Peter Lynch: I will speak about some of the ideas I used when I was an amateur, when I ran Magellan, and which I still use today. They can make sense for investors.

It's a tragedy in America that small investors have been convinced by the media – the print media, radio, television media – they don't have a chance. These media giants have convinced many small investors they can't compete with big institutions – with all their computers and degrees and money. It just isn't true. When this happens, people act accordingly. When they believe it, they buy stocks for a week, and they buy options, and they buy the Chile fund this week. Next week it's the Argentina fund, and they get results proportionate to that investing style. That's bothersome. The public can do extremely well in the stock market on their own. The fact that institutions dominate the market today is a positive for small investors. These institutions push stocks on usual lows. They push them on usual highs. For someone that can sit back and have their own opinion and know something about the industry, this is a positive. It's not a negative. So that's what I want to talk about.

The single most important thing to me in the stock market for anyone is to know what you own. I'm amazed how many people who own stocks would not be able to tell you why they own them. If you press them, they'll say, "The reason I own this is because the sucker's going up." That's the only reason they own it. I'm serious. If you can't explain to a 10-year-old in two minutes or less why you own a stock, you shouldn't own it. That's true of about 80% of people who own stocks.

This is the stock people like to own. This is the company people adore owning. These are relatively simple companies, and they make a narrow, easy-to-understand product. They make a one-megabit, SRAM, CMOS, bi-polar risk, floating point data IO array processor, with an optimized compiler, a 16-bit dual-port memory, a double-defused metal oxide semiconductor monolithic logic chip with a plasma matrix vacuum fluorescent display with a 16-bit dual memory with a UNIX operating system, four whetstone megaflop poly-silicone emitter, a high bandwidth – that's important – six-gigahertz double metallization communication protocol, an asynchronous backward compatibility, peripheral bus architecture, four-way interleaf memory, a token ring interchanging backplane, and it does it in 15 nanoseconds of capability. If you own a piece of crap like that, you will never make money. Somebody will come along with more whetstones or less whetstones, a bigger megaflop or a smaller megaflop. You won't have the foggiest idea what's happening, and people buy this junk all the time.

I made money in Dunkin' Donuts. I can understand it. When there were recessions, I didn't have to worry about what was happening. I could go there, and people were still there, I didn't have to worry about low-priced Korean imports. I can understand it. And you laugh. I made 10 or 15 times my money in Dunkin' Donuts. Those are the stocks I can understand. If you don't understand it, it doesn't work. This is the single biggest principle.

It bothers me that people are careful with their money. The public, when they buy a refrigerator, they go to Consumer Reports. They buy a microwave oven, they do that. They ask people what's the best radar range or what car to buy. They do research on apartments. When they go on a trip to Wyoming, they get a Mobil travel guide. When they go to Europe, they get the Michelin travel guide. People hear a tip on a bus on some stock and they'll put half their life savings in it before sunset, and they wonder why they lose money in the stock market. When they lose money, they blame it on the institutions and program trading. That is garbage. They didn't do any research. They bought a piece of junk, they didn't look at the balance sheet, and that's what you get for it. That's what we're being driven to, and it's self-fulfilling. The public invests terribly, and they say they don't have a chance. It's because that's the way they're acting. I'm trying to convince people there is a method. There are reasons for stocks to go up. This is magic. It's a magic number, easy to remember. Coca-Cola is earning 30 times per share what they earned 32 years ago. The stock has gone up thirtyfold. Bethlehem Steel is earning less than they did 30 years ago. The stock is half its price of 30 years ago. Stocks are not lottery tickets. There's a company behind every stock. If a company does well, the stock does well. It's not that complicated.

People get too carried away. They try to predict the stock market. That is a total waste of time. No one can predict the stock market. They try to predict interest rates. If anybody can predict interest rates right three times

in a row, they'd be a billionaire. Certainly, there's not that many billionaires on the planet. I took logic, syllogism, when I studied at Boston College. There can't be that many people who can predict interest rates because there'd be lots of billionaires, and no one can predict the economy. I know a lot of people in this room were around in 1981 and 1982 when we had a 20% prime rate with double-digit inflation, double-digit unemployment. I don't remember anybody telling me in 1981 about it. I read. I study all this stuff. I don't remember anybody telling me we'll have the worst recession since the Depression. It would be useful to know what the stock market will do. It would be terrific to know the Dow Jones average a year from now, to know we'll have a full-scale recession, or to know interest rates will be 12%. That's useful stuff. You never know it, though. You just don't get to learn it.

I've always said if you spend 14 minutes a year on economics, you've wasted 12 minutes. Now, I must be fair. I'm talking about economics in the broad scale, predicting the downturn for next year, or the upturn, or M1 and M2, 3B. All of these economic terms are less useful to me than when you talk about scrap prices. When I own auto stocks, I want to know what's happening to used car prices. When used car prices rise, it's a good indicator. When I own hotel stocks, I want to know hotel occupancies. When I own chemical stocks, I want to know what's happening to the price of ethylene. These are facts. If aluminum inventories go down five straight months, that's relevant. I can deal with that. I want to know about home affordability when I own Fannie Mae, or I own a housing stock. These are facts. There are economic facts and there are economic predictions, and economic predictions are a total waste. Alan Greenspan is an honest guy. He would tell you he can't predict interest rates. He can tell you what short rates will do in the next six months. Try and stick him on what the long-term rate will be three years from now. He'll say, "I don't have any idea." So how are you, the investor, supposed to predict interest rates if the head of the Federal Reserve can't do it?

You should study history. History teaches you the market goes down. It goes down a lot. The math is simple. There have been 93 years this century. The market has had 50 declines of 10% or more. With 50 declines in 93 years, the market falls at least 10% about once every two years. We call that a "correction," a euphemism for losing a lot of money rapidly. Of those 50 declines, 15 have been 25% or more. That's known as a "bear market." We've had 15 declines of at least 25% in 93 years, so every six years, the market has a 25% decline. That's all you need to know. You need to know the market will go down sometimes. If you're not ready for that, you shouldn't own stocks.

It's good when the market goes down. If you like a stock at $14 and it goes to $6, that's great. You understand the company. You look at the balance sheet. They're doing fine. You hope for $22; $14 to $22 is terrific, $6 to $22 is exceptional, so you take advantage of these declines. Declines happen, and no one knows when they'll happen. People tell you they predicted it, but they predicted it 53 times. You can take advantage of the volatility of the market if you understand what you own. That's a key element.

Another key element is that you have plenty of time. People are in an unbelievable rush to buy a stock. I'll give you an example of a well-known company. Walmart went public in October of 1970. It already had a great record with 15 years' performance and a great balance sheet. You're a conservative investor. You're not sure if Walmart can make it. You want to check. You see them operate in small towns. You're afraid. They make it in seven or eight states. You want to wait until they go to more states. You keep waiting. You could have bought Walmart 10 years after it went public and made 35 times your money. If you bought it when they went public, you would have made 500 times your money, but you could have waited 10 years after it went public and made over 30 times your money. You could have waited three years after Microsoft went public and made 10 times your money. I know nothing about software. If you knew something about software, you would have said, "These guys have it. I don't care who's going to win, Compaq, IBM. I don't know who's going to win, Japanese computers. I know Microsoft, MS-DOS is the right thing.

Stocks are not a lottery ticket. There's a company behind every stock, and you can watch it. You have plenty of time. People are in an amazing rush to purchase a security. They're out of breath when they call up. You don't need to do this.

You need an edge to make money, too. People have incredible edges and they throw them away. I'll give you a quick example of Smith Kline. This is a stock that had the successful drug, Tagamet. You didn't have to buy Smith Kline when Tagamet was doing clinical trials. You didn't have to buy Smith Kline when Tagamet was talked about in the New England Journal of Medicine or in the British version, Lancet. You could have bought Smith Kline when Tagamet first came out or a year after it came out. Let's say somebody in your family or you are a nurse, a druggist, or a physician writing all these prescriptions. Tagamet was doing an amazing job of curing ulcers. It was a wonderful pill for the company because if you had stopped taking it, the ulcer came back. It wasn't a crummy product, you took it for a buck and then it went away. You could have bought it two years after the product was on the market and made 5 or 6 times your money. All the druggists, all the nurses, all the people, millions of people saw this product, but instead they're out buying oil companies or drilling rigs. It happens. Then three or four years later Glaxo, an even bigger company, a huge company, a British company, bought Zantac which was, at that time, an improved product. You could have seen that take market share and do well. You could have bought Glaxo and tripled your money. You only need a few stocks in your lifetime. They're in your industry.

If you'd worked in the auto industry – let's say you have been an auto dealer for the last 10 years – you would have seen Chrysler come up with the minivan. If you were a Buick dealer, a Toyota dealer, a Honda dealer, you would have seen the Chrysler dealership packed with people. You could have made 10 times your money on Chrysler a year after the minivan came out. Ford introduced the Taurus Sable, the most exceptional line of cars in the last 20 years. Ford went up sevenfold on the Taurus Sable. So, if you're a car dealer, you only need to buy a few stocks every decade. When your lifetime is over, you don't need a lot of five-baggers to make a lot of money starting with $10,000 or $5,000. In your own industry you'll see a lot of stocks, and that's what bothers me. There are good stocks out there looking for you. People aren't listening and they're not watching.

People have big edges over me. They work in the aluminum industry. I see the aluminum industry has been coming down; the inventory has declined for six straight months. I see demand improving. In America today, it's hard to get an EPA permit for a bowling alley, never mind an aluminum smelter. You know when aluminum gets tight, and you just can't build seven aluminum smelters. When you see this coming, you can say, "Wait a second. I can make some money." When an industry goes from terrible to mediocre, the stock goes north. When it goes from mediocre to good, the stock goes north. When it goes from good to terrific, the stock goes north. There are lots of ways to make money in your own industry. You can be a supplier in the industry. You can be a customer. This thing happens in the paper industry. It happens in the steel industry. It doesn't happen every week, but if you're in some field, you'll see it turn. You'll see something in the publishing industry. These things come along, and it's just mindboggling that people throw it away.

I want to throw out a couple of rules I find useful. People buy when they see a stock has gone down. They ask how much further it can go down. I remember when Polaroid went from $130 to $100 and people said, "Here's this great company, great record. If it ever gets below $100, just buy every share." It did get below $100 and a lot of people bought on that basis saying, "Look, it's gone from $135 to $100. It's now at $95. What a buy!" Within a year, Polaroid was $18. This is a company with no debt. It was just so overpriced, it went down.

I did the same thing in my first or second year in Fidelity. Kaiser Industries had gone from $26 a share to $16. I said, "How much lower can it go at $16?" I think we bought one of the biggest blocks ever probably on the American stock exchange of Kaiser Industries at $14. I said, "It's gone from $26 to $16. How much lower can it go?" At $10, I called my mother and said, "Mom, you got to look at this Kaiser Industries. How much lower can it go? It's gone from $26 to $10." It went to $6. It went to $5. It went to $4, and it went to $3. I am fortunate this happened rapidly, or I would probably still be caddying or working at the Stop and Shop. It happened fast. It was compressed.

At $3, I figured out there's something wrong here because Kaiser Industries owns 40% of Kaiser Steel. They own 40% of Kaiser Aluminum. They own 32% of Kaiser Cement. They own Kaiser Broadcasting, Kaiser Sand and Gravel, and Kaiser Engineers. They own Jeep. They own business after business, and they had no debt. I learned this early. This might be a breakthrough for some of you people. It's hard to go bankrupt if you don't have any debt, and the whole company, at $3, was selling at a total market cap of about $75 million. At that

point, it was equal to buying one Boeing 747. I said there's something wrong with this company selling for $75 million. I was a little premature at $16, but I said everything's fine, and eventually this will work out.

Kaiser effectively gave away all their shares to their shareholders. They passed out shares at Kaiser Cement. They passed out shares in Kaiser Aluminum. They passed out the public shares in Kaiser Steel. They sold all the other businesses, and you got about $50 a share. But if you didn't understand the company, if you were just buying on the fact the stock had gone from $26 to $16 and then it had gone to $10, what would you do when it went to $9? What would you do when it went to $8? What would you do when it went to $7? This is the problem people have. They sell stocks because they didn't know why they bought it, then it goes down and they don't know what to do. Do you flip a coin? Do you walk around the block? What do you do? Psychiatrists haven't worked so far. I haven't seen the psychiatric or psychological fund file with the SEC and make it through as a mutual fund. They haven't seemed to help. I've tried prayer. That hasn't worked. If you don't understand the company, you have this problem when they go down. Eventually, they think it will always come back. This line of thinking doesn't work, either. People think RCA just about got back to its 1929 high when General Electric took it over. Double knits never came back. Remember those beauties? Floppy disks, Western Union, the list goes on and on. People say it'll come back. It doesn't have to come back.

Here's another one you hear all the time. I've had people call me up saying, "I'm thinking of buying this stock at $3. How much can I lose?" Well, you may need a piece of paper for this, but if your neighbor put $20,000 at $50 into the stock and you put $20,000 in at $3 and it goes to zero, you lose exactly the same amount of money, everything. If people say, "It's $3. How much can I lose?" If you put $1 million on it, you can lose $1 million.

This may be a reason to research a stock. The fact a stock is down $3 from $100 doesn't mean you should buy it. In fact, short sellers – people who make money in stocks – don't short Walmart. They don't short Home Depot. They don't short the great companies like Johnson & Johnson. They short stocks down from $80 to $7. They'd like to short it at $22, but they figured out at $7, this company will go to zero. They just haven't blown taps on this thing yet. It's going to zero, and they're selling short at $7. They're selling short at $6, at $5, at $4, at $3, at $2, at $1.25. And you know what? If you sell something short, you need a buyer. Somebody must buy the damn thing! You wonder who's buying this thing. The buyers are people saying, "It's $3. How much lower can it go?"

You can't get too attached to a stock. You must understand there's a company behind it. You can't treat this like your grandchildren. You must deal with the stock and say, "I understand the company." If it deteriorates, if the fundamentals slip, you must say goodbye to it. Remember the rule that the stock does not know you own it. This is a breakthrough. You must understand it and say, they're doing well and as long as they're doing well, I'll hold on to my position. My best stocks have been the stocks I owned in my fifth, sixth, and seventh years, not my fifth, sixth, or seventh day.

I'll switch through to my long shots. Avoid long shots. I bought about 30 long shots in my life. I've never broken even on one of them. I call the bad ones "whisper stocks." If Arthur Levitt were here, he'd appreciate these stories. These are the times that somebody calls you up and says, "Hi, Peter. How's Carolyn? How are the kids? I'd like to talk to you about international blivit. Earnings will be unpredictable. They'll be small. It's $3 a share," and they keep whispering all these things. What are you talking about? I don't understand. Either they're so surrounded by people that are going to run out and buy this stock because it's so exciting, or they think the SEC is listening in. They'll get a shorter term –they'll get six months in the camp rather than two years in the camp. But whisper stocks don't work.

I want to conclude by saying there's always something to worry about if you own stocks. You can't get away from it. What happened in the 1950s, people were worried about. The only reason we got out of the Depression was World War II. We got another recession in the early 1950s. We said we're going to go right back into a depression. People were worried about a depression in the 1950s, and they were worried about nuclear war. Back then, the little warheads they had then, they couldn't blow up a McLane in West Virginia, or a McLane in Virginia or Charleston. All of these countries that end in -stan – there's nine of these "-stan" countries that came out of Russia. They all have enough warheads to blow the world up and no one worries about it. When I

was a kid, people built fallout shelters. We used to have civil defense drills. Remember this one in high school? You get under your desk. I never thought, even then, that was a particularly good thing to do. They'd blow a whistle, somebody would put on a hat, and we would all get under our desks. But in the 1950s, people wouldn't buy stocks. Except for the 1980s, the 1950s was the best decade this century of the stock market. People wouldn't buy stocks in the 1950s because they were worried about nuclear war and they were worried about a possible depression.

Remember when oil went from $4 to $40 and was headed for $100 and we were going to have a depression? About three years later, the same experts who said oil would go to $100 are higher paid now and they said it was headed for $4 and we're going to have a depression.

Remember how the Japanese were going to own the world, and we were going to have a depression? And then about two years later, we were all worried about Japan collapsing. This is the most absurd thing I've ever heard. This is a country with a 20% savings rate, incredible work force, incredible productivity, and people were saying we're going to have a depression because Japan is going to collapse. In their prayer list, they've lowered Mother Teresa and crippled children and they're praying for Japan at night. It's unbelievable.

Remember the LDC debt? Chase had lent their net worth to Brazil, Chile, Peru and those other countries. They were not going to pay it back and we were going to have a depression. It always ends in we're going to have a depression, or we'll have the Great Depression. Now, I understand what these are called – then, they were called "less developed" countries. We used to call them "underdeveloped" countries. Those are all wrong terms. Those are not politically correct. You must call these "emerging" countries. The other day I heard the politically correct term for somebody that's overweight: laterally challenged. There is always something to worry about.

The key organ in your body in the stock market is your stomach. It's not the brain. If you can add 8 and 8 and get reasonably close to 16, that's the only level of math you need to know. You don't need to know the area under the curve. Remember that quadratic equation and integral calculus and the area under the curve? Whoever cared what was under the damn curve? But you had to study this. You don't need this in the stock market. All you must know is that it'll always be scary, there will always be something to worry about. You must forget all about it. Cut it all out and own good companies or own turnarounds. Study them and you'll do well.

The following are excerpts of the Q&A session:

Monroe Karmin: When managing a portfolio, do you pay attention to the activities of Congress and the regulators?

Lynch: I spend zero time thinking about what's happening down here in Washington, and I spend only a little time thinking about what's going on in Russia or China. I just deal with facts. When the economy's going down, when economy's going the wrong way, I can deal with that. But this whole healthcare reform bill drove a lot of drug stocks down to low levels. I could say to myself, "60% of Johnson & Johnson's earnings are outside the United States." Their pharmaceutical drug business is all patented and nothing's coming off patent. They only have 5% of sales from one product, which is Tylenol, which is already an over-the-counter drug and it's growing overseas. Why has this stock gone from $58 to $36? These companies are already dealing in Japan and overseas. They already have the government controlling pharmaceutical prices. They've dealt with them. I deal with facts. They might, this year – I thought it was likely they'd have a bill passed on healthcare. It didn't happen. It drove the stocks down, but I think the stocks would have rebounded anyway even if the healthcare bill had passed. I don't deal with what's happening in Congress or what's going to happen in the future. I just deal with what's happening in the economy and what's happening in the companies I call.

Karmin: How useful is the financial reporting in the general daily press to you? And how useful should it be to investors in general?

Lynch: It has improved dramatically not just in the press but also company reporting. Ten years ago, companies didn't have interim balance sheets. I'd imagine they only gave their balance sheet to you annually. Now they share it quarterly. They report inventories, receivables, and other useful information. In the major newspapers, they even show types of funds. There are around 2,500 companies in the New York Stock Exchange. There are over 5,000 different mutual funds, twice as many mutual funds as stocks. At least in the paper, they explain something about the fund.

If you own auto stocks, you shouldn't be reading the financial part of the newspaper. Many local newspapers devote a whole four pages on automobiles weekly. They talk about new models and offer opinions about automobiles. If you own auto stocks, that's the part of the newspaper automobile stock owners should look at.

You shouldn't be calling your broker four times a day to get stock quotes. It doesn't work. Getting up in the morning to see how your stock did yesterday is not useful, either. All this stuff is just a waste of time. If you're adding up how much your stocks are worth, it's an absolute waste of time. You should be looking at the company when you get the quarterly reports.

If you were in the retailing industry or if you were in the restaurant industry, you would have seen companies like Taco Bell, McDonald's, and Toys "R" Us. You would have seen all these companies do terrifically well. You would have seen Bombay and Radio Shack and its Tandy. You would have seen Radio Shack roll across the country until there were 25 Radio Shacks in every major city. You said there's not much room for them to grow, but they had a great 20-year run. That's what you're dealing with. You're not dealing with the minutiae of today. You're dealing with what this company is doing two years, three years, four years, five years from now. If you're dealing with a cyclical and business is turning around, you wait for signs that business is slowing down. When you see it, you move on to something else.

Karmin: Are you concerned about the volatility in the financial markets today? Do you think something needs to be done to reduce it?

Lynch: I love volatility. I remember the market went down dramatically in 1972. Taco Bell went from $14 to $1. It had no debt. It never closed a restaurant. I started buying at $7, but I kept on it and it went to $1. It was the largest position in Magellan in 1978 when Pepsi-Cola bought it out at $42. It would have gone to $400 if Pepsi hadn't bought it out. Volatility is terrific. These calls are important. I don't think the market going up 80 points one day and down 80 the next is a good thing for the public. But I think all these callers and all these other things to keep the volatility down each day is important, but the market is going to go up and down.

Human nature hasn't changed a lot in 25,000 years. Some event will come out of left field and the market will go down or the market will go up. Volatility will occur, and the markets will continue to have these ups and downs. That presents a great opportunity if people can understand what they own. If they don't understand what they own, they can own mutual funds and keep adding to their mutual funds. Basic corporate profits have grown about 8% per year historically. Corporate profits double about every nine years. The stock market ought to double about every nine years, too. The market is about 3,800 today. I'm convinced the next 3,800 points will be up. It won't be down. After that – the next 500 or 600 points – I don't know which way they'll go. The market ought to double in the next eight or nine years and double again in the eight or nine years after that because profits will go up 8%, then stocks will fall. That's all there is to it.

Karmin: We're in the month of October. Beware of the month of October, the witching month of the stock market. What do you see as the outlook for this month? And when do you think the Dow will hit 4,000?

Lynch: October's always been a special month. In 1987, I was convinced the market was not in trouble and I didn't worry about things. Carolyn and I planned this great golf vacation to Ireland. We planned to visit one course and stay at a little house and visit another and go all along the west coast of Ireland and play golf. We left on a Thursday night. The market went down 55 points that day, which was not too good. The next day, we got to Ireland. Because of the time difference, we had completed our day. I got back to the hotel and called in. The market had gone down 112 on Friday. I said to Carolyn, "I think if the market goes down on Monday,

we're going to have to go back." We stayed there for the weekend, and on Monday, the market went down 508 points. My fund went from around $12 billion to around $8 billion. That gets your attention – two working days. I said by the end of this week, I'd have no fund.

There wasn't a lot I could do. Here it was Monday, because the market didn't open – by 12:00 in Ireland it was still 7:00 in New York. We did spend that day, and we played around and golfed more, and then we went somewhere instead to watch the market deteriorate. I did return home. There was nothing I could do about it. But I think my shareholders thought differently. They called up and asked, "Well, what's Lynch doing?" They said, "He's on the sixth hole. He's even par now, but he's in a trap. This could be a triple bogey here. This could be a big inning." I don't think that's exactly what shareholders wanted to hear, but it's not like I could do something about this damn thing. So, I came back home and suffered with everybody else. I was consistent. When I ran Magellan, in 13 years the market went down nine times. Every time the market went down, Magellan went down. I was nine for nine.

Here's another one of these numbers you must write down: If you put $1,000 in a stock, all you can lose is $1,000. I've done that several times. But if you're right, you make $5,000, $10,000, $20,000. In this business, you don't have to be right one out of two times. You can be right one out of four. A lot of the times you're right, you know the company's doing well, you know they're doing a great job, and you add to it or at least you don't sell it, which is a tragedy. You can make more money on the upside. I just roll those out. I will now flip a coin to tell you whether the market will go to 4,000 this year or next year. Heads means it goes up, but it's a two-headed coin. I flipped the coin and the market will go up in the next year. That's it. That's all I ever know about the stock market.

Karmin: As you can imagine, we have many questions about where people should put their money. I'll divide it into two parts, and you can address it. This questioner intends to put $1,000 yearly into their four-year-old daughter's education fund. Where should it be invested? The other question covers everybody else: What are some of your current market favorites and why?

Lynch: On the first one – and this is important whether you're investing for a four-year-old, a 14-year-old, or a 74-year-old – you must ask, "What am I going to do when the market goes down?" I've had audiences like this, and I've asked, "How many people in the room are short-term investors?" I've never had anybody raise their hand. Everybody in the world is a long-term investor until the market goes down. I remember 1990, a scarier year than 1987. In 1987, the market just fell. You call up companies, and they say, "Our business is terrific. We're about to announce a stock buyback. We're already buying back stock. Business is great, and we can't figure this out." But 1990 was different. Iraq invaded Kuwait. You had the banking system on the ropes, I mean close. You call up a company and they say their business was slowing down.

We sent 500,000 troops to Saudi, and we're about to fight what people thought was the fourth largest army in the world. Some said they were the toughest army in the world. This was going to be a terrible war, and we ought to sit them out. Remember the big theory? A lot of people in this city said we ought to wait them out. We'd still be waiting for them in 120 degrees, about 500,000 people. I think Bush made an incredibly brave decision on the information he was getting to go in there and knock them out or we'd still be there. But that was an ugly time, and that was scary. Some people learned from 1987 and they stood throughout that and said, "I'm confident about the next 5, 10, 15 years in this country," and they hung in there.

If you want to buy a small growth fund or a balanced fund that's part bonds and part stocks and you put so much money in, then you should put more in every year. You'll be pleased in 10, 20, or 30 years. Stocks will beat the hell out of money markets. They'll beat the hell out of bonds. Think of it this way: Great corporations like McDonald's, Marriott, or any other will never get together and say, "We're doing well. Why don't we raise the coupon on our bonds? Those bond holders have been loyal. We've been given 8%. Why don't we raise it to 9%?" Companies like Automatic Data Processing – it does payrolls, an amazing prosaic company, 32 years of higher earnings, 32 years of double-digit earnings growth. We've had recessions. We've had wars. We've had changes in Congress, changes in the Supreme Court, but it's had 32 years of up earnings. That's what you're relying on; Johnson & Johnson has 30 years of up earnings, General Parts 42 years of up earnings, Emerson

Electric 38 years of up earnings. You don't see companies like this in other parts of the world. That's what you buy when you buy a fund. You buy a bunch of good companies.

As for the stocks, the financial area has been attractive. Stocks like Chemical, or Traveler's, or Citicorp, or Bank of Austin, Fannie Mae, Freddie Mac, these stocks have all come down. Their businesses are terrific. They've improved their balance sheets. They're selling at multiples half or 1/3 lower than the general market. We have a chance for the cyclicals for the first time in a long time – the steels, papers, aluminums, chemicals. It's their turn to come to the plate. We seem to have an economy recovering in Latin America. Brazil is turning around. These are facts, again. Things are improving in India. Europe had the worst recession since the Depression. There are 18 million people out of work in Western Europe right now, and the economy is starting to slowly turn. Japan has bottomed. I think you'll see demand.

Commodity prices look attractive. Aluminum prices reached a 30-year low. Ingot has almost doubled. You'll see the same thing with linerboard. We'll see a good time for cyclical stocks, and I think the auto stocks are also extremely cheap at four or five times earnings. These are not extraordinary times. Housing is affordable. It's not as affordable as it was two years ago, but on a 20-year basis, housing is affordable. Automobiles are affordable. Consumer durables are affordable.

We hear about job growth. In the recession, we lost 1.8 million jobs, and now we've added 5.8 million, 4.5 million in the last 19 months. We lost 1.8 million and we've added 5.8 million back. We're 4 million to the good. The tough part of it is we dropped about 600,000 manufacturing jobs and we only brought back 100,000 manufacturing jobs. But there are a lot more people working, and I think that trend will continue. This is key. This is what you hear from the press. This is what you hear from TV. In the decade of the 1980s, the 500 largest companies eliminated 3 million jobs, but there were 2.1 million businesses started in the 1980s. If they just have 10 people each, that's 21 million jobs. It's an incredible job machine we have in America.

That's what happened in the 1980s. These 2.1 million businesses created all the jobs. In the decade of the 1990s, the top 500 companies will eliminate another 3 million jobs, and all you ever hear about is company X lays off 5,000 people in Hartford, and company Y lays off 5,000 people in Rochester. Somebody doesn't buy a sofa in Scottsdale, Arizona because they read about layoffs in the Northeast. That's the nature. These companies must make these layoffs to stay competitive. That's our business. We've had, in the last 2.5 years, 1,750 companies become public. They raised over $100 billion. There are only 2,500 companies on the New York Stock Exchange. They'll put the capital they raised into research and development. They'll put it into more plants and more efficient equipment. This is a fantastic thing for these companies. I think the situation is excellent.

The banking system today has more investments on the left side of the balance sheet. We're talking about the governments they own, the mortgage-backed securities they own, then they have loans for the first time ever since 1951. They're only making 50, 20, 30 basis points and they said, "We'll have to make loans." The banking system has the highest equity-to-assets in 45 years. The banking system is ready to go. There's lots of liquidity to run. I don't know why some people are so depressed about people getting hired all the time. I can't quite figure this out. I've never met a banker or anybody in business that likes recession. I've yet to find these people.

Karmin: Speaking of banks, are you concerned about banks being allowed to offer mutual funds and the confusion that creates among investors over whether bank deposits are insured or not? Are you concerned about the whole question of deregulation?

Lynch: I think it's positive that banks will be allowed to sell mutual funds because they'll probably sell a lot of Fidelity mutual funds. That's important. No, but seriously, I think it's important that people understand when they own a bond fund that bonds can go up and down. Bonds are just about as volatile as stocks. If they own a 30-year bond fund, then you can lose 25%, 30% of your money fast even if they're government bonds. People must understand this.

There's an incredible rate of illiteracy in our public. All they ever hear about is what happened today to Bristol-Myers going up $2 or $3, what happened to Dow Jones. They don't get to learn anything about America. People near retirement are given, say, $450,000 as early retirement. They have no experience. They don't know what a bond is. They don't know what stocks are. They must make decisions in 30 or 60 days, or they'll have a big tax consequence. These people have no experience learning about the stock market. It's a tragedy. I think anything we can do to educate the public, if you can convince people, if they understand the volatility of the stock market – I'm not saying anybody should buy a stock. I'm just saying if you purchase a stock, you must do certain things. If you're not ready to do those things, you should keep your money in the bank. Keep your money in a money market fund.

Some people don't do their homework, they don't have the stomach for it. They should stay out. They're not doing anybody any good by taking half their life savings and putting it in the stock market. They've been lucky enough to save $50,000 or $60,000 to send their kids to college, and one is going to start in a year. They're going to take all that money and put it in an equity mutual fund with a one-year horizon. That's doing no one any good. The SEC is working hard on explaining to people the nature of these products. If they understand them, they'll do better with it. The more information, the merrier.

Fidelity is launching a major study on retirement. It will be out by the end of this year. We'll do it over 1,600 people, over 300 experts. We'll do a major study and explain to people the nature of retirement and how they can best understand how they should invest their assets. We won't mention Fidelity – maybe subliminally! We're trying to help. There's been an incredible push by the SEC to do this, and I think it's a positive element.

Karmin: A couple of questions about that. What do you think of the SEC's proposal to require mutual funds to adapt a quantitative ratings scale for riskiness? Also, what effect do you feel the new shareholder rights proposals for more open disclosure and communication are having on companies and the market?

Lynch: I'm not too familiar with the SEC proposal. Concerning the new shareholder rights proposals, I think you must be careful crossing the bridge on how much we get involved in managing companies. There should be a disclosure about people getting paid and a disclosure on how many shares they own. But I don't think we should decide whether they should make this acquisition or whether they should expand this plant. When you get too involved in running a company, it's complex. A lot of great companies have made a lot of decisions you haven't heard about because they decided not to do something, so the best decision they didn't do is to not do something. If they're under all this pressure from shareholders of what to do and what not to do, they'll take their eye off the ball and won't be able to run the business. The companies that do well look out five, six, or seven years. Some of the decisions they make might not be the right thing for the next year, but they are the right thing for years later. The more we concentrate on what they're doing and we keep commenting on it as outsiders, it's going to be run by an enormous committee and we'll get committee results. I don't think that'll help anybody. But disclosure of relevant facts like how many options people have, whether the options are at the market, and what they're paid – I think that's important.

Comments in a letter by the Chief Executive in the annual report are fairly new. It is a valuable piece of information. You don't realize these companies spend a lot of time on this letter. It's a serious document, and it's helpful to shareholders. Quarterly shareholder reports are excellent. Also, everybody in America can contact a company. Access is not limited to Fidelity and Platinum and Dreyfus. If you own 100 shares, you can call a company, and somebody will talk to you about it. People don't take advantage of that. These companies are willing to talk.

On these quantitative and qualitative risk ratings, I think if it could be done, I think it might be possible. I'm a little confused about it. I'm not that current on it. But I think people should understand that certain stock funds, emerging growth funds, small cap funds, and investment companies with $50 million of sales are more volatile than when you're buying major quality blue chip growth companies. Also, long-term bonds are more viable than medium-term bonds, which are more volatile than one-year bonds. These are things that should be explained to people. People should get a menu like you get at Howard Johnson's.

Karmin: Several people in the audience asked how you view Fannie Mae's stocks and options today.

Lynch: I'd include Freddie Mac in that, too. Both companies have great businesses. People study chess. This would not be a good game to study for the stock market. In chess, an outstanding player beats a good player 1,000 times in a row. Everything's in front of you. All the moves are known. It's all technique. However, in poker and bridge, there are many uncertainties. You can play a hand exactly right and lose. You can say, "Well, I played it right. If I do it again, over a night, over a month…." That's not the stock market. The stock market is closer to poker than to any other game, and I think that's the important thing to know.

Fannie Mae has been like a 27-card stud poker game. Cards keep getting turned over. We were not doing so well in Houston – this was 10 to 12 years ago – with these 5% downs that a lot of people had in mortgages. People moved there for jobs. They brought their spouses along. The job left. They had no ties to those communities and they left. It was the same in Oklahoma or in Alaska. When that card turned over, it was ugly. They were losing $1 million a day. That was easy to remember. That wasn't too pleasant. They finally figured out we have a good business. We're extremely low cost. If we can match our liabilities and assets, make a small spread even when we have low cost, we can have a pretty good business. Then a card would turn over like when real estate prices started to go down in California. They started to go down in the Northeast. Then you'd say, "Oh, I better keep checking to see what foreclosures were like." If you keep watching the story, every year you get a chance to buy this again. Something will come up. People are worried rates would go down. Stocks went down because rates went down. Now that interest rates are going up, the stocks are going down because interest rates are going up. Freddie Mac and Fannie Mae are still doing great, and I think they'll be terrific stocks. They won't quadruple, but they're about 25% undervalued now. They'd be good stocks to own for five years.

Karmin: This next question is from a fellow with a real problem. He says if the real secret of your success is following your daughters to the shopping mall for stock tips, what do we bachelors do?

Lynch: I think one of the reasons people get so depressed is they get away from children. On the weekends they read all these magazines, they need the newspapers, and they'd become economists and get so depressed. They're bullish if they take that lunch to work on Monday. You need to rent a 12-year-old on the weekend. They don't know about the problem of the ozone layer disappearing and all these terrible things we think of all the time and we get so depressed about. They don't know about how second basemen and shortstops get paid $4 million and they can't throw to first base on a bounce. You need to find a 12-year-old and rent him for the weekend and follow this boy or girl around and see where they're shopping.

Our kids love Body Shop. I bought it, and I think it will be a good stock. Our oldest daughter, Mary, likes Ann Taylor. She had to dress up to go to work when she was working a summer in a consulting firm. She thought Ann Taylor's prices were good and the quality was good, and it was a great stock pick. My wife, Carolyn, is an extremely good shopper. She almost got a black belt in shopping. Because of the children, she didn't quite finish that, but she's a good shopper. She's given me some great tips, too. I think either you must use your spouse, or you must go out on your own.

Once the biggest position in my fund was Hanes, which owned L'eggs. It was a huge stock. Consolidated Foods eventually bought it. Hanes had a monopoly on L'eggs, and L'eggs is a big company. I knew somebody would come along with a new product. Kayser-Roth introduced "No Nonsense." I was worried this "No Nonsense" thing was better, and I couldn't quite figure out what was going on. I went to the supermarket and bought 62 pairs of "No Nonsense." I bought different colors, different shapes. They must have wondered what house I came from. I brought them into the office and passed that to anybody, male or female, who wanted one of these things. Just take them all and tell me how it is. They came about in about three weeks and said it's not as good. That's what research is. That's all it was. I held on to Hanes, and the stock was a huge stock. That's what it's about.