings in the market.

More traditionally-minded investors, who presumably would benefit from less short-term focused volatility, might not find the proposed changes to their liking, however. Look at a stock like **Rogers** (TSX:RCI.A)(NYSE:RCI) for instance. This is a very attractive stock at the moment, with its price slashed by 23% of its future cash flow value. But what would reduced disclosure do to its share price?

One might see a swing in its P/E ratio, currently at 19.1 times earnings, while growth outlooks would be harder to ascertain if they were even disclosed at all. Value investors might end up having to rely more heavily on P/B ratios (Rogers currently has one of 4.7 times book).

Stocks like Rogers are popular with a more traditional type of investor, the sort to whom corporate disclosure is a key part of trust and accountability. Risk-wary shareholders like their long-term investments to be stable, and so for them transparency is a big deal. Limiting the amount of information available to the public could hide details of financial health, outlook, and even litigation.

The bottom line

Any positive movement on reduced corporate disclosure is likely to have an unwanted effect on stock markets, with investors reacting negatively to a potential lowering of asset and income transparency. While there may be long-term benefits to the TSX index for reducing volatility, unwanted side-effects such as impacts on entire modes of investing (such as momentum trading) mean that any sea change in the investment ecosystem is likely to create initial fear and potentially long-lasting deleterious effects.

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1. Dividend Stocks
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TICKERS GLOBAL

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2. TSX:MRT.UN (Morguard Real Estate Investment Trust)
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