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## Ranks of stock analysts dwindle as markets shift, demand ebbs

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The ranks of stock analysts around the world are thinning out, as the trends in investing shift away from the business of sell-side research.

Dwindling head counts at the world's top stock-research shops suggest an industry in slow but steady decline, beset by tighter regulations, low profits, heavy competition and reputational challenges.

"We've noticed less work, forget about the quality for a minute," said David Kaufman, president of Toronto-based Westcourt Capital Corp. "Whereas certain names might have had six analysts following them, now there might be three."

This may not come as a huge disappointment to those who see the whole undertaking of sell-side research as ethically compromised.

The number of stock and bond pickers at the world's 12 biggest investment banks has fallen by about 10 per cent over the past four years, according to numbers recently released by Britain-based data provider Coalition, as cited in the Financial Times.

The profitability of investment bank and broker research has been deteriorating ever since the dot-com bubble burst in 2000, when new regulations tried to separate research and underwriting functions.

The equity-research business had basically become a vehicle to generate underwriting revenues, by supporting the investment banking division with favourable research. A negative report could risk losing a client. Analysts were not paid to be right, so much as to be bullish. In 1999, for example, Merrill Lynch analysts had 940 "buy" ratings on stocks and "sell" recommendations on just seven.

The global financial crisis made things worse for analysts, as fewer portfolio managers could afford research amid the stock-market crash.

Since then, the shift toward fee-based wealth management has seen the demand for research further eroded.

"The greater the number of assets in fee-based accounts, the less churn, and the incentive to create reports in the first place is much lower," Mr. Kaufman said. "You don't need the idea du jour to generate sales commissions."

Meanwhile, the old criticisms that analysts are overbullish and reluctant to make negative recommendations remain.

"It's rare to see analysts stick their necks out," said Bryan Pilsworth, president and portfolio manager at Toronto-based Foyston, Gordon & Payne.

There are 805 Canadian-listed stocks with at least one analyst rating them, according to Bloomberg data as of Tuesday's close. Of the more than 5,400 total recommendations on those stocks, a measly 225, or 4 per cent, are "sell" ratings.

A negative note on a stock that ultimately proves to be the right call can go a long way to enhancing an analyst's reputation as a shrewd stock picker, Mr. Kaufman said.

"But for your employer, that does virtually nothing."

In wading through the torrent of research reports, identifying those individual analysts most dedicated to making correct calls is crucial, Mr. Kaufman said.

But that sort can be rare.

Consider Valeant Pharmaceuticals International Inc., which had near-unanimous analyst support when it was the country's largest stock and its relentless acquisition campaign made it a cash cow for Canada's banks.

At Valeant's peak of nearly \$350 a share in August, 2015, **Veritas Investment Research** had the only "sell" rating, out of 21 analysts following the stock. Investors trusting the consensus would have lost more than 70 per cent of their investment within three months of the peak.

As a result, reading a positive stock report should be viewed as a "grain-of-salt exercise," Mr. Kaufman said.

But the herd-like nature of sell-side research can also make it useful in an unintended way, Mr. Pilsworth said.

"We're trying to figure out if the market is right or wrong," he said. "And sell-side research can give you a flavour of what the market is thinking today."

Knowing the consensus on a given stock can give valuable insight into how it might behave, Mr. Pilsworth said.

"Even though sell-side research can be poor, it does have an influence in the market. You have to understand how that works."

### Recommendation breakdown

Analysts more often have a positive than negative rating

No. of Canadian listed stocks with at least one analyst covering: **805**

Total number of analyst recommendations:

**5,449**

That number breaks down to:

Number of "buys": 3,351 (61%)

Number of "holds": 1,873 (34%)

Number of "sells": 225 (4.1%)

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