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Stumbling to the Halfway Mark

Schwab Takes the Gold in a Tough Sprint

On average, the stock recommendations of the 10 firms tracked fell short of the market's gains for the first half of this year but exceeded them for longer stretches. Charles Schwab led the pack for two time periods, helped by contrarian picks like Alaska Air, CBS and Humana.

Six Months	Change	One Year	Change	Three Years	Change	Five Years	Change
Charles Schwab	9.82%	Charles Schwab	40.31%	McAdams Wright Ragen	46.85%	Goldman Sachs**	23.91%
McAdams Wright Ragen	9.08	Bank Of America Merrill Lynch	39.66	New Constructs	35.53	Edward Jones	21.92
Morgan Stanley Smith Barney*	6.80	McAdams Wright Ragen	39.47	Charles Schwab	18.53	Charles Schwab	20.38
Goldman Sachs	6.69	Goldman Sachs	37.58	Bank of America Merrill Lynch	17.61	Morgan Stanley Smith Barney	18.23
Bank of America Merrill Lynch	6.17	Morgan Stanley Smith Barney	31.99	Morgan Keegan	17.21	Morgan Keegan	14.29
Edward Jones	5.89	Morgan Keegan	29.40	Edward Jones	16.22	Wells Fargo	12.10
Wedbush Securities	3.83	Edward Jones	28.48	Wedbush Securities	9.85	Bank of America Merrill Lynch***	N.A.
Morgan Keegan	3.75	Wedbush Securities	26.34	Goldman Sachs	6.01	McAdams Wright Ragen	N.A.
Wells Fargo	0.68	New Constructs	26.07	Morgan Stanley Smith Barney	5.98	New Constructs	N.A.
New Constructs	-0.46	Wells Fargo	25.54	Wells Fargo	5.50	Wedbush Securities	N.A.
Average	5.23		32.48		17.93		18.47
S&P 500 Index	6.02		30.69		10.35		15.61
S&P 500 Equal Weight TR	7.20		34.14		22.91		19.86

*Smith Barney and Morgan Stanley merged their brokerage operations and now appear as one entity. **Goldman Sachs changed its focus-list at the end of the third quarter 2008.
***Merrill Lynch changed its focus-list strategy in March 2007. N.A.=Not Applicable. All returns as of 6/30/2011.

Source: Zacks Investment Research

Discount broker Charles Schwab scored a double victory, taking first place in both the six- and 12-month contests, up 10% and 40%, respectively. This marks a return to prominence for the San Francisco-based broker, which was a consistent leader in 2005-2007 but then fell to the middle of the pack.

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Elwood Smith for Barron's

In the three-year tally, McAdams Wright Ragen won going away, with a blistering 47% return, far ahead of the pack and many times better than the market's return. Though a smaller regional broker with a relatively narrow base of analyst coverage, the Seattle-based broker scored a repeat victory. After a poor start in 2007-2008, McAdams Wright has consistently posted enviable returns, punching above its weight class.

THE FIVE-YEAR GOLD MEDAL goes to, appropriately enough, Goldman, up 24%. The firm has regularly scored at or near the top over the years, particularly in this longer-term period. A look at the S&P 500 chart for mid-2006 to mid-2011 shows a steep "V" pattern: from the end of a bull market, to a bear, and back to a bull market. Consequently, strong five-year performances are notable.

Honorable mentions go to Bank of America Merrill Lynch; Edward Jones, another comeback kid; and New Constructs, which finished second in the three-year rally, but also had a tough time in the six-month contest.

Wells Fargo Advisors has the unwanted distinction of cellar-dweller in the other three periods. A WFA spokesman explained in an e-mail: "We take a full balance-sheet approach, focusing not just on individual security selection but asset allocation and long-term planning,"

At a sector level, a successful strategy can be attributed in part to the brave feat of including health-care stocks, a despised group from 2006-2010. In the first half of 2011, health care was the best-performing sector. Having retail stocks also helped the top performers in the first six months, says Tracey Ryniec, a Zacks equity strategist. Both luxury and budget-minded companies boosted returns, she adds. Energy stocks were a plus, too. The lack of financial stocks, the worst-acting group in the period, was a major advantage. Indeed, financials were a curse to all the periods reviewed.

Greg Forsythe, Charles Schwab's director of equity ratings, explains that the broker's revival was due in part to a change in the market. After the credit crunch, stocks were moving up and down indiscriminately on macro factors, and "that's an environment where our approach struggles." That phenomenon is receding, and with the tweaking of Schwab's equity model portfolio—fixed at 100 names and sector-neutral—its performance has improved sharply.

Out-of-favor and contrarian picks such as **CBS** (ticker: CBS) and **Humana** (HUM), both up almost 50% in the first half, and **Alaska Air** (ALK), up 21%, were on Schwab's list, and remain there.

Forsythe has added and removed factors to improve the model, which tries to find stocks with low but improving expectations. For example, it no longer measures share buybacks, as further study shows they are "much less effective" buy signals than they once were, he says.

Sometimes less is more, and with a much smaller list, just 20 names typically, McAdams Wright's director of equity research, Paul Latta, has pulled off another victory. His focus list had financials, but they were the right ones: **MasterCard** (MA) and **Moody's** (MCO), up 35% and 45%, respectively, in the first half. Moody's remains on the list.

For the full three-year ranking, the recent purchase of health-care stocks, few bank holdings, and nimble moves in and out of consumer stocks like **Starbucks** (SBUX), Nordstrom (JWN) and **Whole Foods** (WFMI), propelled performance—stocks that are no longer on the list. More recently, McAdams Wright has taken on some income characteristics, with a 3.1% dividend yield currently, buying stocks like **Microsoft** (MSFT) and **Intel** (INTC).

Another new stock is **Philips Electronics** (PHG), the Dutch maker of medical equipment, lighting and consumer electronics. It's a contrarian value call and a way to diversify the list geographically, Latta says.

Goldman moved up to first place in the five-year score from second last time around. The broker's co-head of Americas equity research, Robert Boroujerdi, says its list benefited from changes in thematic focus as the bull and bear markets played out. Like other winners, Goldman's 50-to-60-stock list generally lacked financial stocks and recently filled out its health-care position.

Pre-Lehman bankruptcy, he says, Goldman included global growth stocks such as **Monsanto** (MON). As the global recovery began, in late 2008, it added cyclical stocks, including vehicle-parts makers **Tenneco** (TEN), **Dana Holding** (DAN) and **Cummins** (CMI). In recent years the "conviction list." as it's called, took on late-cycle names, like entertainment outfit **Viacom** (VIA) and **Precision Castparts** (PCP), both of which remain. New Goldman names: **MAKO Surgical** (MAKO), a medical-device maker, and **Plains Exploration & Production** (PXP), part of an overweight in energy stocks, adds Boroujerdi.

Coming in second over five years is Edward Jones, the St. Louis broker whose conservative approach is geared to its Midwest clientele. The 40-to-60-name stock-focus list goes for high-quality companies that pay good dividends and increase them regularly.

That stood the broker in good stead during the bearish part of the period, says Dave Powers, the director of equity research. An underweight in financials and timely purchases of industrial and heath-care stocks have helped boost performance as well.

A recent addition is Boeing (BA). There are concerns about defense cuts and delivery delays for its new 787 aircraft, but Boeing should overcome them, says Powers. In a small departure, he bought non-dividend-paying **Google** (GOOG): "It has other attributes we look for, including leader in its industry, solid financial position, high returns on capital, strong free cash flow and attractive growth potential."

Bank of America Merrill Lynch also put up market-beating numbers, though it fell to fifth place over the six months, from first in the previous contest.

The firm's 20-to-30-name US 1 List, as it's called, was helped by an underweight in financials and by health-care biotech names like **Alkermes** (ALKS) and **Pharmasset** (VRUS), both of which remain on the list.

Oil-and-gas exploration company **Anadarko Petroleum** (APC) joined the list recently. Steve Fleishman, who is chairman of the committee running the list, says an energy underweight has hurt the list, and Anadarko, which has had impressive exploration success over the past year, will help.

Fleishman says he's become less enthused about "economic plays." Like Schwab's Forsythe, he says that for two years, all stocks were going up together on economic recovery, but "with less clarity on the economic outlook, returns will be more tied to stock-specific factors."

As the most recent period shows, uncertain stock markets can be the undoing of broker-focus lists. But followers of this contest know most brokers go through hot and cold streaks, so investors should look for durable, long-term outperformance from focus lists. If market volatility continues, the average broker-focus return will wobble, too.

Behind the Lists

Zacks Investment Research compiles the data and then scores the brokers by keeping a running tally of each focus list for various periods over the past five years. In tracking brokers' best ideas, Zacks puts a stock in a theoretical portfolio when the broker adds it to its focus list, and takes it out when the broker removes it. While similar in intent, these lists differ in significant ways. For example, some are updated at regular intervals, but others can be changed whenever it's deemed necessary.

The sizes of most lists are flexible, although in some cases the numbers can be fixed. Most lists have 20 to 50 names, but some, like Charles Schwab's, can run to 100. The smaller the list the more exposed it is to one or two stellar or disastrous picks. With big lists, individual picks matter less but it's tougher to beat the index because each stock is a smaller percentage of the portfolio. Some or our participants focus on large caps and others small and mid cap stocks, which over long periods of time tend to outperform big caps.

Additionally, Chicago-based Zacks ranks the brokers' picks on an equal-weighted basis, while the Standard & Poor's 500 index is weighted according to its components' market capitalization. As a result, brokers' results aren't strictly comparable to the S&P 500's. In order to help readers get a better perspective on relative performance, our tables show the S&P returns on an equal-weighted basis as well.

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