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# Lehman bust highlights analyst ‘group-think disease'

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New York — All of Wall Street's bank analysts were caught out by Lehman's collapse – and few have redeemed themselves since.

Just a handful have dared to issue a “buy” on bank stocks that have surged since March – after they all failed to slap that “sell” on Lehman Brothers before it went bust a year ago.

“There's a group-think disease on Wall Street,” said Robert Lutts, chief investment officer of Cabot Money Management who started buying financial stocks for his $400 million fund this year.

Even star analysts like Meredith Whitney – famed for calling Citigroup's troubles in 2007 – and renowned bear Mike Mayo, whiffed on both this year's turnaround and Lehman's problems.

Only 45 per ent of bank analysts managed to beat an index of commercial banks or capital markets firms with their recommendations in 2008, according to Thomson Reuters' StarMine. And it is hardly better this year, with just 46 per cent of analysts beating the market.

You figure analysts would know their own industry better.

Think again. A herd mentality and a concern that controversial calls could damage their careers are holding them back from greatness.

“There's a fear of publicly being wrong,” said David Ellison, chief investment officer at FBR Funds with $1.4-billion (U.S.) under management. Anonymous researchers at fund companies have an easier time making edgy calls because they work behind closed doors, he explained.

It is also tricky to highlight risky business practices or slam misguided strategy at other banks if your own firm is doing the same stuff.

“It's a little bit close to home,” said Ben Wallace, securities analyst at Grimes & Company in Westborough, Massachusetts, adding, “The investment banks really don't cover themselves well.”

It is best to make predictions that sound reasonable at the time you make them, said Henry Blodget, the once celebrated but later reviled dotcom analyst who now runs news site The Business Insider, in an e-mail.

“Analysts who stick their necks way out, especially on the negative side, often get their heads chopped off,” he wrote. “Analysts who never stray from the safe middle ground, meanwhile, often enjoy long, profitable and stress-free careers.”

Mr. Blodget, who made famously bullish calls on Internet stocks but got into hot water when he dismissed some stocks in private, became the poster boy for the flawed analyst.

Add accounting scandals like WorldCom and Enron, and the pressure was on Wall Street's research community to call it as they saw it without hiding behind euphemisms.

Things have looked up since then, but just a bit. In 2008, 8 per cent of analyst recommendations were “sells,” compared with just 1 per cent in 2000, according to Thomson Reuters research.

Still, just nine out of 20 brokers covered the banking sector profitably last year. And the big names had a checkered record.

Investors following veteran Dick Bove would have gained from his call to buy Bank of America Corp shares in April – they have more than doubled since then. But you would have lost big time if you had heeded Mr. ove's call to buy Lehman on Aug. 21, 2008: Shares fell 94 per cent and are now basically worthless.

Ms. Whitney, who launched her own firm this year, made money for investors who followed her calls to sell Citi and Bear Stearns shares in 2008. But if you had taken her advice to hold on to Lehman, Morgan Stanley and Goldman Sachs shares, you would have squandered your Citi and Bear gains.

Mike Mayo, named Institutional Investor's (II) third-best large-cap bank analyst of 2008, adopted a “not so negative“ stance on banks in July last year. The KBW Banks Index had fallen 30 per cent by the end of 2008.

Then he started banks with an “underperform” rating in April, 2009, when he left Deutsche Bank for Calyon Securities. The KBW Banks Index has climbed 60 per cent since.

Ms. Whitney was a runner up in the II ranking, while Mr. Bove did not get a mention. The winner, Matthew O'Connor of Deutsche Bank, and runner-up Ed Najarian, who was at Merrill Lynch in 2008, did not have the handicap of covering Lehman.

Ms. Whitney, Mr. Bove and Mr. Mayo did not return calls seeking comment.

Of course, it is tougher than ever to cover Wall Street. Complex derivatives and high leverage have raised the unpredictability factor for bank results.

“Banking is a black hole, there's no way you can really analyze any of these institutions and know what you're looking at,” said Ethan Heisler, an analyst at Hexagon Securities and former debt analyst at Citigroup.

And there are some analysts who have beaten the market.

Sandler O'Neill + Partners' Jeff Harte and Bank of America's Guy Moszkowski have made the most profitable calls so far this year, according to StarMine.

A long/short portfolio based on Harte's calls would be up 28 per cent, while Moszkowski's calls would have earned about 6 per cent. The KBW Banks Index is flat this year.

Both Mr. Harte and Mr. Moszkowski also beat the market last year, when Mr. Moszkowski was ranked third in Institutional Investor's rankings of broker and asset manager analysts.

Mr. Harte, based in Chicago, is modest about his success.

“After how bad 2008 was, it's hard to be too excited about having picked some stocks that worked in 2009,” Mr. Harte said. “It's been a hard environment.”

Indeed, investors may find that picking the top analyst is just as tricky as picking the top-performing stock. They may be best served by taking FBR's Mr. Ellison's advice – using the analysts' consensus view to do exactly the opposite.

“When the analysts become all bullish is when you should be worried if you own (financial stocks),” Mr. Ellison said. “You should short them when they're all bullish and own them when they're all bearish.”







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