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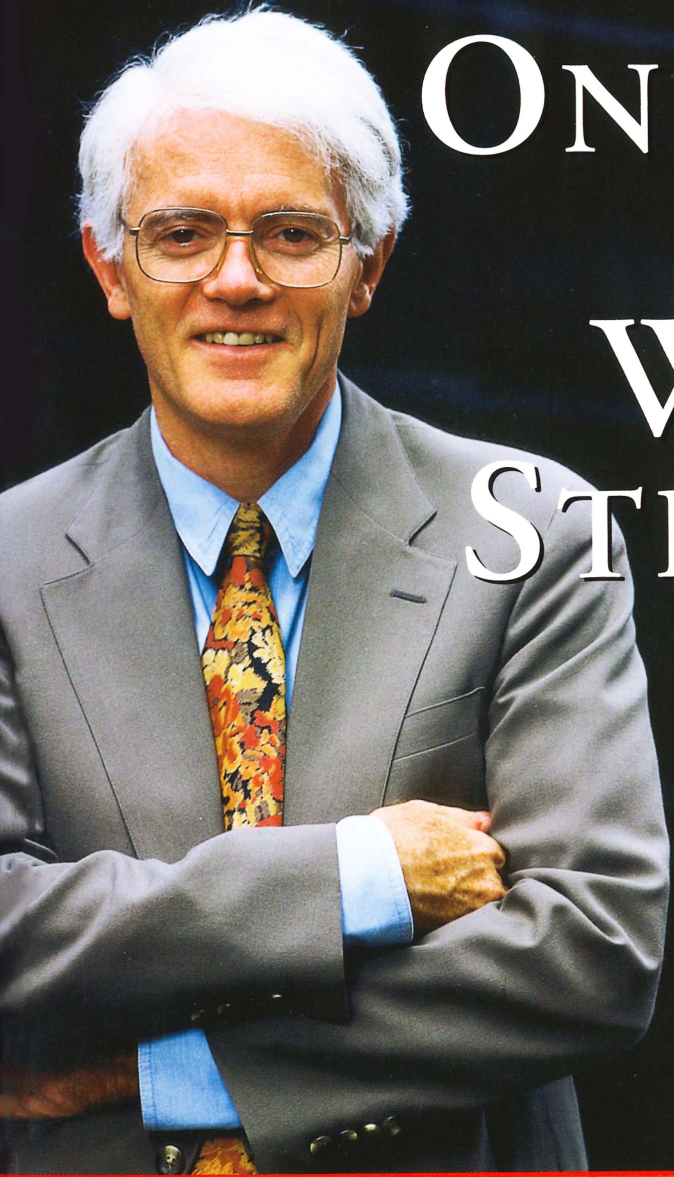
"Mr. Lynch's investment record puts him in a league by himself."
—Anise C. Wallace, *The New York Times*



ONE UP ON WALL STREET

How to Use What You Already Know to Make Money in the Market

More Than One Million Copies Sold

PETER LYNCH

WITH JOHN ROTHCHILD

WITH A NEW INTRODUCTION BY THE AUTHOR

Contents

cash to buy new businesses and to buy back shares. GE's triumph in the 1990s shows the importance of keeping up with a company's story.

Buying back shares brings up another important change in the market: the dividend becoming an endangered species. I write about its importance on page 204, but the old method of rewarding shareholders seems to have gone the way of the black-footed ferret. The bad part about the disappearing dividend is that regular checks in the mail gave investors an income stream and also a reason to hold on to stocks during periods when stock prices failed to reward. Yet in 1999 the dividend yield on the five hundred companies in the S&P 500 sank to an all-time low since World War II: near 1 percent.

It's true that interest rates are lower today than they were in 1989, so you'd expect yields on bonds and dividends on stocks to be lower. As stock prices rise, the dividend yield naturally falls. (If a $50 stock pays a $5 dividend, it yields 10 percent; when the stock price hits $100, it yields 5 percent.) Meanwhile companies aren't boosting their dividends the way they once did.

"What is so unusual," observed *The New York Times* (October 7, 1999), "is that the economy is doing so well even while companies are growing more reluctant to raise their dividends." In the not-so-distant past, when a mature, healthy company routinely raised the dividend, it was a sign of prosperity. Cutting a dividend or failing to raise it was a sign of trouble. Lately, healthy companies are skimping on their dividends and using the money to buy back their own shares, à la General Electric. Reducing the supply of shares increases the earnings per share, which eventually rewards shareholders, although they don't reap the reward until they sell.

If anybody's responsible for the disappearing dividend, it's the U.S. government, which taxes corporate profits, then taxes corporate dividends at the full rate, for so-called unearned income. To help their shareholders avoid this double taxation, companies have abandoned the dividend in favor of the buyback strategy, which boosts the stock price. This strategy subjects shareholders to increased capital gains taxes if they sell their shares, but long-term capital gains are taxed at half the rate of ordinary income taxes.

Speaking of long-term gains, in eleven years' worth of luncheon and dinner speeches, I've asked for a show of hands: "How many of you are long-term investors in stocks?" To date, the vote is unanimous—

Introduction: The Advantages of Dumb Money

This is where the author, a professional investor, promises the reader that for the next 300 pages he'll share the secrets of his success. But rule number one, in my book, is: Stop listening to professionals! Twenty years in this business convinces me that any normal person using the customary three percent of the brain can pick stocks just as well, if not better, than the average Wall Street expert.

I know you don't expect the plastic surgeon to advise you to do your own facelift, nor the plumber to tell you to install your own hot-water tank, nor the hairdresser to recommend that you trim your own bangs, but this isn't surgery or plumbing or hairdressing. This is investing, where the smart money isn't so smart, and the dumb money isn't really as dumb as it thinks. Dumb money is only dumb when it listens to the smart money.

In fact, the amateur investor has numerous built-in advantages that, if exploited, should result in his or her outperforming the experts, and also the market in general. Moreover, when you pick your own stocks, you ought to outperform the experts. Otherwise, why bother?

I'm not going to get carried away and advise you to sell all your mutual funds. If that started to happen on any large scale, I'd be out of a job. Besides, there's nothing wrong with mutual funds, especially the

Part I

PREPARING TO INVEST

Before you think about buying stocks, you ought to have made some basic decisions about the market, about how much you trust corporate America, about whether you need to invest in stocks and what you expect to get out of them, about whether you are a short- or long-term investor, and about how you will react to sudden, unexpected, and severe drops in price. It's best to define your objectives and clarify your attitudes (do I really think stocks are riskier than bonds?) beforehand, because if you are undecided and lack conviction, then you are a potential market victim, who abandons all hope and reason at the worst moment and sells out at a loss. It is personal preparation, as much as knowledge and research, that distinguishes the successful stockpicker from the chronic loser. Ultimately it is not the stock market nor even the companies themselves that determine an investor's fate. It is the investor.

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The Twelve Silliest (and Most Dangerous) Things People Say About Stock Prices

I'm constantly amazed at popular explanations of why stocks behave the way they do, which are volunteered by amateurs and professionals alike. We've made great advances in eliminating ignorance and superstition in medicine and in weather reports, we laugh at our ancestors for blaming bad harvests on corn gods, and we wonder, "How could a smart man like Pythagoras think that evil spirits hide in rumpled bedsheets?" However, we're perfectly willing to believe that who wins the Super Bowl might have something to do with stock prices.

Moving back and forth from graduate school to my summer job at Fidelity, I first realized that even the most intelligent professors on the subject are as wrong about stocks as Pythagoras was about beds. Since then I've heard a continuous stream of theories, each as misguided as the last, which have filtered down to the general public. The myths and misconceptions are numerous, but I've written a few of them down: These are the Twelve Silliest Things People Say About Stock Prices, which I present in the hope that you can dismiss them from your mind. Some probably will sound familiar.