

## False Promise of Wall Street Reform

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Wall Street people who wrote to express their disapproval of my recent, failed, attempt to drive Eliot Spitzer from the face of the earth had two objections to my efforts.

The first was that I was becoming a bore on the subject. The second was that however obnoxious and wrongheaded the New York attorney general is, Merrill Lynch & Co. and all the other investment banks that hyped Internet stocks are worse, and deserve to be punished.

I agree that I am becoming a bore on the subject. That is because it is an important subject. It cuts deeply into the question of Wall Street's identity. I also agree that Internet analysts at investment banks are not the most sympathetic figures, and that the firms who sponsored them deserve whatever punishment they get.

**But I think the wrong sort of punishment will have the reverse of the intended consequences.** And that, as Spitzer moves on from Henry Blodget's e-mails to Mary Meeker's employment contract, he should pause to consider the likely effects of his investigation. He won't do this, of course, but he should.

### The Inquisition's Premise

**The Spitzer Inquisition is devoted to the proposition that Wall Street's leading firms, or at any rate their Internet analysts, acted in bad faith. This may be true, though I'll bet it is less true than Spitzer would like us to believe.**

**The best con man believes his own con,** and the best Internet analysts probably believed most of their ridiculous predictions. They had company. A lot of serious people came to believe that Amazon.com Inc. was a good buy at \$120 a share, and they didn't require the help of Wall Street analysts to do so. An opinion now regarded as absurd was a few years ago conventional wisdom.

**But that is not the fatal flaw in Eliot Spitzer's attempt to punish Merrill Lynch and the other firms that peddled Internet propaganda. Spitzer has more or less proven that no one cares what actually happened; all that matters is what he can persuade investors happened; and he has persuaded them that they never believed anything but what Wall Street analysts made them believe.**

### Fatal Flaw

**No, the fatal flaw in Spitzer's approach is that it makes a distinction between analysts who believe what they say and analysts who don't. Time and again it's been shown that the stock picks of even honest Wall Street analysts aren't worth the paper they are printed on.** (The broad insights about companies and industries that analysts offer along with their picks are another matter.)

Spitzer's attack implies that an analyst working for a big Wall Street firm who is not conflicted by the promise of investment banking fees is more useful to the average investor than one who is conflicted. As a result, the state attorney general's attempts at reform will encourage the illusion that this advice is better than ever before, as it is less tainted by conflicts of interest.

This is a disservice to the American investor, for a couple of reasons.

**The shallow one is that, long after Spitzer moves on to greater political glory, there will remain conflicts of interest on Wall Street.**

The brokers will still be paid for the transactions they generate. The analysts will still be paid for helping to generate turnover, rather than helping to grow wealth. The firms themselves will still take positions in stocks that they recommend to their customers. These positions will still be vastly more important to the firm than the brokerage commissions generated by any one analyst.

If by some miracle there happens to appear inside one of these firms an analyst with a gift for telling investors which stocks will rise and which will fall, he will inevitably wind up running the firm's own trading books. The investors will get what investors pay for: mediocre advice.

### Maintaining a False Image

The deeper problem is the restored credulity of the innocent American investor. I am not as sure as Spitzer that this creature actually exists. But if he does, what he needs more than anything is to wean himself altogether from the idea that Wall Street investment banks should be providing him with investment advice.

Anyone who knows anything about the markets knows that anyone who buys stocks because a Wall Street firm tells him to is far better off putting his money into an index fund. Why is Spitzer suggesting otherwise?

This is the absurdity in American financial life: the influence the big investment banks have on the investing public. The goal of any reform should be to eliminate that influence, either by banning investment banks from issuing investment opinions or, more likely, by stressing the nature of their views. (Merrill Lynch is a passive, minority investor in Bloomberg LP, the parent company of Bloomberg News.)

No matter how many times you try to whip them into shape, Wall Street analysts will always be part and parcel of a larger marketing effort, as that is the only way they can be made to pay for themselves.

We should learn to view their reports the way we view television ads, or late night infomercials. For a moment there I thought we were. But then came Eliot Spitzer, to screw everything up all over again.