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FEATURE

How the Brokers Stack Up

By VITO J. RANCANELLI

Goldman Sachs, McAdams Wright and Morgan Keegan top our latest ranking of brokerages with stock-picking prowess. How an emphasis on technology, financials and small-caps helped boost returns.

THEY'VE GOT GAME AGAIN. WALL STREET BROKERAGE firms look to be regaining their stock-picking prowess after dismal performances during the bear market of 2007-2009.

In the latest round of *Barron's* semi-annual stockpicking contest, ended Dec. 31, the average firm's picks beat the market for all four periods tracked: six months, one year, three years and five years. That extended the market-beating run of the firms' average scores to the full year of 2009.

Last year, our participants did ride the coattails of the furious 65% rally from March 2009 lows. Nevertheless, a number of brokerages managed to outrun the bull. In the six months ended Dec. 31, for example, eight of the 13 participants trumped the market.



Lars Leetaru for Barron's

Some of the best grades went to firms tilted to tech and banking shares.

This round is also marked by important changes in the makeup of the winners. McAdams Wright Ragen, which did well in the previous contest, now takes home the gold in both the 12-month and 36-month battle, with 56% and 0.1% returns, respectively, and the silver medal in the six-month bracket.

With that strong finish, the Seattle-based broker has emerged as a force to be reckoned with and a robust competitor to fellow regional broker Morgan Keegan, a perennial winner and the league leader in the latest 60-month period, with a 28.5% return.

Among the big boys, **Goldman Sachs** (ticker: GS), whose last two rankings were uncharacteristically poor, has returned to its old perch at the top, taking first place in the six-month contest with a 30.5% return. It was second over three and five years.

Showing Their Mettle

For the second tally in a row, the brokers participating in the *Barron's* Focus List ranking have beaten the S&P 500.

Six Months	% Chg	One Year	% Chg	Three Years	% Chg	Five Years	% Chg
Goldman Sachs	30.5%	McAdams Wright	56.4%	McAdams Wright	0.1%	Morgan Keegan	28.5%
McAdams Wright	30.1	New Constructs	48.3	Goldman Sachs	-5.9	Goldman Sachs	25.3
Wells Fargo (Wachovia / AG Edwards)	28.6	Morgan Keegan	45.2	Citigroup Global Markets	-6.3	Citigroup Global Markets	24.0
Citigroup Global Markets	27.0	Goldman Sachs	43.2	Wells Fargo (Wachovia / AG Edwards)	-7.7	Morgan Stanley	15.9
New Constructs	25.9	Citigroup Global Markets	40.5	Edward Jones	-8.0	Credit Suisse	10.4
Morgan Keegan	24.2	Wells Fargo (Wachovia / AG Edwards)	34.1	Credit Suisse	-8.0	Wells Fargo (Wachovia / AG Edwards)	10.0
Credit Suisse	23.2	Wedbush Morgan	33.1	Morgan Keegan	-10.6	Edward Jones	8.9
Edward Jones	22.7	Charles Schwab	32.6	Morgan Stanley	-11.1	Charles Schwab	7.7
Charles Schwab	22.2	Credit Suisse	31.2	Charles Schwab	-16.3	Raymond James	-14.2
Bank Of America_Merrill Lynch	19.5	Edward Jones	26.7	Raymond James	-17.6	*Bank Of America Merrill Lynch	N.A.
Morgan Stanley	18.0	Morgan Stanley	25.4	*Bank Of America Merrill Lynch	N.A.	McAdams Wright	N.A.
Raymond James	15.3	Bank Of America Merrill Lynch	24.1	New Constructs	N.A.	New Constructs	N.A.
Wedbush Morgan	7.8	Raymond James	23.2	Wedbush Morgan	N.A.	Wedbush Morgan	N.A.
Average Broker Returns	22.7%		35.7%		-9.1%		12.9%
S&P 500 Total Returns	22.6		26.5		-15.9		2.1
S&P 500 Equal Weight TR	29.4		46.3		-10.5		12.15

*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. N.A. =Not applicable because broker is a relatively recent entrant.

Sources: Zacks Investment Research, Bloomberg

Honorable mentions go also to New Constructs, which took the silver for the 2009 contest, and to **Citigroup** (C) Global Markets and **Wells Fargo** (WFC), for consistently strong finishes across the board.

Los Angeles-based Wedbush Morgan, and Raymond James, headquartered in St. Petersburg, Fla., brought up the rear. (**See table, Showing Their Mettle.**)

Every six months, *Barron's* ranks the stock picks of brokerages big and small. The ranking is based on the performances of the firms' "focus lists," or best ideas, which can include anywhere from 10 to 100 stocks. Zacks Investment Research tracks the lists and crunches the numbers for *Barron's*. For a detailed description of the methodology, see "Behind the Lists" at the end of this article.

Zacks analyst Tracey Ryniec says the top guns of this round's six-month period tended to have an overweighting in technology stocks, which were up a white-hot 86% in the last three quarters of the year. The winners in the six- and 12-month periods had that, plus an overweighting in financials, particularly in the first half of 2009.

For the full year, small-cap stocks starred. The Standard & Poor's 500, capitalization-weighted toward big stocks, rose 26.5%, but the unweighted return was 46%, meaning that small and mid-cap stocks did much better than their big brothers. That might have helped the regional brokers, which sometimes focus on the small companies that big Wall Street houses ignore.

Another factor in the scores: Firms with shorter focus lists, including McAdams Wright, Morgan Keegan and Citigroup, tended to do well. Such lists can disproportionately benefit from -- or get hurt by -- big changes in or two stocks.

Laura Conigliaro, Goldman's co-head of research in the Americas region, notes that in the second quarter of 2009, Goldman's conviction list, as it's called, moved to a more "pro-cyclical" stance from defensive, with an emphasis on stocks exposed to economic recovery, credit normalization and margin expansion. The inclusion of companies such as China's Internet search firm **Baidu**, (BIDU), which more than doubled last year, and **Ford** (F), a triple, helped the 40-to-80-name list's returns. (Baidu is now off the list, while Ford remains.)

Table: Showing Their Mettle

This year, Goldman's themes include companies with "a lot of cash," she says -- cash that might go toward higher dividends and stock buybacks, or make the companies attractive acquisition targets. The health-care sector is also a theme for 2010. A year ago, big pharmaceuticals like **Merck** (MRK) and **Pfizer** (PFE) "had little going for them," but now they are restructuring.

McAdams Wright Ragen director of research Paul Latta attributes the success of its focus list to a number of factors, such as the inclusion of rebounding consumer stocks like **Nordstrom** (JWN) and **Starbucks** (SBUX). With a list of just 20 to 25 names, the triples by those two stocks really helped.

An overweighting in tech stocks, including **Microsoft** (MSFT), **Intel** (INTC), and **Yahoo!** (YHOO) in the second half also boosted returns. All three remain on the list. **Verizon** (VZ) hurt the score, but Latta says he's thinking of adding more of its shares. "I'm getting more interested in consumer staples, health care and utilities for 2010."

Part of McAdams' victory for the 2007-2009 period, which included the punishing bear market, comes from the outsized 2009 win. But the broker also helped itself by eschewing energy and financial names when those sectors were out of favor in the three-year period. Some winners: **Teva Pharmaceuticals** (TEVA), **Cooper Tire** (CTB), both now off the list, and **Puget Energy**, which was acquired.

The five-year laurels went to Morgan Keegan, its third consecutive win in that category. The broker has never been dislodged from the top post for as long as it has qualified for the five-year category, a remarkable feat considering the period included a bull market, a bear market and the return of a bull market. Elkan Scheidt, chairman of the firm's focus-list committee, says he was helped by an overweighting in tech and industrial stocks last year, and also by strong representation of economically sensitive sectors during the latter part of the 2003-2007 bull period.

Lately, Scheidt has been warming to regional banks, adding **BB&T** (BBT) and **Suntrust Banks** (STI). "If we get a moderation on loan losses, profitability will snap back."

And then there are the losers. Wedbush Morgan slipped from first to worst in the six-month contest. The company said its focus list, typically just 8 to 15 names, was "decimated" by the poor performance of two stocks -- **Chelsea Therapeutics International** (CHTP), down 49%, and **BioMimetic Therapeutics** (BMTI), off 23% -- in the second half of 2009.

Raymond James, too, seems to have lost its touch. The broker has posted poor showings since mid-2008, when it led the pack.

While the average broker did outperform the market consistently, there are signs that the rankings are normalizing. The tally of eight brokers beating the market across the board was down from all 13 in the round for January through June 2009.

Just as financial markets appear to be returning to normal, this latest distribution of fewer market beaters is suggestive of the group's performance before the volatility starting in 2007.

Brokers certainly have raised their game in the past year. But as regular followers of the contest know, most go through hot and cold streaks, so investors should look for durable, long-term outperformance.

Behind the Lists

In tracking brokers' best ideas, Zacks Investment Research puts a stock in a theoretical portfolio when the brokerage adds it to its focus list, and takes it out when the firm 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, and the smaller the list, the more exposed it is to one stellar or disastrous picks, 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 SAP 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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