

# INVESTING AMERICA'S MOST ADMIRABLE COMPANIES

[Update]

## SOMETIMES THE WORST ARE FIRST

Companies with the top reputations don't always have the best-performing stocks.

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**F**OR NEARLY a quarter-century, FORTUNE's survey of America's Most Admired Companies has served as the gold standard of corporate reputation. It was never intended as an investment guide, but that hasn't stopped academic researchers from analyzing the stock performance of the firms on our list. The results have been inconclusive so far, but a new study presents some surprising findings that offer a measure of affirmation to contrarian and value investors.

According to the study, the first to cover the entire span of the survey, the stocks of the companies with lower overall reputation scores have outperformed those of the higher-ranked companies. From 1983 to 2006, the mean annualized return of the less admired companies was 17.8%, beating the more admired group's

15.4% return. Interestingly, both groups beat the S&P 500's 11.2% return over the same period. (The two portfolios were constructed by taking the overall reputation scores of every company in the survey—there were 611 firms in last year's ranking—and splitting the list right down the middle. To read the full study, go to <http://business.scu.edu/finance/faculty/statman/default.htm>.)

How could the corporate *crème de la crème*—General Electric, Wal-Mart, Procter & Gamble—get bested by a group that included names like Delphi and Union Carbide? Part of the explanation lies in psychology, says one of the study's co-authors, Meir Statman, a professor at Santa Clara University whose specialty is behavioral finance, which seeks to understand how investors make decisions.

In Statman's view, we tend to have overly positive gut feelings about successful firms like GE and P&G, and those sentiments—usually based on things like a charismatic CEO or innovative products—heavily influence our perception of the stock, regardless of whether it's

a good investment. "We admire a stock or despise it when we hear its name, whether Google or General Motors," Statman says. Statman believes that investors who have positive feelings about a company may be willing to pay higher prices for the stock. That, in turn, results in those stocks' maintaining higher valuations: The average price-to-book ratio of the admired half of companies over the 23 years was 2.07, compared with 1.27 for the not-so-admired group. Also, the more admired companies tended to have much larger market capitalizations than the less admired ones. And as any smart investor would tell you, over the long term you'll often do better putting your money in smaller, less-loved stocks with lower valuations than in bigger, richly valued ones.

Statman's study should not be taken as a cue to plow your 401(k) into the stocks of troubled companies. While some less admired companies had extraordinary returns (for instance, AOL in 1998)—lifting the average returns of the group—many struggled. Still, as corporate America awaits the release of this year's Most Admired survey, the study serves as a reminder that all that glitters isn't stock market gold. **F**

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**NUMBER CRUNCHER**  
Statman studies the role of emotion in decision-making.

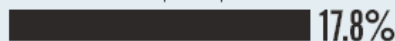
**GOOD FEELINGS ABOUT A NAME CAN TRUMP ANALYSIS OF THE STOCK.**

### The underdogs win

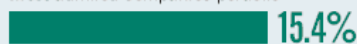
Long term, firms with lower scores on the Most Admired list bested those ranked highest.

MEAN ANNUALIZED RETURN  
April 1, 1983, to March 31, 2006

Least admired companies portfolio



Most admired companies portfolio



FORTUNE CHART/SOURCE: ANGINER, FISHER, AND STATMAN

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For more on the Most Admired Companies, go to [fortune.com/mostadmired](http://fortune.com/mostadmired).