



Ranking the Independents

Independent Research is in Vogue, but Does it Have Staying Power?

A few short years ago, a number of pundits claimed that the proposed decoupling of research departments from investment banking operations to address potential conflicts of interest would be the death knell of Wall Street research, as we know it. In fact, countless studies at the time revealed the surprising fact that the recommendations produced by Wall Street firms severely underperformed the research produced by a bevy of “independent” research providers.

What a difference a year makes. In the wake of a 35% rise in the S&P 500 since the beginning of the fourth quarter of 2002, independent research providers have not fared so well with their performance lagging that of many of their bulge-bracket brethren. But does this suggest that the stellar results seen from the independents over the prior few years was a flash in the pan?

Equity research ratings and consulting firm, Integrity Research Associates’ CEO, Michael Mayhew, doesn’t think so. “The quality of research produced by the top independent firms has in no way diminished, despite this year’s slip in performance. In fact, the rebound seen in the results of investment bank research is consistent with the current bull market as Wall Street tends to be overly optimistic, while independent firms generally make more Sell recommendations. That’s why independent research firms often outperform investment bank research in bear markets, while Wall Street firms outpace the independents in bull markets.”

Despite this trend, a number of independent research firms outdid the research departments of Wall Street's most respected investment banking firms over the past 12 months. For example, independent firms like J.M. Dutton & Associates, Parenteau Corp, American Technology Research, RDEX Research and Fulcrum Global Partners all eclipsed the 15.39% and the 4.60% average returns per recommendation seen by the 12 largest investment banks over the last 12- and 24-month periods, respectively. (This group of investment banks includes Bank of America, Bear Stearns, Credit Suisse First Boston, Deutsche Bank, Goldman Sachs, JP Morgan Chase, Lehman Brothers, Merrill Lynch, Morgan Stanley, Prudential, Salomon Smith Barney and UBS Warburg.)

As a result, many experts anticipate that the ranks of independent research providers will continue to swell as hedge funds and institutional investors turn to them more frequently for unbiased and innovative investment ideas. This is just one of many reasons that the analysts at Integrity Research Associates, project the independent equity research industry will continue to grow at a torrid pace from its current level of approximately \$900 million in annual sales to between \$2 billion and \$3 billion within the next five years.

RESEARCH ACCURACY

For the purposes of measuring and comparing the accuracy of an independent research firm's Buy, Sell and Hold recommendations, Integrity Research Associates has chosen to standardize using Investars' Rate of Success System (ROSS) Synthetic return measure. This measure quantifies a firm's average return per recommendation by creating hypothetical portfolios based on their stock ratings.

Using Investars' performance data, Integrity Research Associates has constructed a Research Recommendation Accuracy (RRA) Ranking comprised of a variety of measures including firms'

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12-month and 24-month ROSS Synthetic returns and the percentage of industries that a research firm's ROSS return ranks in the top quartile.

J.M. DUTTON & ASSOCIATES

The independent research firm with the best overall RRA Ranking for the 12 months that ended on October 31, 2003 was small-cap fundamental research provider, J.M. Dutton & Associates. Dutton topped the list of independents with a 4.8 ranking (out of five) reflecting a stellar 12-month and 24-month average return per recommendation and a surprisingly consistent performance.

As of the close of the market on October 31, 2003, Investars revealed that J.M. Dutton & Associates had recorded

an impressive 12-month ROSS gain on its Buy, Sell and Hold recommendations of 59.26%. This would have ranked as Investars' best independent research provider over this time frame (out of 18 independent research providers) and its highest ranked provider of independent fundamental research on U.S. stocks. Dutton also would have ranked in the top 15% of all research providers during this 12-month period.

As astonishing as Dutton's overall performance, however, was the consistency of its recommendations. In fact, J.M. Dutton ranked in the top quartile in nine of the 10 industries tracked by Investars — by far the best performance of any of its peers.

Over the past 24 months, Dutton posted an average return per recommendation of 51.39% for the 21 stocks the firm followed over this period. This performance ranked second out of the 14 independent research firms tracked by Investars. It also put Dutton in the top 10% of all 111 research firms measured by Investars over the last two years.

Of course, the impressive accuracy of Dutton's recommendations is related to the strong performance seen in the small- and mid-cap sectors as a whole. As a result, we will need to keep watch on the research team at J.M. Dutton & Associates to see if they are able to continue posting such accurate calls in the coming years as other market sectors have their time in the sun.

PARENTEAU CORP.

According to our analysis, the No. 2 independent research firm tracked by Investars over the past 12 months was Montreal-based fundamental research firm Parenteau Corp. with an RRA ranking of 4.6. This reflects an astounding 24-month average return and a solid research consistency rating.

As of the close of the market on October 31, 2003 Investars revealed that Parenteau Corp. had recorded a healthy 12-month ROSS gain on its

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Buy, Sell and Hold recommendations of 24.19%. This would have ranked as Investars' third best independent research provider over this time frame.

The consistency of Parenteau's recommendations over the 12 months that ended October 31 was quite commendable as the firm finished in the top quartile in 50% (three of six) of the industry groups it provided calls in. This includes consumer noncyclicals, where Parenteau ranked No. 1 with an average return per recommendation of 87.55%;

healthcare, where the firm finished second with a return of 74.76%; and consumer cyclicals, where the research firm ranked fourth with an average return of 19.92%.

What really set Parenteau apart from the other independent research firms was the accuracy of its recommendations over the past 24 months as the firm recorded an average return per rating of 94.11%. This ranked first out of all independents over this period — almost doubling the average return of

it's next closest rival. As a result, Parenteau finished second out of all 111 research firms tracked by Investars over this two-year period.

Despite Parenteau's pinpoint accuracy, it must be noted that the firm provides research coverage on substantially fewer companies than most other independent research firms. This is important because it is statistically much easier to generate a high average return when the number of companies under coverage is small.

Research Recommendation Accuracy (RRA) Ranking For the period ending 10/31/03

Compiled by Integrity Research Associates, LLC using Investars' R.O.S.S. Synthetic Average Return Data.

Integrity's RRA Rankings are as follows: 5 = Excellent; 4 = Very Good; 3 = Good; 2 = Fair; 1 = Poor.

Firm Name	Research Style	# Stocks Covered	12-Month Avg. Return	12-Month Rank	24-Month Avg. Return	24-Month Rank	Industries in top Quartile	Overall RRA Ranking
JM Dutton & Assoc.	Fundamental	44	59.26%	1/18	51.39%	2/14	9/10	4.8
Parenteau Corp.	Fundamental	25	24.19%	3/18	94.11%	1/14	3/6	4.6
AmTech Research	Fundamental	71	37.18%	2/18	24.49%	5/14	2/3	4.4
RDEX Research	Fundamental	638	19.77%	5/18	34.03%	3/14	4/10	4.1
Fulcrum Global	Fundamental	343	22.95%	4/18	18.03%	6/14	5/9	3.6
Spelman Research	Fundamental	22	13.98%	6/18	N/A	N/A	4/7	3.5
Standard & Poor's	Fundamental	1362	4.28%	11/18	13.79%	7/14	1/10	3.5
Global Capital Inst.	Quantitative	2772	6.21%	9/18	9.96%	9/14	1/10	3.4
Avalon Research	Fundamental	65	5.06%	10/18	32.37%	4/14	2/8	3.4
Argus Research	Fundamental	320	11.83%	7/18	13.70%	8/14	3/10	3.0
When2Trade	Technical	1414	7.19%	8/18	N/A	N/A	0/10	2.9
ValuEngine	Quantitative	4463	3.29%	13/18	N/A	N/A	0/10	2.6
Columbine Capital	Quantitative	6172	3.23%	14/18	5.93%	10/14	0/10	2.6
Callard Research	Quantitative	1560	3.81%	12/18	3.01%	12/14	0/10	2.4
Ford Equity	Quantitative	4057	-0.13%	17/18	3.80%	11/14	0/10	2.0
Channel Trend	Quantitative	1643	0.32%	15/18	0.56%	13/14	0/10	1.9
Excalibur Research	Fundamental	9	0.12%	16/18	N/A	N/A	0/10	1.8
Market Profile Theorems	Quantitative	2552	-0.59%	18/18	-0.29%	14/14	2/10	1.4

Investars' ROSS Synthetic calculation measures a research firm's average return per Buy / Sell / Hold recommendation over a given period of time. **IMPORTANT:** Investars returns are designed for internal relative rankings of analysts. Please do not compare to portfolio or index returns.

AMERICAN TECHNOLOGY RESEARCH

For the 12 months that ended October 31, 2003, American Technology Research (AmTech) finished with an RRA Ranking of 4.4 — enabling the boutique fundamental research provider to finish third among the 18 independent research firms tracked by Investars.

As of the close of the market on October 31, 2003, Investars revealed that American Technology Research had recorded an impressive 12-month average gain on its Buy, Sell and Hold recommendations of 37.18%. This ranked as Investars' second best independent research provider over this time frame and would have ranked in the top 30% of all research providers tracked by Investars for this period (out of 119 research firms).

While generating a strong overall performance, American Technology Research also produced a consistent one over the past 12 months. In fact, the firm ranked in the top quartile in 75% (two of three) of the industry groups they had stock recommendations in.

Being a relatively young firm, American did not have many stocks under coverage more than 12 months ago. Despite this fact, the average return per recommendation for the 21 stocks the firm has followed over the past 24 months was 24.49%. This performance ranked fifth out of the 14 independent research firms tracked by Investars. It also put it in the top 20% of all 111 research firms measured by Investars.

In general, American's strong research performance can be explained by the fact that the industry groups it focuses on were widely in favor over the past 12 months. This is particularly true of the technology group. In addition, only two percent of its recommendations were Sells reflecting the firm's optimistic view of this segment of the economy.

RDEX RESEARCH

Based on Integrity's Research Recommendation Accuracy (RRA) ranking, RDEX Research posted a strong 4.10

Investars revealed that American Technology Research had recorded an impressive 12-month average gain on its Buy, Sell and Hold recommendations of 37.18%.



rating for the 12 months that ended October 31, 2003. This total helped the Irvine, California-based research firm to place fourth out of the 18 independent research firms tracked by Investars and reflected a healthy showing in all performance categories.

Over the past 12 months, RDEX Research posted an average return per research recommendation of 19.77%. This ranked as the fifth best independent research provider over this period and was the best performance of an independent research firm with more than 500 stocks under coverage. In fact, over this same period, RDEX had the fourth best average return per recommendation when compared to any of the 19 broad-based research firms (either independent or not) that cover more than 500 stocks.

RDEX was also fairly consistent over the past 12 months as the firm finished in the top quartile in 40% (four of 10) of the industry groups it had stock recom-

mendations in. RDEX's best performances occurred in technology (with an average return per recommendation of 31.83%), energy (6.92%), healthcare (15.82%) and telecommunications (10.83%).

In the past two years, RDEX Research recorded an even more impressive performance as the research firm generated a 34.03% average return per recommendation. This ranked as third among the 14 independent research firms, and in the top 15% of all 111 research firms tracked by Investars.

FULCRUM GLOBAL PARTNERS

Ranked the fifth most accurate independent research firm for the 12 months that ended October 31, 2003, New York-based Fulcrum Global Partners achieved a 3.6 ranking (out of a maximum of five) due to the firm's solid 12- and 24-month performance. The firm also displayed impressive consistency in its recommendations.

During the past 12 months, Fulcrum posted a 22.95% ROSS Synthetic return — the fourth highest average per recommendation among the 18 independent research firms tracked by Investars.

This reflected a very consistent performance as the firm finished in the top quartile in 56% (five of nine) of the industries it had recommendations for. This includes consumer cyclicals, where Fulcrum ranked second with an average return per recommendation of 31.67%; telecommunications, where the firm finished second with a return of 16.39%; technology, where the firm's recommendations were rated third with a return of 28.52%; and healthcare, where the research firm ranked third with an average return of 21.85%.

On a 24-month basis, the average return on Fulcrum's Buy, Sell and Hold recommendations was 18.03% — a performance that ranked sixth out of 14 research firms. This enabled Fulcrum to finish in the top third of all 111 research firms tracked by Investars over this time frame. **B**