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Discrete Expectational Data and Portfolio Performance: Discussion

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brokerage firm can be identified or that one brokerage firm is consistently better than a second.

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DISCUSSION

DENNIS E. LOGUE*: This paper explores the value of brokerage firm stock recommendations. It first asks whether significant changes of opinion regarding a stock have some information content. In other words, when analysts boost their evaluation of a stock, does the price rise? It then asks whether there is persistence to the recommendations. For instance, can an investor who buys the stocks presently rated "best" do better than by buying some other portfolios of stocks? Finally, it addresses the persistence of the forecasting ability of any brokerage firm. Can a specific broker continually pick those stocks that subsequently rise relative to other stocks?

The paper shows first that changes of opinion by analysts are correlated with subsequent stock price movements. Stocks elevated to the highest categories have superior risk-adjusted excess returns relative to those either not elevated or downgraded. What was not shown is whether the analysts had true forecasting ability or whether the strength of the marketing effort associated with upgrades led to the price rise. That is, are analysts really identifying positively altered company situations or are the salesmen simply convincing enough investors that company prospects have improved because the experts said so? I do not think we will ever get to untangle this question with the kind of data available, but it is worth pondering.

The authors also evaluate "buy lists." These contain securities that were recently upgraded, but preponderantly have securities that have been labelled "buy" for a while. The findings here are surprising. Buy lists relative to sell lists do very well on a risk adjusted basis. However, we do not know how well they would do if upgrades and downgrades were excluded. The high returns might result from the impact of the upgrades.

Finally, the authors ask whether there is a "best" broker or group of brokers. Specifically, they choose the five best from a prior period, then see if their ability to pick stocks continues into the future. The answer is no: last month's "hot" brokers are not likely to be this month's.

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As it stands, the paper is pretty straightforward, and meets the authors' objectives. However, there are some interesting questions that could be addressed with the same data base.

One question is whether there really are "star" researchers. Every year the *Institutional Investor* compiles an "All American" list of analysts. Are these analysts any better at forecasting than others, or are they merely better marketers of their own status or their firm's commission generating activity?

Another question is how much disagreement there is among research analysts. In the analysis, when a stock's rating was simultaneously altered by more than one broker, it was weighted accordingly in the portfolio. However, when a stock is moved up by one broker and down by another it is included in both the upgrade and downgrade portfolio. Might a portfolio of stocks with changed opinions that excluded those stocks that were simultaneously raised and lowered produce even better results than those shown?

Another question that might also be explored with the data base is the degree of "me-tooism." When an analyst upgrades a stock and it moves up, how quickly, if at all, do other analysts follow with a changed recommendation? This sort of me-tooism could account for the stock gains in the months following a first change of opinion. Analyst 1 upgrades a stock in January and Analyst 2 upgrades the same stock in February. In Table 3, that stock is shown (weighted twice) in time 0, but also occurs in time 1 simultaneously with the second recommendation. It could cause sufficient observation period overlaps to make interpretation of Tables 3, 4, and 5 tenuous regarding persistence of excess returns.

Professors Elton, Gruber, and Grossman have begun an interesting research program. How experts collectively operate and how well they forecast (or move the market as a result of their forecasts) are subjects worthy of investigation. Indeed, recent rulings by the Federal Energy Regulatory Commission wherein it indicated a willingness to use analysts' growth forecasts in computing allowable equity costs, make learning more about the accuracy of experts' predictions and the ways they reach them all the more important.