What a stock analyst can do for you

Tom Jacobs

Just as a patient obtains a second opinion before agreeing to a quadruple bypass, so too may an investor turn to analysts for confirmation about stock selection. In the best cases, the stock analyst's expertise helps determine the suitability of an investment. But unfortunately, no term is more broad, title more easily adopted, nor profession held in lower repute in the financial world today. Thus, it's crucial for investors to know both who analysts are and how to determine the quality of their labor.

The sell side

As Bing Crosby so accurately observed in *White Christmas*, everyone's got an angle. People can still help you, but you've got to know their slant. Analysts' angles depend on the category to which they belong, whether sell-side, buy-side or independent.

Sell-side analysts work for huge, familiar firms such as Merrill Lynch (New York), Morgan Stanley (New York) or Credit Agricole (Paris) that have both large investment banking and brokerage operations. Their job is to write research that attracts companies to bring their deal-making and healthy fees to the investment bankers. They also must entice buy-side analysts to act on the research and haul their firms' stock trades and fat commissions to the brokerage side.

It's unfortunate that sell-side opinions are most frequently trumpeted by the financial media, for the reason that they present two serious problems. Sell-side analysts have no incentive to write anything negative and they are only going to cover companies big enough to offer potential mega-fees. Therefore, sell-siders' sell recommendations and coverage of small company opportunities are as rare as Himalayan beachfront.

Tom Jacobs is cofounder of Complete Growth Investor (<http://www.completegrowth.com>), a stock service for individual investors. Tom cannot give individual investment advice but welcomes your comments at tom@completegrowth.com.

The buy side

Better for us, buy-side analysts toil for pension, mutual and private money funds, such as government retirement funds, Fidelity and Vanguard, university endowments, bankers for the wealthy, and myriad hedge funds. This type of analyst research is geared solely to finding investments that really make money for their clients. Unhappily, it is only for internal consumption and rarely available to you and me. That leaves one option.

The Wild West

The remaining choice for the individual investor is the world of independent analysts. They neither buy stock nor sell ideas to attract investment banking or brokerage business but make money from selling research directly to investors. At the financial top are independents that specialize in identifying companies on the road to trouble. They tart their wares to the buy side and can command \$20,000 a year and up for a subscription.

More affordable for individual investors are stock newsletters or services that offer recommendations and research for fees as low as a few hundred dollars a year. This industry is dominated by companies, such as Phillips, Agora, Forbes, MarketWatch, TheStreet.Com, Morningstar and my former employer, The Motley Fool.

These businesses make more money the more products they can sell you, so they offer primarily niche services, each covering an industry or style of investing, such as biotech, income-producing stocks or speculation. This is great if you want to specialize, but gets pricey if you want to cross categories. They also typically pick a few stocks every month, which offers a large library from which to choose but can be overwhelming after a while. Services that cross categories and offer a one-stop shop for a diversified portfolio include Louis Nevellier, FindProfit.com and yours truly's Complete Growth Investor.

Regardless of your needs or choice, be alert: the quality and performance of independent analysts vary. Make sure you get a trial subscription and road test. No matter what, avoid the avalanche of free independent research. This runs from the obvious scams that come in our email ("buy this \$0.35 stock poised to rise!"), to the less obvious research that companies pay a firm to produce. Remember that anything free is worth what you paid for it and designed to entertain and market, rather than inform.

Credentials

Experience and performance are the best analyst credentials, but one credential is worth mentioning—and it isn't a business or finance degree. The Chartered Financial Analysts designation, or CFA, is available worldwide to candidates who pass three rigorous exams that have low success rates. Although a CFA does not guarantee expertise in any industry or company—nor does its absence mean the opposite—it does ensure that the holder has met a very strong minimum standard for attention to business and financial detail and the ability to see through company hype machines.

Biotech's special advantage

Fortunately, biotech investors have one key factor working for them. Those who hire biotech analysts—whether sell-side, buy-side, independent or butterscotch—usually insist on a medical or scientific degree, such as an MD or PhD, as proof of technical expertise in an area few understand. Although degrees are no guarantee, and some biotech analysts do very well without them, they do generally lead their holders to write something useful about the details of a company's products, trial data, markets and competition more often than do analysts in other areas.

Your very best guarantee of quality? An independent biotech analyst with an MD or PhD and the CFA designation. If you're out there, I'd love to hear from you.