Explanation of “Ensign Effect” – Telecom Sector Market Cap Increase on Bill Introduction

The attached spread sheet depicts changes in market values of publicly traded U.S. telecom service providers (sheet 4) and equipment manufacturers (sheet 5) since Sen. Ensign introduced his bill on Wed. The data are for 7/25 thru 7/28. For purposes of assessing the effects of the bill on stock prices, you should probably assume that the lift actually began on Tues as opposed to Wed morning when the bill was unveiled. The reason being that Wall Street types tend to be pretty good about anticipating events like this and trading a bit a head of them. In any case, the data show that introduction of the bill has had a very positive, and I would add much welcomed and needed impact on nearly all U.S. telecom service and equipment stocks. Specifically, from market close on Monday thru Thurs the total market value of U.S. telecom service companies (ILECs, CLECs, IXCs, etc) increased nearly $10B, while the total market value of U.S. and Canadian equipment manufacturers rose $12B. [In this instance, Canadian companies like Nortel and Research in Motion should be treated as U.S. vendors since they sell primarily into the U.S. market.] It also is interesting to note that, on a percentage basis, the bill apparently had a greater positive impact on facilities-based CLEC stocks than it did on the ILEC stocks. See the summary table at the bottom of sheet 4 for specifics.

I expect the reason for this has to do with the notion that investors view the Ensign bill as a vehicle for reducing exceedingly high levels of regulatory uncertainty (and risk) that the entire telecom industry has labored under for some time. This would certainly explain why nearly all stocks went up but also why the facilities based CLEC stocks outperformed the Bells. It would further explain why the equipment manufacturers stocks outperformed the telecom service providers as a group. Clearing out a lot of unnecessary economic regulation and reducing high levels of regulatory uncertainty that would go with it, will obviously help spur capital spending on telecom networks in the U.S. Increasing capital spending on domestic networks, in turn, is key to jump starting revenue and earnings growth -- as well as R&D spending and innovation -- in the network equipment arena; all essential ingredients to restoring the ability of U.S. equipment manufacturers to compete globally. Sometimes Wall Street thinks well beyond the next quarter or two and this is one of those times. In a very real sense, the investment community's favorable reaction to the bill is simply an affirmation of the various points that Sen. Ensign made in his July 13 article in The Hill. **As Walter Wriston, former CitiCorp Chairman, used to say "capital goes where it’s welcomed and stays where its treated fairly."** Since the Ensign bill would represent a huge and long overdo step in that direction, it is not at all surprising that the bill's mere introduction had the practical effect of creating $22B in new wealth.

The market is telling us that it expects a less regulated environment will strengthen not diminish meaningful faculties based competition (e.g., CLEC stocks up more than ILECs). More robust facilities-based competition, in turn, will give rise to high levels of capital spending on advanced network gear (e.g., equipment stocks up more than service provider stocks) as facilities based network compete more intensively on the basis of service quality as well as price. As they do, of course, the pace of innovation will accelerate --- giving rise to huge consumer welfare gains that result from getting completely new products and service to the market sooner than later.

(Adapted from comments from Bob Blau – CFA – BLS)