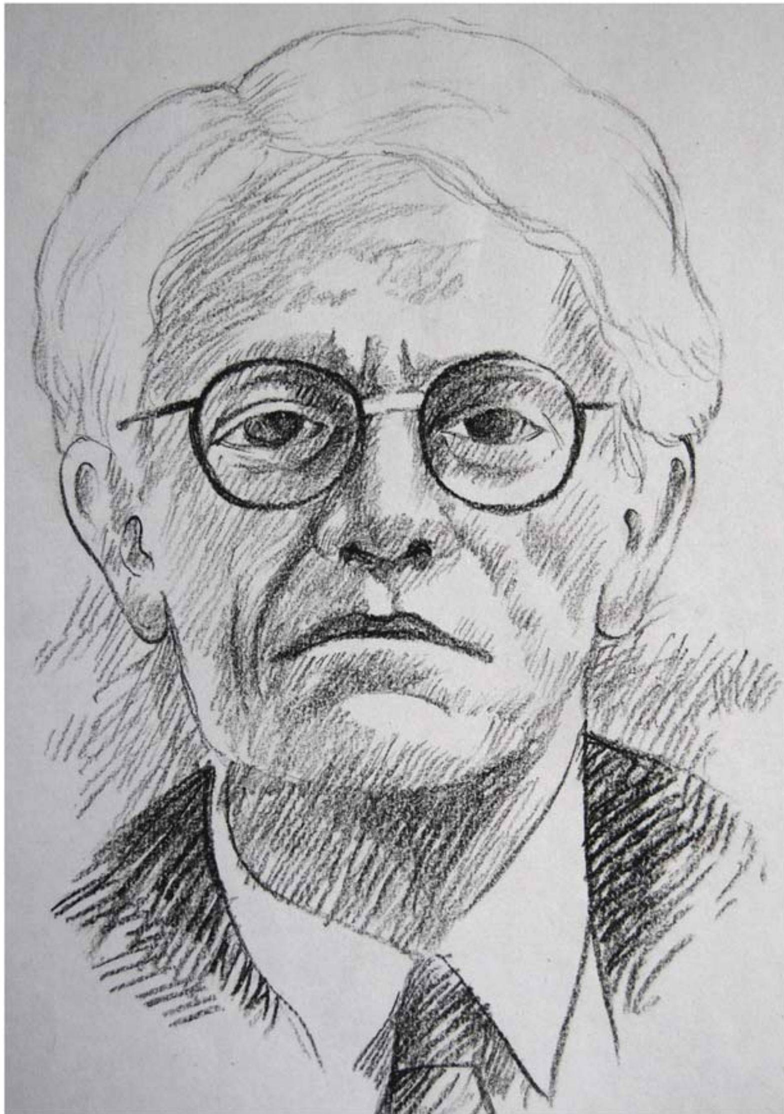
Peter Lynch



A return of 28 times in 13 years. That defines Peter Lynch's achievement as the portfolio manager of the Fidelity Magellan Fund between 1977 and 1990. In India, he is known for his two very popular books on investing: *One Up on Wall Street* and *Beating the Street*

Invest in only what you know

Peter Lynch firmly believed that individual investors had advantages over professionals when it came to research, because unlike the latter, individuals had more freedom to act independently and explore the market without being tied down by committees and superiors.

According to him this flexibility to act gives small investors an edge as they have a better ability and potential of discovering profitable investments. He encourages the adoption of the bottom-up approach to discover good investment opportunities. He suggests digging up possible investment options one-by-one, then getting familiar with the company and lastly conducting the fundamental analysis to verify growth and profitability potential.

'Local knowledge' is what Lynch preached and claimed as the key element to successful investment. His well-known investment principle of 'Invest in what you know' is still deemed as being one of the most essential lessons for any serious investor. What he adopted was a 'story' approach to investment. He believed the more one knew about the company, its business, its products, and its competitors, the more chances there were of finding a good 'story' which had high possibilities of coming true.

Never invest in any idea you can't illustrate with a crayon, and remember, you can't see the future through a rear-view mirror

Additionally, he also considered small or emerging companies as good investments as they have higher growth prospects than more mature companies. However, Lynch stressed strongly that having a good company is not enough, you have to research the fundamentals, and look at the valuation. He presented six types of possible 'stories' for companies that are part of the filter he used to invest.

The Lynch filter

1 Slow Growers: These are large and mature companies not expected to grow faster than the economy but at the same time are regular dividend payers. These are not the type of stocks that Lynch liked.

2 Stalwarts: These are large companies that are still compounding their earnings by at least 13-12 per cent. These firms provide downward protection in bad markets.

3 Fast-Growers: These are smaller, more aggressive companies with annual earnings growth of 20 per cent to 25 per cent a year. This category was Lynch's favourite and he bet the biggest gains could be made of these types of stocks but they also carry along considerable risk.

4 Cyclicals: These we know; steel, cement, aluminium, etc in which there is no end to ups and downs

5 No growers: Or Turnarounds, are stocks that promise to turnaround in a year or two but those that still take time.

6 Asset opportunities: Companies that are essentially what we call asset plays – with assets that outweigh their market capitalisation.

Timeless principles

Invest in what you know. An individual investor is more capable of making money from stocks than a fund manager, because they are able to spot good investments in their day-to-day lives before Wall Street. Since most people tend to become expert in certain fields, applying this basic principle helps individual investors find good undervalued stocks.