



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

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To Carolyn, my wife and best friend for over twenty years, whose support and sacrifices have been critically important to me.

To my children, Mary, Annie, and Beth, whose love for each other and their parents has meant so very much.

To my colleagues at Fidelity Investments, whose extra efforts have made Magellan's performance possible but who have received none of the favorable publicity.

To one million shareholders in Magellan, who have entrusted their savings to me and who have sent thousands of letters and made thousands of calls over the years, comforting me during declines in the market and reminding me that the future will be fine.

To Holy God for all the incredible blessings I have been given in my life.

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Introduction to the Millennium Edition

This book was written to offer encouragement and basic information to the individual investor. Who knew it would go through thirty printings and sell more than one million copies? As this latest edition appears eleven years beyond the first, I'm convinced that the same principles that helped me perform well at the Fidelity Magellan Fund still apply to investing in stocks today.

It's been a remarkable stretch since *One Up on Wall Street* hit the bookstores in 1989. I left Magellan in May, 1990, and pundits said it was a brilliant move. They congratulated me for getting out at the right time—just before the collapse of the great bull market. For the moment, the pessimists looked smart. The country's major banks flirted with insolvency, and a few went belly up. By early fall, war was brewing in Iraq. Stocks suffered one of their worst declines in recent memory. But then the war was won, the banking system survived, and stocks rebounded.

Some rebound! The Dow is up more than fourfold since October, 1990, from the 2,400 level to 11,000 and beyond—the best decade for stocks in the twentieth century. Nearly 50 percent of U.S. households own stocks or mutual funds, up from 32 percent in 1989. The market at large has created \$25 trillion in new wealth, which is on display in

every city and town. If this keeps up, somebody will write a book called *The Billionaire Next Door*.

More than \$4 trillion of that new wealth is invested in mutual funds, up from \$275 billion in 1989. The fund bonanza is okay by me, since I managed a fund. But it also must mean a lot of amateur stockpickers did poorly with their picks. If they'd done better on their own in this mother of all bull markets, they wouldn't have migrated to funds to the extent they have. Perhaps the information contained in this book will set some errant stockpickers on a more profitable path.

Since stepping down at Magellan, I've become an individual investor myself. On the charitable front, I raise scholarship money to send inner-city kids of all faiths to Boston Catholic schools. Otherwise, I work part-time at Fidelity as a fund trustee and as an adviser/trainer for young research analysts. Lately my leisure time is up at least thirtyfold, as I spend more time with my family at home and abroad.

Enough about me. Let's get back to my favorite subject: stocks. From the start of this bull market in August 1982, we've seen the greatest advance in stock prices in U.S. history, with the Dow up fifteenfold. In Lynch lingo that's a "fifteenbagger." I'm accustomed to finding fifteenbaggers in a variety of successful companies, but a fifteenbagger in the market at large is a stunning reward. Consider this: From the top in 1929 through 1982, the Dow produced only a fourbagger: up from 248 to 1,046 in a half century! Lately stock prices have risen faster as they've moved higher. It took the Dow $8\frac{1}{3}$ years to double from 2,500 to 5,000, and only $3\frac{1}{2}$ years to double from 5,000 to 10,000. From 1995–99 we saw an unprecedented five straight years where stocks returned 20 percent plus. Never before has the market recorded more than two back-to-back 20 percent gains.

Wall Street's greatest bull market has rewarded the believers and confounded the skeptics to a degree neither side could have imagined in the doldrums of the early 1970s, when I first took the helm at Magellan. At that low point, demoralized investors had to remind themselves that bear markets don't last forever, and those with patience held on to their stocks and mutual funds for the fifteen years it took the Dow and other averages to regain the prices reached in the mid-1960s. Today it's worth reminding ourselves that bull markets don't last forever and that patience is required in both directions.

On page 280 of this book I say the breakup of ATT in 1984 may have been the most significant stock market development of that era. Today

it's the Internet, and so far the Internet has passed me by. All along I've been technophobic. My experience shows you don't have to be trendy to succeed as an investor. In fact, most great investors I know (Warren Buffett, for starters) are technophobes. They don't own what they don't understand, and neither do I. I understand Dunkin' Donuts and Chrysler, which is why both inhabited my portfolio. I understand banks, savings-and-loans, and their close relative, Fannie Mae. I don't visit the Web. I've never surfed on it or chatted across it. Without expert help (from my wife or my children, for instance) I couldn't find the Web.

Over the Thanksgiving holidays in 1997, I shared eggnog with a Web-tolerant friend in New York. I mentioned that my wife, Carolyn, liked the mystery novelist Dorothy Sayers. The friend sat down at a nearby computer and in a couple of clicks pulled up the entire list of Sayers titles, plus customer reviews and the one- to five-star ratings (on the literary Web sites, authors are rated like fund managers). I bought four Sayers novels for Carolyn, picked the gift wrapping, typed in our home address, and crossed one Christmas gift off my list. This was my introduction to Amazon.com.

Later on you'll read how I discovered some of my best stocks through eating or shopping, sometimes long before other professional stock hounds came across them. Since Amazon existed in cyberspace, and not in suburban mall space, I ignored it. Amazon wasn't beyond my comprehension—the business was as understandable as a dry cleaner's. Also, in 1997 it was reasonably priced relative to its prospects, and it was well-financed. But I wasn't flexible enough to see opportunity in this new guise. Had I bothered to do the research, I would have seen the huge market for this sort of shopping and Amazon's ability to capture it. Alas, I didn't. Meanwhile, Amazon was up tenfold (a "tenbagger" in Lynch parlance) in 1998 alone.

Amazon is one of at least five hundred "dot.com" stocks that have performed miraculous levitations. In high-tech and dot.com circles, it's not unusual for a newly launched public offering to rise tenfold in less time than it takes Stephen King to pen another thriller. These investments don't require much patience. Before the Internet came along, companies had to grow their way into the billion-dollar ranks. Now they can reach billion-dollar valuations before they've turned a profit or, in some cases, before they've collected any revenues. Mr. Market (a fictional proxy for stocks in general) doesn't wait for a newborn Web

site to prove itself in real life the way, say, Wal-Mart or Home Depot proved themselves in the last generation.

With today's hot Internet stocks, fundamentals are old hat. (The term *old hat* is old hat in itself, proving that I'm old hat for bringing it up.) The mere appearance of a dot and a com, and the exciting concept behind it, is enough to convince today's optimists to pay for a decade's worth of growth and prosperity in advance. Subsequent buyers pay escalating prices based on the futuristic "fundamentals," which improve with each uptick.

Judging by the Maserati sales in Silicon Valley, dot.coms are highly rewarding to entrepreneurs who take them public and early buyers who make timely exits. But I'd like to pass along a word of caution to people who buy shares after they've levitated. Does it make sense to invest in a dot.com at prices that already reflect years of rapid earnings growth that may or may not occur? By the way I pose this, you've already figured out my answer is "no." With many of these new issues, the stock price doubles, triples, or even quadruples on the first day of trading. Unless your broker can stake your claim to a meaningful allotment of shares at the initial offering price—an unlikely prospect since Internet offerings are more coveted, even, than Super Bowl tickets—you'll miss a big percent of the gain. Perhaps you'll miss the entire gain, since some dot.coms hit high prices on the first few trading sessions that they never reach again.

If you feel left out of the dot.com jubilee, remind yourself that very few dot.com investors benefit from the full ride. It's misleading to measure the progress of these stocks from the offering price that most buyers can't get. Those who are allotted shares are lucky to receive more than a handful.

In spite of the instant gratification that surrounds me, I've continued to invest the old-fashioned way. I own stocks where results depend on ancient fundamentals: a successful company enters new markets, its earnings rise, and the share price follows along. Or a flawed company turns itself around. The typical big winner in the Lynch portfolio (I continue to pick my share of losers, too!) generally takes three to ten years or more to play out.

Owing to the lack of earnings in dot.com land, most dot.coms can't be rated using the standard price/earnings yardstick. In other words, there's no "e" in the all-important "p/e" ratio. Without a "p/e" ratio to

track, investors focus on the one bit of data that shows up everywhere: the stock price! To my mind, the stock price is the least useful information you can track, and it's the most widely tracked. When *One Up* was written in 1989, a lone ticker tape ran across the bottom of the Financial News Network. Today you can find a ticker tape on a variety of channels, while others display little boxes that showcase the Dow, the S&P 500, and so forth. Channel surfers can't avoid knowing where the market closed. On the popular Internet portals, you can click on your customized portfolio and get the latest gyrations for every holding. Or you can get stock prices on 800 lines, pagers, and voice mail.

To me, this barrage of price tags sends the wrong message. If my favorite Internet company sells for \$30 a share, and yours sells for \$10, then people who focus on price would say that mine is the superior company. This is a dangerous delusion. What Mr. Market pays for a stock today or next week doesn't tell you which company has the best chance to succeed two to three years down the information superhighway. If you can follow only one bit of data, follow the earnings—assuming the company in question has earnings. As you'll see in this text, I subscribe to the crusty notion that sooner or later earnings make or break an investment in equities. What the stock price does today, tomorrow, or next week is only a distraction.

The Internet is far from the first innovation that changed the world. The railroad, telephone, the car, the airplane, and the TV can all lay claim to revolutionary effects on the average life, or at least on the prosperous top quarter of the global population. These new industries spawned new companies, only a few of which survived to dominate the field. The same thing likely will happen with the Internet. A big name or two will capture the territory, the way McDonald's did with burgers or Schlumberger did with oil services. Shareholders in those triumphant companies will prosper, while shareholders in the laggards, the has-beens, and the should-have-beens will lose money. Perhaps you'll be clever enough to pick the big winners that join the exclusive club of companies that earn \$1 billion a year.

Though the typical dot.com has no earnings as yet, you can do a thumbnail analysis that gives a general idea of what the company will need to earn in the future to justify the stock price today. Let's take a hypothetical case: DotCom.com. First, you find the "market capitalization" ("market cap" for short) by multiplying the number of shares outstanding (let's say 100 million) by the current stock price (let's say \$100

a share). One hundred million times \$100 equals \$10 billion, so that's the market cap for DotCom.com.

Whenever you invest in any company, you're looking for its market cap to rise. This can't happen unless buyers are paying higher prices for the shares, making your investment more valuable. With that in mind, before DotCom.com can turn into a tenbagger, its market cap must increase tenfold, from \$10 billion to \$100 billion. Once you've established this target market cap, you have to ask yourself: What will DotCom.com need to earn to support a \$100 billion valuation? To get a ballpark answer, you can apply a generic price/earnings ratio for a fast-growing operation—in today's heady market, let's say 40 times earnings.

Permit me a digression here. On page 170 I mention how wonderful companies become risky investments when people overpay for them, using McDonald's as exhibit A. In 1972 the stock was bid up to a precarious 50 times earnings. With no way to "live up to these expectations," the price fell from \$75 to \$25, a great buying opportunity at a "more realistic" 13 times earnings.

On the following page I also mention the bloated 500 times earnings shareholders paid for Ross Perot's Electronic Data Systems. At 500 times earnings, I noted, "it would take five centuries to make back your investment, if the EDS earnings stayed constant." Thanks to the Internet, 500 times earnings has lost its shock value, and so has 50 times earnings or, in our theoretical example, 40 times earnings for DotCom.com.

In any event, to become a \$100 billion enterprise, we can guess that DotCom.com eventually must earn \$2.5 billion a year. Only thirty-three U.S. corporations earned more than \$2.5 billion in 1999, so for this to happen to DotCom.com, it will have to join the exclusive club of big winners, along with the likes of Microsoft. A rare feat, indeed.

I'd like to end this brief Internet discussion on a positive note. There are three ways to invest in this trend without having to buy into a hope and an extravagant market cap. The first is an offshoot of the old "picks and shovels" strategy: During the Gold Rush, most would-be miners lost money, but people who sold them picks, shovels, tents, and blue jeans (Levi Strauss) made a nice profit. Today, you can look for non-Internet companies that indirectly benefit from Internet traffic (package delivery is an obvious example); or you can invest in manufacturers of switches and related gizmos that keep the traffic moving.

The second is the so-called "free Internet play." That's where an In-

ternet business is embedded in a non-Internet company with real earnings and a reasonable stock price. I'm not naming names—you can do your own sleuthing—but several intriguing free plays have come to my attention. In a typical situation, the company at large is valued, say, at \$800 million in today's market, while its fledgling Internet operation is estimated to be worth \$1 billion, before it has proven itself. If the Internet operation lives up to its promise, it could prove very rewarding—that part of the company may be “spun off” so it trades as its own stock. Or, if the Internet venture doesn't do well, the fact that it's an adjunct to the company's regular line of work protects investors on the downside.

The third is the tangential benefit, where an old-fashioned “brick and mortar” business benefits from using the Internet to cut costs, streamline operations, become more efficient, and therefore more profitable. A generation ago, scanners were installed in supermarkets. This reduced pilferage, brought inventories under better control, and was a huge boon to supermarket chains.

Going forward, the Internet and its handmaidens will create some great success stories, but at this point we've mostly got great expectations and inefficient pricing. Companies valued at \$500 million today may triumph, while companies valued at \$10 billion may not be worth a dime. As expectations turn to reality, the winners will be more obvious than they are today. Investors who see this will have time to act on their “edge.”

Back to Microsoft, a 100-bagger I overlooked. Along with Cisco and Intel, that high-tech juggernaut posted explosive earnings almost from the start. Microsoft went public in 1986 at 15 cents a share. Three years later you could buy a share for under \$1, and from there it advanced eightyfold. (The stock has “split” several times along the way, so original shares never actually sold for 15 cents—for further explanation, see the footnote on page 34.) If you took the Missouri “show me” approach and waited to buy Microsoft until it triumphed with Windows 95, you still made seven times your money. You didn't have to be a programmer to notice Microsoft everywhere you looked. Except in the Apple orchard, all new computers came equipped with the Microsoft operating system and Microsoft Windows. Apples were losing their appeal. The more computers that used Windows, the more the software guys wrote programs for Windows and not for Apple. Apple was squeezed into a corner, where it sold boxes to 7–10 percent of the market.

Meanwhile the box makers that ran Microsoft programs (Dell, Hewlett-Packard, Compaq, IBM, and so on) waged fierce price wars to sell more boxes. This endless skirmish hurt the box makers' earnings, but Microsoft was unaffected. Bill Gates's company wasn't in the box business; it sold the "gas" that ran the boxes.

Cisco is another marquee performer. The stock price is up 480-fold since it went public in 1990. I overlooked this incredible winner for the usual reasons, but a lot of people must have noticed it. Businesses at large hired Cisco to help them link their computers into networks; then colleges hired Cisco to computerize the dorms. Students, teachers, and visiting parents could have noticed this development. Maybe some of them went home, did the research, and bought the stock.

I mention Microsoft and Cisco to add contemporary examples to illustrate a major theme of this book. An amateur investor can pick tomorrow's big winners by paying attention to new developments at the workplace, the mall, the auto showrooms, the restaurants, or anywhere a promising new enterprise makes its debut. While I'm on the subject, a clarification is in order.

Charles Barkley, a basketball player noted for shooting from the lip, once claimed he was misquoted in his own autobiography. I don't claim to be misquoted in this book, but I've been misinterpreted on one key point. Here's my disclaimer:

Peter Lynch doesn't advise you to buy stock in your favorite store just because you like shopping in the store, nor should you buy stock in a manufacturer because it makes your favorite product or a restaurant because you like the food. Liking a store, a product, or a restaurant is a good reason to get interested in a company and put it on your research list, but it's not enough of a reason to own the stock! Never invest in any company before you've done the homework on the company's earnings prospects, financial condition, competitive position, plans for expansion, and so forth.

If you own a retail company, another key factor in the analysis is figuring out whether the company is nearing the end of its expansion phase—what I call the "late innings" in its ball game. When a Radio Shack or a Toys "R" Us has established itself in 10 percent of the country, it's a far different prospect than having stores in 90 percent of the country. You have to keep track of where the future growth is coming from and when it's likely to slow down.

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Nothing has occurred to shake my conviction that the typical amateur has advantages over the typical professional fund jockey. In 1989 the pros enjoyed quicker access to better information, but the information gap has closed. A decade ago amateurs could get information on a company in three ways: from the company itself, from *Value Line* or Standard & Poor's research sheets, or from reports written by in-house analysts at the brokerage firm where the amateurs kept an account. Often these reports were mailed from headquarters, and it took several days for the information to arrive.

Today an array of analysts' reports is available on-line, where any browser can call them up at will. News alerts on your favorite companies are delivered automatically to your e-mail address. You can find out if insiders are buying or selling or if a stock has been upgraded or downgraded by brokerage houses. You can use customized screens to search for stocks with certain characteristics. You can track mutual funds of all varieties, compare their records, find the names of their top ten holdings. You can click on to the "briefing book" heading that's attached to the on-line version of *The Wall Street Journal* and *Barron's*, and get a snapshot review of almost any publicly traded company. From there you can access "Zack's" and get a summary of ratings from all the analysts who follow a particular stock.

Again thanks to the Internet, the cost of buying and selling stocks has been drastically reduced for the small investor, the way it was reduced for institutional investors in 1975. On-line trading has pressured traditional brokerage houses to reduce commissions and transaction fees, continuing a trend that began with the birth of the discount broker two decades ago.

You may be wondering what's happened to my investing habits since I left Magellan. Instead of following thousands of companies, now I follow maybe fifty. (I continue to serve on investment committees at various foundations and charitable groups, but in all of these cases we hire portfolio managers and let them pick the stocks.) Trendy investors might think the Lynch family portfolio belongs in the New England Society of Antiquities. It contains some savings-and-loans that I bought at bargain-basement prices during a period when the S&Ls were unappreciated. These stocks have had a terrific run, and I'm still holding on to some of them. (Selling long-term winners subjects you to an IRS bear market—a 20 percent tax on the proceeds.) I also own several growth companies that I've held since the 1980s, and a few since

the 1970s. These businesses continue to prosper, yet the stocks still appear to be reasonably priced. Beyond that, I'm still harboring an ample supply of clunkers that sell for considerably less than the price I paid. I'm not keeping these disappointment companies because I'm stubborn or nostalgic. I'm keeping them because in each of these companies, the finances are in decent shape and there's evidence of better times ahead.

My clunkers remind me of an important point: You don't need to make money on every stock you pick. In my experience, six out of ten winners in a portfolio can produce a satisfying result. Why is this? Your losses are limited to the amount you invest in each stock (it can't go lower than zero), while your gains have no absolute limit. Invest \$1,000 in a clunker and in the worst case, maybe you lose \$1,000. Invest \$1,000 in a high achiever, and you could make \$10,000, \$15,000, \$20,000, and beyond over several years. All you need for a lifetime of successful investing is a few big winners, and the pluses from those will overwhelm the minuses from the stocks that don't work out.

Let me give you an update on two companies I don't own but that I wrote about in this book: Bethlehem Steel and General Electric. Both teach a useful lesson. I mentioned that shares of Bethlehem, an aging blue chip, had been in decline since 1960. A famous old company, it seems, can be just as unrewarding to investors as a shaky start-up. Bethlehem, once a symbol of American global clout, has continued to disappoint. It sold for \$60 in 1958 and by 1989 had dropped to \$17, punishing loyal shareholders as well as bargain hunters who thought they'd found a deal. Since 1989 the price has taken another fall, from \$17 to the low single digits, proving that a cheap stock can always get cheaper. Someday, Bethlehem Steel may rise again. But assuming that will happen is wishing, not investing.

I recommended General Electric on a national TV show (it's been a tenbagger since), but in the book I mention that GE's size (market value \$39 billion; annual profits \$3 billion) would make it difficult for the company to increase those profits at a rapid rate. In fact, the company that brings good things to life has brought more upside to its shareholders than I'd anticipated. Against the odds and under the savvy leadership of Jack Welch, this corporate hulk has broken into a profitable trot. Welch, who recently announced his retirement, prodded GE's numerous divisions into peak performance, using excess

cash to buy new businesses and to buy back shares. GE's triumph in the 1990s shows the importance of keeping up with a company's story.

Buying back shares brings up another important change in the market: the dividend becoming an endangered species. I write about its importance on page 204, but the old method of rewarding shareholders seems to have gone the way of the black-footed ferret. The bad part about the disappearing dividend is that regular checks in the mail gave investors an income stream and also a reason to hold on to stocks during periods when stock prices failed to reward. Yet in 1999 the dividend yield on the five hundred companies in the S&P 500 sank to an all-time low since World War II: near 1 percent.

It's true that interest rates are lower today than they were in 1989, so you'd expect yields on bonds and dividends on stocks to be lower. As stock prices rise, the dividend yield naturally falls. (If a \$50 stock pays a \$5 dividend, it yields 10 percent; when the stock price hits \$100, it yields 5 percent.) Meanwhile companies aren't boosting their dividends the way they once did.

"What is so unusual," observed *The New York Times* (October 7, 1999), "is that the economy is doing so well even while companies are growing more reluctant to raise their dividends." In the not-so-distant past, when a mature, healthy company routinely raised the dividend, it was a sign of prosperity. Cutting a dividend or failing to raise it was a sign of trouble. Lately, healthy companies are skimping on their dividends and using the money to buy back their own shares, à la General Electric. Reducing the supply of shares increases the earnings per share, which eventually rewards shareholders, although they don't reap the reward until they sell.

If anybody's responsible for the disappearing dividend, it's the U.S. government, which taxes corporate profits, then taxes corporate dividends at the full rate, for so-called unearned income. To help their shareholders avoid this double taxation, companies have abandoned the dividend in favor of the buyback strategy, which boosts the stock price. This strategy subjects shareholders to increased capital gains taxes if they sell their shares, but long-term capital gains are taxed at half the rate of ordinary income taxes.

Speaking of long-term gains, in eleven years' worth of luncheon and dinner speeches, I've asked for a show of hands: "How many of you are long-term investors in stocks?" To date, the vote is unanimous—

everybody's a long-term investor, including day traders in the audience who took a couple of hours off. Long-term investing has gotten so popular, it's easier to admit you're a crack addict than to admit you're a short-term investor.

Stock market news has gone from hard to find (in the 1970s and early 1980s), then easy to find (in the late 1980s), then hard to get away from. The financial weather is followed as closely as the real weather: highs, lows, troughs, turbulence, and endless speculation about what's next and how to handle it. People are advised to think long-term, but the constant comment on every gyration puts people on edge and keeps them focused on the short term. It's a challenge not to act on it. If there were a way to avoid the obsession with the latest ups and downs, and check stock prices every six months or so, the way you'd check the oil in a car, investors might be more relaxed.

Nobody believes in long-term investing more passionately than I do, but as with the Golden Rule, it's easier to preach than to practice. Nevertheless, this generation of investors has kept the faith and stayed the course during all the corrections mentioned above. Judging by redemption calls from my old fund, Fidelity Magellan, the customers have been brilliantly complacent. Only a small percentage cashed out in the Saddam Hussein bear market of 1990.

Thanks to the day traders and some of the professional hedge fund managers, shares now change hands at an incredible clip. In 1989, three hundred million shares traded was a hectic session on the New York Stock Exchange; today, three hundred million is a sleepy interlude and eight hundred million is average. Have the day traders given Mr. Market the shakes? Does the brisk commerce in stock indexes have something to do with it? Whatever the cause (I see day traders as a major factor), frequent trading has made the stock markets more volatile. A decade ago stock prices moving up or down more than 1 percent in a single trading session was a rare occurrence. At present we get 1 percent moves several times a month.

By the way, the odds against making a living in the day-trading business are about the same as the odds against making a living at race-tracks, blackjack tables, or video poker. In fact, I think of day trading as at-home casino care. The drawback to the home casino is the paperwork. Make twenty trades per day, and you could end up with 5,000 trades a year, all of which must be recorded, tabulated, and reported to the IRS. So day trading is a casino that supports a lot of accountants.

People who want to know how stocks fared on any given day ask, Where did the Dow close? I'm more interested in how many stocks went up versus how many went down. These so-called advance/decline numbers paint a more realistic picture. Never has this been truer than in the recent exclusive market, where a few stocks advance while the majority languish. Investors who buy "undervalued" small stocks or midsize stocks have been punished for their prudence. People are wondering: How can the S&P 500 be up 20 percent and my stocks are down? The answer is that a few big stocks in the S&P 500 are propping up the averages.

For instance, in 1998 the S&P 500 index was up 28 percent overall, but when you take a closer look, you find out the 50 biggest companies in the index advanced 40 percent, while the other 450 companies hardly budged. In the NASDAQ market, home to the Internet and its supporting cast, the dozen or so biggest companies were huge winners, while the rest of the NASDAQ stocks, lumped together, were losers. The same story was repeated in 1999, where the elite group of winners skewed the averages and propped up the multitude of losers. More than 1,500 stocks traded on the New York Stock Exchange lost money in 1999. This dichotomy is unprecedented. By the way, we tend to think the S&P 500 index is dominated by huge companies, while the NASDAQ is a haven for the smaller fry. By the late 1990s, NASDAQ's giants (Intel, Cisco, and a handful of others) dominated the NASDAQ index more than the S&P 500's giants dominated its index.

One industry that's teeming with small stocks is biotechnology. My high-tech aversion caused me to make fun of the typical biotech enterprise: \$100 million in cash from selling shares, one hundred Ph.D.'s, 99 microscopes, and zero revenues. Recent developments inspire me to put in a good word for biotech—not that amateurs should pick their biotech stocks out of a barrel, but that biotech in general could play the same role in the new century as electronics played in the last. Today a long list of biotechs have revenue, and three dozen or so turn a profit, with another fifty ready to do the same. Amgen has become a genuine biotech blue chip, with earnings of \$1 billion plus. One of the numerous biotech mutual funds might be worth a long-term commitment for part of your money.

Market commentators fill airspace and magazine space with comparisons between today's market and some earlier market, such as "This looks a lot like 1962," or "This reminds me of 1981," or when they're

feeling very gloomy, “We’re facing 1929 all over again.” Lately the prevailing comparison seems to be with the early 1970s, when the smaller stocks faltered while the larger stocks (especially the highly touted “Nifty Fifty”) continued to rise. Then, in the bear market of 1973–74, the Nifty Fifty fell 50–80 percent! This unsettling decline disproved the theory that big companies were bearproof.

If you owned the Nifty Fifty and held on to the lot for twenty-five years (preferably you were stranded on a desert island with no radios, TV sets, or magazines that told you to abandon stocks forever), you’re not unhappy with the results. Though it took them a generation to do it, the Nifty Fifty made a full recovery and then some. By the mid-1990s the Nifty Fifty portfolio had caught up and passed the Dow and the S&P 500 in total return since 1974. Even if you bought them at sky-high prices in 1972, your choice was vindicated.

Once again, we’ve got the fifty largest companies selling for prices that skeptics describe as “too much to pay.” Whether this latter-day Nifty Fifty will suffer a markdown on the order of the 1973–74 fire sale is anybody’s guess. History tells us that corrections (declines of 10 percent or more) occur every couple of years, and bear markets (declines of 20 percent or more) occur every six years. Severe bear markets (declines of 30 percent or more) have materialized five times since the 1929–32 doozie. It’s foolish to bet we’ve seen the last of the bears, which is why it’s important not to buy stocks or stock mutual funds with money you’ll need to spend in the next twelve months to pay college bills, wedding bills, or whatever. You don’t want to be forced to sell in a losing market to raise cash. When you’re a long-term investor, time is on your side.

The long bull market continues to hit occasional potholes. When *One Up* was written, stocks had just recovered from the 1987 crash. The worst fall in fifty years coincided with a Lynch golfing vacation in Ireland. It took nine or ten more trips (we bought a house in Ireland) to convince me that my setting foot on Irish sod wouldn’t trigger another panic. I didn’t feel too comfortable visiting Israel, Indonesia, or India, either. Setting foot in countries that begin with “I” made me nervous. But I made two trips to Israel and two to India and one to Indonesia, and nothing happened.

So far, 1987 hasn’t been repeated, but the bears arrived in 1990, the year I left my job as manager of the Fidelity Magellan Fund. While the 1987 decline scared a lot of people (a 35 percent drop in two days can

do that), to me the 1990 episode was scarier. Why? In 1987 the economy was perking along, and our banks were solvent, so the fundamentals were positive. In 1990 the country was falling into recession, our biggest banks were on the ropes, and we were preparing for war with Iraq. But soon enough the war was won and recession overcome, the banks recovered, and stocks took off on their biggest climb in modern history. More recently we've seen 10 percent declines in the major averages in the spring of 1996, the summers of 1997 and 1998, and the fall of 1999. August of 1998 brought the S&P 500 down 14.5 percent, the second worst month since World War II. Nine months later stocks were off and running again, with the S&P 500 up more than 50 percent!

What's my point in recounting all this? It would be wonderful if we could avoid the setbacks with timely exits, but nobody has figured out how to predict them. Moreover, if you exit stocks and avoid a decline, how can you be certain you'll get back into stocks for the next rally? Here's a telling scenario: If you put \$100,000 in stocks on July 1, 1994, and stayed fully invested for five years, your \$100,000 grew into \$341,722. But if you were out of stocks for just thirty days over that stretch—the thirty days when stocks had their biggest gains—your \$100,000 turned into a disappointing \$153,792. By staying in the market, you more than doubled your reward.

As a very successful investor once said: "The bearish argument always sounds more intelligent." You can find good reasons to scuttle your equities in every morning paper and on every broadcast of the nightly news. When *One Up* became a best-seller, so did Ravi Batra's *The Great Depression of 1990*. The obituary for this bull market has been written countless times going back to its start in 1982. Among the likely causes: Japan's sick economy, our trade deficit with China and the world, the bond market collapse of 1994, the emerging market collapse of 1997, global warming, ozone depletion, deflation, the Gulf war, consumer debt, and the latest, Y2K. The day after New Year's, we discovered that Y2K was the most overrated scare since Godzilla's last movie.

"Stocks are overpriced," has been the bears' rallying cry for several years. To some, stocks looked too expensive in 1989, at Dow 2,600. To others, they looked extravagant in 1992, above Dow 3,000. A chorus of naysayers surfaced in 1995, above Dow 4,000. Someday we'll see another severe bear market, but even a brutal 40 percent sell-off would leave prices far above the point at which various pundits called for in-

vestors to abandon their portfolios. As I've noted on prior occasions: "That's not to say there's no such thing as an overvalued market, but there's no point worrying about it."

It's often said a bull market must scale a wall of worry, and the worries never cease. Lately we've worried our way through various catastrophic "unthinkables": World War III, biological Armageddon, rogue nukes, the melting of the polar ice caps, a meteor crashing into the earth, and so on. Meanwhile we've witnessed several beneficial "unthinkables": communism falls; federal and state governments in the United States run budget surpluses; America creates seventeen million new jobs in the 1990s, more than making up for the highly publicized "downsizing" of big companies. The downsizing caused disruption and heartache to the recipients of the pink slips, but it also freed up millions of workers to move into exciting and productive jobs in fast-growing small companies.

This astounding job creation doesn't get the attention it deserves. America has the lowest unemployment rate of the past half century, while Europe continues to suffer from widespread idleness. Big European companies also have downsized, but Europe lacks the small businesses to take up the slack. They have a higher savings rate than we do, their citizens are well educated, yet their unemployment rate is more than twice the U.S. rate. Here's another astounding development: Fewer people were employed in Europe at the end of 1999 than were employed at the end of the prior decade.

The basic story remains simple and never-ending. Stocks aren't lottery tickets. There's a company attached to every share. Companies do better or they do worse. If a company does worse than before, its stock will fall. If a company does better, its stock will rise. If you own good companies that continue to increase their earnings, you'll do well. Corporate profits are up fifty-five-fold since World War II, and the stock market is up sixtyfold. Four wars, nine recessions, eight presidents, and one impeachment didn't change that.

In the following table, you'll find the names of 20 companies that made the top 100 list of winners in the U.S. stock market in the 1990s. The number in the left-hand column shows where each of these companies ranked in total return on the investor's dollar. Many high-tech enterprises (the likes of Helix, Photronics, Siliconix, Theragenics) that cracked the top 100 are omitted here, because I wanted to showcase the opportunities that the average person could have noticed, re-

searched, and taken advantage of. Dell Computer was the biggest winner of all, and who hasn't heard of Dell? Anybody could have noticed Dell's strong sales and the growing popularity of its product. People who bought shares early were rewarded with an amazing 889-bagger: \$10,000 invested in Dell from the outset generated an \$8.9 million fortune. You didn't have to understand computers to see the promise in Dell, Microsoft, or Intel (every new machine came with an "Intel Inside" sticker). You didn't have to be a genetic engineer to realize that Amgen had transformed itself from a research lab into a pharmaceutical manufacturer with two best-selling drugs.

Schwab? His success was hard to miss. Home Depot? It continued to grow at a rapid clip, making the top 100 list for the second decade in a row. Harley Davidson? All those lawyers, doctors, and dentists becoming weekend Easy Riders was great news for Harley. Lowe's? Home Depot all over again. Who would have predicted two monster stocks from the same mundane business? Paychex? Small businesses everywhere were curing a headache by letting Paychex handle their payroll. My wife, Carolyn, used Paychex in our family foundation work, and I missed the clue and missed the stock.

Some of the best gains of the decade (as has been the case in prior decades) came from old-fashioned retailing. The Gap, Best Buy, Staples, Dollar General—these were all megabaggers and well-managed companies that millions of shoppers experienced firsthand. That two small banks appear on this list shows once again that big winners can come from any industry—even a stodgy slow-growth industry like banking. My advice for the next decade: Keep on the lookout for tomorrow's big baggers. You're likely to find one.

—Peter Lynch with John Rothchild

TWENTY BIG WINNERS IN U.S. STOCKS IN THE 1990s*

RANK BY STOCK PERFORMANCE	SYMBOL	COMPANY	BUSINESS	\$10,000 INVESTED AT YEAR END 1989 PRODUCED THESE RETURNS BY YEAR END 1999
(1)	DELL	Dell Computer	Computer Manufacturer	\$8.9 million
(6)	CCU	Clear Channel Comm.	Radio Stations	\$8.1 million
(9)	BBY	Best Buy	Retailer	\$995,000
(10)	MSFT	Microsoft	Technology	\$960,000
(13)	SCH	Charles Schwab	Discount Broker	\$827,000
(14)	NBTY	NBTY	Vitamins, Food Supplements	\$782,000
(20)	WCOM	MCI Worldcom	Communications	\$694,000
(21)	AMGN	Amgen	Biotechnology	\$576,000
(30)	PPD	Prepaid Legal Services	Attorney Services	\$416,000
(33)	INTC	Intel	Computer Chips	\$372,000
(34)	HD	Home Depot	Building Supplies	\$370,000
(40)	PAYX	Paychex	Payroll Services	\$340,000
(46)	DG	Dollar General	Discount Retailer	\$270,000
(49)	HDI	Harley Davidson	Motorcycles	\$251,000
(52)	GPS	Gap	Retail Clothing	\$232,000
(69)	SPLS	Staples	Office Supplies	\$186,000
(75)	WBPR	Westernbank/Puerto Rico	Banking	\$170,000
(77)	MDT	Medtronic	Medical Supplies	\$168,000
(82)	ZION	Zion's Bancorp	Banking	\$161,000
(87)	LOW	Lowe's Companies	Building Supplies	\$152,000

*This list does not include companies that were acquired by other companies.
 Source: Ned Davis Research

Prologue:

A Note from Ireland

You can't bring up the stock market these days without 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 leg-

endary 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.