

May 24, 2009**STRATEGIES****Stock Analysis, Then and Now****By MARK HULBERT**

AFTER federal and state investigations earlier in this decade into possible conflicts of interest among Wall Street analysts, the securities industry made important changes in its practices.

One change imposed by the [National Association of Securities Dealers](#) required firms to be more transparent by disclosing the proportion of their stock-picking advice that fell into the categories of buy, hold and sell. Another requirement, part of a settlement by big brokerage firms and [investment banks](#) with regulators, bound Wall Street to spend \$450 million to provide clients with independent research. Unlike the first change, this one had a five-year limit. It will end this July, with a likely result that small investors will have less access to independent research.

Unfortunate though that may be, Wall Street's proprietary research has already come to more closely resemble that of the independents, and there is reason to believe that its overall quality will be sustained.

That's because the greatest shift in Wall Street stock analysis since those changes appears to be a sharp decline in the number of buy recommendations, according to Brad M. Barber, finance professor at the University of California, Davis. The probable cause of this, he said, was the change that will remain in effect — the one mandating greater transparency in reporting, formally known as N.A.S.D. Rule 2711.

In a [study in the April 2006 issue of the Journal of Accounting & Economics](#), Professor Barber found that in the first year after N.A.S.D. 2711's adoption in 2002, the percentage of Wall Street recommendations in the buy category fell by one-third. Crucially, that was before regulators began making Wall Street firms provide independent research to clients.

(Professor Barber was a co-author of this study, with Reuven Lehavy of the [University of Michigan](#), Maureen F. McNichols of Stanford, and Brett Trueman of the University of California, Los Angeles.)

The investigations into Wall Street practices found that stock analysts might have felt pressure from the investment banking and brokerage sides of their firms to have a buy-side bias that would please executives of the companies being analyzed.

Professor Barber said the transparency rule, in itself, appeared to have cut down on this buy-side

bias. By the time Wall Street firms began distributing independent research, he said, there was no significant difference between them and independents in their share of buy, hold and sell recommendations.

Other than this shift, the overall quality of proprietary Wall Street research hasn't changed much in recent years, he said, although he said that there isn't enough data to yield more than a tentative conclusion.

BEFORE N.A.S.D. 2711, [stocks](#) receiving buy recommendations from Wall Street analysts didn't perform as well, on average, as the "buys" of independents. But when it came to sell recommendations, Wall Street analysts were more on target: stocks getting their sell signals performed worse, on average, than those with "sells" from independents.

This isn't so surprising, Professor Barber said. Because buy signals were so common on Wall Street, the more discriminating independent analysts, on average, could be expected to fare better. But on the other side of the coin, Wall Street analysts were stingier with sell recommendations — and, sure enough, came out ahead.

A separate, forthcoming study in the Review of Financial Studies has also found that the difference between Wall Street and independent stock research has largely disappeared. (It was conducted by Ohad Kadan of [Washington University](#) of St. Louis; Leonardo Madureira of Case Western Reserve; Rong Wang of Singapore Management University and Tazchi Zach of [Ohio State](#).)

Professor Barber offered another factor to consider in interpreting a Wall Street analyst's research report: the buy, hold, and sell recommendations may be less valuable than supporting data and analysis. And when measured along other dimensions, Wall Street analysts often compare favorably with independents. For example, he says, a number of studies have found that Wall Street analysts' earnings forecasts are more accurate, on average.

The bottom line is this: It's doubtful that investors will be worse off come July, when the regulatory arrangement expires, especially if they look beyond specific buy-hold-sell advice and focus on the underlying data and analysis.

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