An investor education initiative

Edelweiss MUTUAL FUND

4 great investing lessons

from Peter Lynch

In the world of investing, Peter Lynch is legendary.

Lynch ran the Fidelity Magellan Fund from 1977 to 1990, delivering an annualised return of 29% over this period, one of the greatest investing tracks records of all time.

When Lynch became Magellan's manager in 1977, the fund had $20 million in assets. It went on to become the largest mutual fund in the U.S. with $13 billion in assets. The ability to manage such a humongous amount and deliver admirably earned him a position in the investing hall of fame, so to speak.

Here are a few nuggets of wisdom taken from an interview and his books One Up on Wall Street and Beating the Street.

All your stocks will not do well.

You only need a few good stocks in your lifetime.

If you have a lot of stocks, some will do mediocre, some will do okay, and if one of two of them goes up big time, you produce a fabulous result. Some stocks go up 20-30% and investors get rid of it and hold on to the dogs. It is like watering the weeds and cutting the flowers. You have to let the big ones make up for your mistakes.

If you looked at 10 companies, you'd find one that's interesting, if you'd look at 20, you'd find two, or if you look at 100, you'll find 10. The person that turns over the most rocks wins the game.

In this business if you're good, you're right 6/10. You're never going to be right 9/10. This is not like pure science where you go, "Aha" and you've got the answer. You have to take a little bit of risk.

Don't get easily afraid.

The unwary investors pass in and out of three emotional states: Concern, Complacency, Capitulation.

Concern after the market has dropped or the economy seemingly falters. This is a hindrance to buying good companies at bargain prices.

When the investor buys buys at higher prices, complacency sets in because the stock price keeps rising higher. Ironically, this is the time when one should be cautious, and fundamentals checked.

Finally, when the stock crashes to prices below the buying price, the investor capitulates and sells in a snit.

Such investors fancy themselves to be long-term investors but only until the next big drop, at which point they quickly become short-term investors and sell out for huge losses.

People who succeed in the stock market accept periodic losses. Calamitous drops do not scare them out of the game. The trick is not to trust your gut feelings, but to discipline yourself to ignore them.

Researching fundamentals will help keep you grounded.

Invest in a company after you have done the homework on the company's earnings prospects, financial condition, competitive position, plans for expansion and so forth. Stand by your stock as long as the fundamental story behind it has not changed.

(The year 1982 was a very scary period for America. Recession. Inflation at 14%. The prime rate was 20%. The economy was apparently in a free fall. One of Fidelity shareholders wrote to Lynch and questioned: "Do you realize that over half the companies in your portfolio are losing money right now?" Lynch answered: "These companies are going to do well once the economy comes back. We've got out of every other recession. I don't see why we won't come out of this one." He was proved right. The market eventually went north.)

Don't look at economics to predict the future. If you spend 13 minutes a year on economics, you've wasted 10 minutes. Focus on your companies. If you own auto stocks, you should be very interested in used car prices. If you own aluminium companies, you ought to be interested in what's happened to inventories of the metal. If your stock are hotels, you research should lead you to find out how many people are building hotels. Deal with facts, not forecasting the future. That's crystal ball stuff. That doesn't work. Futile.

If you think you can play the market, you will get played.

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

The public looks at stocks differently than they look at everything else. When they buy a refrigerator, they do research. They spend weeks planning a trip and hours studying their frequent flier plans. When they buy a microwave oven, they do research. They'll get consumer reports and ask other individuals on what they favourite kind of oven is or what kind of car would they buy and why. But they will invest $10,000 in some zany stock that they heard on a bus on the way to work. And they do it before sunset with no clue what the company does. And then wonder why they lose money.

This is sloppy and ill-conceived. More often than not, they are chronic losers with a history of playing their hunches.

In the end, they are more convinced than ever that investing in stocks is a game, but that's because they have made it one.

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