

The Ambachtsheer Letter

Letter #184

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WHITHER SECURITY ANALYSIS?

"The stories that follow explore the many ways investment banks now abuse the trust of their core customers – investors trying to build capital and companies trying to raise it..."

"...we heard many comments about the conflicts of interest analysts face...and about the pressures applied on some analysts by their employers and by the companies that they review or research..."

FORTUNE, May 14, 2001

Securities Industry Committee
On Analyst Standards, April 2001

Bubble, Bubble, Toil and Trouble

Despite their stratospheric salaries, Street analysts did not distinguish themselves during the latter stages of the 1990s bull market. No statistic underscores this point more emphatically than one provided by First Call/Thompson Financial in October 1999 (ie., within months of the top of the bull market). Their survey revealed that out of 27,700 analyst stock recommendations in their database, over 20,000 were in the 'buy' category, while less than 300 (ie., about 1% of all recommendations) were in the 'sell' category. In a similar survey performed by Bloomberg in Canada, a measly 4% of all analyst recommendations were 'sells'. The obvious question these facts provoke is how any professional group can be paid so much for being so wrong.

A simplistic answer is that these security analysts really do provide a valuable service to investors, but that they got as carried away with the bull market's momentum as their clients did. There is probably some truth to that, but it can't be the whole story. In their own ways, the two quotes we cite above provide a more complete answer to the question. The fact is that during the last few years, there was so much more money to be made supporting the investment banking activities of the Wall Street firms the analysts worked for, that providing unbiased advice to investors simply was not a priority for many of them.

What, if anything, should be done about this reality? Whither security analysis? That is the question we address in this *Letter*.