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Best of the Best

By Peter Lynch

The question, asked of seven premier money managers: What are your favorite stocks for the near term and the long? The questioner: Well, you know him.

Now, what do you think stock pickers talk about when they get together? Other than the Red Sox, that is? Call me predictable, but when I spend time with people in my business, people whose track records I admire and whose opinions I respect, I like to kibitz about companies.

And why not? No stock picker knows so much that he can't learn a trick or a tip from a peer. Nor does a good stock picker get tired of this stuff. That's almost a matter of definition. A good stock picker is good precisely because he or she loves the process: sifting through thousands of public companies; studying balance sheets; learning the workings, the real details, of industries and businesses; investigating how a company treats its customers and vice versa. This is the only way I know to find great companies, and nothing beats the feeling when it pays off.

The peers I've been talking with recently are seven good ones. Yes, a lot of them have Boston-area connections, but that's not my attempt to plug my hometown. It simply reflects the fact that these are people I know as something more than a sketch in *The Wall Street Journal* and a voice on the phone. Some of these relationships, in fact, go back further than I care to admit-in one case to the mist-shrouded days of high school.

Some of the seven stock pickers you'll know by name-certainly you'll know Michael Price-and some of the others might be new to you. Among them, these seven veterans have 150 years of investment experience. All of them were on the job during the down markets of 1987 and 1990. A few were around for the long bear market that ended in 1982. The most experienced member of the group has been at it for 30-odd years and the youngest for 11.

Best of all, these people come from what's known as the buy side of the business. A lot of people tout stocks, talking about companies in newsletters and magazines or on television. These seven money managers actually go out and buy stock in the companies they recommend-thousands, even millions, of shares. This isn't an intellectual exercise-they buy shares in a market that doesn't sit still, paying commissions for the privilege and delivering good results despite these penalties.

I talked with these seven people for a couple of hours each, and it wasn't hard for them to come up with names. People at the top of this field keep a close watch on a large stable of stocks-in several cases 400 to 500. The tough part was getting down to two picks each. I asked the stock pickers to give me one recommendation for the next 12 months and another for a three- to five-year commitment. A number of them felt their picks could go either way-that the company they liked for the next year would also look fine five years out. The difference usually came down to this: The 12-month stories typically involve

a special situation, something that will bring a company back from a down period or will add a little buzz to earnings growth in the near term.

The notion of the story is an important one. As I've said so many times before, if you don't know the story, you don't know the company. (And if you don't know the company...) The level of detail here, in these 14 stories, is the minimum any investor should understand before committing money. Do you own stock in five companies? You should be able to write five stories like these. The language is pretty simple. The ideas are from the real world. It's not nearly as difficult as it is necessary.

There's an alphabetized list [on page 74 of the magazine] of the companies the pickers have picked. I suggest you start by thinking about what isn't on it. There are no technology stocks-no Microsoft, no Intel, no Cisco Systems. There are no classic cyclicals-airlines or automakers. There are only four companies in the Standard & Poor's 500 Stock Index.

I was surprised, as I talked to the stock pickers, that they weren't recommending tech stocks-there's certainly been the kind of volatility in the sector that can create buying opportunities. But then I looked more closely and understood. The stocks with good stories are fairly or highly priced in this market. The stocks that are cheap look questionable on the fundamentals. It makes sense to be cautious, because if there's an investing minefield in this decade it's the technology sector, in which so many companies catch a cold one week and are hospitalized with pneumonia the next.

As for the lack of cyclicals, it doesn't mean the stock pickers can't foresee good conditions for certain industries. But what they're most passionate about is steady earnings growth, which is not in the nature of cyclical stocks. These pros share my insistence, I think, on what I call earnings visibility, which is a way of saying we like to see those earnings coming. Which company is most certain to meet our estimates? That's the one we want to buy.

Finally, what does it suggest that only 4 of the 14 companies are in the S&P; 500? To me, it suggests opportunity. We have ten companies from a segment of the market that has struggled the past three years-the S&P;, after all, has run away from every other index since 1995. It follows that these companies may have been overlooked-which is music to a stock picker's ears.

So what does the table show?

First, it shows a breadth of companies, from all parts of the economy, whose stories any intelligent person can understand.

Second, the table shows that people are looking for value. The market, as measured by the S&P; 500, is expected to trade at a price-to-earnings ratio of 19 or 20 in 1998. Earnings are expected to grow at 10 to 11 percent, which is less than half the growth we've seen the past three years but is in line with historic performance. So the market is selling at about twice the expected growth rate. This suggests that investors are pricing stocks on the basis of unrealistic expectations about growth. Of our 14 stocks, however, 11 are selling below their expected growth rates. At the current prices for these stocks, the market is failing to take into account the real future growth of the companies. That's the essence of a good value and a good opportunity.