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Stupid Investment of the Week

Commentary: Give a cold shoulder to unsolicited hot stock tips

By **Chuck Jaffe**, MarketWatch

BOSTON (MarketWatch) -- Freddy Diaz was excited early Wednesday morning; he had a hot stock that was burning a hole in his pocket.

A broker for National Securities, Diaz cold-called my home-office, anxious to make a sale. He had a hot tip, would waive his commission on the first trade -- so I could give him a try and get comfortable -- and he wanted to move. He invoked every calming influence he could come up with; National Securities works with Fidelity Investments ("You've heard of them, right?") as custodian, and National Securities accounts are protected by the Securities Investor Protection Corp.

Diaz' hot stock was Insteel Industries Inc. . Diaz said that National Securities' analysts -- more than 100 of them -- loved this stock in large part because U.S. Steel Corp. ("You've heard of them, right?") had said Insteel was "their number one candidate for a buyout."

Insteel, according to Diaz, is likely to have gains of as much as 40%; currently trading in the \$11.50 range, Diaz said he "expects the stock to be nothing less than \$16 in the next eight weeks. It could still go to \$22, but I want to stay on the safe side and not get your hopes up too much."

Caller ID

But when I started asking questions and talking about analyst coverage outside of National Securities, Diaz abruptly hung up. The sales pitch was over.

The situation shows why any stock sold by cold-call -- in this case, Insteel -- is the Stupid Investment of the Week.

Freeze Out Cold Calls

Want a hot stock tip? Hang up if a broker cold-calls you. MarketWatch Senior Columnist Chuck Jaffe says even if a legitimate company is selling a legitimate stock, you don't want buy it that way.

Stupid Investment of the Week highlights conditions and concerns that make a security less than ideal for the average investor. It is written in the hope that showcasing trouble in one situation will make danger easier to avoid elsewhere. While obviously not a purchase recommendation, neither is this an automatic sell signal -- there may be cases where stocks purchased through a cold call have a happy ending, even if the sales process was unconventional.

Insteel could be that kind of case. It's not your typical security being pushed by some boiler room, if only because it is no penny stock. With a market capitalization of more than \$200 million, it's an unlikely choice for a pump-and-dump scheme. In fact, there's a compelling case in favor of the stock, although Freddy didn't actually make it.

Cold calling has been a staple of the brokerage and investment business for decades. As a general rule, it was a rite of passage for raw rookies, a chore done to bring in a few clients and prove the adviser's moxie. Once the new broker reached a certain level of success or built a sufficient book of business, they stopped phone-trolling for dollars.

There's a big difference, however, between the guy who is trying to earn an introduction and find a potential financial-planning client for life -- someone who wants face-to-face meetings, who provides background information and research well before trying to make a sale -- and the guy who is just pumping the sale, like Freddy.

Matter of trust

In fact, when I later called Freddy to ask why he'd hung up on me, he made the difference clear. He wanted to be treated like an omnipotent power, not like a partner in a financial-planning lifetime.

"I don't deal with guys who want to second-guess my decisions; it never works out," he said. "I don't want you to analyze the stock to a T. That's my job. If you let me do my job, we can make some money together, but by the time you do that stuff [further analysis] and make a decision, the stock is already up, and that 10% or 20% is a lot to me. I don't want to miss it when I've got it right, and I want customers who trust me to get it right."

My sin was questioning some of his statements (such as National Securities having its entire analyst staff following Insteel, when typically firms assign individual companies to specific analysts so that their staff can cover hundreds or thousands of issues). If Freddy was "so busy" that he'd hang up rather than answer questions, one can only imagine how he responds once he has client money on account.

I tried to get someone from National Securities -- a wholly-owned subsidiary of National Holdings Corp., itself a pink-sheet stock -- to discuss sales tactics, but the firm has no official spokesperson and the executives I called did not respond to my inquiries.

Stocks should be sold based on their suitability to an investor's portfolio and strategy, which involves more than asking "Can you afford to buy 1,000 shares today?"

The sales hype is tough to cut through; the cold-caller typically has a book of responses to counter any logic the customer uses to quash the sale or slow the process.

Like most telephone stock jockeys, Freddy wasn't interested in learning anything more about the client than if he had money and would pull the trigger with it. The proof was in the way he responded to questions, more annoyed by them than figuring they might be a sign the sales pitch was actually working.

(It's worth noting that you can stop most cold-call pitches by putting your phone number on the National Do Not Call Registry at www.donotcall.gov. I keep my home office off the list precisely because I am always looking for the bad investment and consumer ideas that are being pushed on the public.)

Ironically, Freddy had something to sell. There's nothing specific substantiating the U.S. Steel rumors -- I could find nothing even remotely linking the two companies -- but Insteel has strong fundamentals, no debt, and its valuation could make it a takeover candidate. The stock has a decent following of institutional investors and mutual fund managers.

By most ratios, Insteel would be cheap if it were trading below \$11 per share; independent research firm New Constructs from Nashville, Tenn. has the stock rated "attractive." The stock suffered -- which stock didn't -- during the downturn last year, but has more than doubled from its lows since the market rally began, and hitting Freddy's \$16 target would not even put it back to its 52-week high.

Still, if you aren't at ease with the guy selling the stock -- or debate its merits at its current price -- you should have a hard time getting comfortable with the stock itself. So if your phone rings and someone has a stock tip for you, hang up, then use your time and effort to learn how to buy on your own or to find an adviser who takes your needs seriously, and who wants to be your counselor for a lifetime -- not just for today's hot buy. ■

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