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Finding Good Stocks in Bad Markets

By VITO J. RACANELLI

*Wedbush Securities' equity focus list was Wall Street's best performer in the past six months, according to Zacks. **New Constructs took top honors in the 12-month span.***

THERE'S NOTHING LIKE A STORY of redemption to warm investors' hearts, even if it's about a broker. In the latest *Barron's*-Zacks stock-picking competition, Wedbush Securities jumped the field to first, after being the worst performer in the previous contest.

The Los Angeles-based broker's focus list of stocks is aimed at beating the Russell 2000 over six to 12 months. It returned 12% in the six months ended June 2010. Joining Wedbush on the winner's podium is **New Constructs, a small, Tennessee-based independent-research outfit, which grabbed first place in the 12-month race, with a 26% return. It also placed second in the six-month period.**

Longer term, MSSB-Smith Barney took the gold in the 36 months ended June, with a negative 13% return. But that's significantly better than the Standard & Poor's 500, which lost nearly 27% in the same span. Smith Barney can boast of a solid performance across all four periods, never claiming less than the bronze. **Morgan Stanley** (ticker: MS), which has a separate list, has merged its brokerage operations with Smith Barney.



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John Tomac for Barron's

The five-year period effectively has been owned by Morgan Keegan, whose nearly 20% return produced its fourth straight win. For as long as it has qualified, through bull and bear markets, this brokerage hasn't been dislodged from the five-year top post.

Once again, the average brokerage return outperformed the stock market in all periods, but the margin of victory was lower than in previous contests. There's no longer a tailwind from a furious bull

market, as there was for much of 2009 and early 2010. Among the losers, Wells Fargo Advisors was

last in the shortest race, its list down 13%, while Raymond James Financial (RJF) had the misfortune of finishing last in the other three races.

Every six months, Barron's ranks the stock picks of America's brokerages. Some are investment banks, like **Goldman Sachs** (GS), but others are less well known. Zacks Investment Research compiles the data and scores the firms by keeping a running tally of each firm's focus list, or best stock ideas, for various periods in the past five years. (For a more detailed description of the contest's methodology see sidebar below.)

The lists can include 10 to 100 picks. Those with fewer names, such as Wedbush's, which contain eight to 15 stocks, can benefit or be hurt disproportionately by one or two stocks with big moves. In the previous contest, Wedbush fell to last from first in the contest before that..

Zacks analyst Tracey Ryniec notes that those firms at the top in the six-month period tended to overweight tech and health care and to recommend fewer financials in their model portfolios. Sheri Kaiserman, head of equities at Wedbush, says the firm's Best Ideas list benefited from the inclusion of **OmniVision Technology** (ticker: OVTI), an **Apple** (AAPL) supplier that rose almost 50%, and **Coinstar** (CSTR), whose coin-counting and movie-rental kiosks dot the country. Coinstar rose 18%.

Wedbush didn't ride any particular sector, she adds. **Zoll Medical** (ZOLL), a maker of medical devices such as defibrillators, was a recent addition. New products have helped the company exceed analysts' earnings-per-share expectations in the past three quarters. Zoll also has operating leverage as its core business recovers with the economy.

New Constructs President David Trainer points out that his firm's good performance over both the six and 12 months owed to picks such as **Sybase** (SY), which Germany's **SAP** (SAP) agreed to buy in May for \$65 a share. Sybase rose more than 40% in the first half. **Metropolitan Health Networks** (MDF) was another winner. New Constructs (www.newconstructs.com) puts out a monthly roll call of Most Attractive and Most Dangerous stocks of companies whose profits and valuations are understated or overstated, based on its proprietary accounting analysis. Only the Most Attractive list is used for this contest.

At MSSB-Smith Barney, known in previous contests as Citigroup Global Markets, Managing Director Marshall Kaplan leads a team looking for companies with high margins and high free cash flow. Stocks such as Apple; IT outsourcer **Cognizant Technology Solutions** (CTSH), and **DaVita** (DVA), which operates dialysis centers, powered the 15-to-25-name Priority Equity Recommended List to first place over three years, as well as strong performances in the three other races.

Once again, the five-year award went to Morgan Keegan. Elkan Scheidt, chairman of the focus-list committee, says such long-term performance can't be ascribed to any stock or stocks, but "to consistency of process and being in the right sectors at the right time." Lately, Scheidt has added **Zions Bancorp** (ZION) and trucker **J.B. Hunt Transport Services** (JBHT) to the list.

Bottom line: The average brokerage list has beaten the market regularly in the past few contests. But most go through hot and cold streaks, so investors should focus on durable, long-term outperformance.

How We Rate Them

In tracking brokerages' best ideas, Zacks Investment Research puts a stock in a theoretical portfolio when the brokerage adds it to its focus list, and removes it when the brokerage does.

While similar in intent, the lists differ in significant ways. Some are updated at regular intervals; others, ad hoc. Most lists are flexible in size, with 20 to 40 names, but some are fixed. The smaller the list, the more exposed it is to one stellar or disastrous pick. Some lists have as many as 100 names, on them individual picks matter less, but it's tougher to beat the index.

A few additional notes: 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 of 2008.

Zacks ranks all picks on an equal-weighted basis, while the S&P 500 is weighted according to components' market capitalization. As a result, brokerage results aren't strictly comparable to the S&P. To provide a better perspective on relative performance, our tables show S&P returns on an equal-weighted basis, as well.

Who's the Fairest of Them All?

Wall Street's focus-list stocks beat the S&P 500 in the six months ended June 30, a period when Wedbush Securities leapfrogged other brokerages to move into first place from last. Goldman Sachs suffered a comeuppance in the latest span, sliding to No. 12 from No. 1 in the six months ended Jan. 30.

Six Months	%Chg	One Year	%Chg	Three Years	%Chg	Five Years	%Chg
Wedbush Securities	11.85	New Constructs	25.88	MSSB/Smith Barney*	-12.74	Morgan Keegan	19.55
New Constructs	0.01	MSSB/Smith Barney*	24.24	McAdams Wright	-15.88	MSSB/Smith Barney*	17.08
MSSB/Smith Barney*	-2.15	Wedbush Securities	20.58	Edward Jones	-20.52	Goldman Sachs	6.19
Morgan Keegan	-3.82	McAdams Wright	20.53	Morgan Keegan	-25.24	Credit Suisse	1.31
Charles Schwab	-6.02	Morgan Keegan	19.45	Goldman Sachs	-25.63	Edward Jones	-0.10
BofA_Merrill Lynch**	-6.46	Charles Schwab	14.86	Wells Fargo Advisors	-25.80	Wells Fargo Advisors	-1.62
McAdams Wright	-7.46	Goldman Sachs	14.63	MSSB/Morgan Stanley*	-26.73	Charles Schwab	-1.77

Credit Suisse	-8.23	Credit Suisse	13.05	Credit Suisse	-26.95	MSSB/Morgan Stanley*	-1.87
Edward Jones	-8.90	Edward Jones	11.74	Charles Schwab	-28.60	Raymond James	-25.78
MSSB/Morgan Stanley*	-9.32	BofA_Merrill Lynch	11.73	BofA_Merrill Lynch	-30.10	BofA_Merrill Lynch	NA
Raymond James	-11.36	Wells Fargo Advisors	11.48	Raymond James	-32.59	McAdams Wright	NA
Goldman Sachs***	-12.19	MSSB/Morgan Stanley*	7.01	New Constructs	NA	New Constructs	NA
Wells Fargo Advisors	-13.34	Raymond James	2.25	Wedbush Securities	NA	Wedbush Securities	NA
Average Brokerage Return	-5.953		15.186		-24.615		1.44
S&P 500 Total Return	-6.654		14.429		-26.645		-3.909
S&P 500 Equal-Weight Ret.	-2.49		22.78		-25.15		-1.58

Smith Barney and Morgan Stanley have merged their brokerage operations and will appear as one entity on the next list. **Merrill Lynch changed its focus-list strategy in March 2007. *** Goldman Sachs changed its focus-list strategy at the end of 2008's third quarter. NA= Not applicable because broker is a relatively recent entrant. Source: Zacks Investment Research

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