



**Tech Futures:
January 25, 2002**

By [Michael Volker](#)

Outlook 2002, BCSC is Listening, Capital Pool Corps Update, anRRSP Idea and Local Events

Outlook 2002:

Last week, I addressed the **Vancouver Board of Trade** at its annual "Outlook 2002" presentation on the B.C. economy. My talk focused on the B.C. technology sector. I warned, though, that I'm not an economist. When in university I almost dated one though. However, when I asked her for her phone number, she gave me an estimate! Speaking of estimates, have you ever wondered why economists predict to decimal-place accuracy? (Ans: To show that they have a sense of humor). In trying to be vaguely correct rather than precisely wrong, here's what I said.

First, with respect to GDP contribution, in the year 2000, high tech contributed 3.9% of the province's GDP. Although this does not sound like much, it was only 2.6% in 1995. High tech has grown at an impressive 10-year average annual growth rate of 9.2%.

There are currently some 61,000 employees working in more than 7,800 firms in B.C.'s high tech sector. The revenues of these firms add up to close to \$10 billion. If you add up the sales of the top 100 companies as found on the T-net, you'll get a figure over \$6 billion for the 2000 fiscal year. But if you add to that an estimate of sales contributed by firms with branches and divisions, you'll get a number closer to \$8 billion! Firms such as **IBM, Motorola, Crystal Decisions, JDSUniphase** (until recently), **Raytheon, Honeywell, Broadcom** and **Electronic Arts** are among those with a strong presence in B.C. Electronic Arts alone probably produces close to \$500 million in its worldwide studios based in Burnaby.

Just 5 years ago, we had no \$100 million sales companies in this province. Now, we have more than a dozen. **QLT Inc.** (TSE: QLT) is the first biotech company to achieve this level of sales, reporting \$31 million in its latest quarter with an enviable bottom line to boot. When it made its public debut on the CDNX (formerly the VSE - yes, the VSE!) a decade or so ago, you could have bought it for less than a buck. And, two companies made it into the billion dollar club last year. Indeed, **Creo Products** (TSE: CRE) and **PMC Sierra** (NASDAQ: PMCS) both reported more than C\$1 billion in sales for their latest reporting period. I was a little disappointed that these achievements passed by without much hoopla. We really do need to promote our sector a little more! I hope they at least had a pizza and beer employee party.

With regard to what's included under the "high tech" banner, there are three main thrusts. These are: Infotech which includes hardware, software, communications, microelectronics, electronics internet, new media and entertainment companies; Biotech which includes life sciences, genomics, bioinformatics, biopharmaceuticals, medical devices; and Technology (for lack of a better word) which would include alternate energy (fuel cells & components), aerospace (this is an \$800 million industry with 7000 employees in 50 companies), manufacturing, and miscellaneous science & technology ventures. Here's how they stack up:

	Employment	Sales (2000)	Market Cap
INFOTECH	50,000	\$6 billion	\$7b - \$10b

BIOTECH	3,000	\$200 million	\$5b - \$6b
TECH	8,000	\$1 billion	\$5b - \$6b

It's noteworthy that the market values of these three groupings are roughly comparable. Yet, the maturity of these technologies, using revenue (or employment) as a proxy, clearly shows that biotech is still very nascent, yet highly valued.

At the market peak in the Spring of 2000, the aggregate market capitalization of the publicly-traded B.C. tech companies was close to \$100 billion. Currently that figure is closer to \$20 billion. Yet, just 5 years ago, that number was under \$5 billion.

Numbers aside, there's a more grass-rootsy way of seeing the progress that's being made. It really warms my heart when I go on my weekly shopping spree at **Costco** and see products such as **Xantrex's Jazz** (tm) auxiliary power device on the shelves. Or, for that matter, to see the shrink-wrap boxes of EA Sports games produced in Burnaby. Another example occurred during a recent trip to Silicon Valley. I was watching a local business channel which just happened to be talking about Bloomberg's "buy" rating on two B.C. stocks, namely **PMC Sierra** (NASDAQ:PMCS) and **Pivotal Corp** (NASDAQ:PVTL). Imagine, in Silicon Valley!

Although this visibility is encouraging and even though we've seen some impressive growth, the industry, by any measure, is still young with a much bigger future ahead.

What is the "root cause" of this industry progress and what will continue to drive it? Well, it all starts with R&D - research and development. Our universities and colleges are the fountains from which the innovation process emanates. They not only spin off many successful companies directly, they also breed the talent and the intellectual property that perpetuates the process. Just for the record: The **University of B.C.** (UBC) has created more than 100 companies to date. UBC's current research spending is in the \$200M range while **Simon Fraser University** with its more modest \$25M budget has produced some 60 new ventures. According to BC Stats, SFU and UBC have been issued more U.S. patents, on a cumulative basis, than the top institutions in Alberta and Ontario. The **University of Victoria** at \$30M, ranks second in funded R&D.

The amount of R&D conducted in B.C. is approximately \$1 billion. This represents 0.9% of GDP. The general view is that this is too low, especially in comparison to the rest of Canada at 1.5%. At the 2000 **Business Summit** conference in Vancouver, a stated goal was to increase this to 1.125% by 2005. This concerns me because it isn't ambitious enough. When you have political leaders like **Paul Martin** saying that he wants to triple Canada's total R&D spending from \$15 billion to \$45 billion in 10 years, it makes me wonder if we're not being a little too conservative. Why, even according to Canada's "Innovation Agenda", the direct federal support for R&D is slated to double from \$3.7 billion to \$7 billion by 2010. How about that? With a very competitive after-tax corporate cost of 45 cents on the dollar, B.C. is well positioned for more.

But R&D on its own doth not a business make. Innovation is the key to growth. Entrepreneurs are *the* champions of innovation. They are the ones who take the raw intellectual properties and transform these into consumable, market-driven products and economic wealth. As an industry evolves, more entrepreneurs are attracted to, and cultivated by, the industry. Role models emerge for others to emulate. For innovation to occur and entrepreneurship to work, access to capital is needed.

So, how are we doing on the money side in B.C.? Pretty good, actually, especially in B.C. Venture capital investments for the 2001 year were just over \$600 million as compared to approximately \$450 million in 2000. There were some fairly large deals included such as **Xantrex** which raised \$58 million and **Xenon Genetics** which raised \$70 million. This is a good indication that B.C. is becoming an attractive region for tech investment. B.C. outperformed Canada and the USA in terms of VC activity. The level of foreign participation is also on the up.

Entrepreneurs face their greatest challenge when seeking start-up capital. So-called "seed" or

"angel" money is what gets the innovation process rolling and is the first step towards moving an idea or concept closer towards becoming a commercial reality. VCs tend to keep away from, or at best dabble in, early opportunities. This is the turf of angels. In fact, I strongly believe that if a company cannot attract an angel investor, it will find it even tougher to get any form of institutional funding. Angels, which are by my definition tech entrepreneurs investing their own money, provide a company not only with capital but also with some expertise (not to forget the old Rolodex). They also add credibility.

Furthermore, the mindset between angels and VCs is entirely different. VCs, because they invest other people's money, are obligated to think of all the reasons why they should *not* invest in a company. Angels, because they are accountable only to themselves (spouses notwithstanding), think of the reasons why they *should* invest. Getting an angel is kind of a rite-of-passage.

Tracking angel activity is not easy. Because of the more informal and personal nature of this type of investing, reliable statistics are not available. However, by my own estimates, I figure that angel deals in 2001 amounted to something between \$40 and \$90 million. No small change! I base that on just what I've seen or heard about. Hence, the numbers could be even greater. This resource cannot be underestimated. It will, in my view, become the most important resource for startup CEOs. Information on B.C.'s angel network can be found at www.vef.org/vantec.html.

I have been a big fan of the public market as a source of capital. A stock exchange such as the **Canadian Venture Exchange** (CDNX) plays a major role. VCs tend to pooh-poo this exchange because they frown on companies going public "too early". Yet, it provides companies with another option. For those deals that are perceived as too risky to bet other people's money on, a wide public distribution in which hundreds of people risk a few thousand dollars as compared to a few investors risking millions, this is a good alternative. It also gives the street or retail investors a chance to speculate on the next hot tech venture (maybe the next **QLT Inc** or **Westport Technologies** - both of which started off on the CDNX). More tech firms are taking this route. Approximately 50% of new CDNX listings are technology companies.

Last year, CDNX financings suffered badly. In the first nine months of the year, only \$57 million was raised by tech companies as compared to \$187 million the year before (the boom year). This drop was due to the beating which public markets in general took in 2001. Many investors retreated in the wake of the tech fallout. Exacerbating this is the time and cost factor associated with dealing with the regulatory regime and our country's insane system of provincially regulated securities commissions. (On the positive side, it keeps a lot of lawyers employed). Due to the over-regulation which has taken place good companies have been discouraged to list, leaving the marginal ones for investors. The lack of good deals contributes to the lack of investor interest. Hence, we have a downward spiral. Everyone stays away.

In B.C., securities regulators are listening (see item below) and I'm optimistic that in future will have a more conducive regulatory system. Additionally, we'll have to take steps to make the CDNX really hum. We have to get investors, brokers, companies, promoters, and deal-makers back into the game. I think we can do it without compromising on investor protection through adequate disclosure - not so much on business plans and technology as on people backgrounds and track records.

In addition to the entrepreneurial zeal and the improved access to capital, B.C. has a rich infrastructure to support the development of the tech sector. B.C. is home to numerous institutions, industry organizations, and collaborative initiatives. In addition to the five universities and several colleges, we have organizations such as the **B.C. Science Council** and industry-led **B.C. Advanced Systems Institute**, industry "voices" such as the **B.C. Biotech Alliance**, the **B.C. Technology Industries Association**. There are networking and educational opportunities through the **Vancouver Enterprise Forum** and **New Ventures B.C.** Finally, there are specific, new R&D institutes such as the **New Media Innovation Centre** (NewMIC), **Fuel Cells Canada**, and **Genome B.C.** as well as organizations such as the **National Research Council**, and numerous other research facilities (e.g. **B.C. Cancer Agency**, **Feric**, **Forintek**, and **Paprican** - to name a few).

As for technologies that are "hot", I'm seeing lots of interest in the following areas:

Infotech - Microsoft's "dot-net" vision will create some new opportunities especially in communications and collaborative software (side note: even though many software companies saw their revenues fall last year, Microsoft continued to enjoy quarterly growth - now a U\$25 billion goliath). We'll also see lots of activity in data sharing technologies (e.g. XML), wireless products (hardware and software), and digital convergence (the melding of entertainment, communications and computers).

Biotech - There's a lot of interest in genomics, proteomics, and bioinformatics especially as these relate to drug discovery.

Technology - we'll see continued interest in alternate energy (fuel cells), advanced materials and nanotechnology.

How does all this translate into 2002 growth prospects for the industry? I believe that we should see continued growth (as measured by revenues) in the 8-10% range. We won't see the impact of many of the new initiatives (i.e. NewMIC, Fuel Cells Canada, or Genome BC) this year, but these will lay a foundation for the future. High tech tends to create its own demand, too (after all who needs a PC anyway?) and more people are seeking to make their fortunes in high tech.

As some students recently learned, if you take an idea from someone, that's plagiarism but if you take many ideas from many people, that's called research. Here are the results of some of my "research" when I polled some of our industry leaders on their views.

Alan Winter [CEO - NewMIC, now CEO of Genome BC]: "It may be a tough year for B.C. in general but not so bad for the high tech sector. Small companies will find it more difficult to attract funding as V.C.s put their money into previously-funded firms that require follow-on capital. We should see a firming up at the higher end of the value-chain as revenues stabilize and continue from their pre-2000 levels. Overall, I'm optimistic."

Dan Gelbart [President & Co-founder, CREO Products Inc.]: "Creo's fortunes are tied to the printing industry which is tied to the world economy in general (being one of the worlds major industries)... We are using the recession to develop many new products which will be launched over 2002. The first one, for the creative side of graphic arts is being launched (this month) at MacWorld. The price of success and large market share in a large market is that you can not move much faster (or slower) than the market you are in."

Brent Sauder [Exec Director, BC Advanced Systems Inst.]: "What's going to be hot will be limited by what early investors will put their money into. Biotech still attracts the dollars. Telecom (hardware & software) will be tough but basic "building block" technology components are still of interest (e.g. microelectronics firms WestBay, Cogent Semiconductor, Vector 12 come to mind)."

Paul Lee [Sr.V.P. & COO - EA Worldwide Studios]: "My gut [feeling] on Industry Growth in BC is probably 7%. There has certainly been a drop in the technology industry as a result of the dot-com crash and as a result of the economy. As the Premier has stated, technology really is a productivity tool for industry in many ways.... Biotech, alternative energy and the entertainment software industry continue to do well. Companies like EA, Crystal Decisions, ALI Technologies, QLT, Ballard Power, Questair, Inex, Stressgen, Xantrex, MDSI, MDA, Fincentric, and many, many other Biotech and alternative energy companies continue to do well."

Greg Aasen [VP, PMC Sierra]: "We have stated publicly that we see a bumpy year, that inventory problems will continue through mid year. End demand for more bits on the internet is still growing so we are optimistic that the long term outlook is good."

George Hunter [Exec Director, B.C. Tech Industries Assoc.]: "As you might expect, I'm bullish.

We're expecting to see a strengthening market thru the year. Cap-ex numbers indicate an improvement in IT purchasing. It should be a good year for new and refinancings as the positive economic climate begins to unlock the trillions of investment dollars currently sitting on the sidelines. I think it would be a great year to start or finance a company.... Lots of talent available, improving financing environment and technology companies at realistic valuation. Biotechs mobile and alternative energy all look strong."

The prognosis for BC's overall economic performance is that GDP is likely to be around 1% this year and as high as 3% in 2003, much like Canada as a whole. High Tech will be a shining light for many years to come.

BCSC is Listening

I thought you might be interested in knowing that the **B.C. Securities Commission** has launched an initiative to seek advice from "new economy" companies in B.C. making the capital-raising process easier for them. In the past, the BCSC was mostly concerned about protecting investors - not building companies.

As part of Gordon Campbell's promise to cut red tape (cutting red tape is good as long as it's not cut length-wise), the Commission now reports to the **Ministry of Competition Science and Enterprise** (the open-for-business guys) and the focus now is to assist companies rather than collect fines for minor violations.

Its goal is to simplify securities regulations in B.C. for new economy companies. As such, it is asking for **your** opinion. I'm truly impressed at their genuine interest in getting feedback. Go to www.bcsc.bc.ca to respond to the survey which the commission has launched on its website. It is asking industry participants - including those who advise or help fund these ventures - to share their financing experiences and plans and to identify barriers to capital raising in B.C. The survey is an initiative of the commission's newly created New Economy and Adoption of Technologies group. Now, that is NEAT!

In a press release, the commission noted the "growing importance of high-tech companies which generated 3.9 per cent of B.C.'s GDP in 2000 and are growing at a higher rate than the overall provincial economy. It created the NEAT group to help find ways of streamlining regulation of the securities market and to offer regulatory support to firms operating in the new economy."

In addition, the NEAT group will conduct focus groups and interviews with industry participants to hear their thoughts and opinions on specific regulations that hamper their capital-raising and business activities as well as what regulatory changes would help streamline regulations for new economy companies. A summary report of the group's findings is expected to be available in late spring. Any questions or comments should be addressed to Derek Patterson, chair of the NEAT group at 604-899-6801 or dpatterson@bcsc.bc.ca.

An RRSP Idea

Registered Retirement Savings Plan are great tax shelters for Canadians. They sure beat setting up a Cayman Islands Corp (besides, you can go to Whistler rather than bake in the sun).

Due to recent cuts in capital gains taxes, RRSPs are no longer as attractive as they used to be (hey, I'm not complaining) unless you're doing a lot of active stock trading. It may be better to hold long-term investments with no annual income outside an RRSP. An exception to consider is the **Working Opportunity Fund** ("WOF"). WOF is a labor-sponsored venture capital fund available for BC investors.

Here's what **Jarek Matysiak** at **Canaccord Capital** has to say about it: "I recommend WOF highly as a prudent RRSP-type investment. It has been a top 10 Canadian Equity fund over the past 9 years (since inception). Plus, it carries with it a major tax advantage: you get a permanent tax

credit of 30% in the year you buy it. This plum deal is more or less limited to \$5,000 per person per year (one can invest up to \$13,500 to receive a total of 20% deductions, but to maximize the tax credit percentage to 30%, \$5,000 is the limit. I generally recommend \$5,000 as the most clients should consider). The investment requires the money to be locked-in for 8 years (usually not an issue for RRSPs or long-term investors. However, there are also a few exceptions to the 8 year lock-up: death, losing your Union job, or being physically disabled breaks the lock)."

"For a contribution of \$5,000, you receive a \$1,500 tax refund (not to be confused with a mere tax deduction). Approximately half the \$5,000 investment gets invested into either the TSE 300 or money market bonds (your choice) while the other half goes into their venture capital portfolio (their track record has been among the top 10 in Canada over a 9 year period. Examples are their purchase of **Angiotech** (TSE:ANP) at \$2.75, now worth \$90; **Stressgen** (TSE:SSB) at 80 cents, now worth \$4.50; and **HotHaus** (private) in which they invested \$4 million and sold for about \$170 million a few years later, which represented the largest win by any Canadian venture capital manager in Canadian history). This fund completely avoided the dot.com craze as one would expect from truly experienced venture capitalists (they never understood how exactly the revenues would be realized, so they never invested in them). Make a \$5,000 WOF investment as part of an RRSP contribution and you will receive up to \$4,000 back in taxes in April (depending on your tax bracket). Do this year in year out, then, in year 9, sell 1st year investment and roll it back in for a second 30% deduction. So after 8 years, it can feed itself while continuing the annual tax credits beyond year 8 - all without committing any new money."

"Here's an example: Joe invests \$5,000 per year for himself and for his wife Betty's spousal RRSP (\$10,000 total). Let's assume a 40% tax bracket for each. Over an 8 year horizon, a total of \$80,000 of pre-tax money is invested (\$5k x 2 people x 8 years). From this, \$24,000 of tax credits (\$1,500 x 2 people x 8 years) and another \$32,000 of RRSP contribution tax savings will have been refunded (40% of \$5k x 2 people x 8 years). That is a total of \$56,000 of taxes that are avoided (\$24k of the 56k) or deferred (\$32k of the 56k), respectively. Net after-tax out of pocket cost to Joe and his wife? \$80k - \$24k deduction - \$32k deferral = \$24,000. Now, the average return for this fund (not including the tax savings) has been about 12% during the past 9 years. Assuming a conservative 5% going forward, the total after 8 years of 5% annual average growth will be \$100,265. The Bottom line: Joe and Betty will invest \$24,000 out of pocket over 8 years to hold \$100,265 worth of RRSPs after 8 years assuming it grows at less than half its historic average rate. Then, for year 9 and beyond, they will collect \$3,000 of tax credit each year for doing absolutely nothing other than having their investment advisor redeem \$10,000 worth of the fund and then turning around re-purchasing \$10k more that same minute. No new injections of capital need be made to do this. Transactions Costs: first purchases cost \$30 while subsequent purchases in other years will cost \$15. There are no brokerage commissions to pay nor are any costs to sell once the 8 years are up. So, Joe and Betty would pay a total of \$60 for their first \$10k purchase while paying \$30 each year after that in which they buy more (only if they buy more, of course). Foreign Content: WOF is not only Canadian content, it RAISES the foreign content limit of one's RRSP to a maximum of 55% from the normal limit of 30%."

"Why does the government allow this tax break for these investors? Simply, it encourages investment in BC and encourages smaller investors to save money. Please note, though it is labour sponsored, the investment decision making process is in no way shape or form influenced by provincial politics or influenced by the labor movement (i.e. the Unions). Zero patronage has ever or will ever occur. Has the government's objective of granting a tax break increased their taxes collected from capital gains down the line? Yes! The amount of capital gains taxes gleaned from this fund's sales of winners has outpaced the amount of tax credits they gave up over the years. Proof that, when diverted to competent non-government hands, tax cuts today are capable of stimulating greater tax revenue down the road...Finally, know that this fund SELLS OUT each year as there is a limited supply (\$80 million for this RRSP season will be allowed). It is expected to sell out by the end of January"

Call Jarek at Canaccord at 604-643-7347 if you wish to discuss it further or check the WOF web site at www.wofund.com.

Capital Pool Corporation (CPC) Comments and Update

In this column, I keep track of **Capital Pool Corporation** ("CPC") companies as defined by the CDNX because they may provide funding and management to, and in the process acquire, technology companies. They provide companies with an alternative to traditional venture capital financing. CPCs are the continuation of the former VCP (Venture Capital Pool) and JCP (Junior Capital Pool) programs on the Vancouver (VSE) and Alberta Stock Exchanges.

Regrettably, though, the program could be working a lot better than it is. The current market conditions, the lack of broker activity, the glut of CPCs, the red tape and the uncertainty over the CDNX's future have all contributed to making the CPC route one of last - rather than first - choice for companies seeking capital.

If you add up all the CPC, VCP, and JCP companies that were formed since Alberta invented the idea back in 1987, you'll find more than 1200 such companies. In total, these have raised more than \$3 billion (yes, that's a "b") for growing companies.

Since the CPC program was launched in B.C. a few years ago, some 300 CPCs have been formed, but only a small number, i.e. less than 50, have completed their so-called Qualifying Transactions (QT). Right now, there are dozens just sitting there with modest amount of cash - usually around \$500K - not knowing what to do with it. Under a relaxation of rules by the CDNX, CPCs are permitted to merge with one another; coincident with acquiring a qualifying company, thereby eliminating the need to raise additional funds.

Check our [Capital Pool Corporation chart](#) (in .pdf format) for a complete list of the CDNX's CPC and VCP companies, thanks to **David Ing** of **Pacific International Securities**. This list is updated on a regular, e.g. monthly basis. It was recently updated to the end of November and will be updated again in the next week or two (check back!).

An introductory article explaining CPCs may be found at <http://www.bctechnology.com/statics/mvolker-jun0200.html>.

Local Events

This week, the **Vancouver Enterprise Forum** event focused on the topic of: "Finance: Venture Capital, the Banks, and the Market". This is always a popular one and was another sell-out. First, investment bankers and VC's reviewed venture capital activities in the province as compared to other areas. Then, three entrepreneurs talked about their approaches to accessing capital. **Peter Briscoe** talked about his company's (**Convedia Corp**) success in raising some US\$20 million last year from U.S. and Canadian VCs under tough market conditions. Dr. **Mark Murray**, President and CEO of **Protiva Biotherapeutics Inc.**, discussed his company's recent CDN\$14.5 million first round financing from leading Canadian venture capital firms followed by **Derek Spratt**, Chairman and Co-Founder of **Intrinsyc Software Inc.** (TSE: ICS) who discussed his company's decision to go public early in its evolution and the pros and cons of being a public company at an early stage of its development.

What particularly struck home with me, especially during Peter's delivery, was the HUMUNGOUS effort that it takes to raise capital. The time (he started in Jan01 and got funded 9 months later) and effort cannot be underestimated. The amount of work and commitment that goes into the courting of a venture capitalist left me totally exhausted and in awe of those who persist at this game. Indeed, a lesson for the naive!

Details of the talks (and info on upcoming VEF events) are available at: www.vef.org.

A complete calendar of technology events can be found on [T-Net's Events page](#).

Footnotes

If you're an entrepreneur looking for a place to get your company started; there's some great space available at Harbour Centre downtown. The **New Media Innovation Centre** (NewMIC) and **SFU's TIME Centre** have teamed up to provide not only office space but also access to various resources, e.g. tech advisors, access to capital, mentors, etc. Worried about the high cost of being downtown? Well, not to worry - they'll even reduce the fees and take some payment in the form of equity. Check www.sfu.ca/time for contact info.

A reminder: SFU's TIME Centre is open for business - business folks, that is. TIME is an acronym for Technology, Innovation, Management, and Entrepreneurship. TIME supports the growth and development of the tech industry in B.C. TIME features a "BusinessCentre" (looks like an airport business lounge) which is open to technology entrepreneurs and business people to use as a drop-in downtown office facility. Need to plug-in? Make some calls? Do some work? Hold a meeting? There are some great facilities for holding your company's AGM. Why hang out at MacDonald's when you can work productively at the TIME Centre? Drop by and check it out! It is located at SFU's downtown campus at 515 West Hastings St.

For a convenient printable, pdf version of this column, [click here](#).

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Tech Futures is a bi-weekly column that focuses attention on new and emerging BC publicly listed technology companies.

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