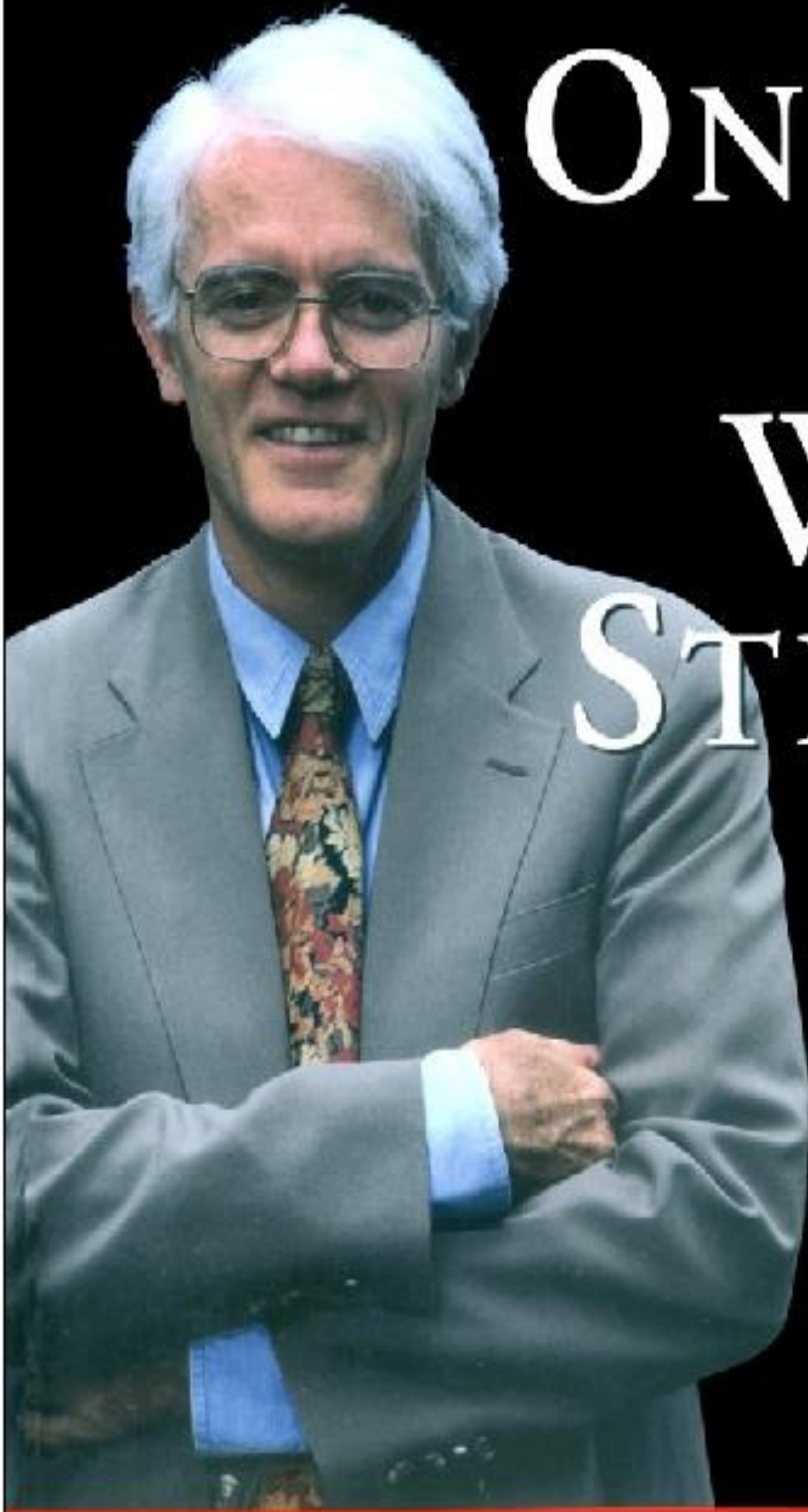
"Mr. Lynch's investment record puts him in a league by himself."
—Anise C. Wallace, *The New York Times*



ONE UP ON WALL STREET

How to Use What You Already Know to Make Money in the Market

More Than One Million Copies Sold

PETER LYNCH

WITH JOHN ROTHCHILD

WITH A NEW INTRODUCTION BY THE AUTHOR

Peter Lynch is America's number-one money manager. His mantra: Average investors can become experts in their own field and can pick winning stocks as effectively as Wall Street professionals by doing just a little research.

Now, in a new introduction written specifically for this edition of *One Up on Wall Street,* Lynch gives his take on the incredible rise of Internet stocks, as well as a list of twenty winning companies of high-tech '90s. That many of these winners are low-tech supports his thesis that amateur investors can continue to reap exceptional rewards from mundane, easy-to-understand companies they encounter in their daily lives.

Investment opportunities abound for the layperson, Lynch says. By simply observing business developments and taking notice of your immediate world—from the mall to the workplace—you can discover potentially successful companies before professional analysts do. This jump on the experts is what produces "tenbaggers," the stocks that appreciate tenfold or more and turn an average stock portfolio into a star performer.

The former star manager of Fidelity's multibillion-dollar Magellan Fund, Lynch reveals how he achieved his spectacular record. Writing with John Rothchild, Lynch offers easy-to-follow directions for sorting out the long shots from the no shots by reviewing a company's financial statements and by identifying which numbers *really* count. He explains how to stalk tenbaggers and lays out the guidelines for investing in cyclical, turnaround, and fast-growing companies.

Lynch promises that if you ignore the ups and downs of the market and the endless speculation about interest rates, in the long term (anywhere from five to fifteen years) your portfolio will reward you. This advice has proved to be timeless and has made *One Up on Wall Street* a number-one bestseller. And now this classic is as valuable in the new millennium as ever.

PETER LYNCH is vice chairman of Fidelity Management & Research Company—the investment advisor arm of Fidelity Investments—and a member of the Board of Trustees of the Fidelity funds. Mr. Lynch was portfolio manager of Fidelity Magellan Fund, which was the best performing fund in the world under his leadership from May 1977 to May 1990. He is the co-author of the bestselling *Beating the Street* and *Learn to Earn,* a beginner's guide to the basics of investing and business. He lives in the Boston area.

JOHN ROTHCHILD has written for *Time, Fortune, Worth,* and *The New York Times Book Review.* The author of *A Fool and His Money* and *Going for Broke,* he is also the co-author, with Peter Lynch, of *Beating the Street* and *Learn to Earn.* He lives in Miami Beach, Florida.

SIMON & SCHUSTER PAPERBACKS

Cover design by Tom Lau
Cover photograph by Sigrid Estrada

Register online at www.simonsays.com for more information on this and other great books.

One Up on Wall Street

How to Use
What You Already Know
to Make Money
in the Market

Peter Lynch
with John Rothchild

A Fireside Book
Published by Simon & Schuster
New York London Toronto Sydney Singapore

Prologue:
A Note from Ireland

You can't bring up the stock market these days with-out analyzing the events of October 16–20, 1987. It was one of the most unusual weeks I've ever experienced. More than a year later, and looking back on it with some dispassion, I can begin to separate the sensational ballyhoo from the incidents of lasting importance. What's worth remembering I remember as follows:

• On October 16, a Friday, my wife—Carolyn—and I spent a delightful day driving through County Cork, Ireland. I rarely take vacations, so the fact that I was traveling at all was extraordinary in itself.

• I didn't even once stop to visit the headquarters of a publicly traded company. Generally I'll detour 100 miles in any direction to get the latest word on sales, inventories, and earnings, but there didn't seem to be an S&P report or a balance sheet anywhere within 250 miles of us here.

• We went to Blarney Castle, where the legendary Blarney stone is lodged inconveniently in a parapet at the top of the building, several stories above the ground. You get to lie on your back, wiggle your way across the metal grating that comes between you and a fatal drop, and then while gripping a guardrail for emotional support, you kiss the legendary stone. Kissing the Blarney stone is as big a thrill as they say—especially the getting out alive.

• We recovered from the Blarney stone by spending a quiet weekend playing golf—at Waterville on Saturday and at Dooks on Sunday—and driving along the beautiful Ring of Kerry.

• On Monday, October 19, I faced the ultimate challenge, which demanded every bit of intelligence and stamina that I could muster—the eighteen holes at the Killeen course in Killarney, one of the most difficult courses in the world.

• After packing the clubs into the car, I drove with Carolyn out on the Dingle peninsula to the seaside resort of that name, where we checked into the Sceilig Hotel. I must have been tired. I never left the hotel room for the entire afternoon.

• That evening we dined with friends, Elizabeth and Peter Callery, at a famous seafood place called Doyle's. The next day, the 20th, we flew home.

THOSE PETTY UPSETS

Of course, I've left out a few petty upsets. In hindsight they hardly seem worth mentioning. One year later you're supposed to remember the Sistine Chapel, not that you got a blister from running through the Vatican. But in the spirit of full disclosure, I'll tell you what was bothering me:

• On Thursday, the day we left for Ireland after work, the Dow Jones industrial average dropped 48 points, and on Friday, the day we arrived, that same average dropped another 108.36 points. This made me wonder if we should be on vacation at all.

• I was thinking about Dow Jones and not about Blarney, even at the moment I kissed Blarney's stone. Throughout the weekend, between the rounds of golf, I sought out several phones and talked to my office about which stocks to sell, and which stocks to buy at bargain prices if the market fell further.

• On Monday, the day I played Killeen at Killarney, the aforementioned average dropped yet another 508 points.

Thanks to the time difference, I finished the round a few hours before the opening bell rang on Wall Street, or else I would probably have played worse. As it was, a sense of gloom and doom carried over from Friday, and perhaps that explained my (1) putting worse than I usually do, which in the best of times is terrible; and (2) failing to remember my score. The score that got my attention later that day was that the one million shareholders in Magellan Fund had just lost 18 percent of their assets, or $2 billion, in the Monday session.

My fixation on this mishap caused me to ignore the scenery on the way to Dingle. It could have been Forty-second and Broadway, for all I knew.

I wasn't napping all afternoon at the Sceilig Hotel, as the earlier paragraph may have implied. Instead, I was on the phone with my home office, deciding which of the 1,500 stocks in my fund should be sold to raise cash for the unusual number of fund redemptions. There was enough cash for normal circumstances, but not enough for the circumstances of Monday the 19th. At one point I couldn't decide if the world was coming to an end, if we were going into a depression, or if things weren't nearly as bad as that and only Wall Street was going out of business.

My associates and I sold what we had to sell. First we disposed of some British stocks in the London market. On Monday morning, stock prices in London were generally higher than prices in the U.S. market, thanks to a rare hurricane that had forced the London exchange to shut down on the preceding

Friday, thus avoiding that day's big decline. Then we sold in New York, mostly in the early part of the session, when the Dow was down only 150 points but well on its way to the nadir of 508.

That night at Doyle's, I couldn't have told you what sort of seafood meal I ate. It's impossible to distinguish cod from shrimp when your mutual fund has lost the equivalent of the GNP of a small, seagoing nation.

We came home on the 20th because all of the above made me desperate to get back to the office. This was a possibility for which I'd been preparing since the day we arrived. Frankly, I'd let the upsets get to me.

THE LESSONS OF OCTOBER

I've always believed that investors should ignore the ups and downs of the market. Fortunately the vast majority of them paid little heed to the distractions cited above. If this is any example, less than three percent of the million account-holders in Fidelity Magellan switched out of the fund and into a money-market fund during the desperations of the week. When you sell in desperation, you always sell cheap.

Even if October 19 made you nervous about the stock market, you didn't have to sell that day—or even the next. You could gradually have reduced your portfolio of stocks and come out ahead of the panic-sellers, because, starting in December, the market rose steadily. By June of 1988 the market recovered some 400 points of the decline, or more than 23%.

To all the dozens of lessons we're supposed to have learned from October, I can add three: (1) don't let nuisances ruin a good portfolio; (2) don't let nuisances ruin a good vacation; and (3) never travel abroad when you're light on cash.

Probably I could go on for several chapters with further highlights, but I'd rather not waste your time. I prefer to write about something you might find more valuable: how to identify the superior companies. Whether it's a 508-point day or a 108-point day, in the end, superior companies will succeed and mediocre companies will fail, and investors in each will be rewarded accordingly.

But as soon as I remember what I ate at Doyle's, I'll let you know.

Introduction: The Advantages of Dumb Money

This is where the author, a professional investor, promises the reader that for the next 300 pages he'll share the secrets of his success. But rule number one, in my book, is: Stop listening to professionals! Twenty years in this business convinces me that any normal person using the customary three percent of the brain can pick stocks just as well, if not better, than the average Wall Street expert.

I know you don't expect the plastic surgeon to advise you to do your own facelift, nor the plumber to tell you to install your own hot-water tank, nor the hairdresser to recommend that you trim your own bangs, but this isn't surgery or plumbing or hairdressing. This is investing, where the smart money isn't so smart, and the dumb money isn't really as dumb as it thinks. Dumb money is only dumb when it listens to the smart money.

In fact, the amateur investor has numerous built-in advantages that, if exploited, should result in his or her outperforming the experts, and also the market in general. Moreover, when you pick your own stocks, you ought to outperform the experts. Otherwise, why bother?

I'm not going to get carried away and advise you to sell all your mutual funds. If that started to happen on any large scale, I'd be out of a job. Besides, there's nothing wrong with mutual funds, especially the ones that are profitable to the investor. Honesty and not immodesty compels me to report that millions of amateur investors have been well-rewarded for investing in Fidelity Magellan, which is why I was invited to write this book in the first place. The mutual fund is a wonderful invention for people who have neither the time nor the inclination to test their wits against the stock market, as well as for people with small amounts of money to invest who seek diversification.

It's when you've decided to invest on your own that you ought to try going it alone. That means ignoring the hot tips, the recommendations from brokerage houses, and the latest "can't miss" suggestion from your favorite newsletter—in favor of your own research. It means ignoring the stocks that you hear Peter Lynch, or some similar authority, is buying.

There are at least three good reasons to ignore what Peter Lynch is buying: (1) he might be wrong! (A long list of losers from my own portfolio constantly reminds me that the so-called smart money is exceedingly dumb about 40 percent of the time); (2) even if he's right, you'll never know when he's changed his mind about a stock and sold; and (3) you've got better sources, and they're all around you. What makes them better is that you can keep tabs on them, just as I keep tabs on mine.

If you stay half-alert, you can pick the spectacular performers right from your place of business or out of the neighborhood shopping mall, and long before Wall Street discovers them. It's impossible to be a credit-card-carrying American consumer without having done a lot of fundamental analysis on dozens of companies—and if you work in the industry, so much the better. This is where you'll find the tenbaggers. I've seen it happen again and again from my perch at Fidelity.

THOSE WONDERFUL TENBAGGERS

In Wall Street parlance a "tenbagger" is a stock in which you've made ten times your money. I suspect this highly technical term has been borrowed from baseball, which only goes up to a fourbagger, or home run. In my business a fourbagger is nice, but a tenbagger is the fiscal equivalent of two home runs and a double. If you've ever had a tenbagger in the stock market, you know how appealing it can be.

I developed a passion for making ten times my money early in my investing career. The first stock I ever bought, Flying Tiger Airlines, turned out to be a multibagger that put me through graduate school. In the last decade the occasional five-and tenbagger, and the rarer twentybagger, has helped my fund outgain the competition—and I own 1,400 stocks. In a small portfolio even one of these remarkable performers can transform a lost cause into a profitable one. It's amazing how this works.

The effect is most striking in weak stock markets—yes, there are tenbaggers in weak markets. Let's go back to 1980, two years before the dawn of the great bull market. Suppose you invested $10,000 in the following ten stocks on December 22, 1980, and held them until October 4, 1983. That's Strategy A. Strategy B is the same, except that you added an eleventh stock, Stop & Shop, which turned out to be the tenbagger.

The result from Strategy A is that your $10,000 would have increased to $13,040 for a mediocre 30.4% total return over nearly three years (the S&P 500 offered a total return of 40.6% in the same period). You'd have a perfect right to look at this and say: "Big deal. Why don't I leave the investing to the pros." But if you added Stop & Shop, your $10,000 would have more than doubled to $21,060, giving you a total return of 110.6% and a chance to brag on Wall Street brag on Wall Street.

Furthermore, if you had added to your position in Stop & Shop as you saw the company's prospects improving, your overall return might have been twice again as high.

To make this spectacular showing, you only had to find one big winner out of eleven. The more right you are about any one stock, the more wrong you can be on all the others and still triumph as an investor.

APPLES AND DONUTS

You may have thought that a tenbagger can only happen with some wild penny stock in some weird company like Braino Biofeedback or Cosmic R and D, the kind of stock that sensible investors avoid. Actually there are numerous tenbaggers in companies you'll recognize: Dunkin' Donuts, Wal-Mart, Toys "R" Us, Stop & Shop, and Subaru, to mention a few. These are companies whose products you've admired and enjoyed, but who would have suspected that if you'd bought the Subaru stock along with the Subaru car, you'd be a millionaire today?

Yet it's true. This serendipitous calculation is based on several assumptions: first, that you bought the stock at its low of $2 a share in 1977; second, that you sold at the high in 1986, which would have amounted to $312 a share, unadjusted for an 8-for-1 split.* That's a 156-bagger, and the fiscal equivalent of 39 home runs, so if you'd invested $6,410 in the stock (certainly in the price range of a car), you'd come out with $1 million exactly. Instead of owning a battered trade-in, you'd now have enough money to be able to afford a mansion and a couple of Jaguars in the garage.

Strategy A Portfolio

	BOUGHT	SOLD	% CHANGE
Bethlehem Steel	$25⅛	$23⅛	–8.0%
Coca-Cola	32¾	52½	+60.3%
General Motors	46⅞	74⅜	+58.7%
W. R. Grace	53⅞	48¾	–9.5%
Kellogg	18⅜	29⅞	+62.6%
Mfrs. Hanover	33	39⅛	+18.5%
Merck	80	98⅛	+22.7%
Owens Corning	26⅞	35¾	+33.0%
Phelps Dodge	39⅝	24¼	–38.8%
Schlumberger (adjusted for splits)	81⅞	51¾	–36.8%
			+162.7%

Strategy B
All of the above, plus

Stop & Shop	$6	$60	+900.0%

You would have been unlikely to make a million dollars by investing as much in Dunkin' Donuts stock as you spent on the donuts—how many donuts can a person eat? But if along with the two dozen donuts you bought every week for a year in 1982 (a $270 total outlay) you had invested an equal amount in shares, then four years later the shares would have been worth $1,539 (a sixbagger). A $10,000 investment in Dunkin' Donuts would have resulted in a $47,000 gain in four years.

If, in 1976, you'd have bought ten pairs of jeans at The Gap for $180, the jeans would have worn out by now, but ten shares of Gap stock purchased for the same $180 ($18 per share was the initial offering price) was worth $4,672.50 at the market high in 1987. A $10,000 investment in The Gap would have resulted in a $250,000 gain.

If during 1973 you'd have spent 31 nights on business trips at La Quinta Motor Inns (paying $11.98 per night for the room), and you matched the $371.38 room bill with an equal purchase of La Quinta stock (23.21 shares), your shares would have been worth $4,363.08 ten years later. A $10,000 investment in La Quinta would have resulted in a $107,500 gain.

If during 1969 you found yourself having to pay for a traditional burial ($980) of a loved one from one of the many funeral outlets owned by Service Corporation International, and somehow in spite of your grief you managed to invest another $980 in SCI stock, your 70 shares would have been worth $14,352.19 in 1987. A $10,000 investment in SCI would have resulted in a $137,000 gain.

If back in 1982, during the same week you bought that first $2,000 Apple computer so your children could improve their grades and get into college, you'd put another $2,000 into Apple stock, then by 1987 those shares in Apple were worth $11,950, or enough to pay for a year at college.

THE POWER OF COMMON KNOWLEDGE

To get these spectacular returns you had to buy and sell at exactly the right time. But even if you missed the highs or the lows, you would have done better to have invested in any of the familiar companies mentioned above than in some of the esoteric enterprises that neither of us understands.

There's a famous story about a fireman from New England. Apparently back in the 1950s he couldn't help noticing that a local Tambrands plant (then the company was called Tampax) was expanding at a furious pace. It occurred to him that they wouldn't be expanding so fast unless they were prospering, and on that assumption he and his family invested $2,000. Not only that, they put in another $2,000 each year for the next five years. By 1972 the fireman was a millionaire—and he hadn't even bought any Subaru.

Whether or not our fortunate investor asked any brokers or other experts for advice I'm not certain, but many would have told him his theory was flawed, and if he knew what was good for him, he'd stick with the blue chips the institutions were buying, or with the hot electronics issues that were popular at the time. Luckily the fireman kept his own counsel.

You might have assumed it's the sophisticated and high-level gossip that experts hear around the Quotron machines that gives us our best investment ideas, but I get many of mine the way the fireman got his. I talk to hundreds of companies a year and spend hour after hour in heady powwows with CEOs, financial analysts, and my colleagues in the mutual-fund business, but I stumble onto the big winners in extracurricular situations, the same way you could:

Taco Bell, I was impressed with the burrito on a trip to California; La Quinta Motor Inns, somebody at the rival Holiday Inn told me about it; Volvo, my family and friends drive this car; Apple Computer, my kids had one at home and then the systems manager bought several for the office; Service Corporation International, a Fidelity electronics analyst (who had nothing to do with funeral homes, so this wasn't his field) found on a trip to Texas; Dunkin' Donuts, I loved the coffee; and recently the revamped Pier 1 Imports, recommended by my wife. In fact, Carolyn is one of my best sources. She's the one who discovered L'eggs.

L'eggs is the perfect example of the power of common knowledge. It turned out to be one of the two most successful consumer products of the seventies. In the early part of that decade, before I took over Fidelity Magellan, I was working as a securities analyst at the firm. I knew the textile business from having traveled the country visiting textile plants, calculating profit margins, price/earnings ratios, and the esoterica of warps and woofs. But none of this information was as valuable as Carolyn's. I didn't find L'eggs in my research, she found it by going to the grocery store.

Right there in a freestanding metal rack near the checkout counter was a new display of women's panty hose, packaged in colorful plastic eggs. The company, Hanes, was test-marketing L'eggs at several sites around the country, including suburban Boston. When Hanes interviewed hundreds of women leaving the test supermarkets and asked them if they'd just bought panty hose, a high percentage answered yes. Yet most of them couldn't recall the name of the brand. Hanes was ecstatic. If a product becomes a best-seller without brand-name recognition, imagine how it will sell once the brand is publicized.

Carolyn didn't need to be a textile analyst to realize that L'eggs was a superior product. All she had to do was buy a pair and try them on. These stockings had what they call a heavier denier, which made them less likely to develop a run than the normal stockings. They also fit very well, but the main attraction was convenience. You could pick up L'eggs right next to the bubble gum and the razor blades, and without having to make a special trip to the department store.

Hanes already sold its regular brand of stockings in the department stores and the specialty stores. However, the company had determined that women customarily visit one or the other every six weeks, on average, whereas they go to the grocery store twice a week, which gives them twelve chances to buy L'eggs for every one chance to buy the regular brand. Selling stockings in the grocery store was an immensely popular idea. You could have figured that out by seeing the number of women with plastic eggs in their grocery carts at the checkout counter. You could just imagine how many L'eggs were going to be sold nationwide, after the word got out.

How many women who bought panty hose, store clerks who saw the women buying panty hose, and husbands who saw the women coming home with the panty hose knew about the success of L'eggs? Millions. Two or three years after the product was introduced, you could have walked into any one of thousands of supermarkets and realized that this was a best-seller. From there, it was easy enough to find out that L'eggs was made by Hanes and that Hanes was listed on the New York Stock Exchange.

Once Carolyn alerted me to Hanes, I did the customary research into the story. The story was even better than I'd thought, so with the same confidence as the fireman who bought Tambrands, I recommended the stock to Fidelity's portfolio managers. Hanes turned out to be a sixbagger before it was taken over by Consolidated Foods, now Sara Lee. L'eggs still makes a lot of money for Sara Lee and has grown consistently over the past decade. I'm convinced Hanes would have been a 50-bagger if it hadn't been bought out.

The beauty of L'eggs is that you didn't have to know about it from the outset. You could have bought Hanes stock the first year, the second year, or even the third year after L'eggs went nationwide and you'd have tripled your money at least. But a lot of people didn't, especially husbands. Husbands (usually also known as the Designated Investors) probably were too busy buying solar-energy stocks or satellite-dish company stocks and losing their collective shirts.

Consider my friend Harry Houndstooth—whose name I've changed to protect the unfortunate. Actually there's a little bit of Houndstooth in all of us. This Designated Investor (each family seems to have one) has just spent the morning reading *The Wall Street Journal,* plus a $250-a-year stock market newsletter to which he subscribes. He's looking for another exciting stock play, something with limited risk but big potential on the upside. In both the *Journal* and his newsletter there's a favorable mention of Winchester Disk Drives, a headstrong little firm with a dandy future.

Houndstooth doesn't know a disk drive from a clay pigeon, but he calls his broker and learns that Merrill Lynch has put Winchester on its "aggressive buy" list.

All this can't be pure coincidence, thinks Houndstooth. He is soon convinced that putting $3,000 of his hard-earned money into Winchester is a very clever idea. After all, he's done the research!

Houndstooth's wife, Henrietta—also known as the Person Who Doesn't Understand the Serious Business of Money (these roles could be reversed, but usually aren't)—has just returned from the shopping mall where she's discovered a wonderful new women's apparel store called The Limited. The place is mobbed with customers. She can't wait to tell her husband about the friendly salespeople and the terrific bargains. "I bought Jennifer's entire fall wardrobe," she exclaims. "Only two hundred and seventy-five dollars."

"Two hundred and seventy-five dollars?" grouses the Designated Investor. "While you've been out squandering money, I've been home figuring out how to make it. Winchester Disk Drives is the answer. As near to a sure thing as you could get. We're putting three thousand dollars into it."

"I hope you know what you're doing," says the Person Who Doesn't Understand the Serious Business of Money. "Remember Havalight Photo Cell? That sure thing went from seven dollars to three dollars and fifty cents. We lost fifteen hundred dollars."

"Yeah, but that was Havalight. This is Winchester. *The Wall Street Journal* calls disk drives one of the major growth industries of this decade. Why should we be the only ones not to get in on it?"

The rest of the story is easy to imagine. Winchester Disk Drives has a bad quarter, or there's unexpected competition in the disk drive industry, and the stock price drops from $10 to $5. Since the Designated Investor has no possible way to understand what any of this means, he decides the prudent thing is to sell out, delighted that he only lost another $1,500—or a little more than five sets of Jennifer's wardrobes.

Meanwhile, unbeknownst to Houndstooth, the stock price of The Limited, the store that impressed his wife, Henrietta, has been moving steadily higher, from less than 50 cents a share (adjusted for splits) in December, 1979, to $9 in 1983—already a twentybagger to there—and even if he'd bought it at the $9 price (and suffered through one drop back to $5), he'd have made more than five times his money as the stock soared to $52⅞. That's over a 100-bagger from the beginning, so if Houndstooth had invested $10,000 early enough, he would have made over a million dollars on the stock.

More realistically, if Mrs. Houndstooth had matched the $275 she put into the wardrobe with another $275 put into the stock, it's conceivable that even her tiny investment would have paid for a semester's tuition for her daughter.

But our Designated Investor, who had plenty of time to buy into The Limited even after he sold out on Winchester, continued to ignore the great spousal tip. By then there were four hundred Limited stores in the country, and most of them crowded, but Houndstooth was too busy to notice. He was following what Boone Pickens was doing with Mesa Petroleum.

Sometime near the end of 1987, and probably just before the 508-point jiggle, Houndstooth finally discovers that The Limited is on his brokerage firm's buy list. Furthermore, there have been promising articles in three different magazines, the stock has become a darling of the big institutions, and there are thirty analysts on the trail. It occurs to the Designated Investor that this is a solid, respectable buy.

"Funny thing," he mutters one day to his wife. "Remember that store you like, The Limited? Turns out to be a public company. That means we can buy the stock. Pretty good stock, to boot, judging by the special I just saw on PBS. I heard *Forbes* even had a cover story on it. Anyway, the smart money can't get enough of it. Gotta be worth at least a couple of thousand from the retirement fund."

"We still got a couple of thousand in the retirement fund?" asks the skeptical Henrietta.

"Of course we do," blusters the Designated Investor. "And it'll soon be more, thanks to your favorite store."

"But I don't shop at The Limited anymore," Henrietta says. "The merchandise is overpriced and no longer unique. Other stores carry the same thing now."

"What's that got to do with anything," bellows our Designated Investor. "I'm not talking about shopping. I'm talking about investing."

Houndstooth buys the stock at $50, near the all-time 1987 high. Soon the price begins to fall to $16, and about halfway down, he sells out, delighted once again to have limited his losses.

IS THIS A PUBLIC COMPANY?

I'm a fine one to chide Houndstooth for missing The Limited. I didn't buy any shares on the way up, either, and my wife saw the same crowds at the shopping mall as his wife did. I, too, bought into The Limited when the story got popular and the fundamentals had begun to deteriorate, and I'm still holding on at a loss.

Actually I could go on for several pages about the tenbaggers I've missed, and more sorry examples will crop up further along in the book. When it comes to ignoring promising opportunities, I'm as adept as the next person. Once I was standing on the greatest asset play of the century, the Pebble Beach golf course, and it never occurred to me to ask if it was a public company. I was too busy asking about the distance between the tees and the greens.

Luckily there are enough tenbaggers around so that both of us could fail to notice the majority and we'll still hit our share. In a large portfolio such as mine I have to hit several before it makes an appreciable difference. In a small portfolio such as yours, you only have to hit one.

Moreover, the nice thing about investing in familiar companies such as L'eggs or Dunkin' Donuts is that when you try on the stockings or sip the coffee, you're already doing the kind of fundamental analysis that they pay Wall Street analysts to do. Visiting stores and testing products is one of the critical elements of the analyst's job.

During a lifetime of buying cars or cameras, you develop a sense of what's good and what's bad, what sells and what doesn't. If it's not cars you know something about, you know something about something else, and the most important part is, you know it before Wall Street knows it. Why wait for the Merrill Lynch restaurant expert to recommend Dunkin' Donuts when you've already seen eight new franchises opening up in your area? The Merrill Lynch restaurant analyst isn't going to notice Dunkin' Donuts (for reasons I'll soon explain) until the stock has quintupled from $2 to $10, and you noticed it when the stock was at $2.

GIGGING THE GIGAHERTZ

Among amateur investors, for some reason it's not considered sophisticated practice to equate driving around town eating donuts with the initial phase of an investigation into equities. People seem more comfortable investing in something about which they are entirely ignorant. There seems to be an unwritten rule on Wall Street: If you don't understand it, then put your life savings into it. Shun the enterprise around the corner, which can at least be observed, and seek out the one that manufactures an incomprehensible product.

I heard about one such opportunity just the other day. According to a report somebody left on my desk, this was a fantastic chance to invest in a company that makes the "one megabit S-Ram, C-mos (complementary metal oxide semiconductor); bipolar risc (reduced instructive set computer), floating point, data I/O array processor, optimizing compiler, 16-bytes dual port memory, unix operating system, whetstone megaflop polysilicon emitter, high band width, six gigahertz, double metalization communication protocol, asynchronous backward compatibility, peripheral bus architecture, four-way interleaved memory and 15 nanoseconds capability."

Gig my gigahertz and whetstone my megaflop, if you couldn't tell if that was a racehorse or a memory chip you should stay away from it, even though your broker will be calling to recommend it as the opportunity of the decade to make countless nanobucks.

A POX ON THE CABBAGE PATCH

Does that mean I think you ought to buy shares in every new fast-food franchise, every business that has a hot product, or every public company that opens an outlet in the local mall? If it were that simple, I wouldn't have lost money on Bildner's, the yuppie 7-Eleven right across the street from my office. If only I'd stuck to the sandwiches and not to the stock, fifty shares of which would scarcely buy you a tuna on rye. More on this later.

And how about Coleco? Just because the Cabbage Patch doll was the best-selling toy of this century, it couldn't save a mediocre company with a bad balance sheet, and although the stock rose dramatically for a year or so, spurred on first by home video games and then by the Cabbage Patch enthusiasm, eventually it dropped from a high of $65 in 1983 to a recent $1¾ as the company went into Chapter 11, filing for bankruptcy in 1988.

Finding the promising company is only the first step. The next step is doing the research. The research is what helps you to sort out Toys "R" Us from Coleco, Apple Computer from Televideo, or Piedmont Airlines from People Express. Now that I mention it, I wish I'd done more checking into what was happening at People Express. Maybe then I wouldn't have bought that one, either.

All my failures notwithstanding, during the twelve years I've managed Fidelity Magellan, it has risen over twentyfold per share—partly thanks to some of the little-known and out-of-favor stocks I've been able to discover and then research on my own. I'm confident that any investor can benefit from the same tactics. It doesn't take much to outsmart the smart money, which, as I've said, isn't always very smart.

This book is divided into three sections. The first, Preparing to Invest (Chapters 1 through 5), deals with how to assess yourself as a stockpicker, how to size up the competition (portfolio managers, institutional investors, and other Wall Street experts), how to evaluate whether stocks are riskier than bonds, how to examine your financial needs, and how to develop a successful stockpicking routine. The second, Picking Winners (Chapters 6 through 15), deals with how to find the most promising opportunities, what to look for in a company and what to avoid, how to use brokers, annual reports, and other resources to best advantage, and what to make of the various numbers (p/e ratio, book value, cash flow) that are often mentioned in technical evaluations of stocks. The third, The Long-term View (Chapters 16 through 20), deals with how to design a portfolio, how to keep tabs on companies in which you've taken an interest, when to buy and when to sell, the follies of options and futures, and some general observations about the health of Wall Street, American enterprise, and the stock market—things I've noticed in twenty-odd years of investing.