

Good Times Getting Better

With commission-sharing agreements extending the boom in independent research, investors have access to more information than ever. Here are the firms they consider the best. **BY ROSALYN RETRWA**

Independent research firms were among the biggest beneficiaries of the Global Research Analyst Settlement, the agreement between regulators and big brokerages that required, among other things, that the Wall Street firms pay nearly half a billion dollars to subsidize independent research over five years. The settlement triggered a wave of hires at established independents, and a new generation of firms appeared as researchers left leading investment banks to start their own shops. From about 150 in 2003, before the settlement was

gave its stamp of approval to the use of commission-sharing agreements, or CSAs, which allow money managers to trade with the firms that give them the best execution and direct a portion of the commissions they generate to pay for third-party research. The advisory, issued in July 2006, gave a boost to smaller firms that do not dominate the trading business on Wall Street, effectively encouraging the start-up of independent research operations.

"That is one of the most significant developments to impact

independent research, but they hadn't provided any clarity on how the buy side could pay for it," says portfolio strategist Jason Trennert, who co-founded the New York-based firm with sector strategist Nicholas Bohnsack and economist Donald Rissmiller. With a limited number of clients, he says, Strategas outsources trading so its 12 analysts can "focus on what we're good at — research."

They appear to have chosen a good time, as the market for independent research is growing. According to an exclusive *Institutional Investor* survey, 36.5 percent of buy-side analysts plan to increase their use of independent or boutique research providers over the next 12 months.

There are hundreds of firms from which to choose, but investors say none is better than Sanford C. Bernstein & Co., which takes top honors in 15 categories in our annual rankings of the Best Boutiques, Regionals & Independents. The results are based on

firms received votes in both the boutique/regional and independent rankings.

Adam Parker, a former top-ranked semiconductor analyst in the All-America Research Team survey, was named global director of research for New York-based Sanford C. Bernstein in February, after former research director James Gringrich was promoted to chairman and CEO. Parker has since hired seven investment specialists to support the 25 analysts in the U.S. who publish research and 15 more in the U.K., but the new hires will not begin coverage until next year.

"One of our biggest distinctions is that we hire industry experts to be analysts, and we give them 12 months to initiate coverage," explains Parker. "We spend much more time to do industrial-strength research — it's what the buy side wants."

Many investors agree. "I always find Bernstein's research thought-provoking, in-depth and unbiased," says one portfolio manager. "Their analysts don't simply regurgitate facts but instead spend time peeling back an extra layer or two or provide an alternative perspective."

Despite the defections of the Strategas analysts, ISI Group remains the No. 1 independent in four categories: Economics, Integrated Oil, Technical Analysis and Washington Research. (The New York-based firm is also voted best boutique in Economics.) Chairman Ed Hyman, who has been the top-ranked economist on the All-America Research Team for 28 years running, says his firm hired seven analysts in the past year, for a total of 27, including four analysts for its new office in Beijing. "China is changing so rapidly, it would be hard to follow it without being there," he says.

Research from ISI Group is "brief and to the point," according to one asset manager, "but you always know the detailed work behind it has been done and is available on request." She also praises ISI Group's analysts for their "approachability."

When firms pay a set amount for research, rather than having it bundled in with the brokers' execution bill, they are much more aware of its quality, observes Michael Kirby, chairman and director of research for Green Street Advisors, which wins top honors as both best independent and best boutique for its coverage of real estate investment trusts. (The Newport Beach, California-



From left: Adam Parker, research director at Sanford C. Bernstein & Co.; Dana Telsey, CEO of Telsey Advisory Group; Thomas Gallagher, director of Washington research for International Strategy & Investment Group.

approved, the ranks of independent research firms has grown to more than 650, according to Michael Mayhew, co-CEO of Integrity Research Associates, an independent research firm based in New York.

The settlement period expires in less than two years, but Mayhew believes independent research firms will continue to flourish. The Securities and Exchange Commission breathed new life into the business last year by offering interpretive guidance on a provision of federal securities law that lets investors use brokerage commissions to pay for research. The SEC

the research business in quite some time," Mayhew says. "A money manager doesn't have to trade with someone to pay for their research anymore, which makes it easier for a small firm to set up a business and not have to worry about registering as a broker-dealer or setting up a trading desk."

Among those taking advantage of the new rules were three analysts from International Strategy & Investment Group in New York, who in September 2006 launched Strategas Research Partners.

"Three or four years ago, one of the problems was that the regulators wanted to encourage indepen-

the responses of portfolio managers and analysts at hundreds of asset management firms and hedge funds. More than 760 voters submitted ballots for best boutiques and regional firms, and 420 cast votes for independent firms. For boutiques and regionals, balloting was sufficient to publish results in 39 of the 68 sectors in the 2007 All-America Research Team survey (*Institutional Investor*, October 2007); for independents, there was sufficient depth of voting to publish results in 35 sectors. Participants were given a free hand to classify research firms; therefore, some

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BEST BOUTIQUES & REGIONAL FIRMS In polling for our 2007 All-America Research Team, we asked investors to name the best boutique or regional firms by sector. Here are the winners in their respective categories.

| CATEGORY/SECTOR | FIRM (CITY, STATE) |
|--|--|
| BASIC MATERIALS Metals & Mining Paper & Forest Products | KeyBank Capital Markets (CLEVELAND, OH) Buckingham Research Group* (NEW YORK, NY) |
| CAPITAL GOODS/INDUSTRIALS Airfreight & Surface Transportation Business & Professional Services Electrical Equipment & Multi-Industry Machinery Packaging | Stephens (LITTLE ROCK, AR) Robert W. Baird & Co. (MILWAUKEE, WI) Robert W. Baird & Co. Stifel, Nicolaus & Co. (ST LOUIS, MO) KeyBank Capital Markets |
| CONSUMER Apparel, Footwear & Textiles Beverages Retailing/Broadlines & Department Stores Retailing/Food & Drug Chains Retailing/Hardlines | Buckingham Research Group Stifel, Nicolaus & Co. Cleveland Research Co.† (CLEVELAND, OH) Cleveland Research Co.† Cleveland Research Co.† |
| ENERGY Integrated Oil Natural Gas Oil & Gas Exploration & Production Oil Services & Equipment | Simmons & Co. International (HOUSTON, TX) Pickering Energy Partners† (HOUSTON, TX) Pickering Energy Partners† Simmons & Co. International |
| FINANCIAL INSTITUTIONS Banks/Large-Cap Banks/Midcap Brokers & Asset Managers Consumer Finance Insurance/Life Insurance/Non Life REITs | Keefe, Bruyette & Woods (NEW YORK, NY) Keefe, Bruyette & Woods Keefe, Bruyette & Woods Keefe, Bruyette & Woods Keefe, Bruyette & Woods Dawling & Partners Securities (FARMINGTON, CT) Green Street Advisors† (NEWPORT BEACH, CA) |
| HEALTH CARE Biotechnology Health Care Technology & Distribution Managed Care Medical Supplies & Devices Pharmaceuticals/Major Pharmaceuticals/Specialty | Leerink Swann & Co. (BOSTON, MA) Leerink Swann & Co. Dawling & Partners Securities Leerink Swann & Co. Leerink Swann & Co. Leerink Swann & Co. |
| MEDIA Cable & Satellite Entertainment | Poli Capital (NEW YORK, NY) Poli Capital |
| TECHNOLOGY IT Hardware Semiconductor Capital Equipment Semiconductors Software | Pacific Crest Securities (PORTLAND, OR) Pacific Crest Securities Pacific Crest Securities Pacific Crest Securities |
| MACRO Economics Portfolio Strategy Quantitative Research Washington Research | International Strategy & Investment Group* (NEW YORK, NY) Empirical Research Partners* (NEW YORK, NY) Empirical Research Partners* Stanford Group Co. (WASHINGTON, D.C.) |

* Voters also named this firm as among the best independents.
† Pickering Energy Partners and Tudor Capital Partners merged effective August 13; the combined company is Tudor Pickering & Co.

based firm, which has 20 analysts actively tracking between 65 and 70 companies, is also the No. 1 independent firm in Gaming & Lodging.) "Our business has thrived because money managers are much more focused on paying only the people who are really adding value," says Kirby. "The world has changed."

It certainly has for retailing analyst Dana Telsey, who left Bear, Stearns & Co. to start Telsey Advisory Group in January 2006. The New York-based firm, which employs 17 analysts covering 50 stocks, is named the best independent research provider in two categories: Apparel, Footwear & Textiles and Retailing/Specialty Stores.

"Given that we're not involved in the investment banking process, buy-siders know we have our own independent perspective," says Telsey, the firm's CEO and chief research officer, who was ranked No. 1 seven times in the All-America Research Team survey. She plans to expand her coverage universe by adding restaurants before the end of the year and, later, gaming and lodging companies. "Our goal is to be the preeminent consumer research firm."

They are well on their way, investors say. Telsey "keeps great up-to-date interactive and working models and is a veritable encyclopedia on her stocks," says one money manager, who also lauds her for her "great management contacts."

Another relatively new firm that is impressing investors is Cleveland Research Co. The Ohio-based firm, launched in June 2006 by FTN Midwest Securities Corp. alumni Eric Bosshard and Chris Byke, is voted the best independent in three retailing categories: Broadlines & Department Stores, Food & Drug Chains and Hardlines. (The firm is also named the best boutique in those three categories.)

"Cleveland bases its research on extensive and continuous channel checks with industry players and, in doing so, gets a great sense as to how businesses are trending from an 'on-the-ground' perspective," says one portfolio manager.

The work is becoming more challenging. "Hedge funds have made the market more efficient and faster to respond, and it has become harder for them to get a real edge," says Bosshard, Cleveland's CEO and director of research, who adds that his analysts "dig in the channels to get incremental information that the

rest of the world doesn't know."

The firm has added only one senior analyst since its inception, bringing the total to 14, but has nearly doubled the number of research associates who conduct channel checks, from 15 to 26.

Cleveland Research typifies a new breed of independent research shop that provides "all kinds of unique stuff that traditional Wall Street firms don't produce — channel checks, market research, expert networks, proprietary data, forensic accounting and short ideas," says Integrity Research's Mayhew. "Today you have a large number of firms that don't fit any of the traditional categories."

That is because smaller firms have greater flexibility and can more readily adapt to change, according to Scott Sandbo, chairman and CEO of Pacific Crest Securities, named the best boutique in IT Hardware, Semiconductor Capital Equipment, Semiconductors and Software. "There's a very big market opportunity to be forward-looking and innovative," Sandbo says, "but you also have to be willing to continually change and evolve."

In 1998 the Portland, Oregon-based boutique decided to abandon its multisector approach and focus exclusively on technology companies: "We've grown very steadily since we made that shift," says Sandbo. Over the past year the firm added three senior analysts, bringing its total to 18 researchers covering more than 200 stocks, and Sandbo says he anticipates hiring several more as the firm delves deeper into "up-and-coming technology companies in Asia."

Signs point to CSAs continuing to fuel growth for small-firm research. "When you're in an environment where you can buy execution separately from research, you actually know how much you're spending on your research, and the cost of an independent provider is significantly less than the cost of a large brokerage firm's research," Mayhew says. As more and more sell-side firms reach that conclusion, the future of independent research is looking very promising.

ON THE WEB

● For additional information about the Best Boutiques, Regionals & Independents, as well as results of this year's All-America Research Team survey, visit www.iiimagazine.com.

BEST INDEPENDENTS Here are the firms that produced independent research that was deemed most valuable by voters in the 2007 All-America Research Team survey.

| CATEGORY/SECTOR | FIRM (CITY, STATE) |
|---|---|
| BASIC MATERIALS | |
| Chemicals | Gulley & Associates/Soleil Securities (New Canaan, CT/New York, NY) |
| Metals & Mining | Bradford Research/Soleil Securities (New York, NY) |
| Paper & Forest Products | Duckingham Research Group (New York, NY) |
| CAPITAL GOODS/INDUSTRIALS | |
| Aerospace & Defense | Sanford C. Bernstein & Co. (New York, NY) |
| CONSUMER | |
| Apparel, Footwear & Textiles | Telsey Advisory Group (New York, NY) |
| Automobiles & Auto Parts | Ward Transportation Research/Soleil Securities (Westport, CT/New York, NY) |
| Beverages | Sanford C. Bernstein & Co. |
| Cosmetics, Household & Personal Care Products | Sanford C. Bernstein & Co. |
| Gaming & Lodging | Green Street Advisors (Newport Beach, CA) |
| Retailing/Broadlines & Department Stores | Cleveland Research Co. (Cleveland, OH) |
| Retailing/Food & Drug Chains | Cleveland Research Co. |
| Retailing/Hardlines | Cleveland Research Co. |
| Retailing/Specialty Stores | Telsey Advisory Group |
| ENERGY | |
| Integrated Oil | International Strategy & Investment Group (New York, NY) |
| FINANCIAL INSTITUTIONS | |
| Banks/Large-Cap | Sanford C. Bernstein & Co. |
| Banks/Midcap | Sanford C. Bernstein & Co. |
| Brokers & Asset Managers | Sanford C. Bernstein & Co. |
| Consumer Finance | Partakis Partners (New York, NY) |
| Insurance/Life | Sanford C. Bernstein & Co. |
| Insurance/Nonlife | Sanford C. Bernstein & Co. |
| REITs | Green Street Advisors |
| HEALTH CARE | |
| Biotechnology | Sanford C. Bernstein & Co. |
| Pharmaceuticals/Specialty | Sanford C. Bernstein & Co. |
| MEDIA | |
| Cable & Satellite | Sanford C. Bernstein & Co. |
| Entertainment | Sanford C. Bernstein & Co. |
| TECHNOLOGY | |
| Computer Services & IT Consulting | Sanford C. Bernstein & Co. |
| Imaging Technology | Cross Research/Soleil Securities ¹ (Livingston, NJ/New York, NY) |
| IT Hardware | Sanford C. Bernstein & Co. |
| Semiconductors | American Technology Research (Greenwich, CT) |
| TELECOMMUNICATIONS | |
| Data Networking & Wireline Equipment | Sanford C. Bernstein & Co. |
| MACRO | |
| Economics | International Strategy & Investment Group |
| Portfolio Strategy | Empirical Research Partners (New York, NY) |
| Quantitative Research | Empirical Research Partners |
| Technical Analysis | International Strategy & Investment Group |
| Washington Research | International Strategy & Investment Group |

¹ Effective August 15, Cross Research is no longer affiliated with Soleil Securities.