Chapter 9

Create Sustainable Proprietary Sources of Insight

The toughest part of being a successful analyst is finding good industry sources.

—*Sell-side analyst who was top ranked for over 10 years*

Many equity analysts believe that managers within the companies they're researching are the best sources of information because they're so close to the action. While there are some good inside sources, the problem is that they're inside. In countries with the most developed financial markets, this means that they can't speak about some of the most crucial information, and if they do, the information is often biased to meet the company's needs.

It's for this reason that you should always have good industry sources—individuals who are not employed by the companies you're following. They're usually candid with their answers and willing to help at no cost if you provide information or recognition in return. As my career progressed I found that I spoke less to company management and more to my unique sources. On one phone call I made to an investor relations (IR) contact, I heard, "I haven't talked to you in a while," which made me pause. Was I not doing my job? After the call I reflected a bit on that question; considering the objective data used to evaluate my performance, I was doing as well as if not better than when I had more frequent discussions with the company. Granted, I had the benefit of a talented research associate who would periodically call the company for the routine topics, but I still didn't feel the need to speak frequently with management, partly because the time was better spent with independent information sources and partly because companies often led me astray. One of my most colorful buy-side clients put it well when he said, "The more I speak with companies, the stupider I get."

Seeking proprietary insights is sometimes referred to as *channel checking*, a phrase I've slowly come to adopt. Although I don't have a problem with channel checking per se, I do question the way this phrase came into wide use on Wall Street. Prior to the tech bubble, those of us who did day-to-day research were discovering proprietary information about our companies, including insights from the channels we checked, as part of a daily routine. The bull market of the late 1990s brought with it a number of newly minted terms, including "channel checking", suggesting a new way of conducting research. My assertion that this phrase was more hype than reality (especially among the tech analysts) became validated when we saw the market implode in 2000, a disaster that presumably could have been avoided (or mitigated) had the channels been checked better. We now have this coined phrase that identifies with the current generation of analysts and so I'll use it throughout my thoughts, but understand it's an activity the best equity analysts have been conducting for decades.

There are two primary forms of channel checking: (1) informal, open-ended discussions with your industry sources; and (2) surveys conducted either one-on-one or in an automated manner. I'll discuss the first of these in this best practice and leave the survey process until Chapter 13.

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