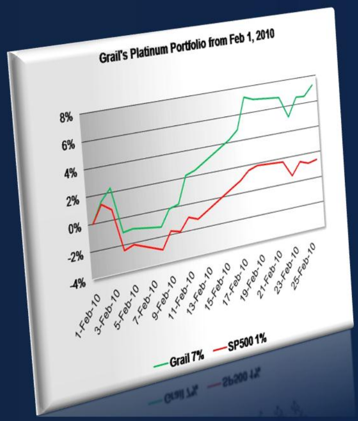

GRAIL SECURITIES (SWITZERLAND)

CHÄSIGASS 7, CH-6331 HÜNENBERG, SWITZERLAND

Telephone & Fax: 0041(0)41 781 36 01
Cell Phone: 079 693 26 45
Email: info@greenmail.ch
Website: www.grailsecurities.com

IS STOCK-PICKING DEAD?

In the attached article published in the Wall Street Journal and titled "*Macro' Forces in Market Confound Stock-Pickers*", James Bianco of Bianco Research contends that stock-picking is a dead art form. What was shocking much more than his assertion was the news that macro-economic funds now dominate 30% of the U.S. stock market as more and more investors jump from the stock-picking ship and switch to other investment vehicles that appear to be fundamentally safer, but in the case of treasuries arenʼt. For me the article was a revelation that tinged me with awe at my own stock selection success, because Grail Platinum is up 50% since the beginning of February! This dichotomy can only be explained by ensuring that a model has the superstructure to weather the ferocious systemic storms that beset markets from time to tim, such as the one in 2008 and early 2009.

THE CORRELATION PHENOMENON

At times, the market has its ways of grinding down investors into making devastating losses, particularly those that donʼt heed the market signs. As *The Journal* points out, stocks have been moving in lock-step to a degree that is practically unprecedented:

> *A widely followed statistic called correlation measures the tendency of investments to move together in a consistent way. Between 2000 and 2006, on average, the correlation of stocks in the S&P 500 was 27%, according to Barclays Capital. Between October 2008 and February 2009, at the height of the financial crisis, correlation hit 80%. When stocks rallied last year, the figure fell to 40%, then it spiked back over 80% during the European debt crisis, according to Barclays. What has caught many investors off guard is that correlation stayed high over the summer. In mid-August, correlation was 74%. In recent weeks, it has drifted down to 66%.*

For stock-picking mutual fund managers, the inability to generate excess returns through efficient stock selection is a serious threat, because it can mean chronic underperformance that leads to massive fund outflows, as we have seen recently with over $32 billion vacating the stock market this year and switching mainly into U.S. treasuries.

The argument is that when all stocks move together it means that stock pickers don't get any extra juice for the time and effort they put into trying to pick out the very best equities and instead are all too often stuck with the returns of some broader group of stocks that their individual picks are a part of. However, Iʼm euphoric to say that this is a broad brush assumption that has very substantial exceptions, because no stock is exactly correlated either to each other or the stock market as these tables of Grail performance show:

Symbol	Grail Alpha Stocks From 1 Oct 08 to 27 Feb 09		
	Industry	**Correlation to the SP 500**	**Price Gain or Loss**
SP 500	Market Index	1.00	-36.3%
ESI	Education & Training	-0.56	+37.3%
PEGA	Business & Software	-0.43	+13.4%
DV	Education & Training	-0.43	+3.4%
NFLX	Music & Video Stores	-0.36	+30.6%
HANS	Beverages ï Soft Drinks	-0.32	+6.6%

	Grail Alpha Stocks From 1 Mar 09 to 31 Dec 09		
Symbol	**Industry**	**Correlation to the SP 500**	**Price Gain or Loss**
SP 500	Market Index	1.00	+59.1%
AAPL	Personal Computers	0.98	+139.3%
BYI	Gaming Activities	0.97	+140.7%
VPRT	Business & Management	0.97	+143.1%
ESRX	Business & Management	0.96	+89.0%
CTRP	Consumer Services	0.96	+275.4%

Contrary to the Wall Street Journalôs position, Grailôs Alpha portfolio clearly demonstrates that there is sufficient differentiation in the performance of individual stocks to debunk the conclusions of commentators like James Bianco. In fact in the first table 27 stocks out of the portfolioôs 38 or 71% beat the SP 500ôs 36% fall and in the second table 18 out of 38 or 47% beat the SP 500ôs rise of 59%.

This is all the more impressive because correlation measures only the propensity of co-movement, but not movement magnitude. This is shown clearer in the second table, where the five stocks significantly outperformed the market with nigh to near lock-step correlation with the broad market and argues that in down and up markets Grail stocks have better chances of reducing systemic risk and releasing the pent up momentum that gathered after the bear storms have passed.

As a diehard stock picker David Pedowitz of Neuberger Bernam LLC, which manages $4.5 billion for wealthy clients, refutes the opinion that stock-picking is dead, because it would imply that what things are worth no longer matter. His observation has particular merit when bear market pressures dissipate and in their wake greater investor confidence returns as the market starts trending higher. Even the article itself acknowledges that the near lock-step unison of the bears gives way to the less co-ordinated momentum of a wider stock-picking market with a consequence that correlations move in the reverse direction.

For those of you who enjoy videos, the following link to my website brings you to the Wall Street Journal video on this very important matter.

http://grailsecurities.com/news/news.html