

## 93/01-Besting the Blundering Herd

By Peter Lynch

Nothing bedevils the average investor more than the false sense of inferiority that comes from playing against the institutions. After all, the institutions are so big, and get so much attention for dominating the markets, that the amateur stockpicker can't help but feel that he's trapped in a fantasy baseball camp, competing against the Atlanta Braves.

I've said this before, but having had nearly three years to reflect on life in the pro ranks on Wall Street, I'm still convinced that it's not the Atlanta Braves, or even the Toledo Mud Hens, that the average investor is competing against. It's more the Thundering Herd.

"Thundering Herd," as you may recall, is how the financial press once described the great mass of stockbrokers hired by Merrill Lynch to service the average investor, back in the days when average investors bought and sold most of the stocks. Today there's another kind of Thundering Herd on Wall Street: institutional investors, including the mutual fund managers, who now do most of the buying and selling.

A sizeable faction of this Thundering Herd could even be called the Blundering Herd. I can say that with confidence, having ridden with the Blundering Herd on more occasions than I care to admit.

The fact that the professionals now dominate the markets, which so often leads people to conclude that the amateur has no chance, has actually improved the amateur's chance. He or she can take an independent tack by zigging when the Herd zags and buying stocks that the Herd has overlooked, and especially the ones that the Herd has recently trampled. What holds them back is the inferiority complex they've gotten from mistaking a cattle drive for the Atlanta Braves.

The inferiority complex causes investors to do one of three self-destructive things: (1) imitate the pros by buying "hot" stocks or trying to "catch the turn" in, say, IBM; (2) become "sophisticated" by investing in futures, options, options on futures, etc.; (3) buy what they've heard a pro has recommended, either in a magazine or on one of the popular financial news programs. Information on what the pros think is so readily available that the celebrity tip has replaced the old-fashioned tip from Uncle Harry as the most compelling reason to invest in a company.

Let's say that in the spirit of doing it yourself, you take money out of your savings account at the local S&L, America First and Foremost, and decide to buy stock with it. You're somewhat intrigued by the fact that the price of the common stock of America First and Foremost has fallen in half. You know this to be a solid institution with a strong balance sheet and no commercial lending because you checked into these things before you put your money there. (Forgive me for using an S&L; example twice in the three columns I've written for this magazine, but lately I've been very taken with this sector.)

Just as you are about to pick up the phone and order the latest annual report from America F&F; to see if the story is as good on paper as it seems to be in real life, a little voice from the inferiority lobe whispers, "Who do you think you are, buying a stock in a company that has never been touted in Barron's, Forbes, or Business Week?"

So instead of ordering the annual report, you go to the newsstand to pick up their latest copies to see what the experts are saying, and in one of them you discover that Mario Gabelli owns shares in Coca-

Cola Enterprises, a bottling company for the world's favorite soft drink. You buy the stock, on the theory that a famous fund manager like Gabelli knows a lot more than you and your Uncle Harry put together. In fact, Gabelli does know a lot more than you and everybody's Uncle Harry put together, but that doesn't mean you're going to profit by betting on his tip regarding Coca-Cola Enterprises. (I mention this company because three years ago I, too, recommended it in Barron's at a price \$3 higher than its current price of \$11 a share.)

Since Gabelli doesn't give out his home phone number, you can't call him up to ask if he still likes Coca-Cola Enterprises and whether he views the price drop as an opportunity to buy more, or whether he has soured on the company and gotten out of the stock to cut his losses.

Most likely, the drop in the price will cause you to lose faith in the stock, and without Gabelli to reassure you, you sell your shares to cut your own losses - maybe you've even sold them to Gabelli! Then you take your diminished capital and repeat the process with another celebrity tip, perhaps from an analyst at your brokerage firm. If you cut enough losses, sooner or later there's nothing left to cut.

Picking your own stocks in this popular fashion only confirms what you have always suspected: There is no way an amateur investor can compete with the Atlanta Braves. If you're lucky enough to become totally demoralized before the money runs out, you'll send the remains to a mutual fund. My advice here is that if you want to bet on the pros, the way to do it is to invest in their funds to get the full benefit from their expertise coming and going.

I suspect that amateur stockpickers would have a much higher opinion of their abilities, as well as a greater net worth, if they avoided all expert buy recommendations in favor of their own research. This is the only kind of "independent investing" that makes sense. It's taken me three columns to get around to saying this, but the investor's edge is something you already have, not something you acquire by listening to the latest tips from notable sources. As a depositor at America First and Foremost, you are close enough to the situation to at least have a chance of keeping track of it, and also a chance of buying the stock at a bargain price before the Herd comes back.

Actually, there are two kinds of investor's edges: the on-the-job edge, in which you have a working relationship with an industry and the related companies with whom you do business; and the consumer's edge, with which you can capitalize on your experiences in restaurants, airports, and shopping malls.

In fact, of the 20 top-performing stocks on the New York Stock Exchange in the last decade, no fewer than six (Home Depot, Circuit City, the Gap, Wal-Mart Stores, Liz Claiborne, and Dillard Department Stores) have been stuck under the noses of millions of shoppers who, if they'd paid attention to the popularity of these enterprises, could have profited from their edge. And they had time to do so: It often takes 15 years for a retailer or a restaurant chain to expand across the country, as more and more investors become aware of it, before the Wall Street professionals catch on.

The line about New York, "If I can make it there, I'll make it anywhere," may be true for singers, comedians, and cab drivers, but public companies routinely make it in dozens of places before the news of their success reaches the institutional trading desks in New York or Boston, the two places where most of the Thundering Herd is corralled.

A colleague of mine on the board of Morrison Knudsen, Irene Peden, recently used her coffee lover's edge and bought shares in Starbucks, the popular Seattle coffee company. Peden is a professor of electrical engineering and an expert in subsurface remote sensing, whatever that is, and she always starts her day with a cup of Starbucks coffee. She became a fan of Starbucks back in Seattle, where she normally resides, but now that she's on temporary assignment in Washington, D.C., she gets the Starbucks beans sent to her.

Except for the shares she owns in companies on whose boards she serves, Peden had never bought a single stock until last year, when Starbucks came public. Her own experience with Starbucks convinced her the company had two great advantages: It made a product that people wanted, and it sold it at a profit.

Peden did not have to look far under the subsurface to find out that Starbucks was well-capitalized, with earnings growing at a steady pace, and that it had begun to expand east and south out of the Seattle area. The story is still a good one, and so far the stock has done well.

Cheryl Peterson, who recently retired from a local charity in which I'm involved, used her letter writer's edge and bought shares in Mail Boxes Etc., which sells stamps, mails packages, and rents boxes to people who are tired of waiting in line at the post office. This is basically the same story as Starbucks's: good company, strong balance sheet, and a huge potential market - millions of Americans who are fed up with the post office. The stock was first offered at just under \$2 a share (adjusted for splits) and is worth \$15 today.

Here's another one: Any subscriber to a computer magazine or owner of an IBM personal computer or IBM clone could have used the consumer's edge and discovered Microsoft. Practically every IBM-based PC you buy comes with the Microsoft disk operating system (MS/DOS), for which Microsoft has the exclusive rights. You can't run the machine without DOS. Microsoft's virtual monopoly on this product puts it in the same enviable position as a < wam-co NYSE:GT>Goodyear with the exclusive right to make all the tires for all the cars on the road. But even if you failed to recognize DOS as a potential profitmaker at the onset, once the company went public in 1986, you had other chances to follow its progress each time the company innovated. Microsoft continued to boast steady earnings growth as it introduced "Word," "Windows," various products for the Macintosh line, and "Excel," its spreadsheet that challenged the popular Lotus version.

Making computers has been a treacherous business, with too many competitors killing each other off, but what was bad for them was good for Microsoft because every time IBM sold a computer with DOS, Microsoft made a profit. While many individual investors were busy trying to think like the pros and figure out how to catch the turn in IBM, they should have been thinking like amateurs, looking for clues in their PCWeek or in their computer boxes (they'd have noticed Microsoft software in every one of them). I wish I'd noticed myself. The stock has been a 35-bagger.

In my recent travels, I have noticed Au Bon Pain, a name I continue to mispronounce, beginning with the "O," which I call "Ow," and ending with the "Pan," which I call "Paw." This croissant-and-coffee franchise has appeared in airports and food courts in malls, where people like me have a chance to use their croissant-lover's edge. The company went public only recently, but it's been in business for more than a decade. It has a good balance sheet, well-conceived plans for expansion, and so far it's only in a few major markets - but don't take my word for it. Do your homework.

Peter Lynch retired in 1990 from managing the Magellan Fund, the best-performing of all mutual funds over a 15-year period. He is currently a trustee of the Fidelity Group of funds, and is working on a book to be published next spring by Simon & Schuster.