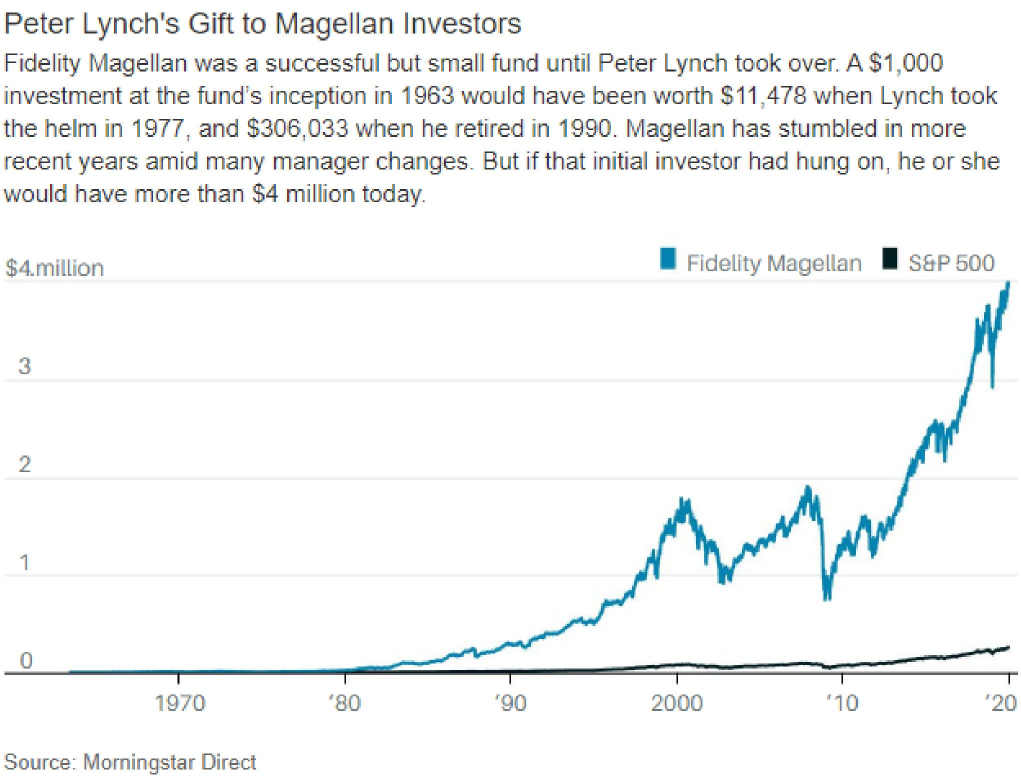
[FREE Stock Market Investing Course by Sven Carlin]

7 TIPS For stock market beginners from the best investor ever - Peter Lynch

## Contents



I continue summarizing one of the best stock market investing books ever written, One Up On Wall Street by Peter Lynch, Fidelity Magellan fund manager that delivered 29.3% yearly returns over 13 years.




He did even better for his wife.

I recently read a Barrons interview with him and to give a long-term overview of what he did with his investments, he said that he turned the $750 per year his wife invested in her IRA between 1974 and 1978 into more than $10 million!

> Has he beaten the market? He answers by relating the history of his late wife's IRA, which he managed. She put just $750 a year into it from 1974 to 1978. Along the way, the Lynches took out about $3 million to pay for weddings, graduations, honeymoons. When Carolyn died of leukemia in 2014, it was worth $8 million, even after the withdrawals. He reckons the account was up 350,000%—which, in Lynch parlance, would make it a 3,500-bagger. The account went to the Lynch Foundation.

YES, that is more than 3,000X return by simply, boring investing in the stock market.

The first part of his book is dedicated to stock market beginners and I'll summarize the 50 pages for you and turn it into 7 tips for stock market beginners. While summarizing the stock market for beginners part and giving tips we will also answer the most important questions that plague beginning investors;

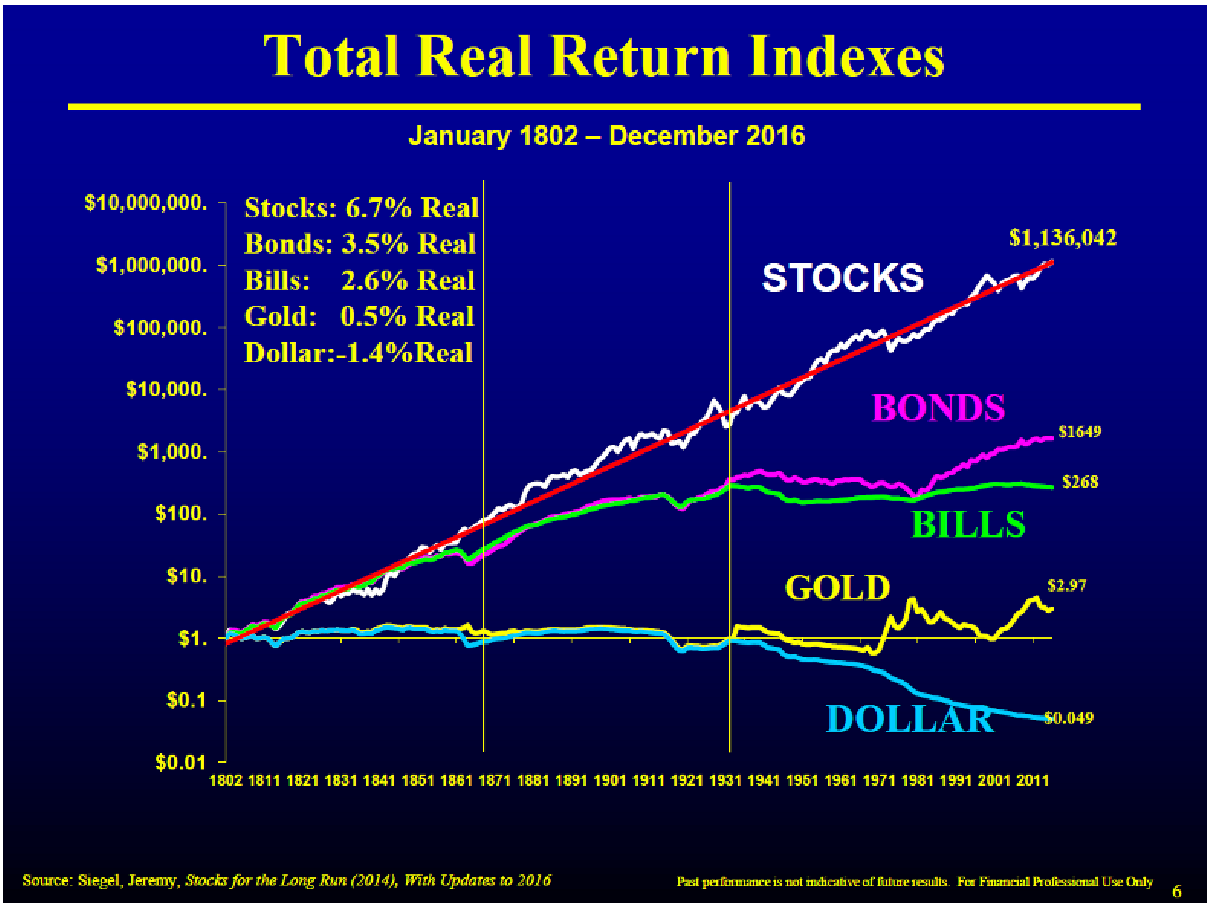
- What is a stock?
- What to focus on as a beginner?
- What is a PE ratio?
- Is it risky to invest in stocks, is it gambling?
- How the stock market works?
- Is it worth to invest small sums?
- Should you invest in stocks at all? The mirror test!
- Is this a good time to start investing?

## 1) Investing in stocks is not gambling because the odds are in your favor – what are stocks? What is a price earnings ratio – PE ratio?

Many think that the stock market is just a casino. Well, it is not. What is a stock? A stock is not just something traded on the stock market, a stock is a piece of paper that gives you part ownership of a businesses.

You can't say to a business owning baker, plumber, hotel owner, engineer, programmer, sofa maker, carpenter or farmer that they are gamblers. They simply do what they know how to do to sell their products and services. The same applies to the stock market, when you buy a stock, you buy a share in a business. The gambling part depends only on you, not on the stock market.

Do you know what has been the best investment over the last century? The best investment has been to invest in businesses, or part of businesses through stocks.



Stock market returns versus bonds, Treasuries, gold and the dollar - Source: Bogleheads

Just $1 dollar invested in stocks in 1802, adjusted for inflation, would now be around $1,136,042, while the same dollar invested in bonds would be just $1649, $268 if invested in short term Treasury bills, $2.97 if invested in gold and just $0.49 if kept under the mattress.

So, I never understand how can something that is proven to be one of the best investments out there, be called gambling? Well, I do, when people focus on stock prices, not on the business they get to own, it can quickly turn into gambling.

So, in order not to make the stock market turn into gambling for you, you need to focus on buying businesses, see how much are you willing to pay for a business and whether you have better opportunities elsewhere. The point is that you invest in businesses and only if the stock market gives you crazy opportunities to sell your share of a business at an extremely high price or to buy extremely cheap, only then you look at stock prices.

**You have to take advantage of stock market volatility, don't be taken advantage of.**

A great example is Apple stock because it is a business we all understand. The stock was below $100 3 years ago, the it went above $220, fell below $150 in December of 2018 only to jump to the current level of $280. This looks like a rodeo and some might consider it gambling.


Apple stock price volatility – CNN MONEY AAPL

However, as an investor in stocks, you look at the business, what is the business delivering and what you are willing to pay for it. If we look at AAPL's earnings per share, those increased from around $8 to the current $11 over the last 3 years while the stock went from $100 to $280.

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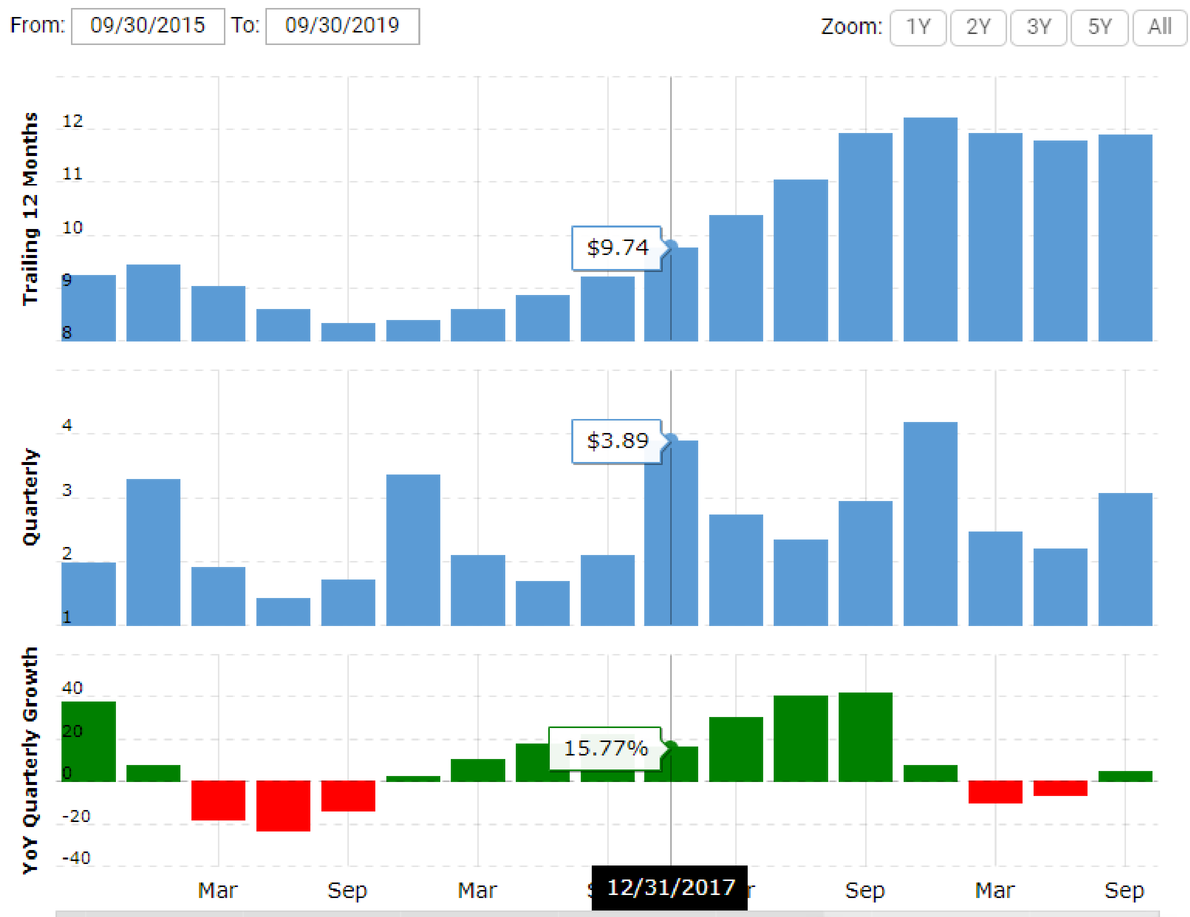



Apple stock earnings – AAPL Earnings

So, 3 years ago, the market was willing to pay a price 12 times earnings. As I am writing this, the market is willing to pay 24 times earnings. Personally, I don't see any changes in AAPL's business, it is just that the market is now exuberant about something it was pessimistic about.

**PRICE EARNINGS RATIO EXPLAINED**

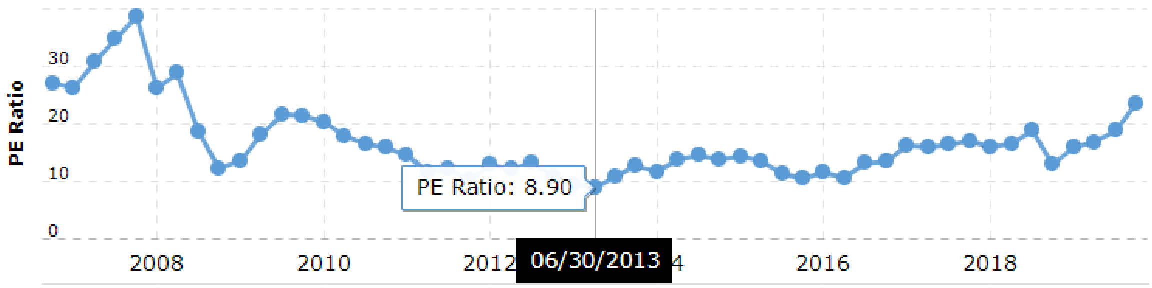
The price to earnings ratio is important because it tells you what is the price you have to pay in relations to the returns the business is delivering. Remember, we are investing in businesses, not stocks. So, investors that invested in apple with a price to earnings ratio of 12, were buying a business with an 8.33% yearly business earnings yield. I think that 99% of investors should be happy with an 8.33% investment return. Your investment return depends on the business earnings the company will deliver, but more about that when we touch on that subject.

Calculation of the business' earnings yield using a price to earnings ratio.

$$BUSINESS\ EARNINGS\ YIELD\ (\%) = \frac{100}{Price\ to\ earnings\ ratio}$$

Today, when the price to earnings ratio is 24, the yield of the business is: 100/24 = 4.16%.

This means that suddenly, due to optimism, investors are willing to pay a much higher price and get a much lower return for the same business. Now, if in the next 2 years, investors become pessimistic about Apple again (something that happens every few years) and are willing to pay just 12 times earnings, it is possible that we see Apple's stock price below $150 (EPS of $12 * PE ratio of 12 = $144). If that happens, those that bought Apple at $280 would probably say that the stock market is just a casino, that it is all about luck and that you should avoid it altogether.




But, when you are paying $280 for Apple stock, you are saying you are happy with a 4.17% yearly return from the business. If I deduct the 1.1% dividend yield from the expected return, investors should be happy with a 3% return from Apple's stock over the long-term.

So, if I pay now $280 and the yearly return is just 3%, in 10 years, the stock will be at $376.

$$A = P(1 + r)^{nt}$$

Yearly compound interest calculation where:

A is the final price, P is the current price, *r* is the return (interest rate) and *nt* is the number of years.

$$\$376 = \$280(1 + 0.03)^{10}$$

Not bad but not even great. The key to understand here is that investors' expectations influence the stock price. However, what you have to care about is what your expectation is and then simply buy businesses that cater for your expectations.

The problems arise when you buy Apple at $280 because you think the market is going to pay $350 for it within 12 months. Then you are gambling because it is impossible to know where the stock price will be in 12 months. But, it is pretty possible to estimate that Apple as a company will make between $50 ad $70 billion in earnings over the next 12 months.

If you can grasp this key difference between investing in businesses and speculating with stocks, you are on the right way and already ahead of 95% of other stock market participants.

**Don't forget businesses grow over time – another odd in your favor**

Another great benefit of investing in stocks is that businesses grow. Going back to Apple's earnings, those grew from $3 in 2011 to the current $11.89.

That is a 4x increase and investments that can give you such improvements are really rare. Only stocks or owning your own business can give you something similar.


As Apple's earnings per share increased 4 times, so did the stock price. Therefore, the thing to remember is that earnings are the key to investing, nothing else. All the rest is speculation and that is a game your will likely lose in the long-term because 100% of the investors playing the long-term common sense game win, while 99.8% of speculators lose when speculating or trading constantly.

## 2) Is investing is stocks risky – how the stock market works

According to Lynch, investing in stocks isn't risky at all, you just need to know what you are doing. Where by knowing what you are doing, he just means you need to understand how the stock market works and how investing in stocks works.

There are risks wherever you turn when it comes to investing. If you hold cash, as we have seen in the stock market versus bonds returns chart, if you hold cash you are 100% sure you will lose, bonds are risky also due to inflation while stocks usually do better. However, you have to understand stocks and how investing in stocks works.

The core of investing in stocks is that you can never be right, you cannot know the future, but if you make a mistake the maximum you can lose is what you invested while if you invest in the right business, the upside is unlimited.

To quote Peter Lynch: "Six out of 10 I s all it takes to produce an enviable record on Wall Street".

6 out of 10 is for an enviable record, but will 4 out of 10 be enough for a good record? Let's see.

Let's say you invest $100,000 in 10 stocks. You buy them now and you let them in there for 10 years without looking at them at all.

| $100,000 Investment | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | STOCK 1 | STOCK 2 | STOCK 3 | STOCK 4 | STOCK 5 | STOCK 6 | STOCK 7 | STOCK 8 | STOCK 9 | STOCK 10 |
| Investment | $10,000 | $10,000 | $10,000 | $10,000 | $10,000 | $10,000 | $10,000 | $10,000 | $10,000 | $10,000 |
| Outcome | Bankrupt | Bankrupt | nothing happened | nothing happened | nothing happened | nothing happened | double | triple | quadruple | tenbagger |
| Result | $0 | $0 | $10,000 | $10,000 | $10,000 | $10,000 | $20,000 | $30,000 | $40,000 | $100,000 |
| Total | $230,000 | Stoks are RISKY and you never know what can happen, but if you belive in humanity, your portfolio will do well over time. The last century with two world wars has been pretty good for investors investing in businesses! | | | | | | | | |
| YEARLY RETURN on 4 out of 10 | 8.69% | | | | | | | | | |

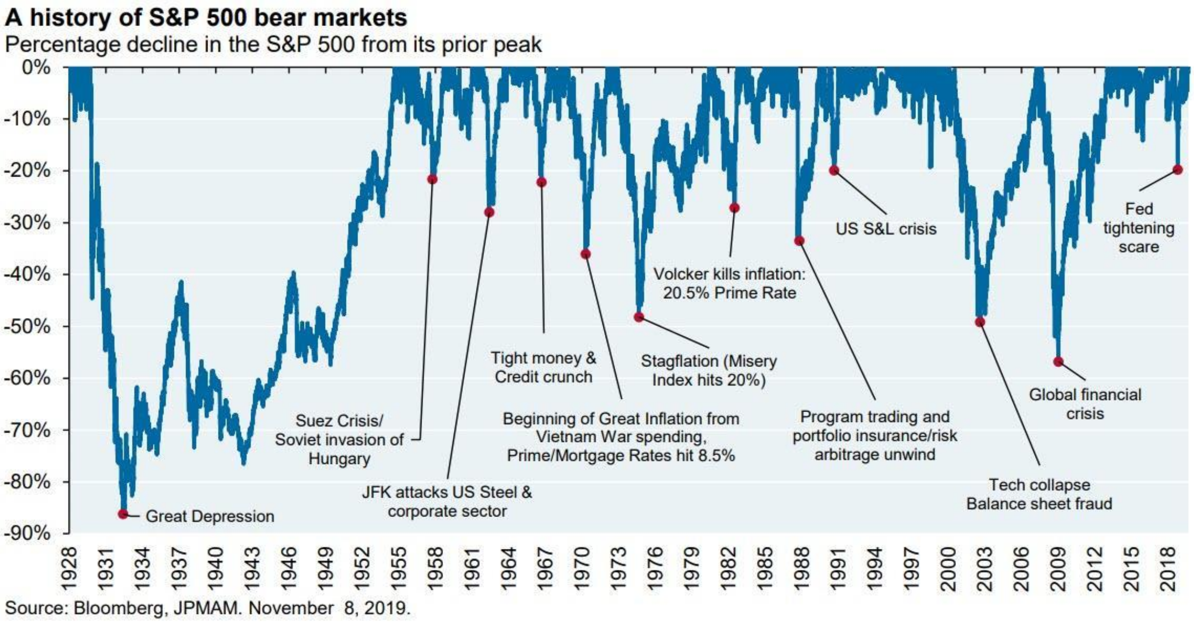
If two go bankrupt, 4 do nothing and just 4 stocks do good, your long-term investing return would amount to 8.69% per year despite you being right only on 4 out of 10.

So, yes, stocks are risky, you just need to accept the way things work in the stock market. The fact that the upside is unlimited thanks to economic growth, business growth, and that you are constantly rewarded through earnings and dividends that compound returns, makes investing in stocks a positive sum game.

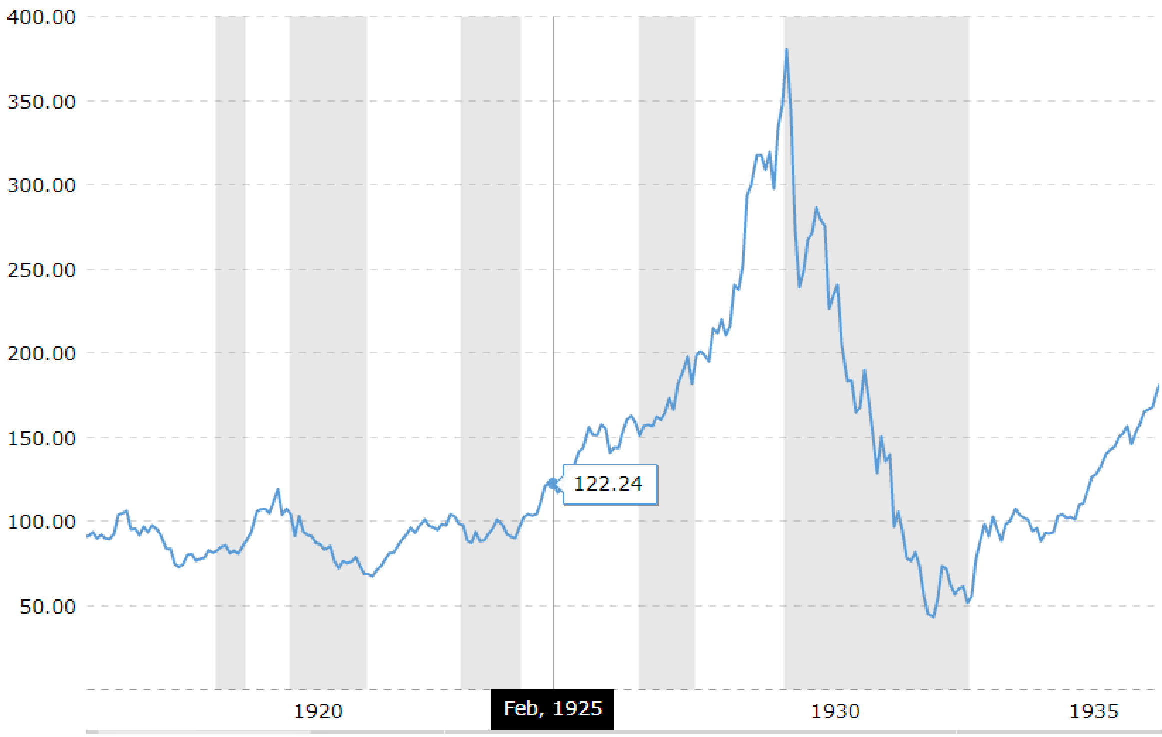
Further, by asking the right questions before investing, something we'll be learning about when we touch on the second part of One Up On Wall Street on how to pick great stocks, you can lower your percentage of losing stocks and increase your exposure to the good stocks, thus, over time you can improve the odds in your favor even more.

### Stock market crashes

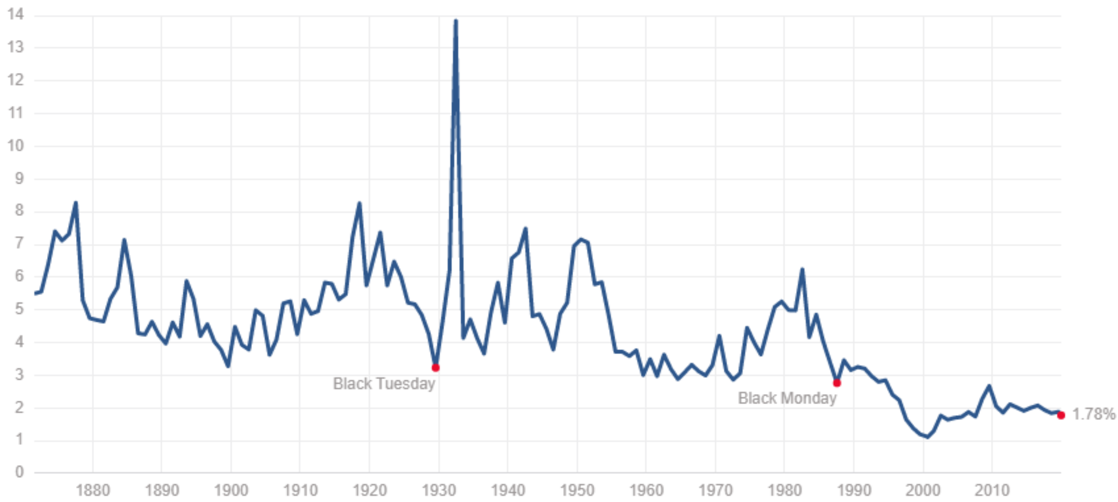
Many see the 1929 stock market crash like a terrible situation and as and example of a huge risk when it comes to investing in stocks.



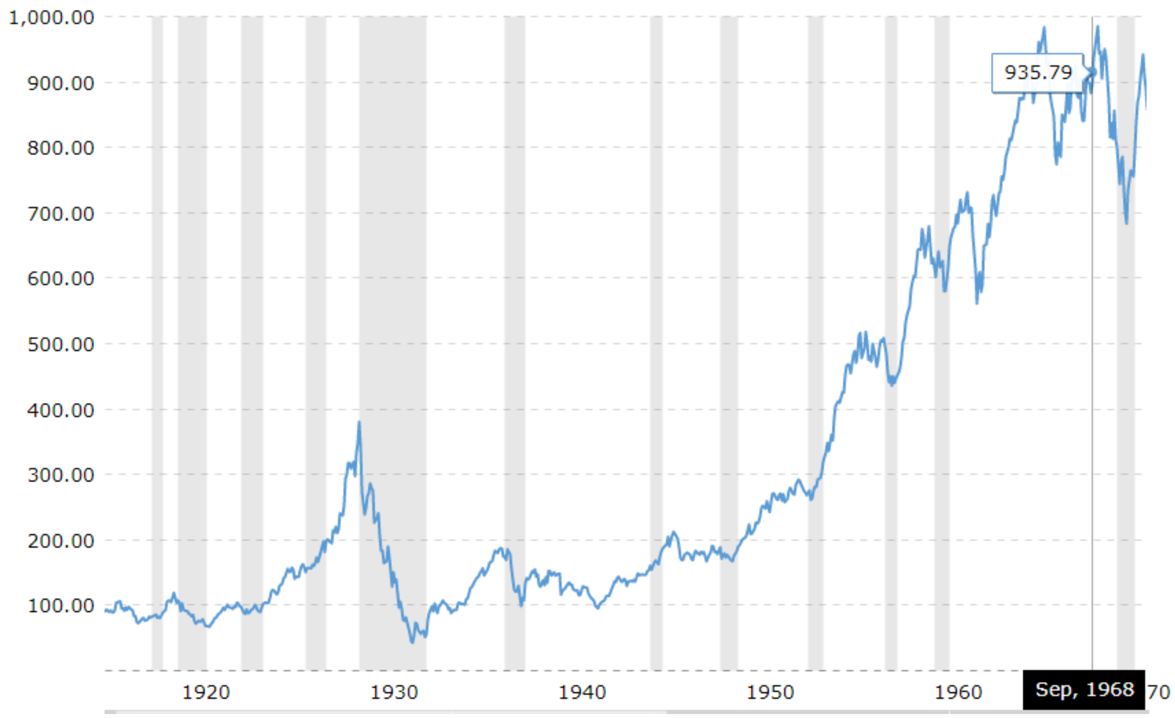

But, Lynch clearly explains how those who didn't invest at the peak in 1929 when valuations were crazy, but let's say in 1925 and invested in good businesses




And those that reinvested the dividends that good businesses kept paying in that time, where the dividend yield spiked to 14% for stocks at the bottom from 1931 to 1933, those that reinvested were already well ahead by 1935.




Not to mention that their increased portfolios, that they managed to increase by reinvesting the dividends alongside bargain stock prices, allowed them to really take advantage of the subsequent 10x rally over the coming 10 years.




This is how a few thousand bucks gets turned into millions. I can't get it into my head why people call investing in stocks risky. The stock market works how it works, that is it, accept it and take advantage of it. Actually, we should all be begging for a huge, long-term and painful stock market crash that will allow us to buy great companies on the cheap for a decade or two. Think about that before being happy that your stock went up😊

But, before investing in stocks and putting the odds of investing in your favor, you need to answer the 3 questions of the mirror test.

## 3) Should you invest in stocks – the mirror test

Your biggest enemy when it comes to investing is not a stock market crash or a recession, those would actually be your best friends. The biggest enemy is the investor himself because people do the wrong thing at the wrong moment in time. Answering the 3 mirror test questions tells you whether you should invest into stocks at all.

**QUESTION 1 – Do I own a house?**

You might think, what has owning a house to do with the stock market? Well, stocks are just a part of your financial life.

Lynch discusses how a house is usually a good investment everyone manages to make. There are so many tailwinds when it comes to owning a house:

- You get tax breaks
- You get leverage, a mortgage with low interest rate, that you can get fixed
- Home prices will likely go up over 30 years while your mortgage payment will remain the same

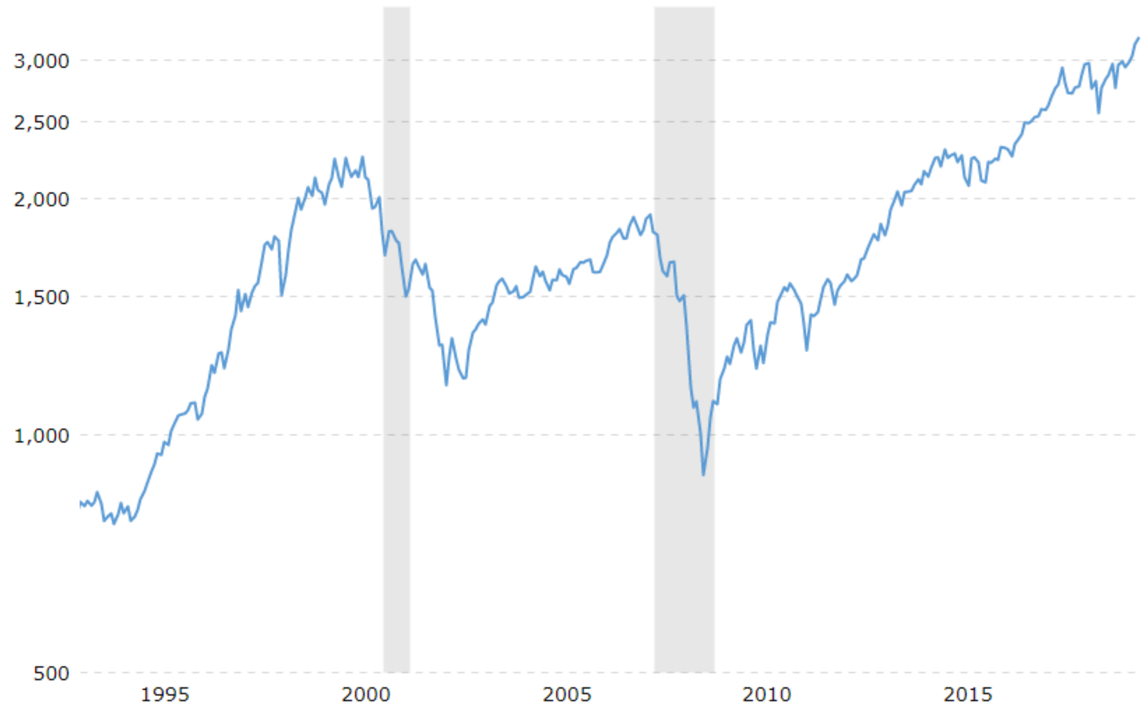
- When your kids move out you can sell the big house, buy something smaller and get a tax free windfall
- It is a long-term investment, you can't just selling with a click like it is the case for stocks, you need a moving van or truck.
- People usually spend months looking for a house; they analyze schools, taxes, trends in the area, termites, roof leaks, rusty pipes, wiring, the foundations etc. However, most people usually spend more time thinking about what shoes to buy than what stock to buy.

The point is that a house is something you can get financed, thus 80% financed by somebody else where what you pay for rent is usually equal to what you pay for a mortgage. Plus, a house gives you piece of mind, if you don't buy something much over the limit of what you can afford, you'll sleep well and have piece of mind. The think is that having something like a house will give you the necessary piece of mind to invest in stocks because:

**QUESTION 2 – Do I need the money?**

The key when it comes to investing in stocks is whether you need the money for something in the future, let's say within the next 10 years. If you do need the money for your children's college tuition, down payment on house, retirement or whatever, it is better that you don't invest in stocks.

What happens is that you keep the thing you need in mind and watch your portfolio go down when a stock market crash occurs, and those always come. Thus, people usually panic, fear they will lose more and sell exactly at the wrong moment in time.




Many have sold during the 2000/02 and 2008/09 bear markets in panic not to lose more because headlines and everybody that owns something is in panic and forecasts the end of the world. 4 tips to protect yourself from stock market crashes.

Consequently, it is not strange that the average investor does much worst than the market. In order to do better than the market you need to know yourself and answer the following question:

**QUESTION 3 – Do I have the personal qualities it takes to succeed?**

It was Benjamin Graham who said:

**“The investor's chief problem – and even his worst enemy – is likely to be himself.”**

So, it is all about knowing who you are and whether you have what it takes to invest in stocks.

Even Lynch considers this the “Most important question of all”

We can distill this into smaller questions:

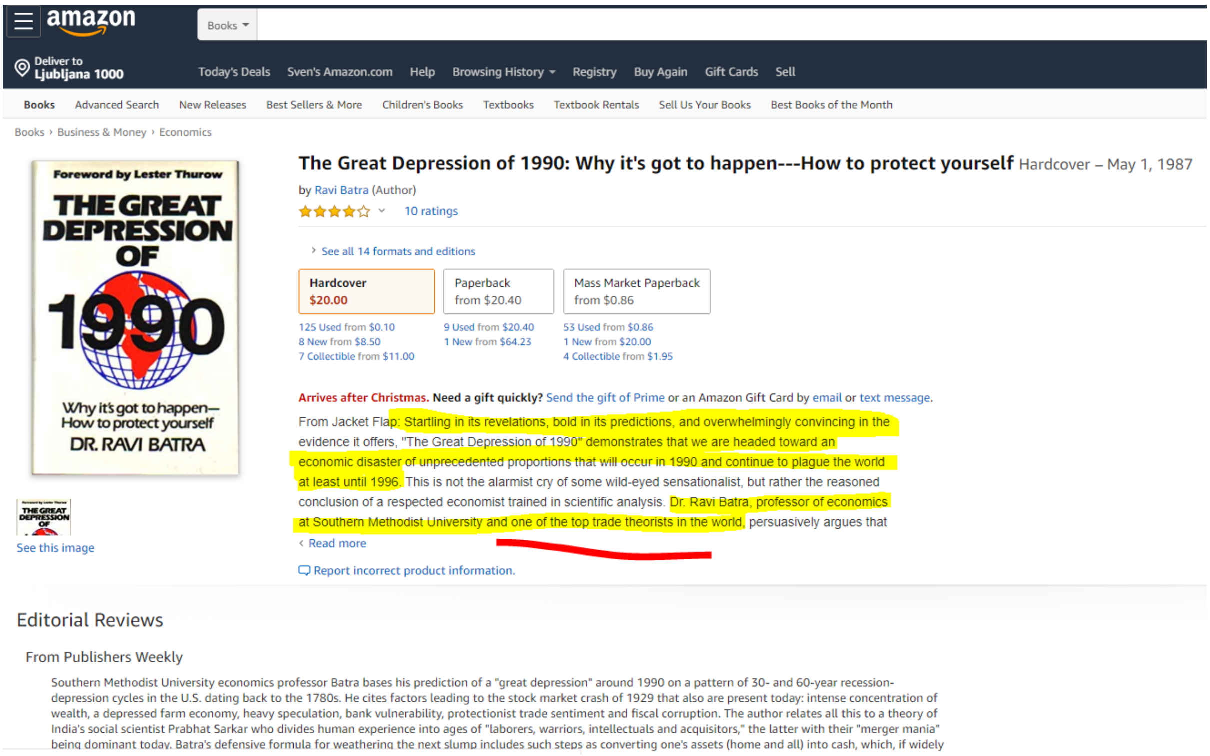
- How do you behave in uncertainty?

Things are never clear on Wall Street and therefore you have to keep in mind that even with 4 out of 10, you will do good. The key to keep in mind is that you don’t sell low and buy high.

- Can you go against the herd?

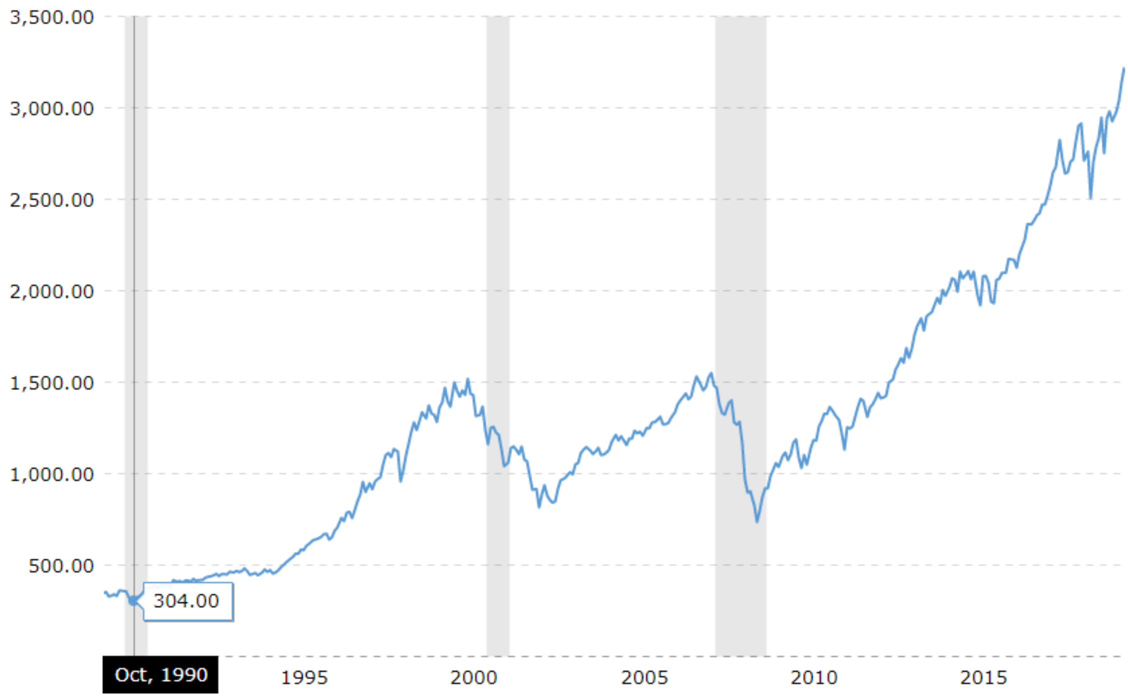
Now, in late 2019, it is easy to be a stock market investor, practically everything you could have bought went up. However, the best investments are made by not selling when everybody around you is panicking. Thus, when others sell in frenzy, you have to buy more.

It is funny how in 1990, when Lynch wrote his seminal book, there was another book at the top of the New Yorkers bestselling list – The Great Depression of 1990 by Ravi Batra.




Source: [Amazon – The Great Depression of 1990](#)

Imagine what mistake did those that sold stocks in the recession of 1990 make due to listening to theorists like Ravi Batra. 1990, with saving and loans banks going bust, the war in Iraq etc. could you had gone against the crowd?




In the midst of the 1990 recession, the S&P 500 was down 20% and there was a lot of panic. What happened, over the last 30 years stocks had one of their best runs ever. Not to mention buying during the 2000 or 2009 recession.

The key is to resist your human nature and your "gut feelings". You can't predict the economy nor stock prices, all you can do is focus on the quality of the businesses you own.

### Be aware of concern, complacency, and capitulation

The 3 emotional states most dangerous to investors are concern, complacency and capitulation.

### Concern

When the stock falls 20%, like it did in December of 2018, many were concerned that it will fall more.


I don't even have to mention the 2008/2009 situation where many investors remained concerned up to 2018 when they finally decided to get back in the market missing on huge returns.

Those that bought in 2018, often become complacent because stocks, as we have seen in 2019, can only go up!

When stocks reach all time highs, the thing one has to check are the fundamentals. Is the PE ratio still satisfying in relation to my investing goals? Can I find better investments elsewhere with lower risk? When stocks reach all-time highs, it is time to get concerned, not when stocks reach decade lows when most experience capitulation and sell.

The thing to focus on are fundamentals and the best emotional state to have when it comes to investing is snoring! Snoring at everything else that is not related to the long-term fundamentals of the business you own.

### 4) Is this a good time to start investing?

As a stock market beginner, you probably ask yourself whether you are too late to the party? Whether it is smart to invest now when there is a crash around the corner?

If you ask Lynch, nobody can forecast the stock market. Therefore, the only thing you can focus on are the earnings of the companies you are buying in relation to what you are paying for those earnings.

Many theoretic economics make their living by watching the FED, interest rates, gold bugs, technical analyses, trade wars etc. However, nothing of that is useful for anything except for telling you a good story and make you complacent, concerned or make you capitulate.

The only economists you should listen to are practitioners, it can be by listening to the conference calls of the business you own or hope to own, there you hear from those in the business about the business and what is really going on.

During bull markets, you'll constantly hear people talking about how the next recession is around the corner. During recessions and bear markets, you'll constantly hear people talking about how this is the next depression and you should expect an 80% drop in stocks.

1982 was a period when the United States has 14% unemployment, 15% inflation and 20% interest rates. People were running away from stocks, as stocks have been a terrible investment since 1967, but that was exactly the best time to invest in stocks. The point is not that you have to wait for such and economic situation again to start investing, the point is that you can't know what will happen with stocks. You can only focus on business fundamentals.

**Penultimate preparedness**

Lynch introduces an extremely interesting concept in his book; 'penultimate preparedness'.

It is a concept explaining how we humans always prepare for what has happened the last time, not for what will happen. Many investors in 2020 are preparing for the next stock market crash that they expect will look exactly like the last two crashes of 50%. However, like nobody was preparing himself for extremely low inflation in 1982, that has been the case for the last 30 years. So, nobody is preparing for high inflation and that might be the case for the next 30 years, you never know. The point is that by owning businesses, good businesses, you are protected from inflation while most other investments, except real estate, don't give the same protection.

**What stock market?**

Lynch's point is that you simply have to forget about the market. You can only use it as a reference what is the price of the value you plan to buy.

The only thing you have to worry about is whether the business you own is getting better. Pick the right stocks, with strong and growing earnings, and the market will take care of itself, and of your portfolio for you.

Is a market overvalued and is it smart to invest now?

Well, if you can't find a business to own that is reasonably priced for you, in relation to your expected investment returns, then the market is overvalued and you should not invest. If you can find businesses that you are happy paying the current price for, they you can forget about the market.

The only think you have to do when it comes to investing is find a company you like, if you find that, it is never too soon nor too late to buy shares.

5) **Small investors tend to be pessimistic and optimistic at precisely the wrong times**

The fifth tip is that you are not supposed to follow the markets, what most investors do, is to start investing when there is a lot of exuberance surrounding the stock market and then sell everything in desperation when the market turns south.

So, before you even start investing, you need to have the right mindset, the right conviction:

NO MATTER WHAT HAPPENS WITH THE MARKET, I'LL KEEP INVESTING AND BUILDING MY PORTFOLIO OF GREAT BUSINESSES!

We are going to learn how to find great businesses when we summarize the second part of Lynch's book.

The average investor usually buys high and sells low. I can easily assume most of my readers started investing in the following periods: late 1990s, before the 2008 crisis and in the last 5 years because stocks are hot and can only go up.


S&P 500 Index over the last 30 years –Macrotrends

Now, don't be scared by the above, investing is not about where the market is, it is about the quality of the assets you are buying which is another core tip from Peter Lynch. The key thing is, even if you just started investing, to understand what investing is all about so that you don't make the biggest mistake investors usually make, which is buy high and sell low.

JP Morgan's chart showing investment returns over the last 20 years is extremely indicative on how investing returns don't really depend on what the stock market does, it is also not about the companies you invest. What it all depends is the investor, IT ALL DEPENDS ON YOU.

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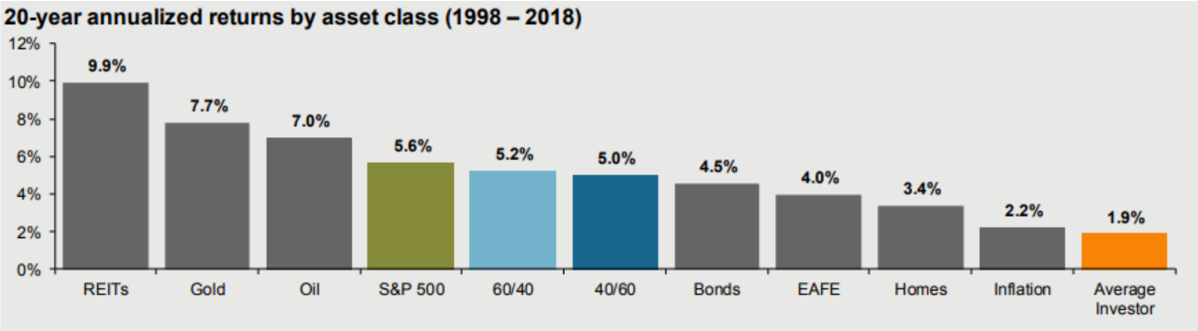



Stock Market Investing Returns – JP Morgan Guide to the markets

I don't know whether I should cry or laugh, but the average investor managed to achieve a return of 1.9% per year over the last 20 years, while practically ever other asset class you could had invested in did better. Index funds like the S&P 500 delivered 5.6% per year on average, while REITs delivered close to 10% per year. So, how come that the average investor achieved a return of just 1.9% when everything you could had bought went up?

Well, investors usually panic and sell at the wrong time, while in fear of missing out and when stocks have already done extremely well in the past, they feel confident and buy.

The key to understand here is that the stock market and individual stocks work in cycles. All you need to do is to find good businesses, and if the stocks you bought declines, but you still think it is a good business, you simply thank Mr. Market for the opportunity to buy the good stuff on the cheap. I don't see people complain when stores offer sales, but it is full panic mode when stocks are on sale. Keep that in mind before buying stocks.

## 6) You don't need financial education to be a great investor – all you need is common sense

Peter Lynch was a liberal arts major, he studied history, psychology, political science, religion and the philosophy of ancient Greeks. He is an avid promotor of the fact that studying history is a much better preparation for stock market investing than statistics.

All the math you need to invest in stocks, you have learned by fourth grade, if you finished that. If you have, there is nothing to worry about financials.

We will cover all the important financials through the summary of One Up On Wall Street as part of the Free Stock Market Course.

Another great investor that didn't even have a computer for a long time is Warren Buffett. He is famous for saying that whenever you see a Greek letter in an investment analysis, you should run away.

CANVA – PICTURE BUFFETT and QUOTE

"Read Benjamin Graham and Philip Fisher, read annual reports, but don't do equations with Greek letters in them" Warren Buffett

Just an addition from my personal experience. I spent 4 years doing my Ph.D. on the topic of investing, accounting and more precisely stock market investing risk. Apart from making it easy to land a well-paid job as an accounting professor, it didn't give me any additional knowledge that I didn't have before starting my Ph.D. You will see, it is all about a few simple formulas and a lot of common sense.

My educational experience is similar to Lynch's. In his book, he explicitly says how: "most of what I learned at Wharton, which was supposed to help you succeed in business, could only help you fail".

So, the message is simple, you don't need complex mathematics, all you need is common sense, something we all have somewhere deep inside. This leads us to the following tip, don't listen to professionals.

## 7) Don't listen to stock market professionals

It is strange to hear this coming from Peter Lynch, but when you invest, you really shouldn't listen to professionals. Here are a few reasons why:

- Professionals operate with many restrictions.

Many fund managers have to pick investments from a preapproved list. Further, stock market analysts are forced to cover stocks that the public is already interested in because that will drive in new clients. Talking about some obscure stock, that might be a great investment, will not make you the cool guy at cocktail parties and therefore you don't want to invest in that and you don't want to talk about such under covered stocks.

Also, a company with a market capitalization of $100 million, where the founder/owner owns 80% of the number of shares outstanding, wouldn't even move the needle for Buffett. He needs investments of above $10 billion for them to make any sense to him.

Do you sense something here? It is exactly the place where Lynch advises to look for the best investments. Look there where professionals are not looking.

- Professionals read the same news, use the same Bloomberg terminal…

One of Warren Buffett's investment advantage is that he was operating from Omaha, not from Wall Street. If you are on Wall Street, you'll most likely follow the herd or risk to much in order to stay ahead of the pack. If you invest from Omaha or somewhere from the Slovenian mountains, you can operate independently and calmly think for yourself. Plus, if you look as an investor at what is going on around you, you might find it before Wall Street does.

- Professionals wait for others to move first

A running joke, but eternal truth and rule withing the professional investing community is that:

"You'll never lose your job by losing your client's money in Google."

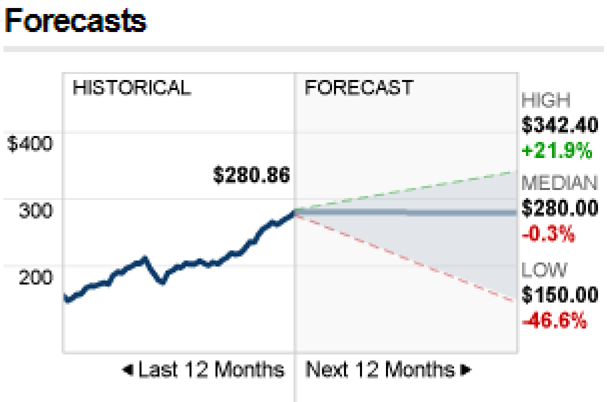
If Google does bad, people will simply ask what went wrong with Google this year. If you invest in a small cap company like the Norwegian solar plant utility Scatec Solar, they will probably yell at you asking why the hell did you invest in that?

- Professionals don't travel, don't get their hands dirty

An investing professional, goes to his working desk and reads what other investment professionals wrote about investment opportunities. All sitting at their desks. They've been drinking their lattes at Starbucks for 20 years now, but they probably recommended it as a buy just over the last few years when the company actually became a Wall Street darling.


It is unlikely that anyone recommended Starbucks as a buy in 2008. Of course, since then investors would have been rewarded with a 20bagger returns, in place of a 20% return since 2016.

If we look at what professionals are forecasting about a famous stock like Apple, where everything you can know about it is known, some forecast price growth of 22% over than next year while some forecast a decline of 46.%.




Apple stock forecast – CNN Money

Lynch's main message is that the stocks to buy are actually those that the professionals overlook. He kept looking at stocks as an amateur through his whole career. An amateur can find the next Starbucks, can see what is it that the crowd likes because you have eyes on the field, while professional investors have eyes on the scoreboard.

**Peter Lynch tells us that the tenbaggers come from where Wall Street doesn't look or isn't allowed to look.**

Lynch's points to remember are:

- Invest in companies, not stocks.
- Ignore the market and short-term fluctuations
- You can't predict the economy.
- You can't predict the stock market in the short term.
- The long-term returns will be good and in line with earnings.
- If the company keeps delivering, keep it.
- See whether stocks are for you.
- Buy a house before a stock
- Don't listen to professionals
- Take advantage of what you know (your business, your circle of competence, your spouse's shopping)
- Look where others are not looking
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Next – How to pick winning stocks!