FINANCE ANGLE

A Question of Trust

With prominent analysts accused of wrongdoing, investors are wondering where to turn for advice.

By **James Armstrong**
Editorial Assistant

One might expect a stock analyst for the nation's number-one brokerage firm to be beyond reproach. That's why investors were shocked when New York State Attorney General Eliot Spitzer uncovered e-mails from analysts at Merrill Lynch deriding stocks they were recommending to the public. Merrill Lynch settled the probe by paying a $100 million fine and by agreeing to change the way it compensated its analysts. But the question remains for investors: Whom can you trust?

"My God, aren't we supposed to be relying on these analysts for independent research?" asks Gayle Buff, a certified financial planner in Newton, Mass.

Ms. Buff says that when things are going well in the market, investors don't pay attention to how analysts and brokerage firms operate. But once people are losing money, they start to wonder about possible conflicts of interest.

"Theoretically, there should be what's called a Chinese wall," says Ms. Buff. "That means that though they're all under the umbrella of the same company, what's happening on the investment-banking side shouldn't influence what's happening on the research-analyst side."

MERRILL LYNCH'S E-MAIL WOES

New York State Attorney General Eliot Spitzer recently uncovered e-mails from Merrill Lynch analysts privately criticizing companies the firm publicly endorsed.

Company	Date	Analyst Comment	Published Long-Term

			Rate
Aether System	3/15/01	"fundamental horrible"	Buy
Excite@home	6/3/00	"such a piece of crap"	Buy
Infospace	10/20/00	"piece of junk"	Buy
Internet Capital Group	10/06/00	"we see nothing that will turn this thing around"	Buy
24/7 Media	10/10/00	"piece of [expletive]"	Accumulate

Source: Office of NYS Attorney General

But the reality is, critics charge, investment banking is far more profitable, and it is difficult for analysts to make a negative recommendation against a company that is a client, or potential client, in another branch of the firm.
That's why experts urge investors not to buy a stock purely on the recommendation of one person. It's usually best to do a little research yourself.

Ms. Buff points out that the whole purpose of going to a full-service broker is so that you don't have to do everything yourself. "If you're going to spend the time investigating [a company], then why are you paying the broker to do that?" she asks.

Ms. Buff says that some investors with large brokerage firms will call her for a second opinion. An hour consultation with an independent financial planner may help you feel better about your investments, but it is an extra expense.

"People do that with physicians all the time," says Ms. Buff. "If someone's recommending that you get a complex surgical procedure, you probably want to get a second opinion and make sure before you do that."

Ms. Buff also warns investors against always second-guessing their advisers after reading the latest money magazines. Investors who always act on the latest article they've read end up churning their portfolios, continually buying and selling, which creates added expenses and possible negative tax consequences.

One option to protect yourself is to go to a fee-only financial planner. Ms. Buff points out that when brokers and financial specialists are paid by the transaction, or compensated more for selling certain products rather than others, their own financial interest may differ from that of the client.

Instead, planners may charge a percentage of the client's assets. That usually ranges from 1 to 1.5 percent.

"Because your fee is driven by the dollars in the portfolio, your incentive is not to churn it, and if anything to minimize the expenses that are inside the portfolio," she says. "It puts you on the same side of the table as the client."

Many experts contend that the hype over analysts' conflicts of interest is overblown. "When you're talking about the top 10 or so firms, it's akin to when's the best time to fly an airline-after a crash," says David Trone, senior brokerage analyst for Prudential. He says that with major firms facing so much bad press and regulatory scrutiny, they'll be sure to steer clear of questionable practices in the near future.

"At the end of the day, I still believe that the bigger, more established, well-known firms are more trustworthy in the sense that they have a brand to protect," he says.

Yet Mr. Trone says that investors need to take a certain amount of personal responsibility for their money. While he recommends full-service brokers, he suggests that investors still monitor their assets to make sure that their portfolios are meeting their needs.

"This last bull run, what happened was a lot of people were looking for alternative investments, [and] they were being solicited constantly from your bigger firms," says Mario Sicari, regional vice president for CJM Planning. "People were not really looking at what clients' needs and goals were. They were more interested in selling products."

Mr. Sicari thinks the trend for the future will be certified public accountants getting licensed to offer full financial services. He says that a CPA is in the best position to determine what a client's needs and goals are. In the past, many CPAs felt that offering advisory services presented a conflict of interest if they also served as an accountant. But according to Mr. Sicari, the high standards of ethics set forth by the CPA society are sufficient to protect investors.

He is more concerned with the growing trend of commercial banks also offering their customers investment services. In the 1990s, when Americans were moving their money out of CDs and into the stock market, large banks started adding and expanding brokerage services. An investment sold by a bank representative is no more secure than one purchased through Merrill Lynch or any other brokerage, but banking customers may be under the false impression that their investments are FDIC insured when they are not. Mr. Sicari thinks that more state regulation may be necessary to ensure that customers investing through banks know what they're getting into.

Regardless of with whom you invest, it's important that you're able to trust your financial adviser. "A lot of that's kind of a tummy feel," says Tom Shipley, chief marketing officer for the Atlanta-based Financial Service Corporation. But he says that investors can also contact the National Association of Securities Dealers (NASD) and the Board of Certified Financial Planners.

He also says that investors should meet with their planners at least quarterly. "That doesn't have to be a four-hour meeting," he says. "That could be a one-hour meeting."

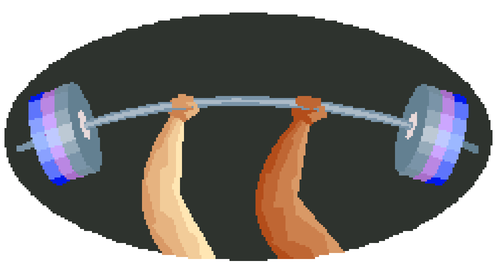
In May, the Securities and Exchange Commission (SEC) approved new rules written by NASD and the New York Stock Exchange. Among other things, the new rules prohibit tying analyst compensation to specific investment banking transactions, ban investment banking departments from supervising or approving analysts' research reports, restrict personal trading by analysts in the companies they follow and increase disclosure of possible conflicts of interest in research reports.

"These tough, comprehensive rules are a big step forward in investor protection," says NASD chairman and CEO Robert Glauber. "They will go a long way toward winning back investor confidence-once a given in our industry-that analyst research reports contain useful information, not mere salesmanship."

But Ashley Baker, spokesperson for the North American Securities Administrators Association (NASAA), says that the new rules don't go far enough. NASAA would like to see an end to analysts appearing at "road shows" to promote new stock offerings by the investment banks that employ them. They also would like to see an end to "booster shots," analyst reports timed to raise the value of a company's stock at the end of the lock-up period, during which executives are barred from selling their shares. NASAA is also calling on NASD and the New York Stock Exchange to adopt strong anti-retaliation rules to keep firms from intimidating or punishing analysts who write negative reports. The group has even suggested that the SEC consider separating analyst research arms from investment banking companies if other remedies fail.

NASAA also recommends that investors call their state securities regulator to make sure that both an investment and the person attempting to sell it are licensed by the state. If not, don't invest, Mr. Baker says.
NASD Regulation also provides information about brokers' business, educational and disciplinary background on its Website at www.nasdr.com. You can also call 1-800-289-9999.

John Gannon, director of investor education for NASD, says that over the past decade information about investments has become much more easily available for those who wish to do a little digging. For instance, SEC filings on companies are now readily accessible on the Internet at www.sec.gov. "Before that was available, you basically had to go to a broker to get that information, or request it from the company," Mr. Gannon says.



The new rules for analysts should also make recommendations easier for investors to understand. "What did 'buy' mean? What did 'strong buy' mean? There needed to be some clarification about what analysts were saying," remarks Mr. Gannon. "I think the rules address those issues."

But you'll still want a broker or adviser with whom you feel comfortable. "You want a broker that listens to you and understands your investment objectives and what you consider your level of risk to be," says Mr. Gannon.

"Investors should put at least as much attention into their investments as they do into buying a car," says NASAA's Mr. Baker. "You walk around, you kick the tires, you get on the Internet, you read Consumer Reports, you do comparison shopping, right?"

Mr. Sicari of CJM Planning agrees. "It's funny, because when we buy a car or we buy a tangible asset, we'll shop around," he says. "But when we're talking to an individual about our financial situation, we kind of park ourselves in one place." Visit several different financial professionals before deciding on one. And ask for referrals, Mr. Sicari advises. Or you may regret it later if your trusted adviser turns out to be a real lemon.

PFN's **Finance Angle** archive dates back to January 2000.

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January 15, 2000	August 15, 2001 July 15, 2001 June 15, 2001 March 15, 2001 January 15, 2001	December 15, 2002 November 15, 2002 July 15, 2002 January 15, 2002	May 15, 2003 April 30, 2003 April 15, 2003 March 15, 2003 February 28, 2003 January 15, 2003

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