Learn how to Invest from Peter Lynch

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Abstract

Peter Lynch has written many investment books, such as "Peter Lynch's Successful Investment", "Victory of Wall Street", "Learning to Get Rich", etc., from which we can see the practical investment strategy he followed: pay attention to the fundamentals of stocks by carefully studying the operation of individual stocks, and hold stocks for a long time to obtain high returns. After collecting and arranging the investment strategy discussion of investment master Peter Lynch, I introduce Lynch's investment philosophy from five aspects of how to judge the bull and bear, stock selection, buying, holding, and mentality.

Keywords

Stock investment; Peter Lynch; Fundamental Analysis.

1. Introduction

Investment can help us earn money lying down. However, can investment always make money? Not necessarily. I have a relative who wants to invest with spare money, but blindly listens to others, does not think independently, and is fooled into private loans, direct sales, then she lose money. It is necessary to receive training before investing, mainly including investment knowledge training, discipline and patience training. I think reading the book of investment masters is a good training method, because these are the essence of investment experience of investment masters in their lifetime.

Investment and financial management should follow the general trend. Wealth accumulation largely depends on the opportunities brought by the economic situation. The relationship between the economy and the stock market is just like the owner and the dog. The dog will always run in front of the owner, but when it has a certain distance from the owner, it will run back to find its owner. We should believe that the stock market can make money because the economy is constantly evolving, but we also need to keep in mind that investment is risky. Learning to judge bulls and bears and finding good companies is the key to surging in the investment market.

2. How to identify bulls and bears

The stock price will never equal the actual value of the company, otherwise, there will be no stock exchange. During the index rise, even the worst speculators can make some money; and during the index fall, even those who pick good stocks can't make any money. Therefore, Speculation focuses on general trends, followed by stock picking.

2.1 Through market sentiment

Lynch's cocktail party theory humorously explained how to judge the stock market bulls and bears from the level of market sentiment. "In the first stage, when 10 people would rather talk about the treatment of dental plaque with the dentist than talk about the stock with a mutual fund manager, it is very likely that the stock market is about to stop falling and rebound. In the second stage, after I replied that I am a mutual fund manager, the newly met guests stayed with me for a longer period of time--perhaps long enough to tell me how risky the stock market is--and then they went to talk to the dentist again at the cocktail party. More talk is still about plaque instead of stocks. From the first stage to the second stage, the stock market has risen by 15%, but few people have noticed this. In the third stage, as the stock market has risen by 30% since the first stage, a large group of excited people have

been around me all night, ignoring the presence of the dentist. Enthusiastic guests pulled me aside and asked which stock should I buy one after another, and even the dentist will ask me this. Everyone at the reception put money on a certain stock, and are talking about the future trend of the stock market. In the fourth stage, when the neighbors told me which stock to buy, and I regretted not following their advice after the stock price rose, it is an accurate signal that the stock market has reached its highest point and is about to fall."

This example tells us that when the stock falls in the bear market and everyone is disappointed with it and no longer pays attention to it, the stock market will gradually bottom out and then gradually rebound; while the public is still immersed in the losses and disappointment of the last bear market, stocks have gradually started to rise, and it is undoubtedly the best choice to enter at this time; when people find that the stock market has begun to recover and a large number of capital have poured into the stock market, it means that a new round of bull market is booming, and stocks will also enter a stage of crazy rise; when everyone is keen to talk about stocks while injecting capital frantically, the stock market is already close to the highest point and is ready to fall. At this time, smart investors will withdraw their capital in time.

3. How to select stock

3.1 Basic principles for stock selection: choose a company you really know

Each stock is actually a company behind it, you have to figure out the operation of this company. It often happens that in the short term, for several months or even years, the performance of a company has nothing to do with its stock price performance, but in the long run, the performance of a company is completely consistent with its stock price performance. Choose the stocks of successful companies and hold it patiently will achieve investment success. You have to figure out what the fundamentals of the company you are holding are and why you hold this stock.

Think of stocks as your own children. You can't raise too many children, and you can't invest too much in stocks. You have not enough time to take care of too much children. An amateur investor, even using all available spare time, can only track 8-12 stocks at most. Lynch suggested that amateur investors should not hold more than 5 stocks at the same time.

If there is no way to find a stock of a listed company worth investing in, then stay away from the stock market and save money in the bank until you find a stock worth investing in. Never invest in company stocks that you do not understand their financial status. Before buying stock, first check the company’s balance sheet to see if the company has sufficient solvency and whether there is a risk of bankruptcy.

3.2 Stock selection strategy

(1) Pay attention to the companies around you

For ordinary investors, there are many opportunities to discover excellent companies. Ordinary investors come from all walks of life, and they can understand the real outstanding companies in each industry. In addition, while daily life involves a wider range of industries, as long as investors can pay attention to the details of life, they can seize good investment opportunities.

(2) Classify companies

Lynch divides the company into six types:

- Stable and slow growth type: This kind of company is characterized by huge scale and long history, and its growth rate is slow. Such companies cannot bring in high amounts of reporting and we should avoid investing in it.
- Big elephant type: The company's performance is stable, and its price is relatively stable during the economic recession, which can provide better protection for the asset portfolio and can be properly held to reduce risks.
- Rapid growth type: This type of company has the basic characteristics of small scale, annual growth rate of 20%-25%, and vitality. In a slow-growing industry, a company that can

continuously expand its market share can also become a fast-growing company. Such companies have good investment value.

- Cyclical type: This kind of company , such as automobiles and airlines, and steel companies, goes through cycles of expansion and contraction and their sales revenues and profits rise or fall regularly. Investors must discover early signs of a company's decline or prosperity in order to buy stocks at the right time.
- Transformation dilemma type: Transformation dilemma companies are those that have been hit hard by the recession. The investment risk seems to be greater, but the return is considerable. It is important to be able to judge whether the transformation will succeed, which requires calm analysis of information and good patience from investors.
- Asset surplus type: An asset surplus company is a company that operates valuable assets that are ignored by experts. Assets refer to real estate, metals, oil, and even debt. Assets may not be related to the company's main business, but there is great room for appreciation. Once such a company is discovered, it is an excellent investment opportunity.

Lynch pays special attention to asset-surplus companies, fast-growing companies, cyclical companies and companies with difficulties in transformation which involve risk but high returns.

(3) Some useful rules

Peter Lynch, an investment guru, sums up some of the characteristics of companies with investment opportunities. These features seem simple and simple, but actually contain an important lesson about how the fundamentals of a company are good.

1. A company's name sounds silly;
2. A company's business is "boring";
3. A company that is separate from its head office by drawing funds;
4. A company’s share that institutional investors won't buy, and analysts don't pay attention to;
5. There are many rumors about the company;
6. An industry you don't want to focus on;
7. An industry with zero growth;
8. A company with protective barriers;
9. A company producing consumable consumer goods;
10. Even the company’s employees would like to buy its share;
11. A company that buys back its own shares.

Companies with these characteristics are actually those companies are doing well and are not noticeable and therefore are undervalued. At the same time, don't be fooled by your industry when investing in companies. Any company that has both great-growth and undervaluation is a good company to invest in.

Avoid hot stocks in hot industries. 'If there's a stock I wouldn't buy, it's the hottest stock in the hottest industry,' Mr. Lynch says. Hot stocks are so popular because their stock prices have risen so fast that they are always unbelievable. Unfortunately, hot stocks also fall quickly, even faster than the rise which makes you unable to find an opportunity to get out. The stocks of outstanding companies in unpopular industry and no growth industry tend to be the most profitable big bull stocks. For small company stocks, it is best to wait patiently and wait until these small companies start to realize profitability, and at this time it is not too late to consider investing.

3.3 Valuation

The most basic principle of investing in stocks is to buy undervalued stocks. Lynch mainly uses the P/E ratio for stock valuation.

According to Lynch's six classifications of stocks, the stock price-earnings ratio of different types of companies also varies greatly. Many investors look for stocks with low P/E ratios by comparing the

P/E ratios of different industries and different companies in the same industry to obtain excess investment profits. But Lynch reminded us that stocks with low price-earnings ratios are not necessarily worth investing in: "Some investors think that no matter what stocks should be bought as long as its price-earnings ratio is low. But this investment strategy makes no sense to me. We should not compare apples to oranges. The price-earnings ratio that measures the value of Dow Chemical's stock is not necessarily suitable for Wal-Mart."

It is of course silly to only consider the price-earnings ratio, but it is a very easy-to-obtain data after all. When used correctly, it also has a considerable use for analyzing stocks. Therefore, you should not ignore it, but analyze it reasonably.

When judging whether the stock is overvalued or undervalued based on the price-earnings ratio, a full and comprehensive comparison must be made. One is to compare the industry price-earnings ratio with the overall market price-earnings ratio; the second is to compare the target company's price-earnings ratio with the industry's average price-earnings ratio; the third is to compare the target company's historical price-earnings ratio in different years.

Regarding the use of the price-earnings ratio indicator, Lynch's advice to investors is: "If you can't remember anything about the price-earnings ratio, but you must remember that you should never buy stocks with particularly high price-earnings ratios."

4. Buy-in

Lynch believes that the prerequisite for choosing the best time to buy stocks is to find stocks that are undervalued by the market: "In fact, the best time to buy stocks is always when you are sure that you have found a stock at the right price, just as you found a commodity at a reasonable price in the mall."

From years of investing experience, Lynch has found that the best trading opportunities may occur in the following two specific periods.

The first opportunity is at the end of the year. It is no accident that the worst falls in share prices always occur between October and December of the year, as brokers and investors are often willing to sell shares cheaply in order to spend at the end of the year. Institutional investors also like to clear some loss-making stocks at the end of the year in order to adjust their future securities portfolio. All these sell-offs will cause the stock price to fall, which will have a greater impact on stocks with lower prices.

The second opportunity occurs during the crash, fall, and plunge that the market will appear every few years. In these scary times, if investors have the courage to buy calmly while shouting "sell" in their hearts, they will seize the good opportunities that they once thought will not appear again. For those well-managed and profitable company stocks, it is a good time to invest in a market collapse.

5. Shareholding

The people who try to take advantage of even the smallest fluctuations are the stock players. The stock players are the gamblers, without any big analysis, without any strategy, who behave like roulette players, moving from one table to another. In the long run, sooner or later, the players will go bankrupt when the stock price is flat or falling. There are two types of investors, stubborn and hesitant, and the winners are stubborn. In the long run, the profits of the stubborn investor are paid by the hesitant investor. The players in the stock market are hesitant investors. Stubborn investor needs four essential ingredients: money, ideas, patience and luck. Imagination is more important than knowledge. Only when you have patience can you enter the market. Without funds or even debts, you cannot have patience.

After buying a good stock, you should take sleeping pills and fall asleep, ignoring the turmoil in the stock market during this period, so as not to panic and sell all the stocks before the market goes up.

6. Mentality

Stock market crashes often occur, just as snowstorms often occur during the severe winter in the northeast region. If you are fully prepared in advance, you will not be harmed at all. Investors in the stock market who are not prepared in advance will be frightened, sell at a low price, and escape from the stock market. Many of the shares will be very cheap. But for investors who are good at looking ahead, it will be a great opportunity to buy on the cheap.

Only if you have the knowledge and courage can make a lot of money in stock. If you are easily influenced by others in the panic of the stock market crash, and you are scared to throw away the stocks you hold, then you who are afraid of the decline should not invest in stocks and stock funds.

Don't be anxious about the alarmist comments on the social platforms, or ignore the pessimistic predictions in the news reports, and don't be scared to worry that the story will collapse and sell in a hurry. Unless the company's fundamentals deteriorate, do not panic and fear and throw out good company stocks.

No one can predict future interest rate changes, macroeconomic trends and stock market trends in advance. Ignore any predictions about future interest rates, macroeconomics and the stock market. All you have to do is focus on what is happening to the companies you invest in.

When you hold a good company's stock, time will be on your side, the longer you hold it, the greater the chance of making money. Holding good company stocks patiently will eventually pay off well.

If you have the courage to invest in stocks, but do not have the time or interest to do homework on the fundamentals, then your best option is to invest in stock funds. You should diversify your investment in different stock funds. The investment style of fund managers can be divided into growth type, value type, small-cap stocks, large-cap stocks, etc., you should invest in several types of stock investment funds with different styles. Investing in six stock funds with similar stock styles is not a diversified investment. If one or several funds to be invested perform well, do not abandon them casually, but hold firmly.

7. Conclusion

Reverse is the key to success. Only a few people can speculate to succeed. The key is to be different and believe in yourself. Continue to buy during the first phase of the rally, watch and passively follow the moves during the second phase, and exit during the third phase of general euphoria. The whole trick is to determine where the market is. In addition, choose an enterprise that you really understand and really optimistic about this enterprise to invest. We have to choose companies that are undervalued and hold them patiently, like snowballing. Be an investor, don't be a securities player. Always keep calm and control the emotional elephant

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