One up on Wall Street by Peter Lynch (1989)

Buy asset-rich companies at fifty cents on the dollar and then wait for the market place to pay full amount. The size of a company can be reached by multiplying the stock price by the number of outstanding shares. The bigger the company, the more energy it takes to move it. Small companies have bigger moves. The average stock price fluctuates 50% within an average year. The 16-month recession between July ’81 & Nov ’82 we had 14% unemployment, 15% inflation & 20% prime rate.

L’eggs & Pampers were the two top products of the ‘70’s. Here are 6 stock categories: slow growers (2-4% growth plus dividends like utilities), medium growers (10-15% growth like Kelloggs), fast growers (20-25% growth like Wal-Mart), cyclicals (sales regularly rise & fall like autos), asset plays (like land-rich railroads) & turnarounds (like Chrysler in ’83). Spin-offs have strong balance sheets. Buying back shares is the simplest & best way a company can reward its investors (less stocks increase EPS & stock price). Obviously selling more shares dilutes the existing shares.

Avoid the “hot” stocks everyone is talking about (that’s when they usually peak). The p/e ratio can be thought of as the number of years it will take the company to earn back the amount of your initial investment. The average p/e for a utility company is about 7-9 and a fast grower can average 14-20. Avoid p/e’s higher than that since they are over-priced. Low interest rates and bull markets push p/e ratios up. Hotels save money by eliminating the conference rooms and restaurant. Read the annual reports in a few minutes by concentrating on the balance sheet (increasing assets & reducing debt). Divide the cash assets by the # of shares.

A great new product won’t affect a big company, but watch what it can do for a small one. A p/e ratio that’s half the growth rate (earnings) is positive and one that’s twice the growth rate is negative (add dividend to the growth rate). Banks generally have a p/e of 10. The debt:equity ratio should be < 3:1. Younger companies are more at risk since they have higher debt. Funded (bonds) debt is better than bank debt (which can be called in on demand). The more cash that builds up in the treasury, the greater the pressure to piss it away.

During a down turn, people love blue chip companies with regular dividends. 10:1 stock price to cash flow ratio or better is good. Inventory build-up is bad for manufacturers and retailers. In a debt pay-off, banks get paid 1st, then bonds, and stock holders get what’s left. Buy stocks of strong companies and hold until the fundamentals fall apart. He is suspicious of companies with 50-100% growth rate. He looks for a good company Wall Street hasn’t found and preferably one in a non-growth industry. Aim for a 12-15% return. Diversify with 30-40% growth, 10-20 stalwarts, 10-20 cyclical & the rest in turnarounds.

He doesn’t like “stop orders” since the market is so volatile. Stock prices tend to drop in Nov-Dec (year end tax selling) and rebound in Jan. He has never bought a future or option (80-95% of amateurs lose). He & Warren Buffett think they should be outlawed. He doesn’t like to see a company that spends lavishly on corporate offices.

<u>Books:</u> Beating the Street (Peter Lynch)
<u>Quotes:</u> “Things are more like they are now than they ever were before.” (Pres Eisenhower)