



ALSO BY PETER LYNCH

Learn to Earn

One Up on Wall Street

(with John Rothchild)

BEATING THE STREET

The Best-selling Author of *One Up on Wall Street*
Shows You How to Pick Winning Stocks and
Develop a Strategy for Mutual Funds

PETER LYNCH

with John Rothchild

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DEDICATION

*To my wife, Carolyn, and our daughters, Mary, Annie, and Beth.
To my brothers, Eugene Lynch and Thomas Lynch, and my
cousin Thomas Leahy.*

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PREFACE

I turned off my Quotron at the Fidelity Magellan Fund on May 31, 1990. This was exactly 13 years from the day I took the job. Jimmy Carter was president back then, and he admitted to having lust in his heart. I had lust in my heart as well—lust for stocks. In the end, I figure I'd purchased more than 15,000 of them for investors in Magellan—and many more than once. No wonder I'd gotten a reputation for never having met a share I didn't like.

My departure was sudden, but it wasn't something I dreamed up overnight. The task of keeping track of so many companies had begun to take its toll by mid-decade, as the Dow hit 2000 and I hit 43. As much as I enjoyed managing a portfolio the size of the GNP of Ecuador, I missed being home to watch the children grow up. They change fast. They almost had to introduce themselves to me every weekend. I was spending more time with Fannie Mae, Freddie Mac, and Sallie Mae than I spent with them.

When you start to confuse Freddie Mac, Sallie Mae, and Fannie Mae with members of your family, and you remember 2,000 stock symbols but forget the children's birthdays, there's a good chance you've become too wrapped up in your work.

In 1989, with the Great Correction of 1987 already behind us and the stock market sailing along smoothly, I was celebrating my 46th birthday with my wife, Carolyn, and my daughters, Mary, Annie, and Beth. In the middle of the party, I had a revelation. I remembered that my father had died when he was 46 years old. You start to feel mortal when you realize you've already outlived your parents. You start to recognize that you're only going to exist for a little while, whereas you're going to be dead for a long time. You start wishing you'd seen more school plays and ski meets and afternoon soccer games. You remind yourself that nobody on his deathbed ever said: "I wish I'd spent more time at the office."

I tried to convince myself that my children required less of my attention than they had when they were younger. In my heart, I knew the reverse was true. During the Terrible Twos they rush around and bang into things, and parents have to patch them up, but patching up a toddler takes less time and effort than helping adolescents with Spanish homework or the math that we've forgotten, or driving them for the umpteenth time to the tennis court or the shopping mall, or reassuring them after they've taken the latest hard knocks from being teenagers.

On weekends, to have any hope of keeping up with teenagers and their thoughts, parents must listen to their music and make a perfunctory stab at remembering the names of rock groups, and accompany them to movies that otherwise no adult would ever want to see. I did all this, but infrequently. Saturdays, I was sitting at my desk facing a Himalaya of paperwork. On the rare occasions I took the kids to the movies or the pizza parlors, I looked for an investment angle. It was they who introduced me to Pizza Time Theater, a stock I wish I hadn't bought, and Chi-Chi's, a stock I wish I had.

By 1990, Mary, Annie, and Beth had reached the ages of 15, 11, and 7, respectively. Mary was away at boarding school and came home only on the odd weekend. In the fall she played in seven soccer games, and I'd gotten to see just one. That was also the year the Lynch family Christmas cards went out three months late. We kept scrapbooks of our children's accomplishments, stuffed with piles of memorabilia that hadn't yet been pasted in.

The nights I didn't stay late at the office, I could be found attending a meeting of one of a number of charitable and civic organizations on whose boards I'd volunteered to serve. Often, these organizations put me on their investment committees. Picking stocks for worthy causes was the best of all possible worlds, but the demands of my pro bono activities had continued to grow, right along with the demands of the Magellan Fund, and of course my daughters, whose homework assignments were getting more difficult, and who had to be driven to more and more lessons and activities every day.

Meanwhile, I was seeing Sallie Mae in my dreams, and my wife, Carolyn, and I had our most romantic encounters as we met coming in and out of the driveway. At my annual medical checkup, I confessed to the doctor that the only exercise I got was flossing my teeth. I was aware that I hadn't read a book in the last 18 months. In two years, I'd seen three operas, *The Flying Dutchman*, *La Bo-*

hème, and *Faust*, but not a single football game. This leads me to Peter's Principle #1:

When the operas outnumber the football games three to zero, you know there is something wrong with your life.

By mid-1990, it finally dawned on me that the job had to go. I remembered that my fund's namesake, Ferdinand Magellan, also retired early to a remote island in the Pacific, although what happened to him afterward (torn to shreds by angry natives) was enough to give me pause. Hoping to avoid a similar fate at the hands of angry shareholders, I met with Ned Johnson, my boss at Fidelity, along with Gary Burkhead, the director of operations, to discuss a smooth exit.

Our powwow was straightforward and amicable. Ned Johnson suggested I stay on as a group leader for all the Fidelity equity funds. He offered to give me a smaller fund to operate, one, say, with \$100 million in assets as opposed to the \$12 billion with which I'd had to cope. But even with a couple of digits knocked off, it seemed to me that a new fund would require the same amount of work as the old one, and I'd be back to spending Saturdays at the office. I declined Ned's gracious invitation.

Unbeknownst to most people, I'd also been running a \$1 billion employees' pension fund for several major corporations, including Kodak, Ford, and Eaton, with Kodak having the largest stake. This pension fund had a better record than Magellan because I was able to invest the money without as many restrictions. For instance, a pension fund was allowed to put more than 5 percent of its assets into a single stock, whereas a mutual fund could not.

The people at Kodak, Ford, and Eaton wanted me to continue to manage their pension money whether I left Magellan or not, but I declined their gracious invitation as well. From outside Fidelity, I'd gotten numerous offers to start a Lynch Fund, the closed-end variety listed on the New York Stock Exchange. The would-be promoters said they could sell billions of dollars' worth of Lynch Fund shares on a quick "road show" to a few cities.

The attraction of a closed-end fund, from the manager's point of view, is that the fund will never lose its customer base, no matter how badly the manager performs. That's because closed-end funds

are traded on the stock exchanges, just like Merck or Polaroid or any other stock. For every seller of a closed-end fund there has to be a buyer, so the number of shares always stays the same.

This isn't true of an open-ended fund such as Magellan. In an open-ended fund, when a shareholder wants to get out, the fund must pay that person the value of his or her shares in cash, and the size of the fund is reduced by that amount. An unpopular open-ended fund can shrink very fast as its customers flee to other competing funds or to the money markets. This is why the manager of an open-ended fund doesn't sleep as soundly as the manager of the closed-end kind.

A \$2 billion Lynch Fund listed on the NYSE would have continued to be a \$2 billion enterprise forever (unless I made a series of horrendous investment boo-boos and lost the money that way). I would have continued to receive the 75 basis points (\$15 million) as my annual fee, year in and year out.

It was a tempting proposition, monetarily. I could have hired a bunch of assistants to pick stocks, reduced my office hours to a leisurely minimum, played golf, spent more time with my wife and my children plus gotten to see the Red Sox, the Celtics, and *La Bohème*. Whether I beat the market or lagged the market, I'd still have collected the same hefty paycheck.

There were only two problems with this arrangement. The first was that my tolerance for lagging the market is far exceeded by a desire to outperform it. The second was that I've always believed fund managers should pick their own stocks. Once again, I'd be back where I started, stuck in the office of the Lynch Fund on Saturdays, lost in the piles of annual reports, a man with a thicker bankroll but just as time poor as ever.

I've always been skeptical of millionaires who congratulate themselves for walking away from a chance to enrich themselves further. Turning one's back on a fat future paycheck is a luxury that few people can afford. But if you're lucky enough to have been rewarded in life to the degree that I have, there comes a point at which you have to decide whether to become a slave to your net worth by devoting the rest of your life to increasing it or to let what you've accumulated begin to serve you.

There's a Tolstoy story that involves an ambitious farmer. A genie of some sort offers him all the land that he can encircle on foot in a day. After running at full speed for several hours, he acquires several square miles of valuable property, more soil than he could

till in a lifetime, more than enough to make him and his family rich for generations. The poor fellow is drenched with sweat and gasping for breath. He thinks about stopping—for what's the point of going any further?—but he can't help himself. He races ahead to maximize his opportunity, until finally he drops dead of exhaustion.

This was the ending I hoped to avoid.

PREFACE TO THE TRADE PAPERBACK EDITION

The publication of this paperback edition gives me a chance to respond to the feedback I got from the hardcover edition, both from the press and from callers on late-night radio call-in shows.

There are points I thought that I made quite forcefully in the hardcover edition but that the reviewers have never mentioned. There are other points that caught the reviewers' fancy that I never intended to make at all. This is why I'm delighted to have this new preface, where I can correct what I think are three important misconceptions.

At the top of my list is the one that puts Lynch on a pedestal as the Babe Ruth of Investing, talking down to the Little Leaguers and giving them the false hope that they can perform like Big League professionals. The Babe Ruth comparison, although flattering, is wrong on two counts. First, I've struck out or grounded out far too often to be compared to the Sultan of Swat. Second, I don't think the Little Leaguers, a.k.a. small investors or average investors or the general public, should even try to imitate the Big League professionals.

What I've tried to get across is that the average investor isn't in the same ballpark with the Wall Street mutual-fund or pension-fund managers. The individual is free of a lot of the rules that make life difficult for the professionals. As an average investor, you don't have to own more than a handful of stocks and you can do the research in your spare time. If no company appeals to you at the moment, you can stay in cash and wait for a better opportunity. You don't have to compete with the neighbors, the way professionals do, by publishing your quarterly results in the local shopper.

Proof that average investors can do quite well for themselves, free of the burdens that weigh down the professionals, comes from the NAIC, the organization that represents 10,000 local investment clubs, which are made up of ordinary men and women. According to the NAIC, 69.4 percent of the local clubs managed to outperform the S&P 500 in 1992. More than half these clubs have beaten the S&P in four of the past five years. It appears that the investment clubs are getting more adept at picking stocks, by taking full advantage of their amateur status.

If you have done well as a stockpicker, it's probably because you have also exploited your natural advantage of being an amateur. You have researched your own investments and bought shares in great companies that Wall Street may have overlooked. The remarkable record of local mutual savings banks and S&Ls is powerful evidence that neighborhood investing pays off.

Misconception #2 is that Lynch thinks everybody should be out there with hand-held calculators, reading balance sheets, investigating companies, and buying stocks. In fact, millions of Americans should refrain from buying stocks. These are people who have no interest in investigating companies and cringe at the sight of a balance sheet, and who thumb through annual reports only for the pictures. The worst thing you can do is to invest in companies you know nothing about.

Unfortunately, buying stocks on ignorance is still a popular American pastime. Let's return to the sports analogy. When people discover they are no good at baseball or hockey, they put away their bats and their skates and they take up amateur golf or stamp collecting or gardening. But when people discover they are no good at picking stocks, they are likely to continue to do it anyway.

People who are no good at picking stocks are the very ones who say that they are "playing the market," as if it is a game. When you "play the market" you're looking for instant gratification, without having to do any work. You're seeking the excitement that comes from owning one stock one week, and another the next, or from buying futures and options.

Playing the market is an incredibly damaging pastime. Players of the market may spend weeks studying their frequent flier miles, or poring over travel guides in order to carefully map out a trip, but they'll turn around and invest \$10,000 in a company they know nothing about. Even people who are serious about their vacations get caught up in playing the market. The whole process is sloppy and ill-conceived.

This is a group I'd like to address, the chronic losers with a history of playing their hunches. They buy IBM at \$100 a share because they sense it's overdue for a comeback or they buy a biotech stock or a riverboat casino stock because they've heard it's "hot."

Whatever they can salvage from these losses they sink into deutschemark futures or call options on the S&P 500 because they have a feeling that the S&P 500 is going up this month. In the end they're more convinced than ever that Wall Street is a game, but that's because they've made it one.

Misconception #3 is that Lynch has it in for mutual funds. Why would I bite the hand that fed me so well? Equity mutual funds are the perfect solution for people who want to own stocks without doing their own research. Investors in equity funds have prospered handsomely in the past, and there's no reason to doubt they will continue to prosper in the future. There's no rule that says you can't own individual stocks *and* mutual funds. There's no rule that you can't own several mutual funds. Even in an equity fund that fails to beat the market average the long-term results are likely to be satisfying. The short-term results are less predictable, which is why you shouldn't buy equity mutual funds unless you know you can leave the money there for several years and tolerate the ups and downs.

I'm cheered by the evidence that individual investors are learning not to get scared out of their stocks or their equity mutual funds during market corrections, as occurred in October 1987. There was a scary period in 1989 when the Dow Jones Industrial Average dropped 200 points and another big drop of 500 points in 1990, and in both cases the general public was a net buyer of stocks in the aftermath. So perhaps the message about corrections being as routine as snowstorms, and not the end of the world, is beginning to sink in.

One message that hasn't sunk in, apparently, is that in the long run owning stocks is more rewarding than owning bonds and CDs. Recently, I was dismayed to discover that in the retirement accounts that thousands of people have opened at my own firm, Fidelity, only a small percentage of the money is invested in pure equity funds. Most of it has gone into money-market funds, or bond funds, or the equity income funds. Yet history shows that over a long period of time assets will grow much faster when they are 100 percent invested in stocks. The retirement account is the perfect place for stocks, because the money can sit there and grow for 10 to 30 years.

INTRODUCTION

Escape from Bondage

A retired fund manager is qualified to give only investment advice, not spiritual advice, but what inspires me to retake the pulpit is that a majority in the congregation continue to favor bonds. Obviously, they must have slept through the last sermon, *One Up on Wall Street*, in which I tried to prove once and for all that putting money into stocks is far more profitable than putting it into bonds, certificates of deposit, or money-market accounts. Otherwise, why are 90 percent of the nation's investment dollars still parked in these inferior spots?

Throughout the 1980s, which was the second-best decade for stocks in modern history (only the 1950s were slightly more bountiful), the percentage of household assets invested in stocks declined! This percentage, in fact, has been declining steadily—from nearly 40 percent in the 1960s to 25 percent in 1980 to 17 percent in 1990. As the Dow Jones average and the other stock indexes quadrupled in value, a mass of investors was switching out of stocks. Even assets invested in equity mutual funds shrunk from around 70 percent in 1980 to 43 percent in 1990.

This calamity for the future of individual and national wealth cannot go unchallenged. Let me begin, then, where I left off the last time: if you hope to have more money tomorrow than you have today, you've got to put a chunk of your assets into stocks. Maybe we're going into a bear market and for the next two years or three years or even five years you'll wish you'd never heard of stocks. But the 20th century has been full of bear markets, not to mention recessions, and in spite of that the results are indisputable: sooner

or later, a portfolio of stocks or stock mutual funds will turn out to be a lot more valuable than a portfolio of bonds or CDs or money-market funds. There, I've said it again.

The most persuasive bit of proof I've discovered since I argued this point before can be found in the *Ibbotson SBBI Yearbook, 1993*, chapter 1, page 17, under the heading "Average Annual Return for the Decades 1926–1989." This is a summary of the profits you would have made, per year, by investing your money in the S&P 500 stocks, small-company stocks, long-term government bonds, long-term corporate bonds, and short-term Treasury bills. The results are shown in Table I-1.

The investment geniuses among us could have put all their money into the S&P 500 stocks in the 1920s, switched in 1929 to long-term corporate bonds and held these throughout the 1930s, moved into small-company stocks in the 1940s, back into the S&P 500 in the 1950s, back to small companies in the 1960s and the 1970s, and returned to the S&P 500 in the 1980s. The people who followed that inspired strategy are now all billionaires and living on the coast of France. I would have recommended it myself, had I been clever enough to know beforehand what was going to happen. In hindsight, it's quite obvious.

Since I've never met a single billionaire who made his or her fortune exactly in this fashion, I must assume that they are in short supply relative to the rest of us who exhibit normal intelligence. The rest of us have no way of predicting the next rare period in which bonds will outperform stocks. But the fact that it's only happened in one decade out of seven, the 1930s (the 1970s was a standoff), gives the dedicated stockpicker an advantage. By sticking with stocks all the time, the odds are six to one in our favor that we'll do better than the people who stick with bonds.

Moreover, the gains enjoyed by the bondholders in the rare decade when bonds beat stocks cannot possibly hope to make up for the huge advances made by stocks in periods such as the 1940s and the 1960s. Over the entire 64 years covered in the table, a \$100,000 investment in long-term government bonds would now be worth \$1.6 million, whereas the same amount invested in the S&P 500 would be worth \$25.5 million. This leads me to Peter's Principle #2:

Gentlemen who prefer bonds don't know what they're missing.

Table I-1. AVERAGE ANNUAL RETURN

	1920s*	1930s	1940s	1950s	1960s	1970s	1980s
S&P 500	19.2%	0.0%	9.2%	19.4%	7.8%	5.9%	17.5%
Small-Company Stocks	— 4.5%	1.4%	20.7%	16.9%	15.5%	11.5%	15.8%
Long-Term Government Bonds	5.0%	4.9%	3.2%	— 0.1%	1.4%	5.5%	12.6%
Long-Term Corporate Bonds	5.2%	6.9%	2.7%	1.0%	1.7%	6.2%	13.0%
Treasury Bills	3.7%	0.6%	0.4%	1.9%	3.9%	6.3%	8.9%
Inflation	— 1.1%	—2.0%	5.4%	2.2%	2.5%	7.4%	5.1%

*Based on the period 1926–29.

SOURCE: Ibbotson *S&P Yearbook*, 1993

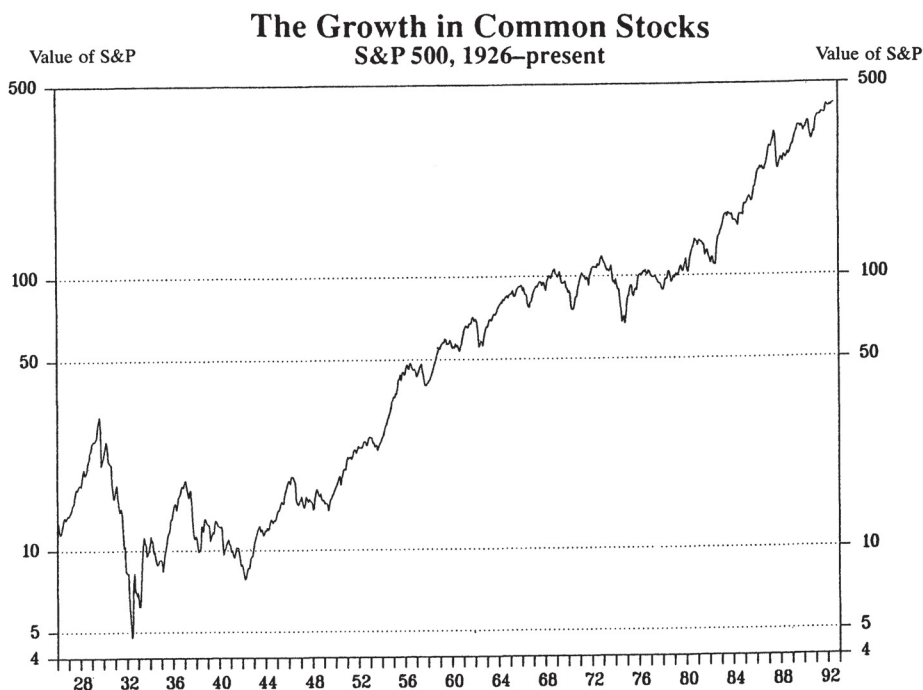


FIGURE I-1

Yet we continue to be a nation of bondholders. Millions of people are devoted to collecting interest, which may or may not keep them slightly ahead of inflation, when they could be enjoying a 5–6 percent boost in their real net worth, above and beyond inflation, for years to come. Buy stocks! If this is the only lesson you learn from this book, then writing it will have been worth the trouble.

The debate over whether to invest in small stocks or big stocks, or how to choose the best stock mutual fund (all subjects of later chapters), is subordinate to the main point—whichever way you do it, big stocks, small stocks, or medium-sized stocks, buy stocks! I'm assuming, of course, that you go about your stockpicking or fund-picking in an intelligent manner, and that you don't get scared out of your stocks during corrections.

A second reason I've taken on this project is to further encourage the amateur investor not to give up on the rewarding pastime of

stockpicking. I've said before that an amateur who devotes a small amount of study to companies in an industry he or she knows something about can outperform 95 percent of the paid experts who manage the mutual funds, plus have fun in doing it.

A sizable crowd of mutual fund managers dismisses this notion as hokey, and some have called it "Lynch's ten-bagger of wind." Nevertheless, my 2½ years away from Magellan have only strengthened my conviction that the amateur has the advantage. For non-believers on this point, I've stumbled onto some additional proof.

This can be found in Chapter 1, "The Miracle of St. Agnes," which describes how a bunch of seventh graders at a Boston area parochial school have produced a two-year investment record that Wall Street professionals can only envy.

Meanwhile, a larger bunch of adult amateur investors claims to have bested their professional counterparts for many years in a row. These successful stockpickers belong to the hundreds of investment clubs sponsored by the National Association of Investors, and their annual rates of return have been just as enviable as those turned in by the students at St. Agnes.

Both bunches of amateurs have this in common: their stockpicking methods are much simpler and generally more rewarding than many of the more baroque techniques used by highly paid fund managers.

Whatever method you use to pick stocks or stock mutual funds, your ultimate success or failure will depend on your ability to ignore the worries of the world long enough to allow your investments to succeed. It isn't the head but the stomach that determines the fate of the stockpicker. The skittish investor, no matter how intelligent, is always susceptible to getting flushed out of the market by the brush beaters of doom.

A group of us investment seers meets every January to participate in a panel discussion sponsored by *Barron's* magazine, which later publishes the transcript. If you had bought many of the stocks that we recommended, you would have made money, but if you paid attention to our expert opinions on the direction of the market and the economy you would have been too scared to own stocks for the last seven years. Chapter 2 deals with the pitfalls of this "weekend worrying" and how to ignore it.

Chapter 3, "A Tour of the Fund House," is my attempt to devise a strategy for mutual fund investing. Although I remain a stockpicker at heart, my retirement gives me the opportunity to discuss a subject

I was reluctant to tackle as a fund manager. When you're still in the business, almost anything you say about it could be construed as either self-serving or a sneaky way to attract new customers—charges that I trust will not be leveled against me now.

Recently, I helped a not-for-profit organization in New England devise a new portfolio strategy. (This organization shall remain nameless because its identity isn't relevant to the exercise.) We first had to decide how much of the money to put into stocks and how much into bonds, and then how to invest each portion. These are the same decisions that every household CEO must make, which is why I've provided a detailed description of how we approached the problem.

Chapters 4, 5, and 6 are a three-part retrospective: how I managed Magellan during 13 years and 9 major corrections. This exercise gave me an excuse to go back and figure out exactly what factors contributed to whatever successes I had. Some of the conclusions have surprised even me, and I was there.

In this part of the book I've tried to concentrate on methodology and to downplay the idle reminiscence. Perhaps there's something to be learned from my occasional triumphs and my numerous mistakes.

In Chapters 7 through 20, which account for more than half of these pages, I describe how I went about picking the 21 stocks I recommended to the readers of *Barron's* magazine in January 1992. I've talked before about theories of investing, but in making these selections I took notes as I went along. With these notes in hand, I've tried to analyze my stockpicking habits in as much detail as possible. This includes both how to identify promising situations and how to go about researching them.

The 21 stocks that I've used to illustrate this Lynch Method cover many of the important categories and industry groups (banks and S&Ls, cyclicals, retailers, utilities) in which people routinely invest. I've arranged the chapters so that each one deals with a specific kind of company. Chapter 21, "The Six-Month Checkup," describes the regular process of reviewing the story of each company in a portfolio.

I have no pat formulas to offer. There are no bells that ring when you've bought the right stock, and no matter how much you know about a company you can never be certain that it will reward you for investing in it. But if you know the factors that make a retailer

or a bank or an automaker profitable or unprofitable, you can improve your odds. Many of these factors are laid out here.

The text is fortified with liberal doses of Peter's Principles, such as the two you've already had to tolerate. Many of these lessons I've learned from experience, which is always an expensive teacher, so you're getting them here at a discount.

(The stock prices of the 21 companies that I describe in the second half of this book were constantly changing in the course of my research. For example, Pier 1 was selling for \$7.50 when I began looking into it and \$8 when I finally recommended it in *Barron's*. On one page, I may refer to Pier 1 as a \$7.50 stock, and on another as an \$8 stock. Several such anomalies may appear in the text.)

ONE

THE MIRACLE OF ST. AGNES

Amateur stockpicking is a dying art, like pie-baking, which is losing out to the packaged goods. A vast army of mutual-fund managers is paid handsomely to do for portfolios what Sara Lee did for cakes. I'm sorry this is happening. It bothered me when I was a fund manager, and it bothers me even more now that I have joined the ranks of the nonprofessionals, investing in my spare time.

This decline of the amateur accelerated during the great bull market of the 1980s, after which fewer individuals owned stocks than at the beginning. I have tried to determine why this happened. One reason is that the financial press made us Wall Street types into celebrities, a notoriety that was largely undeserved. Stock stars were treated like rock stars, giving the amateur investor the false impression that he or she couldn't possibly hope to compete against so many geniuses with M.B.A. degrees, all wearing Burberry raincoats and armed with Quotrons.

Rather than fight these Burberried geniuses, large numbers of average investors decided to join them by putting their serious money into mutual funds. The fact that up to 75 percent of these mutual funds failed to perform even as well as the stock market averages proves that genius isn't foolproof.

But the main reason for the decline of the amateur stockpicker has to be losses. It's human nature to keep doing something as long as it's pleasurable and you can succeed at it, which is why the world

population continues to increase at a rapid rate. Likewise, people continue to collect baseball cards, antique furniture, old fishing lures, coins, and stamps, and they haven't stopped fixing up houses and reselling them, because all these activities can be profitable as well as enjoyable. So if they've gotten out of stocks, it's because they're tired of losing money.

It's usually the wealthier and more successful members of society who have money to put into stocks in the first place, and this group is used to getting A's in school and pats on the back at work. The stock market is the one place where the high achiever is routinely shown up. It's easy to get an F here. If you buy futures and options and attempt to time the market, it's easy to get all F's, which must be what's happened to a lot of people who have fled to the mutual funds.

This doesn't mean they stop buying stocks altogether. Somewhere down the road they get a tip from Uncle Harry, or they overhear a conversation on a bus, or they read something in a magazine and decide to take a flier on a dubious prospect, with their "play" money. This split between serious money invested in the funds and play money for individual stocks is a recent phenomenon, which encourages the stockpicker's caprice. He or she can make these frivolous side bets in a separate account with a discount broker, which the spouse doesn't have to know about.

As stockpicking disappears as a serious hobby, the techniques of how to evaluate a company, the earnings, the growth rate, etc., are being forgotten right along with the old family recipes. With fewer retail clients interested in such information, brokerage houses are less inclined to volunteer it. Analysts are too busy talking to the institutions to worry about educating the masses.

Meanwhile, the brokerage-house computers are busily collecting a wealth of useful information about companies that can be regurgitated in almost any form for any customer who asks. A year or so ago, Fidelity's director of research, Rick Spillane, interviewed several top-producing brokers about the data bases and so-called screens that are now available. A screen is a computer-generated list of companies that share basic characteristics—for example, those that have raised dividends for 20 years in a row. This is very useful to investors who want to specialize in that kind of company.

At Smith Barney, Albert Bernazati notes that his firm can pro-

vide 8–10 pages of financial information on most of the 2,800 companies in the Smith Barney universe. Merrill Lynch can do screens on ten different variables, the *Value Line Investment Survey* has a “value screen,” and Charles Schwab has an impressive data service called “the Equalizer.” Yet none of these services is in great demand. Tom Reilly at Merrill Lynch reports that less than 5 percent of his customers take advantage of the stock screens. Jonathan Smith at Lehman Brothers says that the average retail investor does not take advantage of 90 percent of what Lehman can offer.

In prior decades, when more people bought their own stocks, the stockbroker per se was a useful data base. Many old-fashioned brokers were students of a particular industry, or a particular handful of companies, and could help teach clients the ins and outs. Of course, one can go overboard in glorifying the old-fashioned broker as the Wall Street equivalent of the doctor who made house calls. This happy notion is contradicted by public opinion surveys that usually ranked the stockbroker slightly below the politician and the used-car salesman on the scale of popularity. Still, the bygone broker did more independent research than today’s version, who is more likely to rely on information generated in house by his or her own firm.

Newfangled brokers have many things besides stocks to sell, including annuities, limited partnerships, tax shelters, insurance policies, CDs, bond funds, and stock funds. They must understand all of these “products” at least well enough to make the pitch. They have neither the time nor the inclination to track the utilities or the retailers or the auto sector, and since few clients are invested in individual stocks, there’s little demand for their stockpicking advice. Anyway, the broker’s biggest commissions are made elsewhere, on mutual funds, underwritings, and in the options game.

With fewer brokers offering personal guidance to fewer stock-pickers, and with a climate that encourages capricious speculation with “fun” money and an exaggerated reverence for professional skills, it’s no wonder that so many people conclude that picking their own stocks is hopeless. But don’t tell that to the students at St. Agnes.

THE ST. AGNES PORTFOLIO

The fourteen stocks shown in Table 1-1 were the top picks of an energetic band of seventh-grade portfolio managers who attended the St. Agnes School in Arlington, Massachusetts, a suburb of Boston, in 1990. Their teacher and CEO, Joan Morrissey, was inspired to test the theory that you don't need a Quotron or a Wharton M.B.A., or for that matter even a driver's license, to excel in equities.

You won't find these results listed in a Lipper report or in *Forbes*, but an investment in the model St. Agnes portfolio produced a 70 percent gain over a two-year period, outperforming the S&P 500 composite, which gained 26 percent in the same time frame, by a whopping margin. In the process, St. Agnes also outperformed 99 percent of all equity mutual funds, whose managers are paid considerable sums for their expert selections, whereas the youngsters are happy to settle for a free breakfast with the teacher and a movie.

Table 1-1. ST. AGNES PORTFOLIO

<i>Company</i>	<i>1990-91 Performance (%)</i>
Wal-Mart	164.7
Nike	178.5
Walt Disney	3.4
Limited	68.8
L.A. Gear	- 64.3
Pentech	53.1
Gap	320.3
PepsiCo	63.8
Food Lion	146.9
Topps	55.7
Savannah Foods	- 38.5
IBM	3.6
NYNEX	- .22
Mobil	19.1
Total Return for Portfolio	69.6
S&P 500	26.08

Total return performance January 1, 1990-December 31, 1991

I was made aware of this fine performance via the large scrapbook sent to my office, in which the seventh graders not only listed their top-rated selections, but drew pictures of each one. This leads me to Peter's Principle #3:

Never invest in any idea you can't illustrate with a crayon.

This rule ought to be adopted by many adult money managers, amateur and professional, who have a habit of ignoring the understandably profitable enterprise in favor of the inexplicable venture that loses money. Surely it would have kept investors away from Dense-Pac Microsystems, a manufacturer of "memory modules," the stock of which, alas, has fallen from \$16 to 25 cents. Who could draw a picture of a Dense-Pac Microsystem?

In order to congratulate the entire St. Agnes fund department (which doubles as Ms. Morrissey's social studies class) and also to learn the secrets of its success, I invited the group to lunch at Fidelity's executive dining room, where, for the first time, pizza was served. There, Ms. Morrissey, who has taught at St. Agnes for 25 years, explained how her class is divided every year into teams of four students each, and how each team is funded with a theoretical \$250,000 and then competes to see who can make the most of it.

Each of the various teams, which have adopted nicknames such as Rags to Riches, the Wizards of Wall Street, Wall Street Women, The Money Machine, Stocks R Us, and even the Lynch Mob, also picks a favorite stock to be included in the scrapbook, which is how the model portfolio is created.

The students learn to read the financial newspaper *Investor's Business Daily*. They come up with a list of potentially attractive companies and then research each one, checking the earnings and the relative strength. Then they sit down and review the data and decide which stocks to choose. This is a similar procedure to the one that is followed by many Wall Street fund managers, although they aren't necessarily as adept at it as the kids.

"I try to stress the idea that a portfolio should have at least ten companies, with one or two providing a fairly good dividend," says Ms. Morrissey. "But before my students can put any stock in the portfolio, they have to explain exactly what the company does. If they can't tell the class the service it provides or the products it

makes, then they aren't allowed to buy. Buying what you know about is one of our themes." Buying what you know about is a very sophisticated strategy that many professionals have neglected to put into practice.

One of the companies the students at St. Agnes knew about was Pentech International, a maker of colored pens and markers. Their favorite Pentech product, with a marker on one end and a highlighter on the other, was introduced into the class by Ms. Morrissey. This pen was very popular, and some of the kids even used it to highlight their stock selections. It wasn't long before they were investigating Pentech itself.

The stock was selling for \$5 at the time, and the students discovered that the company had no long-term debt. They were also impressed by the fact that Pentech made a superior product, which, judging by its popularity in house, was likely to be just as popular in classrooms nationwide. Another positive, from their point of view, was that Pentech was a relatively unknown company, as compared, say, to Gillette, the maker of Paper Mate pens and the Good News razors they saw in their fathers' bathrooms.

Trying to come to the aid of a colleague, the St. Agnes fund managers sent me a Pentech pen and suggested I look into this wonderful company. This advice I wish I had taken. After I received the research tip and neglected to act on it, the stock nearly doubled, from $5\frac{1}{8}$ to a high of $9\frac{1}{2}$.

This same kid's-eye approach to stockpicking led the 1990 St. Agnes fund managers to the Walt Disney Company, two sneaker manufacturers (Nike and L.A. Gear), the Gap (where most of them buy their clothes), PepsiCo (which they know four different ways via Pepsi-Cola, Pizza Hut, Kentucky Fried Chicken, and Frito-Lay), and Topps (a maker of baseball cards). "We were very much into trading cards within the seventh grade," Ms. Morrissey says, "so there was no question about whether to own Topps. Again, Topps produced something the kids could actually buy. In doing so, they felt they were contributing to the revenues of one of their companies."

They got to the others as follows: Wal-Mart because they were shown a videotaped segment of "Lifestyles of the Rich and Famous" that featured Wal-Mart's founder, Sam Walton, talking about how investing benefits the economy; NYNEX and Mobil because of their excellent dividends; Food Lion, Inc., because it was a well-run

company with a high return on equity and also because it was featured in the same video segment that introduced them to Sam Walton. Ms. Morrissey explains:

“The focus was on eighty-eight citizens of Salisbury, North Carolina, who each bought ten shares of Food Lion stock for one hundred dollars when the company went public back in 1957. A thousand dollars invested then had become fourteen million dollars. Do you believe it? All of these eighty-eight people became millionaires. These facts impressed all the kids, to say the least. By the end of the year they had forgotten a lot of things, but not the story of Food Lion.”

The only clunker in the model portfolio is IBM, which I don’t have to tell you has been the favorite of professional adult money managers for 20 years (yours truly included—grown-ups keep buying it and keep wishing they hadn’t). The reason for this destructive obsession is not hard to find: IBM is an approved stock that everybody knows about and a fund manager can’t get into trouble for losing money on it. The St. Agnes kids can be forgiven this one foolish attempt to imitate their elders on Wall Street.

Let me anticipate some of the criticisms of the St. Agnes results that are sure to come from the professional ranks. (1) “This isn’t real money.” True, but so what? Anyway, the pros ought to be relieved that St. Agnes isn’t working with real money—otherwise, based on St. Agnes’s performance, billions of dollars might be pulled from the regular mutual funds and turned over to the kids. (2) “Anybody could have picked those stocks.” If so, why didn’t anybody? (3) “The kids got lucky with a bunch of their favorite picks.” Perhaps, but some of the smaller portfolios chosen by the four-person teams in Ms. Morrissey’s class did as well as or better than the model portfolio selected by the class at large. The winning four-some in 1990 (Andrew Castiglioni, Greg Bialach, Paul Knisell, and Matt Keating) picked the following stocks for the reasons noted:

- 100 shares of Disney (“Every kid can explain this one.”)
- 100 shares of Kellogg (“They liked the product.”)
- 300 shares of Topps (“Who doesn’t trade baseball cards?”)
- 200 shares of McDonald’s (“People have to eat.”)
- 100 shares of Wal-Mart (“A remarkable growth spurt.”)
- 100 shares of Savannah Foods (“They got it from *Investor’s Daily*.”)