

TO SELL OR NOT TO SELL

MAY 2004

“Is an “Underperform” stock in an “Outperform” industry more attractive than an “Outperform” stock in an “Underperform” industry?”

The April 26th, 2004 issue of the *Wall Street Journal*, Susanne Craig and Ann Davis asked this valid yet confusing question. We at the *Markowski Monthly* have been warning investors that, despite Eliot Spitzer’s infamous stock research reforms, today’s investment research is as confusing and misguided as it has ever been. The bottom line is that individual investors are still in the dark and it isn’t getting any better.

The new rules require firms to regularly disclose the percentage of stocks they assign to the equivalent of a “Buy”, “Hold” or “Sell.” These rules were put into effect in order for investors to get a clear picture on who was doing the best job in regards to stock picking. However, the last thing that Wall Street wants is for investors to get a clear picture. Clarity would bring the masses to realization that the emperor has no clothes, and there is no difference between big firm A and big firm B. The results garnered from these new rules are completely useless to investors. Why do you think the large firms agreed to them? Comparing research results is like comparing apples to oranges. The big brokerage firms have not accepted a standard ratings methodology, thus making comparisons impossible.

The NASD is currently engaged in a review of Wall Street to see if firms are complying with their fancy new ratings rules and whether or not they need “*newer, even fancier*” rules. I can hardly wait! All of this perpetual nonsense that was supposed to clear up investor confusion has turned stock ratings into some art-house foreign film. Everyone says how wonderful and cerebral it is, however nobody really understands it.

For example: While at some firms a “Buy” actually means a stock is expected to rise in value, at others it could mean the stock could fall, but less than its rivals.

“*Overweight*”, what does that mean? I didn’t think you were supposed to say that word anymore; not politically correct or something. To most investors it means that you strongly suggest salads or Buy. But wait, not so fast! Get out your Wall Street decoder ring it could mean something completely different, depending on how much stock you already own.

The *Wall Street Journal* chronicled the ratings follies using Intel Corporation as their test company. Warning: reading this may cause you to feel dizzy, lightheaded and nauseous. Pregnant woman and people with heart conditions are suggested not to read this.

Credit Suisse First Boston is among the firms whose rating system looks at whether a given stock will outperform its peers, as well as whether the particular industry is expected to meet, beat or trail behind the broader market. Intel, for instance, is currently rated “*Outperform*,” while the chip-making sector is “*Market Weight*.” According to the firm’s definition of “*Outperform*,” this means Intel shares are expected to exceed the industry average by at least 10% to 15%. In other words, Intel shares may fall in value, but the analyst expects them to do better than those of its peers. As for the peers, the analyst doesn’t have particularly high hopes for the sector: “*Market Weight*” means “in line with the relevant broad market benchmark over the next 12 months.”

Here's another ratings approach: UBS Warburg rates Intel stock a "Buy 2," one of its highest rankings. This means -- get ready for a mouthful -- that the "forecast stock return," or the expected "percentage price appreciation plus gross dividend yield over the next 12 months," will be 10% above the "market return assumption." That is defined "as the one-year local market interest rate plus 5%." With a "2" attached to the rating, the analyst is indicating there is less precision about the price target than with a stock carrying a "Buy 1" rating.

UBS, which has two million individual investor accounts, circulates a 13-page "equity rating system primer" to investors about its approach. *"It is conventional in our industry to summarize research opinions with definite-sounding words, such as "Buy," and set precise price targets," the primer reads. "This is popular with users, who crave clarity and simplicity; but it introduces a false sense of certainty."*

In an effort to make sense out of this, we have come up with this simple rule, what you need to know as an investor that uses one of the big firms is that the definition of being right or wrong does not apply. These firms can put a buy on a stock, have the stock drop in value and still be right. Sounds like a Jedi mind trick to me, ***"You lost money, but we were right anyway, send more money."*** If this system makes sense to you, keep investing with these firms and keep praying for better results. If not, make a change fast.