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