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FEATURES MAIN

The Other Surprise in Tampa Bay

By VITO J. RACANELLO

Raymond James comes from behind to win the top spot in our latest ranking of brokers' stock recommendations, thanks to a jolt from energy. (Video)

IS THERE SOMETHING UNUSUAL IN THE DRINKING water around Tampa Bay, Fla., these days? What else can explain the surprising first-place performances so far this year of both the once-woeful Tampa Bay Rays baseball team and Raymond James Financial? The broker, headquartered in the bay-side city of St. Petersburg, has likewise put its poor record behind it, with a top showing in *Barron's* most recent ranking of brokers' stock recommendations.

Barron's every half-year vets the stock picks of some important U.S. brokerages for the astuteness of their buying advice. The rankings include giants that most investors would recognize, like Morgan Stanley (ticker: MS), as well as the less well known, like little Matrix USA.

Our final roster is based on data compiled by Zacks Investment Research, a Chicago-based independent outfit that analyzes brokers' research and keeps a running tally of their focus lists, or best stock ideas, for various periods over the past five years. (For more on the methodology, please see "Behind the Lists" at the end of this article.)

Raymond James (RJF) has had its share of bad finishes in our rankings over the past three years. Yet in the latest competition, its focus list posted an uncommon double win, taking first place in the January-June 2008 period, as well as in the 12 months ended June 30.

Stuart Goldenberg

Raymond James took top honors in both the six months and year ended June 30.

THIS CONTEST MARKS the second in a row with a poorly acting and volatile stock market as a backdrop. In these battles for Wall Street's bragging rights, the highest finishes are always backed by savvy stock picks, but the most common thread has been the avoidance of sectors and stocks that suffered huge collapses. That's particularly important with a relatively small focus list of 20 names or less, as some of our contestants have.

In the battle for the January-June crown, this meant avoiding financial stocks -- no surprise -- and consumer-related picks. In both the six- and 12- month periods, brokers that kept natural-resource stocks, particularly energy sectors, on their focus lists, enjoyed a neat boost.

All that might be reversed in the next ranking, given the market's recent sector flip-flop. But in the contest at hand, oil explorers, natural-gas companies and sundry other energy stocks ruled. A supporting role was played by small-cap stocks, which began to outstrip large-caps toward the end of the period.

Matrix took the gold in the three-year contest with returns of 51.72%, moving up from second place last time. Indeed, Matrix improved its position in all ranked periods. Meanwhile, perennial powerhouse Goldman Sachs (GS) again won the five-year match going away, and took silver in the three-year (see nearby table, "A Very Tough League"). Charles Schwab (SCHW), alone among our contestants with a solely quantitative stock-picking method and with the largest focus list -- 100 names, had a middling short-term return, but finished second in the five-year period and first in the seven-year race (not shown).

Not only did Raymond James' strategy handily outperform the market's 12% drop in the difficult six-month period, it alone had a positive return, up 0.27%. Chief investment officer David Henwood, who by the way is a Rays fan and has season tickets, explains: "We avoided some bad areas, like financials, real estate and consumer goods in the last half of 2007 and first half of this year."

The way financial stocks were tattooed, that alone might have been good enough for a win, but Raymond James' portfolio was also turbocharged by being overweight during most of the period in energy, with picks like Continental Resources (CLR), which jumped about 165% in the period. (Continental is now off the

Vito Racanelli discusses which brokers have bragging rights as rated by Barron's survey of professional stockpickers . (Aug. 25)

list on profit-taking, and the energy weighting was reduced in April-June to one stock from six.) In a focus list of only 15 to 25 names, a pick like Continental generates plenty of torque. Henwood adds that some methodology changes made in 2007, like automatically dropping stocks that fall 15% from the entry price, have helped address a previous tendency to cling to laggards too long.Lately, Henwood has added Pharmaceutical Product Development (PPDI), an outsourcing company that helps drug companies put together clinical trials for product testing. (PPDI was the subject of a favorable Aug. 12 article in *Barron's* Online.) He also likes Walter Industries (WLT), a coal miner. Henwood, who isn't buying the dips in financial stocks, "hopes" that the housing market stabilizes by mid-2009.

Morgan Keegan, which, like Raymond James, follows small- and mid-size stocks, came storming back to grab the No. 2 spot in the six-month period. In our previous contest, the Memphis-based regional broker, a unit of Regions Financial (RF), uncharacteristically had finished last.

Table: A Very Tough League

"I'LL BE BACK!" VOWED Morgan Keegan's Elkan Scheidt, chairman of the focus-list committee, in our last contest -- and he made good on that promise. The broker lost a painful 17% in 2007's second half, but has rebounded notably, to an almost flat performance in this year's tumultuous first half. Morgan Keegan's 15-to-20-name list benefited from energy issues -- the weighting has since been reduced -- plus rail stocks and merger activity.

Morgan recently added Kirby (KEX), a barge operator whose stock is down 25% on recent Midwest river-flood damage. "But it's a case of the baby being thrown out with the bath water, as Kirby operates well south of the problem areas," Scheidt adds. Morgan Keegan took third place in our three-year assessment.

Our three-year winner, Matrix, uses a quantitative method, as does Schwab, but combines it with a traditional analyst approach. An investment committee sets sector themes, and then Matrix applies a quant approach that cuts a 3,000-stock universe to about 200 by scoring for economic value added, or EVA. This is measured by the growth in the spread between a company's return on capital and its cost of capital. On those 200 stocks, Matrix then employs a fundamental approach to whittle the list to between 15 and 25 names.

Matrix CEO Mike Blaustein says "ConocoPhillips was an important part of our three-year performance, as was Apple." ConocoPhillips (COP) remains on the list, but Apple (AAPL) is off. "The U.S. economy is going through a marinating process and [is] not yet ready to start cooking," says the CEO. So Matrix has been adding "value stocks with stable cash flows and a potential catalyst," like Time Warner (TWX) and Nasdaq OMX Group (NDAQ).

GOLDMAN SACHS REPRISED its five-year win in this contest -- with a nearly 97% return, more than double the market return, but slipped to second in the three-year race from the top spot last time. Among all the brokers in the half-decade that *Barron's* has run the contest, Goldman probably has the best overall track record, with the most consistent league-leading finishes in both the long and short terms. What's impressive is that Goldman's list has 80-odd names. With so many picks, it's tough to best much slimmer focus lists.

Anthony Carpet, the broker's co-head of Americas Investment Research, says it benefited from an overweighting in energy and basic materials, as well as technology and exchange stocks. Winners included Cabot Oil & Gas (COG), EOG Resources (EOG), US Steel (X), Brazilian mining giant Vale (RIO), Nasdaq, CME Group (CME), Research In Motion (RIMM) and Google (GOOG). Nasdaq, CME and RIM are now off the list.

Carpet adds that Goldman remains favorably disposed to energy and materials "in light of the pullback in these stocks... . One of the major things we are thinking about is the likelihood that we will see a bounce out of energy and materials." The broker remains cautious, however, on financial and consumer-related stocks. A recent Goldman addition is Amazon (AMZN), where the broker expects significant past investments in new categories and distribution will drive sustainable 20%-plus revenue growth.

Not every broker scored well, of course, in our latest rankings.

New Constructs, which just joined the contest, had a tough time of it in the first half. David Trainer, president, says the ranking method, which measures only long advice, hurt the performance of NC's Most Attractive and Most Dangerous stocks portfolio, as it's called, in which short recommendations play an integral role. For example, according to Trainer, the New Constructs long/short portfolio rose 2.6% in the first half, thanks to a 12.4% return from its shorts.

Meanwhile, McAdams Wright Ragen's picks lost 20% in the 12 months ended June 30. A spokesman for the Seattle-based regional broker replied in an e-mail message: "We underperformed because we were overweight one of the worst-performing sectors of the S&P [consumer cyclicals] and underweight the best-performing sector [energy]."

And though Raymond James did well in the recent periods, past poor performances still dog its longer-term ranking, as it finished last in the three-year period. Also not covered in garlands was Edward Jones, the St. Louis-based broker, which occupied last place in the five-year challenge.

The Bottom Line

Energy stocks plumped up many brokers' rankings; that may soon change. A supporting role was played by small-cap stocks, which have begun outpacing large-caps again.

Most brokers go through hot and cold stock streaks, so investors should look for durable, long-term outperformance. The average broker surveyed by Zacks beat the S&P 500 in all four periods shown, a notable achievement in a bear market.

As we head into autumn, the Rays are still in first place, which perhaps bodes well for Raymond James. But in a challenging bear market like this one, all the top brokers are going to have to keep their eyes on the ball if they want to hold on to their hard-won bragging rights.

Behind the Lists

IN TRACKING BROKERS' BEST IDEAS, Zacks Investment Research puts a stock in a theoretical portfolio on the day the broker adds it to its focus list, and takes it out when the broker removes it. While similar in intent, these lists can differ in significant ways. For example, some are updated by the brokers at regular intervals, but others are changed ad hoc. The sizes of most lists are flexible, although some are fixed. Most lists have 20 to 40 names. But the smaller the list, the more exposed it is to one or two stellar or disastrous picks. With big lists, individual picks matter less, so it's tougher to beat the index or a small list with a hot name.

Additionally, Zacks ranks the brokers picks on an equal-weighted basis, while the Standard & Poor's 500 index is weighted according to its components' market capitalizations. As a result, brokers' results aren't strictly comparable to the S&P 500's, particularly when one market-cap size is significantly outperforming others. So to help readers get a better perspective on relative performance, our tables show the S&P's returns on an equal-weighted basis as well.

Note: Regulatory restrictions prevented Merrill Lynch, which changed its focus-list strategy in 2007, from publishing new performance results.

E-mail comments to mail@barrons.com

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A Very Tough League

There weren't many runs batted in–as in positive focus-list returns–in the latest period examined by Zacks. But longer-term performance tends to pull up good stockpickers' numbers.

Six Months	Change
Raymond James	0.27%
Morgan Keegan	-0.18
Credit Suisse	-4.26
Matrix	-5.47
Goldman Sachs	-8.11
Charles Schwab	-10.29
Morgan Stanley	-10.60
Edward Jones	-11.08
A.G. Edwards	-11.41
Smith Barney	-12.65
Merrill Lynch	-14.62
McAdams Wright Ragen	-14.85
Wedbush Morgan	-15.77
Average Broker Returns	-9.15
S&P 500 Total Returns	-11.91
S&P 500 Total Return Equal-Weighted	-10.86

One Year	Change
Raymond James	-2.89%
Goldman Sachs	-3.48
Morgan Stanley	-8.74
Credit Suisse	-11.20
A.G. Edwards	-11.71
Edward Jones	-12.13
Smith Barney	-13.44
Charles Schwab	-15.48
Matrix	-15.72
Merrill Lynch	-16.99
Morgan Keegan	-17.47
McAdams Wright Ragen	-20.11
Wedbush Morgan	NA
Average Broker Returns	-12.45
S&P 500 Total Return	-13.12
S&P 500 Total Return Equal-Weighted	-16.88

Three Years	Change
Matrix	51.72%
Goldman Sachs	37.82
Morgan Keegan	31.98
Credit Suisse	23.15
Morgan Stanley	22.22
A.G. Edwards	17.07
Charles Schwab	16.28
Smith Barney	16.13
Edward Jones	10.44
Raymond James	6.91
Merrill Lynch	NA
McAdams Wright Ragen	NA
Wedbush Morgan	NA
Average Broker Returns	23.37
S&P 500 Total Return	13.81
S&P 500 Total Return Equal-Weighted	12.66

Five Years	Change
Goldman Sachs	96.93%
Charles Schwab	71.19
Morgan Stanley	67.61
Smith Barney	66.62
Credit Suisse	60.97
A.G. Edwards	43.51
Raymond James	41.78
Edward Jones	41.47
Merrill Lynch	NA
Morgan Keegan	NA
Matrix	NA
McAdams Wright Ragen	NA
Wedbush Morgan	NA
Average Broker Returns	61.26
S&P 500 Total Return	44.13
S&P 500 Total Return Equal-Weighted	60.45

*Merrill Lynch changed its Focus One list strategy in March 2007. NA=Not Applicable.

Sources: Zacks Investment Research; Standard & Poor's