

# Betting on the Market

## PROS Peter Lynch

**Lynch ran Fidelity's Magellan Fund for thirteen years (1977-1990). In that period, Magellan was up over 2700%. He retired in 1990 at the age of 46.**

**Q How did you first get interested in the stock market.**

**A** Well, I grew up in the 1950s. I started caddying when I was 11. So the would have been 1955 and in that part -- the '50s were a great decade for the stock market. I caddied a very nice club out in west Newton, had a lot of people, corporate executives, and some of these were buying stocks and I remember them talking about stocks and they mentioned the names and I'd look in the paper and look at it a month later, a year later, and I noticed they were goin' up. And I said, "Gee, this makes a lot of sense." And so I watched it. I didn't have any money to invest, but I remember the stock market being very strong in the 1950s and some people, not everybody, but a lot of people on the golf course talking about it.



**Q What was your first stock?**

**A** Well, when I got a caddie scholarship to college. It was actually a partial scholarship, a Frances Wimen Scholarship, a financial aid scholarship, but it was thousand dollars to go to Boston College and they gave me a \$300 scholarship and I got to earn over \$700 a year caddying. So I was able to build up a little bit of money and I worked also during the winters. So while I was in college I did a little study on the freight industry, the air freight industry. And I looked at this company called Flying Tiger. And I actually put a thousand dollars in it and I remember I thought this air cargo was going to be a thing of the future. And I bought it and it got really lucky because it went up for another reason. The Vietnam War started and they basically hauled a lot of troops to Vietnam in airplanes and the stock went up, I think, nine- or ten-fold and I had my first ten bagger. I started selling it, I think, at 20 and 30 and 40, sold all the way up to 80 and helped pay for graduate school. So I almost had a Flying Tiger graduate school fellowship.

**Q You originated the expression "four bagger", "five bagger" et cetera. What's that mean exactly?**

**A** I've always been a great lover of baseball. I mean if you grew up in Boston, you know that the last time we won the World Series, Babe Ruth pitched for us. It was 1918. So it's been a long drought here. So I've always loved baseball and the ten bagger is two home-runs and a double. It's you run around a lot, so it's very exciting.

**A** You made ten times your money. Is a ten bagger.

**Q That's pretty good.**

**A** Excellent. You don't need a lot in your lifetime. You only need a few good stocks in your lifetime. I mean how many times do you need a stock to go up ten-fold to make a lot of money? Not a lot.

**Q Was that your secret?**

**A** Well, I think the secret is if you have a lot of stocks, some will do mediocre, some will do okay, and if one of two of 'em go up big time, you produce a fabulous result. And I think that's the promise to some people. Some stocks go up 20-30 percent and they get rid of it and they hold onto the dogs. And it's sort of like watering the weeds and cutting out the flowers. You want to let the winners run. When the fun ones get better, add to 'em, and that one winner, you basically see a few stocks in your lifetime, that's all you need. I mean stocks are out there. When I ran Magellan, I wrote a book. I think I listed over a hundred stocks that went up over ten-fold when I ran Magellan and I owned thousands of stocks. I owned none of these stocks. I missed every one of these stocks that went up over ten-fold. I didn't own a share of them. And I still managed to do well with Magellan. So there's lots of stocks out there and all you need is a few of 'em. So that's been my philosophy. You have to let the big ones make up for your mistakes.

In this business if you're good, you're right six times out of ten. You're never going to be right nine times out of ten. This is not like pure science where you go, "Aha" and you've got the answer. By the time you've got "Aha," Chrysler's already quadrupled or Boeing's quadrupled. You have to take a little bit of risk.

**Q When you first went to Fidelity, what was the market like?**

**A** Well, after the great rush of the '50s, the market did brilliantly and everybody says, "Wow, looking backwards, this would be a great time to get in." So a lot of people got in in the early '60s and in the mid-60s. The market peaked in '65-66 around a thousand, and that's when I came. I was a summer student at Fidelity in 1966. There were 75 applicants for three jobs at Fidelity, but I caddied for the president for eight years. So that was the only job interview I ever took. It was sort of a rigged deal, I think. I worked there the summer of '66 and I remember the market was close to a thousand in 1966, and in 1982, 16 years later, it was 777. So we had a long drought after that. So the people were concerned about the stock market early in the '50s. They kept watching and watching, not investing. It started to go up dramatically and they finally caved in and bought big time in the mid-60s and got the peak.

**Q So people got in at the wrong time, in effect?**

**A** A lot of people got in at the wrong time. A lot of people did very well and some people said, "This is it. I'll never get back in again." And they maybe meant it, but they probably got back in again anyway.

**Q How much did you make on your first job at Fidelity?**

**A** I was paid, \$16,000 a year. I was an analyst. I was the textile analyst, the metals analysts, and I remember the

second year I got a raise to \$17,000. That was great, you know.

**Q Did you get other job offers?**

**A** I was in ROTC studies, I spent two years in the Army and I did two years of graduate school and in, a business at Wharton School of Finance, University of Pennsylvania. So I was about 25 when I joined Fidelity.

**Q How old were you when you took over Magellan?**

**A** That was 1977, so I guess I was 33.

**Q What kind of fund was Magellan?**

**A** It was a small aggressive capital appreciation fund. Magellan Fund basically started in the early '60s. In the name, it was an international fund, but right after it started in 1963, they put sort of a barrier and a heavy tax on foreign investing. So it did very little foreign investing. It had the ability to do it, but there was very little interest then. There was a big penalty. So even though it was Magellan Fund, it was primarily a domestic fund. And when I took over in May of 1977, the fund was \$20 million.

**Q And that was your first portfolio managing job?**

**A** That's correct. I was director research in 1974. I still continued to be an analyst, and then May of 1977 I took over Magellan Fund.

**Q But the market really didn't do much between '77 and '82, between the beginning of that bull market, and yet your fund performed quite spectacularly. What do you do?**

**A** Well, I think flexibility is one of the key things. I mean I would buy companies that had unions. I would buy companies that were in the steel industry. I'd buy textile companies. I always thought there was good opportunities everywhere and, researched my stocks myself. I mean Taco Bell was one of my first stock I bought. I mean the people wouldn't look at a small restaurant company. So I think it was just looking at different companies and I always thought if you looked at ten companies, you'd find one that's interesting, if you'd look at 20, you'd find two, or if you look at hundred you'll find ten. The person that turns over the most rocks wins the game. And that's always been my philosophy.

**Q How did Magellan begin to make a name for itself in '82?**

**A** Well, the first three years I ran Magellan, I think one-third of the shares were redeemed. I mean there was very little interest. People didn't care. The market was doing okay and Magellan was doing well, but people were sort of recovering from their losses, so they from the '50s and '60s, and so literally one-third of the shares were redeemed the

first three years I ran it. And in 1982, the market started to pick up. It bought 'em in August of '82, and from then on a lot of interest came back in the market in '83 and '84. Magellan had the best five-year record in 1982 and the best five-year record in 1983 and people tend to look, the press and the media and the newspapers, tend to look at who's had a good record and Magellan was there.

**Q Tell about the first time you were on Ruckeyser.**

**A** Well, 1982, I think it was the market had just gone over a thousand maybe a week or two before that. So this would have been, I think, October of '82 and Chrysler was my biggest position and the stock, I think, was 10 and I recommended Chrysler and I remember I had, ah -- I had people who said, "Gee, we thought you were interesting." These were relatives of mine. "But how could you ever recommend Chrysler? Don't you know they're going bankrupt?" I remember friends of mine and relatives saying, "That sound crazy to me." So it worked out fine.

And amazing, I think I was on "Wall Street with Louis Ruckheyser" in 1990 and Chrysler was 10 again. It had a stock split that had gone all the way down to 10 and I recommended it again in October of 1990 on "Wall Street with Louis Ruckeyser".

**Q Chart the growth of the fund in the '80s, just for chronology.**

**A** Well, the fund was not very big in 1982, even though I had ran it for five years. And in '80-- end of '82 when the market really started to come in and people started to look to the future, I think it was April of '83 it passed one billion. That was a big number. I remember that number has a lot of zeros and it's kind of a magic number. So I remember that point and people just continued to be interested in the market and these were lots of individuals coming. This was not people putting in four million at the time or three million. It was lots of two-, and three- and five-thousand-investments coming in. And it was steady. It wasn't a torrent. It just was there every day.

**Q Was it becoming more famous? Wasn't it on "Jeopardy", for instance?**

**A** Yeah. At some point in time I remember -- I didn't watch the show. I always liked "Jeopardy", but I remember my wife watched the show and somebody was saying "What's the fund that was named after an explorer." And all the people, they all hit the button at the same time on "Jeopardy" and they knew it was Magellan. So, I guess it became more famous then, but there wasn't that much coverage. I mean today I think The Wall Street Journal has three full-time reporters covering the mutual fund industry. They had none in the early '80s. So the coverage was really basically Wall Street, Louis Ruckheyser, Barron's, a little bit in The New York Times every quarter. There was not coverage of the mutual fund industry. It was really coverage of stocks. And, you know, occasionally, ah, Forbes or Fortune or a periodical would write an article, but there wasn't very much interest even in the '80s.

**Q What caused that to change?**

**A** Well, I think the great decade of the '80s and people thinking that, you know, "There's a lot of publicity on the Social Security System not gonna make it," and a lot of pension plans. I mean people used to retire and they'd say, "Right now I'm going to get half my last year's salary for the rest of my life, or 60 percent. I don't have to worry about it."

Now a lot of people are given their entire pension plan, the most important financial asset they ever got, and they said, "Okay, sweetheart, it's yours. Take care of it." Or there's no pension plan. So today people have to think about their future. They're worried about Social Security and they may have to do their own pension or they already have been given their pension and say, "You manage it." So I think there's -- you have to become finally literate today.

**Q Was your success part of reason why the press, et cetera, began to look at mutual funds more carefully?**

**A** Well, I think the fact the fund went up, I mean that was the key. If I'd had gone down, I'd have had to dye my hair and grow a beard and move to Fiji. It was just the fact it went up, people made a lot of money and there was a lot of word-of-mouth. I mean it was people saying that "Investing is good," and "We should put some of our money aside and put so much in quarterly." And I think the IRA was invented and there was a lot of things that were to encourage people to save.

**Q If had put a thousand dollars in Magellan on the day you took it over, how much would I have reaped on the day you retired?**

**A** Well, if somebody invested a thousand dollars in Magellan on May 31st, 1977, the day I left, the thousand would have been \$28,000, --May 31st 13 years later, 1990.

**Q Talk about the change in '86-87.**

**A** Well, I remember in my career you'd say to somebody you worked in the investment business. They'd say, "That's interesting. Do you sail? What do you think of the Celtics?" I mean it would just go right to the next subject. If you told them you were a prison guard, they would have been interested. They would have had some interest in that subject, but if you said you were in the investment business, they said, "Oh, terrific. Do your children go to school?" It just went right to the next subject. You could have been a leper, you know, and been much more interesting. So that was sort of the attitude in the '60s and '70s.

As the market started to heat up, you'd say you were an investor, "Oh, that's interesting. Are there any stocks you're buying?" And then people would listen not avidly. They'd think about it. But then as the '80s piled on, they started writing things down. So I remember people would really take an interest if you were in the investment business, saying "What do you like?" And then it turned and I remember the final page of the chapter would be you'd be at a party and everybody would be talking about stocks. And then people would recommend stocks to me. And then I remember not only that, but the stocks would go up. I'd look in the paper and I'd notice they'd go up in the next three months. And then you've done the full cycle of the speculative cycle that people hate stocks, they despised, they don't want to hear anything about 'em, now they're buying everything and cab drivers are recommending stocks. So that was sort of the cycle I remember going through from the '60s and early '70s all the way to '87.

**Q Where were you when the Crash of '87 came?**

**A** Well, I was very well prepared for the Crash of 1987. -- my wife and I took our first vacation in eight years and we left on Thursday in October and I think that day the market went down 55 points and we went to Ireland, the first

trip we'd ever been there. And then on Friday, because of the time difference, we'd almost completed the day and I called and the market was down 115. I said to Carolyn, "If the market goes down on Monday, we'd better go home." And "We're already here for the weekend. So we'll spend the weekend." So it went down 508 on Monday, so I went home. So in two business days I had lost a third of my fund. So I figured at that rate, the week would have been a rough week. So I went home. Like I could do something about it. I mean it's like, you know, if there was something I could do. I mean there I was -- but I think if people called up and they said, "What's Lynch doing," and they said, "Well, he's on the eighth hole and he's every par so far, but he's in a trap, this could be a triple bogey," I mean I think that's not what they wanted to hear. I think they wanted to hear I'd be there lookin' over -- I mean there's not a lot you can do when the market's in a cascade but I got home quick as I could.

### **Q Why did the Crash of '87 happen?**

**A** Well, I think people had not analyzed '87 very well. I think you really have to put it in perspective. 1982, the market's 777. It's all the way to '86. You have the move to 1700. In four years -- the market moves from 777 to 1700 in four years. Then in nine months it puts on a thousand points. So it puts on a thousand points in four years, then puts on another thousand points in the next nine months. So in August of 1987 it's 2700. It's gone up a thousand points in nine months. Then it falls a thousand points in two months, 500 points the last day. So if the market got sideways at 1700, no one would have worried, but it went up a thousand in nine-ten months and then a thousand in two months, and half of it in one day, you would have said.... "The world's over." It was the same price. So it was really a question of the market just kept going up and up and it just went to such an incredible high price by historic, price earnings multiple load, dividend yields, all the other statistics, but people forget that basically it was unchanged in 12 months. If you looked at September, 1986 to October '87, the market was unchanged. It had a thousand point up and a thousand points down and they only remember the down. They thought, "Oh, my goodness, this is the crash. It's all over. It's going to go to 200 and I'm going to selling apples and pencils," you know. But it wasn't. It was a very unique phenomenon because companies were doing fine. Just, you know, you'd call up a company and say, "We can't figure it out. We're doin' well. Our orders are good. Our balance sheet's good." "We just announced we're gonna buy some of our stock. We can't figure out why it's good down so much."

### **Q Was that the most scared you ever were in your career?**

**A** '87 wasn't that scary because I concentrate on fundamentals. I call up companies. I look at their balance sheet. I look at their business. I look at the environment. The decline was kinda scary and you'd tell yourself, "Will this infect the basic consumer? Will this drop make people stop buying cars, stop buying houses, stop buying appliances, stop going to restaurants?" And you worried about that.

The reality, the '87 decline was nothing like 1990. Ninety, in my 30 years of watching stock very carefully, was by far the scariest period.

### **Q What was so scary about 1990?**

**A** Well, 1990 was a situation where I think it's almost exactly six years ago approximately now. In the summer of 1990, the market's around 3000. Economy's doing okay. And Saddam Hussein decides to walk in and invade Kuwait. So we have invasion of Kuwait and President Bush sends 500,000 troops to Saudi to protect Saudi Arabia. There's a very big concern about, you know, "Are we going to have another Vietnam War?" A lot of serious military

people said, "This is going to be a terrible war." Iraq has the fourth largest army in the world. They really fought very well against Iran. These people are tough. This is going to be a long, awful thing. So people were very concerned about that, but, in addition, we had a very major banking crisis. All the major New York City banks, Bank America, the real cornerstone of this country were really in trouble. And this is a lot different than if W.T. Grant went under or Penn Central went under. Banking is really tight. And you had to hope that the banking system would hold together and that the Federal Reserve understood that Citicorp, Chase, Chemical, Manufacturers Hanover, Bank of America were very important to this country and that they would survive. And then we had a recession. Unlike '87 you called companies, in 1990 you called companies and say, "Gee, our business is startin' to slip. Inventories are startin' to pile up. We're not doing that well." So you really at that point in time had to believe the whole thing would hold together, that we wouldn't have a major war. You really had to have faith in the future of this country in 1990. In '87, the fundamentals were terrific and it was -- it was like one of those three for two sales at the K-Mart. Things were marked down. It was the same story.

**Q Is there so much pressure because you're handling so much money for other people?**

**A** It wasn't the pressure. I loved the job. I mean I worked for the best company in the world. I get paid extremely well. We had free coffee. I mean it's a great place to work. I could see any company I wanted to see. I didn't have to, say, get permission to go visit companies in California or Indiana. I just -- lot of freedom, a lot of responsibility. The pressure wasn't it. It was just too much time. I was working six days a week and that wasn't even enough.

**Q Were you surprised by the outpouring in the wake of your retirement?**

**A** I was really shocked at people's response and all the networks and news overseas and all around the world that it was such a big deal. I mean I was amazed by it. I could write five letters a day for the next seven years to get back to the people that wrote thanking me or wishing me the best and literally maybe my secretary screened me from the nasty ones, but I don't remember anybody saying, "You god. I just got in yesterday and you left." I mean there were all these very nice notes saying, "You're doing the right thing. I'm very happy about it," and ...

**Q Tell the story about your wife stumbling on a big stock for you in the supermarket.**

**A** I had a great luck company called Hanes. They test marketed a product called L'Eggs in Boston and I think in Columbus, Ohio, maybe three or four markets. And Carolyn, ah, brought this product home and she was buying and she said, "It's great." And she almost got a black belt in shopping. She's a very good shopper. If we hadn't had these three kids, she now -- when Beth finally goes off to college, I think we'll be able to resume her training. But she's a very good shopper and she would buy these things. She said, "They're really great." And I did a little bit of research. I found out the average woman goes to the supermarket or a drugstore once a week. And they go to a woman's specialty store or department store once every six weeks. And all the good hosiery, all the good pantyhose is being sold in department stores. They were selling junk in the supermarkets. They were selling junk in the drugstores. So this company came up with a product. They rack-jobbed it, they had all the sizes, all the fits, a down they never advertised price. They just advertised "This fits. You'll enjoy it." And it was a huge success and it became my biggest position and I always worried somebody'd come out with a competitive product, and about a year-and-a-half they were on the market another large company called Kaiser-Roth came out with a product called No Nonsense. They put it right next to L'eggs in the supermarket, right next to L'eggs in the drugstore. I said, "Wow, I gotta figure this one out." So I remember buying -- I bought 48 different pairs at the supermarket, colors, shapes, and sizes. They must have wondered what kind of house I

had at home when I got to the register. They just let me buy it. So I brought it into the office. I gave it to everybody. I said, "Try this out and come back and see what's the story with No Nonsense." And people came back to me in a couple weeks and said, "It's not as good." That's what fundamental research is. So I held onto Hanes and it was a huge stock and it was bought out by Consolidated Foods, which is now called Sara Lee, and it's been a great division of that company. It might have been a thirty bagger instead of a ten bagger, if it hadn't been bought out.

**Q The beginning of the bull market in 1982 and the environment. Were you surprised?**

**A** 1982 was a very scary period for this country. We've had nine recessions since World War II. This was the worst. 14 percent inflation. We had a 20 percent prime rate, 15 percent long governments. It was ugly. And the economy was really much in a free-fall and people were really worried, "Is this it? Has the American economy had it? Are we going to be able to control inflation?" I mean there was a lot of very uncertain times. You had to say to yourself, "I believe it in. I believe in stocks. I believe in companies. I believe they can control this. And this is an anomaly. Double-digit inflation is rare thing. Doesn't happen very often. And, in fact, one of my shareholders wrote me and said, "Do you realize that over half the companies in your portfolio are losing money right now?" I looked up, he was right, or she was right. But I was ready. I mean I said, "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." And it came out and once we came back, the market went north.

**Q Nobody told you it was coming.**

**A** It's lovely to know when there's recession. I don't remember anybody predicting 1982 we're going to have 14 percent inflation, 12 percent unemployment, a 20 percent prime rate, you know, the worst recession since the Depression. I don't remember any of that being predicted. It just happened. It was there. It was ugly. And I don't remember anybody telling me about it. So I don't worry about any of that stuff. I've always said if you spend 13 minutes a year on economics, you've wasted 10 minutes.

**Q So what should people think about?**

**A** Well, they should think about what's happening. I'm talking about economics as forecasting the future. If you own auto stocks you ought to be very interested in used car prices. If you own aluminum companies you ought to be interested in what's happened to inventories of aluminum. If your stock are hotels, you ought to be interested in how many people are building hotels. These are facts. People talk about what's going to happen in the future, that the average recession last .2 years or who knows? There's no reason why we can't have an average economic expansion that lasts longer. I mean I deal in facts, not forecasting the future. That's crystal ball stuff. That doesn't work. Futile.

**Q Talk about going from one to five to ten billion and whether people thought it was getting too big.**

**A** Sure. I certainly remember when Magellan passed the billion. I remember it was sometime in 1983 and then remember I think in '84, I don't remember exactly when it became the largest fund in the country, and people said, "Magellan's too big at a billion to get in, to get out. It's hopeless. Leave." And then when it became a largest fund, "It's obviously too big now." And then it got to five billion, they said, "Forget it." When it got to ten billion, they said, "Forget

it." And I'd always say, "If I could beat the market by three or four percent a year I'm really doing a service to the public." And then after I left, they said, "The fund's too big. Forget it." And, ah, Magellan's done extremely well in the six years since I left it. It's beaten the market. It's beaten 80 percent of all funds. So I mean I hope they keep warning people to stay away from it. It's been a terrific thing for it.

**Q Can the little guy play with the big guy in the stock market?**

**A** There's always been this position that the small investor has no chance against the big institutions. And I always wonder whether that's the person under four-foot-eight. I mean they always said the small investor doesn't have a chance. And there's two issues there. First of all, I think that he or she can do it, but, number two, the question is, people do it anyway. They invest anyway. And if they so believe this theory that the small investor has no chance, they invest in a different format. They said, "This is a casino. I'll buy stock this month. I'll sell it a month later," same kind of performance that they do everywhere. When they look at a house, they're very careful. They look at the school system. They look at the street. They look at the plumbing. When they buy a refrigerator, they do homework. If they're so convinced that the small investor has no chance, the stock market's a big game and they act accordingly, they hear a stock and they buy it before sunset, they're going to get the kind of results that prove the small investor can do poorly. Now if you buy a -- you make a mistake on a car, you make a mistake on a house, you don't blame the professional investors. But now if you do stupid research, you buy some company that has no sales, no earnings, a terrible financial position and it goes down, you say, "Well, it because of the programmed trading of those professionals," that's because you didn't do your homework. So I -- I've tried to convince people they can do a job, they can do very well, but they have to do certain things.

**Q Wouldn't one of those things be letting you do it for them?**

**A** Well, the small investor can do three things. They can avoid the market entirely. They can just say, ah, "I can't stand it. It's too volatile for me. I'll just put my money in money market funds or put my money in the bank." That's one choice. The other choice is they can invest directly in the stock market by buying stocks individually, or they can buy mutual funds and invest in stock. I think they can do the course of investing in mutual funds and every now and then, they find some stocks, they have a chance the make a big hit. I think the average person could know three or four or five companies very well. They could lecture on those three or four or five companies, and if one or two of 'em becomes attractive, they buy 'em. They just can't wake up in the morning and say, "Now's the time to buy this. Now's the time to buy IBM. Now's the time to buy GE. Now's the time to buy Dow Chemical. Now's the time to buy some biotechnology company," if they don't know something about it. You have to know the story. And people have lots of edges and they throw them away.

**Q Talk about market timing.**

**A** The market itself is very volatile. We've had 95 years completed this century. We're in the middle of 1996 and we're close to a 10 percent decline. In the 95 years so far, we've had 53 declines in the market of 10 percent or more. Not 53 down years. The market might have been up 26 finished the year up four, and had a 10 percent correction. So we've had 53 declines in 95 years. That's once every two years. Of the 53, 15 of the 53 have been 25 percent or more. That's a bear market. So 15 in 95 years, about once every six years you're going to have a big decline. Now no one seems to know when there are gonna happen. At least if they know about 'em, they're not telling anybody about 'em. I don't remember anybody predicting the market right more than once, and they predict a lot. So they're gonna happen. If

you're in the market, you have to know there's going to be declines. And they're going to cap and every couple of years you're going to get a 10 percent correction. That's a euphemism for losing a lot of money rapidly. That's what a "correction" is called. And a bear market is 20-25-30 percent decline. They're gonna happen. When they're gonna start, no one knows. If you're not ready for that, you shouldn't be in the stock market. I mean stomach is the key organ here. It's not the brain. Do you have the stomach for these kind of declines? And what's your timing like? Is your horizon one year? Is your horizon ten years or 20 years? If you've been lucky enough to save up lots of money and you're about to send one kid to college and your child's starting a year from now, you decide to invest in stocks directly or with a mutual fund with a one-year horizon or a two-year horizon, that's silly. That's just like betting on red or black at the casino. What the market's going to do in one or two years, you don't know. Time is on your side in the stock market. It's on your side. And when stocks go down, if you've got the money, you don't worry about it and you're putting more in, you shouldn't worry about it. You should worry what are stocks going to be 10 years from now, 20 years from now, 30 years from now. I'm very confident.

**Q If you had invested in '66, it would have taken 15 years to make the money back.**

**A** Well, from '66 to 1982, the market basically was flat. But you still had dividends in stocks. You still had a positive return. You made a few percent a year. That was the worst period other than the 1920s, in this century. So companies still pay dividends, even though if their stock goes sideways for ten years, they continue to pay you dividends, they continue to raise their dividends. So you have to say to yourself, "What are corporate profits going to do?" Historically, corporate profits have grown about eight percent a year. Eight percent a year. They double every nine years. They quadruple every 18. They go up six-fold every 25 years. So guess what? In the last 25 years corporate profits have gone up a little over six-fold, the stock market's gone up a little bit over six-fold, and you've had a two or three percent dividend yield, you've made about 11 percent a year. There's an incredible correlation over time.

So you have to say to yourself, "What's gonna happen in the next 10-20-30 years? Do I think the General Electrics, the Sears, the Wal-Marts, the MicroSofts, the Mercks, the Johnson & Johnsons, the Gillettes, Anheiser-Busch, are they going to be making more money 10 years from now, 20 years from now? I think they will." Will new companies come along like Federal Express that came along in the last 20 years? Will new companies come along like Amgen that make money? Will new companies come along like Compaq Computer? I think they will. There'll be new companies coming along that make money. That's what you're investing in.

**Q You believe that the majority of small investors had lost money and that's why they're in mutual funds?**

**A** I wrote three books and I had great help with doing it with John Rothschild, is I really want to help the average person. My wife and I have given all the profits from those books to charity. I want to help people do a better job investing, understand the market because what amazes me is we've had this phenomenal market. You start 1982, August of '82, the market's 777. In May of 1996, it's at 5700. I'm that's up almost seven-fold. That's an incredible advance. Now how come there's not a lot more people buyin' stocks? How come the number of registered shareholders hasn't gone up dramatically? When antiques were hot, lots of who were doin' antiques. When rugs were hot, they were doin' rugs. When baseball cards were in, thousands of people were into baseball cards, tens of thousands. And people were fixin' up old cars. The only thing I can conclude from the fact there hasn't been a great jump in the amount of people directly investing in the stock market has been in this best bull market of all time, August of '82 to 19-- May of '96, best stock market ever, people must have done a mediocre job or they would be doing more of it themselves and they'd be telling their friends about it and their friends'd be doing it. So their method must be flawed.

## **Q** What does that say to you about their frame of mind?

**A** Well, for some reason, the public looks at stocks differently than they look at everything else. When they buy a refrigerator, they do research. When they buy a microwave oven, they do research. They'll get Consumer Reports. They'll ask a customer "What's your favorite kind of oven? What kind of car would you buy?" Then they'll -- they'll put \$10,000 in some zany stock that they don't even know what it does that they heard on a bus on the way to work and wonder why they lose money, and they do it before sunset. Well, you've got plenty of time. You could have bought Wal-Mart ten years after it went public -- Wal-Mart went public in 1970. You could have bought it ten years later and made 30 times your money. You could have said, "I'm very cautious. I'm very careful. I'm gonna wait. I want to make sure this company -- they're just in Arkansas and I want to watch 'em go to other states." So you watch, five years later the stock's up about four-fold. You say, "I'm still not sure of this company. They have a great balance sheet, great record." I'm going to wait another -- wait another five years, it goes up another four-fold. It's now up twenty-fold. You still haven't invested. You say, "Now I think it's time to invest in Wal-Mart." You still could have made 30 times your money because ten years after Wal-Mart went public they were only in 15 percent of the United States. They hadn't saturated that 15 percent and they were very low cost. They were in small towns. You could say to yourself, "Why can't they go to 17? Why can't they go to 19? Why can't they go to 21? I'll get on the computer. Why can't they go to 28?" And that's all they did. They just replicated their formula. That doesn't take a lot of courage. That's homework.

## **Q** The high and the low analysis.

**A** People spend all this time trying to figure out "What time of the year should I make an investment? When should I invest?" And it's such a waste of time. It's so futile. I did a great study, it's an amazing exercise. In the 30 years, 1965 to 1995, if you had invested a thousand dollars, you had incredible good luck, you invested at the low of the year, you picked the low day of the year, you put your thousand dollars in, your return would have been 11.7 compounded. Now some poor unlucky soul, the Jackie Gleason of the world, put in the high of the year. He or she picked the high of the year, put their thousand dollars in at the peak every single time, miserable record, 30 years in a row, picked the high of the year. Their return was 10.6 That's the only difference between the high of the year and the low of the year. Some other person put in the first day of the year, their return was 11.0. I mean the odds of that are very little, but people spend an unbelievable amount of mental energy trying to pick what the market's going to do, what time of the year to buy it. It's just not worth it.

## **Q** So they just buy and hold?

**A** They should buy, hold, and when the market goes down, add to it. Every time the market goes down 10 percent, you add to it, you'd be much -- you would have better return than the average of 11 percent, if you believe in it, if it's money you're not worried about. As the market starts going down, you say, "Oh, it'll be fine. It'll be predictable." When it starts going down and people get laid off, a friend of yours, loses their job or a company has 10,000 employees and they lay off two. The other 998,000 people start to worry or somebody says their house price just went down, these are little thoughts that start to creep to the front of your brain. And they're the back of your brain. And human nature hasn't changed much in 5,000 years. There's this thing of greed versus fear. The market's going up, you're not worried. All of a sudden it starts going down and you start saying, "I remember my uncle told me, you know, somebody lost it all in the Depression. People were jumping out of windows. They were selling pencils and apples." It must have been a great decade to buy a pencil or an apple, but they were always -- there must have been everybody selling

pencils. That start to -- we laugh about it. People start to think about these things with the market going down. These ugly thoughts start coming into the picture. Gotta get 'em out. You have to wipe those out and you -- you either believe in it or you don't.

**Q The fact of the matter is, in the America that we live in, there are a lot of people who feel they have no choice, that they have to be in the market. What do those people do?**

**A** Well, if people don't have the stomach, they really don't have it, the volatility's too much for them with the stock market, they can avoid it. They could buy money market funds and they'd get a little bit better than inflation. They will not get, in my opinion, the same return the next 20 years, the next 30 years they would get by buying stocks. That doesn't sound like much, but over the long period of time Treasury Bills and money markets have yielded a little bit higher than inflation, bonds have yielded five or six percent, and stocks have yielded a total of 11. The differences are massive over 30 years, but that's not a bad return to get a positive return. If you're worried, it's better than losing money.

**Q How do those people educate their kids and retire?**

**A** They have to save more. The public's not saving enough. Our whole system's all backwards. If you borrow money to spend, add addition to your house, it's tax deductible, you save money, they tax you on it. I mean the public has figured out very well there's no inducement to save. Our system is very confusing. We have the highest capital gains rate in the history of this country right now. The capital gains rates in Japan is zero. They have a 20 percent savings rate in Japan. We have to have a higher savings rate. No one's encouraging savings. And it's the one thing I remember from college is savings equals investment. For every savings of a dollar, money goes into capital investment, that yields more productivity, yields more jobs, yields better standard of living. We are not saving enough money. That's the most single important thing people have to do, they have to save some more.

**Q With so many people investing in mutual funds, let's consider two issues. Short-term profit...long-term stability?**

**A** Well, if corporate management's job is to make the company deal well and make a good job for employees, provide a good service, they know if they do something very slick, very fast and it works well for three months, their competitors will knock 'em off. They have to come out with a better product. They have to come out with better services. So I think the real issue is they have to think long-term and they're doing that. They have to say, "We have to stay competitive and we have to think about ways -- we just introduced a me-too product. That's not enough. It has to be a better product." And I think that's been the difference. "Can we lower our costs?" You see that with the telephone companies. You see it with electric utilities. You see it with broadcasting. You see it with gas companies, industries that never even thought of this -- publishing, just throughout all of the America in the retailing industry, better ways of delivering products. And it's a serious effort and it's a long-term effort. And they're trying to spend more and more time to say, "How can we do a better job? We just can't raise prices. That game's over."

**Q So companies get a bad rap for this short-term, long-term business?**

Well, there is a group of people that buy companies, sell this division, sell that division, sell that off and divide it up and

**A** that's a very small minority. It doesn't happen very often. And they used to be able to use junk bonds. That day's over. They used to get a lot of money from the banking system to do an LBO. That day's over. So now a corporate buyer's a legitimate buyer. It's a major company buys another company. It's not somebody who puts a thousand dollars down and borrow 23 billion and then tries to sell parts off. So I think corporate managements are doing a very good job of saving companies. But a lot of times it's a tough decision. They don't like lettin' people go. No one enjoys that. The question is, if we can slim down and get more efficient, it'd be better off for 90 percent of the employees than "If we don't do it, we could become another Eastern Air Lines, another Pan Am and everybody loses their job."

**Q** **A lot of people worry that the mutual fund pressure has caused a lot of pain in this country ...**

**A** Well, I think it was the recession of '81 and '82 that was the wake-up call. It wasn't the stock market. It wasn't mutual funds managers. It's competition. It's competitor in the apparel industry. It's competition in the textile industry. It's competitor in the housing industry. It's competitor in the broadcast industry independent of mutual fund managers. Now you look at AT&T, about 11 years ago they broke up AT&T, had one million employees. One out of every hundred Americans was working for the telephone company. If you put together AT&T and all the Baby Bells today, you'd have about 700-- less than 700,000 workers and they're doing double the amount of telephone calls, twenty times the faxes, a hundred times the data communications, a thousand times the cellular with 30 percent less employees. Now is that good for America or bad for America? Would we be better off if they had two million employees? I think we're just better off that they have less employees and they're doing a better job.

**Q** **Why?**

**A** That's -- competition, because we have the lowest cost communication system in the world. It's the single most important thing. It's not the highway system. Communications is the single most important and we're the lowest cost. That helps us compete with the rest of the world.

Now hopefully these companies have done a good job when they had to let people go, they helped 'em find other jobs or they let people retire. I'm hoping they were good corporate citizens. That would be very good. That's important. So they just don't say, "Sorry, fellas. Sorry, lady. You're outta here." That would be not a very good thing to do. That'd be terrible. So that would be an abuse. That's not the way to treat people. But holding onto people and all of a sudden you have to cut everybody's pay by 10 percent and then cut everybody's pay by another 15 percent, then your whole company folds. No one wins by that.

**Q** **Talk companies that have gone public since the bull market started and the flow of capital ...**

**A** I get asked a lot by people, you know, "Where's this money that's going into mutual funds of my money? Other people's money. Where is this going to wind up?" One wonderful thing that happened, the last three years over a hundred-billion dollars has gone into initial public offerings. These are new companies coming public. We've had over 2,500 companies come public. That's over two a business day. These companies now have more money for equipment, more money for research. They have a better balance sheet. They can borrow more. They are going to hire more people and more jobs. These are going to be the companies like the next Staples, the next Federal Express, the next Compaq. That's what made America grow.

In the decade of the '80s the 500 largest companies eliminated three million jobs. We added 18 million jobs. This is the greed decade. The decade of the '80s we added 18 million jobs in the United States. There's 2.1 million businesses started. Some didn't make it, but they just had 10 jobs each. That's 21 million jobs. Some medium-sized companies grew to be big companies. That's what's made America grow. When the stock market does well the next two years or the next three years, that money's there. They've got it now. It didn't just go to a bunch of rich people. It went into the companies' treasuries. It's now being used for research & development. Companies like Amgen has come along and they have two one-billion-dollar drugs. Company didn't exist 20 years ago.

**Q So my money winds up in Amgen?**

**A** The money the public puts into mutual funds, a large percentage of that is wound up going into finance new issues. From '65 to 1995 in America we added 54 million jobs. The European Union, the old Common Market, has 100 million more people. In those 30 years, they added 10 million jobs. They added 10 million jobs in 30 years. We added 54 million jobs. There's 10 percent unemployment in Europe, 20 million people out of work. We are very lucky we've had these companies come public. That's what made this country hold together. Business has done a terrific job. We ought to be very happy. I don't think 2,500 companies have come public in Europe since Charlemagne, and I think he became King of the Franks in 788. This is a wonderful thing we have in this country, this initial public offerings, putting money into small and medium-sized companies and let them grow.

**Q Do you think Vinik got a bad rap, too much emphasis put on short-term record?**

**A** Jeff Vinik ran Magellan Fund for a little over four years. It beat the market. It beat 80 percent of all other funds. So if you went somewhere else, you would have been in the 80 percent that lost out to Magellan. Now the last nine months Magellan didn't have a great record, but when you have a basketball game and at the end of the game its 105 to 85, they don't say to the team, "the third quarter you lost by 32 to 22. What happened to the third quarter?" I mean I think a four years is a reasonable period of time to look over a record. I think Jeff Vinik did a very good job the time he ran Magellan.

**Q Too much scrutiny is unfair at this point?**

**A** Well, I can't say whether there's too much scrutiny or not enough scrutiny. I think there's a lot of watching of the largest fund in the country. The question is, can it continue to beat the market like it's done under Morris Smith, under Jeff Vinik, and under Bob Stansky. And it's still a very small percent of the market. I mean 50 billion is a very large number, but when you think the New York Stock Exchange is five-and-a-half trillion. If you look at the hundred largest stocks over-the-counter, there's another trillion. You look at the 200 largest stocks overseas is several trillion, I mean it's not a very small -- it's a very small percentage of the available market. All you have to do really is find the best hundred stocks in the S&P 500 and find another few hundred outside the S&P 500 to beat the market.

**Q That's all?**

**A** That's all you do.

**Q** What was Magellan's size when you left?

**A** When I left Magellan Fund, it was 14 billion.

**Q** And where is it today?

**A** Today over 50 billion.

**Q** What has caused that incredible influx of money?

**A** Well, part of it, the market was 2700 when I left. You know, and before today the market was 5500. So, the market doubled, plus dividends has brought a lot of it, and people already were there. So they kept adding. So every year people kept adding money and as it's gone up, it was up over 35 percent in 1995, I mean those compound to give you very big numbers. So it's some people adding do it and the fund doing very well. It went up when Morris Smith ran it. So it's gone up a lot in six years.