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FEATURE

The Bull Resurfaces Just in Time

By VITO J. RACANELLI

In the first half, all 13 of the brokerages in Barron's stock-picking ranking beat the market. Wedbush Morgan was the best sprinter, while Citigroup Global Markets led in the long-distance race.

WALL STREET'S BROKERS HAVE gotten their revenge on the stock market. All it took was a rip-snorthing 50% rally from March lows to help them. In *Barron's* semi-annual ranking of brokerages' stock recommendations, the average firm bested the market in every period measured, something that hadn't happened much since the bullish days of 2006. An unrelenting bear had bloodied the participants in the previous showing, the worst since we began publishing the focus list rankings in 2004.

Happier days have returned for now. In the six months ended June 30, 2009, each of our 13 participants beat the market. While we don't want to take anything away from the champs, the rally certainly gave every broker a leg up. Second, the two shorter periods are marked by the emergence of two regional brokers as new kings of the hill.

Los-Angeles based Wedbush Morgan won the six-month contest, with a sizzling 23% return, going to first from worst in the previous standings. Meanwhile, another regional, Seattle-based McAdams Wright Ragen, took the gold in the battle for the 12 months ended June, with a loss of 12.6%. (See nearby table.) The latter contest still carries the 2008 bear's claw marks. Nevertheless, McAdams handily outperformed.

Every six months *Barron's* ranks the stock picks of America's brokerage outfits -- some of them investment banks that the average investor recognizes, like Morgan Stanley, and others not so well known. Zacks Investment Research compiles the data and scores the firms. The Chicago-based firm analyzes the firms' research and keeps a running tally of the focus lists, or best stock ideas, of these brokers over various periods in the past five years. (For a more detailed description of the methodology see "Behind the Lists" at the end of this article.)

Table: [Wall Street Brokers Strike Back](#)

Zacks analyst Tracey Ryniec notes that the winners of this contest derived much of their strength from stocks in the tech sector, up a sizzling 60%-plus since March 9, and, to a lesser extent, financial and retail stocks.

The most recent period is also notable for the return of small-cap outperformance, something prevalent in the bull market of 2003-2007. In the six months period, the S&P 500 index -- capitalization weighted toward big- cap names -- rose just 3%, but the unweighted return was 13%, meaning small- and mid-cap stocks did much better than their big brothers. That fact might also have helped the regional brokers, some of whom focus on smaller stocks that big Wall Street brokers ignore.

Wall Street Brokers Strike Back

After a terrible showing in the second half of 2008, when all the brokers participating were beaten by the market, all 13 saw their focus lists beat the S&P 500 index in the first half of 2009.

Six Months	Change	One Year	Change	Three Years	Change	Five Years	Change
Wedbush Morgan	23.43%	McAdams Wright Ragen	-12.63%	Citigroup Global Markets	-14.98%	Morgan Keegan	15.27%
McAdams Wright Ragen	20.24	New Constucts	-14.43	Edward Jones	-15.08	Citigroup Global Markets	8.41
New Constucts	17.85	Citigroup Global Markets	-18.85	Morgan Stanley	-16.30	Goldman Sachs	6.59
Morgan Keegan	16.93	Edward Jones	-19.05	Wells Fargo	-19.90	Morgan Stanley	5.06
Citigroup Global Markets	10.68	Morgan Keegan	-24.17	Credit Suisse	-20.08	Credit Suisse	3.53
Goldman Sachs	9.73	Wells Fargo	-24.62	Goldman Sachs	-21.43	Charles Schwab	-2.20
Charles Schwab	8.48	Bank of America-Merrill Lynch	-24.63	Charles Schwab	-25.31	Edward Jones	-5.12
Raymond James	6.77	Morgan Stanley	-24.96	Morgan Keegan	-26.06	Wells Fargo	-9.73
Credit Suisse	6.48	Charles Schwab	-26.46	Raymond James	-31.07	Raymond James	-20.42
Morgan Stanley	6.30	Credit Suisse	-27.23	Wedbush Morgan	NA	Wedbush Morgan	NA
Wells Fargo	4.24	Wedbush Morgan	-27.89	McAdams Wright Ragen	NA	McAdams Wright Ragen	NA
Bank of America-Merrill Lynch	3.93	Raymond James	-32.11	New Constucts	NA	New Constucts	NA
Edward Jones	3.33	Goldman Sachs **	-32.78	Bank of America-Merrill Lynch*	NA	Bank of America-Merrill Lynch*	NA
Average Broker Returns	10.65	Average Broker Returns	-23.83	Average Broker Returns	-21.13	Average Broker Returns	0.15
S&P 500 - Total Returns	3.16	S&P 500 - Total Returns	-26.21	S&P 500 - Total Returns	-22.69	S&P 500 - Total Returns	-10.72
S&P 500 Equal Weight Total Return	13.04	S&P 500 Equal Weight Total Return	-23.56	S&P 500 Equal Weight Total Return	-23.00	S&P 500 Equal Weight Total Return	-4.75

*Merrill Lynch changed its focus-list strategy in March 2007. **Goldman Sachs changed its focus-list strategy at the end of the third quarter 2008. NA=Not applicable because broker is a relatively recent entrant.

Sources: Zacks Investment Research; Bloomberg



Dan Picasso for Barron's

Happier days have returned. Each of our 13 participants beat the market over the last six months.

In the longer races, Citigroup Global Markets placed first over 36 months, with a loss of 15%, outperforming the market's 23% decline. Morgan Keegan, a regional broker that's been a consistent winner over time, was the best over five years. Its focus list returned more than 15% in that time, compared to the S&P 500's 11% loss. Honorable mention goes to another new face, New Constructs, based in Nashville, which took the bronze in the six months and the silver over 12 months.

Meanwhile, St. Louis-based Edward Jones did the reverse of Wedbush and fell to last in the six months from first. It still managed second place over 36 months. During the terrible bear market of 2008, this proponent of a conservative "buy and hold" large, dividend-paying defensive stocks did well.

Wedbush Morgan typically has an eight-to-15-name stock focus list, and the broker specializes in consumer discretionary, retail, tech, biotech and pharmaceutical sectors, as well as small- and mid-cap stocks, notes director of research Mark Benson. In particular, Wedbush got a boost from semiconductor maker [Monolithic PowerSystems](#) (ticker: MPWR), which is now off the focus list, as well as two that remain: video-game supplier [Activision Blizzard](#) (ATVI), and biotech [United Therapeutics](#) (UTHR).

Wedbush suffered the last time round by its relatively narrow focus, but Benson points out the broker has expanded its coverage universe, tripling both the number of analysts, to 36, and the number of stocks covered, to 450 by year end.

AT REGIONAL BROKER McAdams Wright Ragen, director of research Paul Latta notes the firm's 20-25-name focus list is typically broader than its coverage universe, which tends toward Pacific Northwest companies, including [Microsoft](#) (MSFT) and [Starbucks](#) (SBUX), for example. McAdams took first place in the 12-months battle with consumer stock picks like [Nordstrom](#) (JWN), Starbucks and [Whole Foods Markets](#) (WFMI). These shares hurt the firm one year ago but were among the biggest rebounders in the rally. Whole Foods has been dropped from the list.

Financial stocks like [Moody's](#) (MCO) and [M&T Bank](#) (MTB) also helped McAdams in the first half of this year. "And in the second half of 2008, it wasn't so much what we owned, but what we didn't, like financial and commodity stocks," Latta notes.

Over three and five-year periods, which cover both a bull and bear market, sector and market cap themes play a more significant role than single stock picks. At Citigroup Global Markets, Marshall Kaplan runs the priority-equity recommended list, which won the three-year and was second in the five-year tilt. Kaplan's 20-30 stock list concentrates on free cash flow, profit margin growth and valuation. Only two names, broker [Charles Schwab](#) (SCHW) and energy-service provider [Enterprises Products Partners](#) (EPD), remained on the list for the entire three-year contest. Natural gas play [Energy Transfer Partners](#) (ETP), with a dividend yield of about 8.5%, has recently replaced EPD.

Morgan Keegan's Elkan Scheidt, chairman of its focus-list committee, notes his firm's gold medal in the five-year race was partly attributable to an underweight in tech stocks, which suffered after the 2001-2003 bear market. It also benefited from having economically sensitive sectors represented in its up to 20-name focus list during the 2003-2007 bull. Moreover, Morgan Keegan's traditional concentration on small- and mid-cap stocks boosted the first part of the list in the five-year contest.

Of note on a broader scale, most of our winning stock-pickers believe that the 2009 rally has been driven by the green shoots of inventory replenishment and sharp cost cutting, but that companies must show sales growth to sustain the market rise.

Now that the average broker performance has again beaten the S&P 500, don't be surprised if our contestants begin thumping their chests. Regular followers of the contest know most brokers go through hot and cold streaks, so investors should look for long-term outperformance.

Behind the Lists

IN TRACKING BROKERS' best ideas, Zacks Investment Research puts a stock in a theoretical portfolio when the broker adds it to its focus list, and takes it out when the broker removes it. While similar in intent, these lists differ in significant ways. For example, some are updated at regular intervals, but others are changed ad hoc. The sizes of most lists are flexible, although some are fixed. Most lists have 20 to 40 names, but the smaller the list the more exposed it is to one stellar or disastrous pick, and some are as big as 100 names. With big lists, individual picks matter less but it's tougher to beat the index.

Additionally, Zacks ranks the brokers' picks on an equal-weighted basis, while the Standard & Poor's 500 index is weighted according to its components' market capitalization. As a result, brokers' results aren't strictly comparable to the S&P 500's. So to help readers get a better perspective on relative performance, our tables show the S&P returns on an equal-weighted basis as well.

Note: Regulatory restrictions prevented Merrill Lynch, which changed its focus-list strategy in March, from publishing new performance results. Goldman Sachs changed to a new strategy at the end of the third quarter.

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