Excerpt reprinted
with permission of:
OUTSTANDING INVESTOR DIGEST
14 East 4th Street, Suite 501
New York, NY 10012
(212) 777-3330

Outstanding Investor Digest

PERSPECTIVES AND ACTIVITIES OF THE NATION'S MOST SUCCESSFUL MONEY MANAGERS.

Volume VII Numbers 9 & 10 November 25, 1992

Investors featured in this Issue:

BARON CAPITAL MGM'T'S RON BARON...1, 38, 64

LEHMAN BROTHERS' BRUCE BERKOWITZ ...1, 53, 64

TWEEDY, BROWNE'S CHRIS BROWNE, WILL BROWNE, JIM CLARK & JOHN SPEARS...1, 16, 64

MARK COOPER...1, 59, 64

BAUPOST GROUP'S SETH KLARMAN...1, 10, 64

PETER LYNCH...1, 2, 19, 64

Other Investors in this Issue:

BERKSHIRE HATHAWAY'S WARREN BUFFETT ...8, 18, 19, 53, 54, 60

CARRET & CO'S PHILIP CARRET & JERRY CARRET...37, 64

CUNDILL VALUE FUND'S PETER CUNDILL...22

SOGEN FUND'S JEAN-MARIE EVEILLARD ...22, 32

GRAHAM-NEWMAN'S BEN GRAHAM...14, 19, 61

WESCO FINANCIAL'S CHARLIE MUNGER...19

SEQUOIA FUND'S BILL RUANE & BOB GOLDFARB...18, 34

SOROS FUND MGM'T'S GEORGE SOROS...19, 64

MICHAEL STEINHARDT...64

TEMPLETON FUNDS' JOHN TEMPLETON...34

(and more.)

Companies & Investments in this Issue

ADEZA...44
ADVO...38, 40
AMERICAN EXPRESS...7
BANCO DE SARDEGNA...29, 30
BANKAMERICA...54, 55, 56
BM GROUP...25
CAREMARK...43, 44, 48
CAPSTEAD MORTGAGE...8
CENTRAL COOPERATIVE...8
CHRYSLER...8
CIBA...33
CIRCUS CIRCUS...38
CITICORP...8
COCA-COLA...6
COLONIAL GROUP...8
COMPAGNIE D'INVESTISSEMENT DE PARIS...31
DANZAS...22
DEERE...9
DEVRY...51
DUPONT...7
EASTMAN KODAK...7
ESCO ELECTRONICS...14
FANNIE MAE...8, 62
FILENE'S BASEMENT...38, 39
FIRST INTERSTATE...54
FORD...8
FREDDIE MAC...8, 53, 62, 63
GM...8
HEALTHDYNE...43, 44, 48, 49
IBM...7
INDO INTL...23, 24
ING...26, 27, 28, 31
INTL GAME TECH...38
JOHN WILEY...38, 40
KEMPER...8
LA CONCORDE...31, 32
LINDT AND SPRUENGLI...22
MANOR CARE...39, 40, 49, 51
MARRIOTT...7
MIRAGE...38
MOULINEX D'ESPANA...32, 33
NESTLE...22, 33
NORTHSIDE SVGS BANK...8
OFFICE DEPOT...39, 45, 52
PIER ONE IMPORTS...8
RAG SHOPS...9
SAFEGUARD SCIENTIFICS...15
SALLIE MAE...8
SALOMON...53, 63
SEARS...7
SUPER CUTS...9
TOKOS MEDICAL...38, 40-52
WAL-MART...18, 20, 21
WELLS FARGO...8, 53-63
WEST NEWTON SVGS BK...8
WESTINGHOUSE...9
XEROX...7
ZEHNDER HOLDINGS...28

(and more.)

PETER LYNCH, FORMERLY OF FIDELITY MAGELLAN,
& BAUPOST GROUP'S SETH KLARMAN
"GUESS WHAT? WE ALWAYS MAKE IT OUT OF RECESSIONS,
BUT BEWARE THE REAR VIEW MIRROR."

Before retiring in 1990 to spend more time with family and other interests, Peter Lynch directed Fidelity Magellan to the best record among all mutual funds for the preceding dozen calendar years — compounding shareholder equity at over 30% per year vs. 16.7% for the S&P 500.

We're pleased to bring you the following comments by

(continued on page 2)

AN OID INTERVIEW WITH TWEEDY, BROWNE'S
CHRIS BROWNE, WILL BROWNE, JIM CLARK & JOHN SPEARS
"WE'RE FINDING OPPORTUNITIES ABROAD.
IT'S LIKE 1974 OR 1982 ALL OVER AGAIN...."

As one of Warren Buffett's "Super Investors of Graham and Doddsville," Tweedy, Browne has a track record to match. For example, during the 33 years ended December 31, 1991, TBK Partners achieved a compound return of 19.7% per year versus 10.5% per year for the S&P 500.

Interestingly, their occasional foray into non-U.S. stocks from 1983 to 1991 was even more rewarding — with their average return on those stocks approximately 31% per year.

(continued on page 16)

BARON CAPITAL MANAGEMENT'S RON BARON
"I LOVE TO UNDERSTAND WHAT MAKES BUSINESSES TICK
AND TOKOS MEDICAL IS QUITE A TICKER...."

Ron Baron founded Baron Capital Management in 1983 — the year small-cap stocks began a stint in the doghouse. Despite that unfortunate coincidence, however, and what Baron terms "the worst year of his career" in 1990, he's still outperformed all of the major indices — earning a compound annual return of 17.8% versus 11.1% for the Russell 2000 and 17.2% for the S&P 500.

Unaudited returns for his managed accounts going back

(continued on page 38)

BRUCE BERKOWITZ AND MARK COOPER
WELLS FARGO REVISITED
"A PHENOMENAL CASE STUDY —
THE NUMBERS ARE RIGHT OUT ON THE TABLE...."

In past issues, we've brought you contributors pounding the table on Wells Fargo — Robert Noel in October 1990 (at \$41) and, more recently, Bruce Berkowitz in November 1991 (in the mid-\$60s).

Therefore, when Wells' stock price recently retreated back to the mid-\$60s (in fact, it got to \$61-1/4) and Buffett reported continuing purchases, we thought you might enjoy an in-depth update on the company and its prospects from

(continued on page 53)

PETER LYNCH
(cont'd from page 1)

Peter Lynch at the first Charles Schwab investor conference held November 6th in San Francisco. We'd like to thank both Charles Schwab and Peter Lynch for allowing us to share them with you.

We found Lynch's comments highly educational and hope that you will as well.

IT'S BEEN A TYPICAL RECESSION AND I'M SURE WE'LL MAKE IT OUT....

Guess what — we always make it out of recessions....

Lynch: I just thought I'd say a few words about what I see in business and the stock market today.

I'm here to report that the world's OK.... Every time we have a recession, people say, "This one is different." Those are the four famous words. And they're right. They all *are* different. But guess what — we always make it out. And we're eight for eight since World War II. This is number nine. And I'm sure we'll get out of this one.

When Joe DiMaggio played for the Yankees, they played in ten World Series — and only won nine of them. So our economy has a better record than the Yankees — even with Joe DiMaggio.

The timing of the recovery isn't important — within limits....

Lynch: As for all these bears who think the world won't make it, I think they're wrong. And as far as the stock market's concerned, it's not really important whether the economy starts recovering in three months, six months or eighteen months. If it recovers in four years, that's a different story. But if business conditions are better a year from now — and a year later they're better still — then that's very relevant because the market looks out.

Based on the indicators, we're just waiting for the whistle....

Lynch: I've always looked at used car prices as a great indicator. They went through a long period of decline that bottomed out at the end of 1991. And they've been going up through 1992. I think that's a very good indicator.

The average work week is just about the longest it's been since World War II. And normally when things first pick up, businesses will add an extra hour, they'll add an extra shift, but they're very reticent to call people back. They're even more reticent to hire new people — with all of the social security, pension benefits and health care. Therefore, the average work week is a very good indicator.

Inventories relative to sales are extremely low. They've been lower, but they're at an extremely low level.

All that needs to happen is for someone to blow a whistle. There's no ground hog day for the official start — three economists don't come out of their hole, see their shadows and announce that the recession's over. But it'll happen at some point.

Based on lost jobs, this has been an average recession....

Lynch: Normally, it happens when layoffs abate.... In the average recession, we had about a 2% decline in the work force since World War II.

[For the precise decline in the work force for the current recession,] it depends on which group you use [because] there's a debate on whether there were 110 million people working or 120 million. That gives you an idea of how good our economic figures are. But under either scenario, we've lost a little over 2 million jobs. So we've had about a 2% decline. In 1982-83, we lost 3%. So this one's been average — if there is such a thing. It hasn't been more severe than usual.

WHO'S PRESIDENT IS NOT AS CRITICAL AS A HOST OF OTHER FACTORS....

In politics, timing is everything. The first commandment....

Lynch: It may not be fair to people out of work to tell them it's average. It's extremely unfortunate for those people. It also didn't help one of them — President Bush — because he also lost his job because of the recession.

But it's interesting. I haven't heard anybody say this in all of these post-mortems. But what would've happened if Reagan had come up for re-election in 1982? We had a 20% prime rate and 14% inflation and 12% unemployment. Reagan would've been a one-term President if he'd had to run in 1982.

But he was lucky enough to have his re-election in 1984. And by then, the economy had turned.

I've always brought this up: the first commandment of political leaders — and there may not be a second — is, "Thou shall not have recessions in years divisible by four." That's what happened to Bush.

The choice of President is not the most important thing.

Lynch: Who's President is so overwhelmed by whether or not the economy gets better and who the Secretary of the Treasury will be. Who's President is not as critical....

Today, *Standard and Poors*, *Moody's* and *Fitch's* have such power when they go to visit a company, chairmans of boards of Fortune 500 companies can't sleep at night the week before the guy at *Fitch's* comes to look them over. These rating agencies are more important than Alan Greenspan now. They're more important than Clinton.

People are really looking at balance sheets. They're really looking at interest coverage. It's a whole new, different environment since World War II.

It obviously won't effect Merck or any other companies with pristine balance sheets and great businesses. They don't have to worry when *Fitch's* comes or *Moody's* or *S&P*.

BIG COMPANIES' LAYOFFS ARE NOTHING NEW. JOBS HAVE ALWAYS COME FROM SMALL COMPANIES....

Big companies laying off lots of people is nothing new....

Lynch: Incidentally, I don't know why Bush didn't focus on this — on how strong our country is. In the decade of the 1980s, the 500 largest companies eliminated 2 million jobs — 2 million! People talk about how this company is letting go of people and that company's letting go of people. But that's the way big companies operate. During the decade of the 1980s — which was a great decade — we added 18 million jobs in the United States ... while the 500 largest companies eliminated 2 million.

Guess what — in the next ten years, the 500 largest companies are going to eliminate another 2 million jobs.

(continued on next page)

PETER LYNCH
(cont'd from preceding page)

Small businesses provide *all* of this country's growth....

Lynch: But in the decade of the 1980s, 2.2 million businesses started — 2.2 million! The math's very easy. Some of them obviously didn't make it. But if some grew to be 500 or 1,000 employees and on average they finished the decade with ten employees, that would be 22 million jobs — 22 million jobs! That's what our country's about....

People say that's *most* of the growth in America. Well, that's *more* than "most" of the growth. It's *all* of the growth. In fact, it's *more* than all the growth — because it makes up for the big companies. And 1982, with its 20% prime rate, huge unemployment and terrible psychology, 150,000 new businesses started. Last year, when we had a tough recession, a credit crunch and the banks were in trouble, we had over 200,000 new businesses start in the U.S. And I think it's going to be a higher number this year....

If it's bad news, it's news. Otherwise....

Lynch: When somebody starts a new company, it doesn't make the front page of any newspaper.

When somebody lets 3,000 people go, it's easy to cover. They never cover Harry Forsnick and Mary Hepplewhite starting a business. It just doesn't make it. But there's a lot of them starting every week.

And that's what's different about the United States versus Europe. You don't have the small companies starting up like that in Europe....

PSYCHOLOGY FAR WORSE THAN REALITY, BUT THAT, TOO, SHALL PASS....

The psychology is much worse than the reality.

Lynch: This recession has been different because it's been white collar-driven — spread among electric utilities, banks, insurance companies, retailers, the publishing industry, the broadcast industry — everywhere, even museums. It's been very broad based. And it's been a lot more the people on salary rather than the hourly worker.

So although it may sound like President Bush, I think it's accurate to say that the psychology is much worse now about the recession relative to [the reality].

For example, Travelers will announce they're letting 3,000 people go and it'll be on the front page of a newspaper in Arizona — not just in Connecticut. The coverage of this recession is amazing. So somebody in Phoenix doesn't buy a sofa that week because they read about the layoffs at Travelers. I know a lot of newspapers are weak on stories, but the coverage of this recession is quite impressive.

So I think the psychology is bad. I don't know when it will get better, although it seems to be groping for a bottom.

When psychology changes, consumers will return to brands.

Lynch: The consumer's 60% to 65% of the economy and always will be. [When the psychology changes], they'll just feel a little better. And they'll buy fancier cookies in the supermarket instead of commodity cookies.

They're buying the generic brand cereals right now. It's amazing — cereal companies that have had thirty years of up earnings are now having a pretty tough go of it. People are cutting back on the brand name cereals.

So the consumer will spend a little more money. They'll buy more brand names. And they'll be a little more upscale in their purchasing.

I'm not worried about whether the consumer comes back....

Lynch: Right now, they're not buying houses or cars. However, unsold new homes are at a fifteen-year low. So all the indicators are there. It's going to start. It could be that people will feel better about Clinton in January or next year.

I don't know what'll start it. But I'm not worried about whether the consumer will come back.

STATE AND LOCAL DEFICITS AND SURPLUSES ARE VERY CYCLICAL TOO....

The big untold story: state and local government layoffs....

Lynch: Another major element that's somewhat different than past recessions is the severity of the cutbacks at the state and local level. Again, I'm surprised how little focus there's been on this issue in the national or local media. There are 15 million people working for government — only 3 million of them at the federal level. When people think of government, they always think about this huge sucker in Washington. But the majority of people work for state or local governments.

And unlike the Federal government — which can let their debt go from $3 trillion to $4 trillion — [the states don't have that option]. But the Federal government can keep adding to debt and nothing ever happens.

State and local governments act pro-cyclically. When they have a recession, they have to raise taxes and let people go. And we're talking about a big number. People talk about the auto industry. If you count the hourly workers of the three auto companies, I think it's gone from 750,000 workers down to 400,000 workers. If you count all of the suppliers to the auto industry, you might have a million employees. [But] state and local governments have 12 million employees.

The biggest foot in the country is squarely on the brake....

Lynch: I think for the first time since World War II, they're going to have a decline this year in the number of workers at a state and local level — they're letting go of firemen, teachers and policemen. It's a massive industry and no one talks about it. These people aren't going to be buying sofas or cars or houses or getting an upgrade in their apartment.

And it's the psychology. If you work for a company that has 5,000 employees and they let 300 of them go, the other 4,700 don't go out and buy a sofa. And we experienced this in Massachusetts several years ago. California's had it the last 18 months. It's an amazing phenomenon. The state goes out and raises taxes. And guess what — the revenues go down ... because people spend less. It doesn't work the way it's supposed to work.

It's feast or famine — deficits or surpluses — in local gov'ts.

Lynch: The revenues of a state or local government are not related to expenses. It's a funny business. When the economy gets better, sales taxes, corporate taxes from employers in the state and personal income taxes go up — and their expenses go down. There's no relationship

(continued on next page)

PETER LYNCH
(cont'd from preceding page)

between their expenditures and their revenues.

And the same thing happens in a recession. They see their expenses going up and their revenues going down because people are buying less. I think 1990 was the first year in California's history that sales taxes went down. With inflation, if they're flat they go down 4% or 5%. But they were actually down in 1991 and may be down in 1992.

So you have all of the psychology of a state — and it's covered in the press and on all of the television and radio programs. Then there's the talk shows. And there's another round of tax increases — and people talk about how gloomy it is. It sort of perpetuates itself.

State and local governments ran a surplus in 1987 — of over $40 billion. They were hiring people, cutting taxes and everything was wonderful. Last year, they had a deficit of more than $30 billion. This year, I think the deficit will be $25 billion — with $10 billion of it in California. These are massive numbers.

But they're getting better. I think Massachusetts is going to be in the black next year. A lot of states are going to bounce back. I think California's deficit will be lower next year. So I think in 1993, the state and local economies will be less of a drag. In 1994, they should break even.

Then in 1995, they'll be running surpluses. And then the first thing they'll do is cut taxes. And guess what — the surpluses will widen. So they'll cut taxes again. And the surpluses will widen again and so forth. This is the kind of cycle you have in the state and local governments.

Right now, this is *the* single largest sector of the economy with its foot on the break. And I never hear anybody talk about it.

<u>When recovery comes, deficits will be replaced by surpluses.</u>

Lynch: The recovery will happen at some point. It could be next week.... Budget deficits will go the other way. State and local governments will go bang. Their revenues will go up and their expenses will still be under surveillance. They'll have massive surpluses. They won't be able to spend it all. They only have a certain number of employees. The only way they can spend it will be to hire a bunch of people — and they can't ... because they're under a lot of pressure.

So when the economy gets better, they get surprised. And then it gets better again. And the first thing they do — because they all want to get reelected — is they cut taxes. And guess what — the surplus widens again. Then they start hiring people.

(continued in next column)

THE BANKING SYSTEM'S MADE IT.
AND BANKS ARE READY TO LOAN....

<u>Banking and real estate — the worst has passed....</u>

Lynch: The banks have reserved for their problems — some are 100% reserved while others are 20% reserved. But every quarter, they're *more* reserved.

As far as the banking system's concerned, remember that they make the construction loan. And when the building's completed and occupied, a long-term lender comes along and takes it out.

So many banks got caught with the construction loans in some buildings that didn't lease up. They've taken the brunt of it. But I think the worst has passed. In fact, I think we're near the end there.

<u>Insurance companies are less vulnerable than banks were.</u>

Lynch: Now it's rolling through insurance companies — the ones that have taken buildings in the last five years or even fifteen or twenty years ago — because rents are rolling down. That's a five to ten-year problem.

However, the insurance companies are much stronger than the banks were — particularly on the liability side. They don't have as much debt. Most of their liabilities are to policyholders.

It's not like when a bank gets in trouble — if it's a wholesale bank like Continental Illinois or Bank of New England — where all of the money market funds have an average maturity of thirty to forty-five days. Once they have a bad quarter or the S&P marks them down, they pull all their money out.

That's why BankAmerica didn't go bankrupt. BankAmerica was in dreadful shape six, seven or eight years ago, but they're all retail funded. Every day, they were selling Federal funds. They had every dime they needed for their loans from retail customers. I remember when they had over a thousand branches in California — maybe 1,100. They had more branches at the time than there were McDonald's in California. They had more branches than there were post offices in California. So that was a nice asset for them. And that's why they made it through the cycle.

If half of your money comes from wholesale funds, then when you get into trouble they take it all back. Then you have to go back into the market and borrow at much higher rates. And if you're making 1% on assets, which is the benchmark of an outstanding bank — and obviously you're not if you're in trouble — if your cost of money goes up 100 to 200 basis points, you're out of business.

But the insurance companies don't have that problem. Some of them have debt to roll over. But they don't have to go out and replace a lot of fast money — like deposits that are going to be taken away. And people keep paying on their policies. So I think it'll be a problem, but I think it's one that we can bear up under.

<u>Banking system is strong, solvent and very under-loaned.</u>

Lynch: I can now declare that the banking industry's made it. They now have record spreads and we're close to a record equity to assets position.

And for the first time since World War II, they have

(continued on next page)

PETER LYNCH
(cont'd from preceding page)

more government and investment securities on their balance sheet than they have loans. So they're very solvent and very liquid. All they need is for someone to come in and want to borrow money for other than a shopping center or a high rise building and they'll make a loan to them. So I think we're ready to go.

PUBLIC HISTORICALLY UNDER-INVESTED IN STOCKS. THEY MUST HAVE DONE POORLY IN A BULL MARKET.

A good sign: the public is under-invested....

Lynch: The public still has a very low percentage of its assets in common stocks. They have a very low percentage of their assets in financial assets. You have to go all the way back to the 1950s to find it anywhere near as low as it is now.

But as people look out and see that social security won't be enough for them or their spouse, I think they'll move more in the direction [of common stocks].

TIMING SERVICES ARE USELESS. HERE'S EVERYTHING YOU NEED TO KNOW....

Expect declines. And be ready to buy when they come.

Lynch: So far in this century, there've been 50 years in which the market was down 10% or more during the year.... So about once every two years, you're going to have a decline of about 15%.

Of those 50 declines, 15 have been big ones of 25% or more — averaging 33%. Every 6 years, you get a big decline averaging 33%. It's interesting that the 1987 decline was exactly 33% from 2,700 in August to 1,700 in October....

So every two years you get a small decline and every six years you get a big decline. If you added to your funds every time the market went down, you'd be better off.

Timing services useless, although *they* can prove otherwise.

Lynch: You don't know when — the next two weeks, two months, two years — the market's going to go down. [But knowing that it will go down] is very easy to predict. It's kind of like predicting that the Red Sox will win the World Series. Unfortunately, the last time they won it was before the Russion Revolution. Or you could predict that the New England Patriots will win a game — they're 0 and 8.

I think people realize that they should take advantage of these declines. And if you put in so much each quarter or each month — and maybe when the market goes down, you put more in that year — you're going to be better off.

But trying to predict what the Dow Jones or the S&P is going to do a year from now or six months from now is useless. People make a big mistake doing that. So I think that these timing services are not helping people — although I know *they* can prove otherwise....

Market timing in one easy lesson....

Lynch: Market timing's terrible, just terrible — a total waste. They have all these fancy models. But basically, when the market goes down five days in a row, they tell everybody to get out. And then when it goes up five days in a row, they tell everybody to get back in.

It's a good business. And they charge 2% a year?! If I'm ever reincarnated.... What a living. You only do something every now and then. You watch and you go, "Oh, gee. There's the fifth day. Get the letters ready. That's it. Everybody out."

THE BAD NEWS: WE NEED MORE EARNINGS. THE GOOD NEWS: IT'S ON THE WAY....

The values are out there..., but we need to get the "E" going.

Lynch: The values are in financial stocks, cyclicals and small growth companies. There *are* values out there. But the market [is another story]. In broad terms, it's sold for between 10 and 20 times earnings the last 50 years. We've done about as much as we can on the "P" side of the P/E equation. We need a lot of "E" here at some point.

It's amazing. Just 10 years ago, in 1982, the market was under 800. It's now 3,200. And corporate profits are unchanged from four years ago. So at some point, we need to get the "E" going.

I think profitability will pick up and really surprise people.

Lynch: The pleasant thing to me is that during the first half of 1992, profits as a percentage of GNP were the lowest since World War II. So I think that profitability will start picking up and really surprise people.

It won't surprise you in Coke, Pepsi and Procter and Gamble. But it'll surprise you in Colgate Palmolive. And it'll surprise you in some retailers, energy companies, all the cyclicals and the financials.... I don't know whether it's going to happen next quarter, a year from now or a year and a half from now. But at some point, there'll be a *massive* recovery in profitability — and I think people are underestimating it.

Productivity gains have been huge — and unreported.

Lynch: There's been *unbelievable* cost cutting. I don't know who they've got measuring productivity in the government where they show that productivity in the service sector hasn't gone up for a decade. But that's total garbage.

When they split up American Telephone in 1984, it employed over a million people — so one out of every 100 Americans was working for them. If you put together American Telephone and all of the RBOCs today, they'd have 600,000 employees and they're handling 50% more calls — or message units including faxes and data transmission. And they've cut 400,000 workers. In industry after industry, you can see it.

All you have to do is go overseas and see how many people they have in banks, insurance companies and telephone companies over there. Yet the government tells us there's been no productivity gain in the service sector.

You'll see a huge jump in profits. And it's worth waiting for.

Lynch: For example, just go to a K-Mart. The government tells us that there's been no productivity gain. But these guys are doing massive numbers with scanners and so forth to the point that there's almost no one in the stores except for the shoppers.... Maybe Chairman Joe Anconinni is there somewhere, but I haven't seen an employee at these retailers....

So I don't know who's measuring it, but when business

(continued on next page)

PETER LYNCH
(cont'd from preceding page)

comes back, there's going to be a huge boost in profits. So it's worth waiting for....

WHEN THE AUTO INDUSTRY GOES, IT GOES AND GOES....

Stock market laggards will enjoy a dead cat bounce....

Lynch: It's generally the laggards — the companies who've been struggling — who are going to have the bounce.

I think if you're going to own stocks for twenty years, Merck and stocks like it will do better than Xerox, Eastman Kodak, Sears or General Motors....

But sometime in the next couple of years, these laggards who are trying to turn around their businesses — like IBM — are going to get it right. And they'll have a bounce. It's called a dead cat bounce — it doesn't bounce very high, but at least you get a bounce.

Others that fit that description include Xerox, Sears, Eastman Kodak and DuPont — they're all companies that are working very hard to turn around their businesses. Marriott and American Express are two others. Eventually, they'll get it right. They're not going under.

When the auto industry goes, it goes and goes and goes....

Lynch: I think all the autos are attractive. I think people underestimate the power of the cycle when it turns. Auto and truck sales will be 2-1/2 million under trend this year. And if you look, auto sales are very predictable. They grow about 1% a year — because registered drivers grow 1% a year and the number of miles driven grow a couple of percent a year....

But consumers can defer [their purchases]. People can stop buying cars. And a lot of people bought cars on five-year or sixty-month paper in the last cycle. So they went to buy a new car and found out that they were underwater. The car was worth less than the loan.

And a lot of these things were done in 1986 and 1987. So now the paper's come due and they've paid off their car. They can trade it in and get a car with four new tires — and this little tiny one in the trunk — that works good, gets good gas efficiency and has an airbag and a nice paint job. All they need is a little confidence. So the auto industry's ready to go.

What I like about it is that if autos went up a million units next year — auto and truck — you'd still be way under trend. So you'd have a good 1994, a good 1995 and a good 1996. When it starts up, it *goes* — and it goes for a long time.

Two exciting product introductions at Chrysler....

Lynch: Chrysler has a new series called the LH series — the Intrepid, the Concord and the Vision [are the] three cars that they have for Dodge, Chrysler and Eagle. Their Cab Four is a spectacular vehicle — it's wider and it has a lot more room inside and so on. If it catches on and is even one-quarter as successful as Taurus was for Ford, then the stock's going to be huge.

And then a year from now, Chrysler has a new truck coming on. They haven't had a new truck in over 20 years. They brought out the Dodge Dakota 12 years ago, but that's sort of a medium-sized truck. This is a full-sized truck. Basically Ford and GM have the whole truck market. The Japanese aren't even here. They don't even have a product.

So a year from now, Chrysler's going to bring out this truck that has a 12-cylinder engine — it's going to be a huge sucker.... If this catches on or if this LH series of cars catches on, that'd be big for a company the size of Chrysler.

Breaking even with 33% market share not a Herculean task.

Lynch: If GM could just break even in U.S. auto — and I'm not saying in U.S. truck because they make money there — consider that they have a 33% share of the market.

They used to have 50%. But think about it. Ford makes money with a 22% share. Chrysler makes money with a 9% share. They're at 33%. It's a lot easier to go from 33% to 25% than it is to go from 9% to 25%.

And at some share of the market and at some point in the cycle, GM ought to be able to make money — or at least break even — in U.S. auto. I don't think that should be a Herculean accomplishment.... If you have 8% or 4% like American Motors had, you can't — you don't have enough dealers and you can't cover the R&D for new products. But if they just break even in U.S. auto, with the money they'd make at truck, the money they'd make at Hughes, the money they'd make at EDS, the money they'd make at GMAC, the money they'd make at Delco and the money they'd make overseas, GM would be a double....

Europe icing on the cake for Ford — actually another cake.

Lynch: And I think that people are looking too near term with Ford and all of their problems. Their major European operation is in England. In addition, they own Jaguar — which is a massive loser right now.

But Ford's a fine company. When the auto industry rebounds, it'll help them. It'll be a couple of years before it comes back in Europe. But the frosting on the cake — actually another cake — will be when Europe rebounds.

SOME BARGAINS AMONG THE FINANCIAL STOCKS. HIGH RISK/HIGH REWARD ENTRY — CITICORP.

Here are some of my favorite financial bargains....

Lynch: I still like Federal National Mortgage, Freddie Mac, Sallie Mae and Kemper — which I think is turning around. Colonial Group, I think, is the cheapest of the mutual fund companies.

Capstead Mortgage has a good yield and it's well run. They're trying to do in jumbo mortgages what Fannie and Freddie have done in conforming mortgages — which is what the average person has. Capstead can do the jumbos — it's a big market. And they've done well at it so far.

Among the thrifts, I like the well capitalized survivors....

Lynch: I like stocks like Northside Savings Bank in New York or West Newton Savings Bank or Central Cooperative — both of which are in Massachusetts. I like some of these thrifts with interest rates where they are now and with improvements in the mortgage markets where these companies had strong balance sheets when the problems started.

So they may be able to write off a lot of real estate and still be in decent financial positions. Pamrepo is a well

(continued on next page)

PETER LYNCH
(cont'd from preceding page)

known name. It's another thrift based in New Jersey that I think is attractive.

I don't know Wells Fargo well. But I wouldn't bet against it.

Lynch: I'm not up-to-date on Wells Fargo. It's a spectacular company. It's well run. They know what they're doing. And a pretty smart guy named Warren Buffett owns a lot of it.

Calling a turn in California is tough. And I'm not up-to-date on how much they have in commercial real estate. But I wouldn't bet *against* them. *I* wouldn't be short Wells

High risk/high reward Citicorp could be a very big stock....

Lynch: Citicorp's in the high risk, high reward category. But it's lower than it was twenty years ago. And I think that they clearly made it through the LDC crisis.

They get a nice spread now. They're still dealing with an incredible amount of real estate problems. But I think they'll chew through that in the next two or three years. And at some point, that stock could be a very big stock. After all, their basic businesses are very good businesses.

RETAILERS, PAPER, ENERGY ET AL. A GOOD WAY TO PLAY THE RECOVERY.

Pier One Imports — the best by a lot at what they do....

Lynch: What I like about Pier One Imports is that every day, one of their local competitors folds up. For example, it's weak in California right now. It used to be weak in New England. When conditions were terrible there, some of their competitors who'd been in business 50 years just folded.

Pier One is staying in business. They're still solvent. They've cut their debt. And they'll be around when the economy gets better.

In addition, all the department stores have seen the success of Gap and The Limited. So they all want to go into sportswear. They all want to be in apparel. They're all getting out of home furnishings. Pretty soon, there'll just be Bloomingdale's, Neiman Marcus and Pier One. Of course, I'm exaggerating, but their competitors are all cutting back....

And they have very good stores. They've upgraded their stores. My wife has a black belt in shopping. And she'll go anywhere. And she goes to Pier One Imports and thinks it's great. She's my indicator there — and she's still buying stuff there.

What I like about it is that they're a national chain — so they can grow. They're the best by a lot at what they do. And they're making money in a recession. They're making decent money now. When the economy gets better, they'll make a lot more money. And they can grow for another ten

(continued in next column)

or fifteen years.

But it's not one of these companies that's going to go from $9 to $600. It's been around a little while. But I wish I had a few of those. You don't get a lot of them in a lifetime.

The great quality consumer stocks — like the American Home Products, the Bristol Myers, the Wal-Marts, the Philip Morris', the Coca-Colas and the Pepsi-Colas — are already known. Pier One Imports, which sells a product that you don't have to buy when there's a recession will get a cyclical bounce — plus they're gaining market share.

The cyclical stocks are a good way to play a recovery....

Lynch: Retailers in general and all the cyclicals and the paper companies are a good way to play an economic recovery. The energy stocks [are also a good way to play an economic recovery] because when the economy comes back, energy demand around the world will pick up. In addition, the energy companies have cyclical businesses that they got into — chemicals and lots of related businesses.

And I like Deere.

Energy stocks represent good value....

Lynch: I think that the natural gas bubble has finally gone away. So there's a play on that. We've had six warmer than normal winters in succession. Now maybe with the El Nino, we'll have a cold winter. We had a cold summer. But even if we don't, I think that the oversupply of natural gas is behind us.

I think in only one year in the last 25 years have we found in the U.S. as much gas as we've used — one year. We're finding about half of what we use. So every year, the reserve index goes down by about six months. We use a year's worth of gas and find six months' worth. It's been that way for a long time.

Many people, including myself, have been predicting the end of the natural gas bubble for about eight years now. And it looks like it's finally arrived.

The natural gas stocks have moved up. But the big integrated guys have natural gas operations as well — it's a freebie. So I think that energy stocks, although they won't quadruple, represent pretty good value.

Great stocks are out there. Just keep your eyes open....

Lynch: How will I stay "One Up On Wall Street"? I see if Carolyn comes back from the store and says, "Pier One Imports' merchandise is stale." Or I see if my oldest daughter says that Ann Taylor looks better right now.

I go to the mall. If you worked in a mall for the last twenty years and didn't make money, you ought to get the all-time dunce cap award. You saw The Limited. You saw the turnaround at Gap. You saw Ann Tayler do well and Ann Taylor not do well.... You see these things all the time. You saw Toys R' Us.

Yet these people were out buying bio-genetic stocks or buying something because Boone Pickens was going to take it over — despite having all of this great information.

Great stocks are out there. They're out there looking for you. You just have to keep your eyes open.

—OID

MARK COOPER, ATTORNEY/INVESTMENT COUNSELOR

"Warren Buffett paid roughly $67 a share for his first purchases of Wells Fargo in 1989. Here's the best investor of his time in the middle of his circle of competence who wrote about and discussed Wells' margin of safety at that time. One way of looking at Wells Fargo is to consider how much *more* of a margin of safety has developed since then. Since he bought his shares in 1989, Wells earned a total of $88 a share, or approximately $4.6 billion, before dividends and about $80, or roughly $4 billion, net of dividends that I view as an extra margin of safety *since* Buffett bought his first shares."

"Assuming the same 30% average loan loss from each problem loan Buffett did, that extra $4 billion margin of safety means that 34% of their $39 billion of loans could be written off an average of 30% without touching a *dime* of Wells' equity. Then, assuming that their pretax, pre-loan loss provision earnings are the same next year as this year, there's an additional 14% margin of safety. So between the last three year's earnings and their current earnings power, nearly 50% of their loans could suffer a 30% loss of principal without hitting their equity. Their margin of safety is just *awesome*."

"It's your classic double dip. You're going to get the first dip from recognition of their current earnings and its growth. Then, if management's as good as I think, you'll get the second dip from the market paying a lot more for those earnings."

"And I think there's the potential for a triple dip. They took very large loan loss reserves, for example, in 1981-82. And they recovered most of them. If 75% of them came back this time, that'd be approximately $1.5 billion of additional earnings — or nearly $30 a share. Finally, I don't think they need to merge with anybody to be a great investment. But management has a very strong track record of making good decisions on consolidating and expanding. And the opportunities are certainly going to be there. So there's the potential for a fourth dip."

"I liked it better at lower prices. But Wells may be a *more* compelling value at $65 to $70 than it was at lower prices."

Conversations with *OID* — November 1992

BRUCE BERKOWITZ, LEHMAN BROTHERS

"Wells Fargo has had fantastic earnings power in the past. I don't see any reason it won't continue. In fact it's growing. Its earning power has been disguised by the intense provisioning for loan losses. But when the provisioning gets back to a normal level, you'll start to see that incredible earning power come down to the bottom line. And it's as simple as that. The recession will end one day. And when it does, Wells will make a fortune."

"Wells is being handed to investors on a silver platter. It's just a matter of time...."

Conversations with *OID* — October/November 1992

Dear Subscriber,

Peter Lynch, George Soros, Seth Klarman, Steve Farley the partners of Tweedy, Browne, and Michael Steinhardt, among others, apparently agree on two things:

[1] That the S&P 500 is relatively expensive.
[2] That pockets of opportunity remain.

It's easy to be a market agnostic, however, when you have the opportunities before you that each of this issue's contributors have shared with us:

•Tweedy, Browne's John Spears, Jim Clark and Chris and Will Browne point to 1973-74-type prices in Europe and describe how they eliminate currency risk.

•Ron Baron shares an in-depth view of a company which sounds like it may have as brilliant a future as almost any company could have — Tokos Medical.

•Bruce Berkowitz and Mark Cooper share their extensive insights about Wells Fargo — a company that we've had in *OID* on a number of other occasions.

Your editor never fails to learn a tremendous amount from preparing issues for you. This one was no exception.

While the format of this issue is somewhat unusual — especially with its in-depth discussion of two companies, currency hedging and shorting, I believe you'll find the time spent with it well worth the effort.

We're very sad to report that one of our friends and contributors, Jerry Carret, passed away since last issue. Like his patriarch father Philip, Jerry was as thoughtful and honest a gentleman as we've had the pleasure of knowing. We'll miss him sorely.

Until next issue,

Henry J. Emerson

Your Editor

P.S. Some of you called us regarding an article about *OID* and yours truly in the Dec./Jan. issue of *Worth Magazine*. And you observed that the only way any writer would ever say such nice things about us was if we bribed him — which we did. (Writer David Schiff is an *OID* subscriber.) Unfortunately, we were unable to bribe the photographer....

P.P.S. Thank you for your support.

Outstanding Investor Digest is published monthly (more or less) by Outstanding Investor Publications, Inc.
Subscription rate: 12 issues — $475
Outstanding Investor Digest, 14 East 4th Street, Suite 501, New York, New York 10012 Telephone: (212) 777-3330