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## Signs that Help Spot an "Objective" Research Report

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There is a lot of "research" available to investors, but is it critical that you learn the six warning signs that differentiate a good research report from a hype piece that is intended to manipulate stock prices. This article will review the key signs that separate a "good" report that provides objective analysis and information from a "bad" report that was written to manipulate stock prices.

### 1. Is there a disclaimer?

The SEC requires that everyone providing investment information or advice must fully disclose the nature of the relationship between the information provider (i.e. research analyst) and the company that is the subject of the report. If there is no disclaimer investors should disregard the report.

The disclaimer is found at the end of the report, is usually in small print (of course), and can range from a paragraph to a page in length. You will need to dig through a lot of legalese and boilerplate to find the relationship clause because it is usually buried somewhere between the middle and the end of the disclaimer. (They figure you'll give up before you get to the good stuff.)

### 2. What is the Nature of the relationship?

Investors can get some good information from pieces published by IR firms, brokerage houses, and independent research companies. Using all of these sources will provide pieces of information and perspectives that can help you make better investing decisions. But you need to evaluate their conclusions in light of the compensation.

Can a Wall Street analyst, who is at least partially compensated by trading generated by the report, write a report more objective than one written by a fee-based research firm that is paid a flat monthly rate with no "performance" bonus? This question is left for each investor to decide, but both reports could be used to evaluate a potential investment. The nature of the compensation will provide information to help you evaluate how objective the report is. (See Appendix 1, below, for tips on interpreting the various types of relationships between researchers and the companies that they research.)

### 3. Is the author identified and is his/her contact information provided?

Generally speaking, if the author's name and contact information is on the report, it is a good sign because (1) it shows the author is proud of the report and (2) It gives you a way to contact the author for additional information. Research reports from legitimate brokerage firms post the author's name and contact information near the top of the front page. However, if you try to contact the analyst at the brokerage, you'll generally be end up talking to a broker who will try to answer your question and get you to open an account.

If the author's name is not given, investors should be very skeptical of the contents of the report.

#### **4. What are the author's credentials?**

Having letters after a name does not necessarily mean that the author of the report is a better analyst, but they do indicate that the analyst has undertaken additional studies to expand his or her knowledge of finance and investing.

The CFA(R), or Chartered Financial Analyst, designation is a key credential. In order to be awarded the CFA designation a person must master a "body of knowledge" that spans ethics, accounting, economics, finance and investments. CFA candidates must pass three eight-hour exams in order to be eligible to receive the designation. The CFA program and testing is administered by the Association for Investment Management and research (AIMR), which is an international association of investment professionals.

However, the CFA designation does not automatically mean that the analyst is a good stock picker. Just as some doctors are better than others, some CFAs are better than other CFAs. And there are good analysts who choose not to get this designation. Other credentials, such as CPA or MD, would suggest that the analyst's education provides her with a unique perspective on the stocks that she follows (assuming the MD follows healthcare stocks), which would benefit investors.

#### **5. How does the report read?**

If the report contains a lot of grandiose words and exclamation points, beware. I'm not saying that good analysts are boring, but good reports don't read like the National Enquirer. We try to make it interesting, but a reputable analyst never makes reference to "sure things" or rockets, and would never suggest that you mortgage your home to buy a stock.

Objective research reports provide reasoned arguments to buy or sell a stock. Key factors such as management expertise, competitive advantages and cash flows are cited as support for the recommendation.

#### **6. Is there an Earnings Model and target price with reasonable assumptions?**

The bottom line for any recommendation is the earnings model and target price. The earnings model should be based upon assumptions that are clearly stated so that the reader can evaluate their reasonableness. The target price should be based upon valuation metrics (such as P/E or P/B) that are also based upon reasonable assumptions. If a report lacks this detail, it is generally safe to assume that the report also lacks a sound basis and investors should ignore the report.

While ratings (such as "Buy" and "Sell") are a convenient marketing tool, they are not as important as detailed information on earnings and valuation models. As we have witnessed during the last two years, "Buy" ratings have cost investors a lot of money. And while target prices can be manipulated, if the detail is presented, you can make your own rating on the stock based upon the information in a good research report.

#### Conclusion

In the "good old days" a report from a Wall Street firm was viewed as preferable due to the resources that were devoted to performing the research. Brokerage firms were THE source of information on stocks and the market because they had the resources to devote to gathering and processing the data into information.

Today, the Internet is the great equalizer and investors are no longer slaves to Wall Street. There are many sources of investment information on the Web and while they are not all of the same quality, they do provide a perspective that could be useful. Investors need to know how to

tell the difference between an objective research report and a “report” written by stock manipulators looking to take advantage of unwary readers. To protect yourself, start by using these signs in this report and you will soon be able to tell the difference between useful information and materials that are best sent to the circular file.

Richard J. Wayman, CFA, is President of [researchstock.com](http://researchstock.com), an independent equity research firm that focuses on under-followed small cap stocks. Prior to co-founding [researchstock.com](http://researchstock.com), he was a buy-side analyst for Fifth Third Bank and a sell-side analyst for The Ohio Company. He contributes articles to [Investopedia.com](http://Investopedia.com), [MultexInvestor.com](http://MultexInvestor.com), and periodically hosts an “Ask the Analyst” show on [MultexInvestor.com](http://MultexInvestor.com). He is an active member of the Association for Investment Management and Research and is the President of the Columbus Society of Financial Analysts.

## Appendix 1: Disclaimer Language and Translation

Following is a sampling of disclosure language that pertains specifically to the relationship between the issuer of the report and the Subject Company and my interpretation of the potential for that relationship to influence objectivity.

What it says...	What it means...
<b><u>Typical Brokerage</u></b>	
"We may function as a market maker in any of these securities...."	The brokerage makes a spread on all the shares of the subject company's stock it trades.
We may perform investment banking or other services for, or solicit investment banking business from, any company mentioned in this report.	The brokerage has done, or is hoping to do, investment-banking business with the subject company. It is up to the reader to decide if this "taints" the research.
<b><u>Investor Relations</u></b>	
We have been retained by [subject company] and received 25,000 restricted shares of stock. [The IR Firm] and/or individuals thereof may have positions in securities referred to herein and may make purchases or sales at any time.	The IR firm accepts stock from the subject company. The language regarding holding or trading these shares means that the IR firm is not restricted from trading in the stock (and, unlike most insiders, it does not have to notify the SEC if its employees do make trades).*
<b><u>Subscription-Based Research Firm</u></b>	
We are an independent research firm with paid subscribers. And we have "been retained to reprint and distribute this report on (subject company)...and has been paid 60,000 shares of common stock by a third party investor of...."	The first sentence gives a sense of reliability, but it isn't until the fifth sentence (in the middle of the disclaimer) that the company discloses that it received stock to "distribute" the report. Whether the subject company or an investor in the company paid the research firm does not make any difference. The company still received stock for its employees' efforts and the risk of a "pump and dump" exists.
<b><u>Fee-Based Research Firm</u></b>	
We are "an independent research firm that publishes research reports on companies that may, or may not be clients. The company ... has been compensated for the preparation of this report. The company's compensation consists of a flat monthly fee of.... The company does not accept any form of equity nor does it accept any "performance bonuses".	The subject company compensates this firm, but not in the form of stock. Therefore, the firm has no opportunity to benefit by influencing movement in the stock price, and the report is more likely to be objective and unbiased.
*Receiving stock, as payment for research is a two-edged sword. On one hand, ownership of the stock shows that the writer is putting her money where her mouth is, and it suggests that she really considers the stock to be a good investment. On the other hand, owing the stock means that the research firm can make a profit by writing a very bullish report (hyping the stock), then selling the shares as the stock rises. This is a classic "pump and dump" situation and is more prevalent with smaller research firms and "boiler rooms".	