

# LGC&D Wealth Management, LLC

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## The Next Peter Lynch

**Overview:** Some investors are constantly searching for the next great fund manager. These investors are hoping to discover someone like Peter Lynch, who ran the Fidelity Magellan Fund and trounced the S&P 500 Index. With his investing insights, he should be an ideal choice as someone who could identify a great fund manager. However, the following demonstrates that not even he has been able to pick the next Peter Lynch.

“If you stay half-alert, you can pick the spectacular performers right from your place of business or out of the neighborhood shopping mall, and long before Wall Street discovers them.”<sup>1</sup>

Those are the words of the legendary Peter Lynch, considered one of the greatest stock-pickers of all time. Lynch ran the Fidelity Magellan Fund from 1977–1990, racking up returns of 29.2 percent per annum versus 15.8 percent per annum for the S&P 500 Index. The fund's value exploded from \$20 million to \$13 billion by the time Lynch retired.

Lynch is also considered one of the sages of the investing world. He has written several books on investing, including the best-seller *One Up on Wall Street*, and has been described by the *Wall Street Journal (WSJ)* as “a master of the wry one-liner and quotable anecdote.”<sup>2</sup> With such a legendary track record and high regard from peers, one would figure that Lynch would be the perfect person to pick the next great fund manager.

Indeed, Lynch had a few opportunities to make such a choice. After his retirement from Fidelity Magellan in 1990, Lynch's impact remained on the fund for many years. The next three men to take Fidelity Magellan's helm — Morris Smith, Jeffrey Vinik and Robert Stansky — were all Lynch protégés, complete with strong track records running other Fidelity funds. Did any of them prove to be the next Peter Lynch?

### **Morris Smith**

The track record seemed spot on:

- σ Lynch and Smith were trained and developed by Fidelity.
- σ Both earned an MBA from the University of Pennsylvania.
- σ Smith was a certified public accountant prior to earning his MBA. Lynch had previously said the best job one could have to prepare for managing a stock fund would be a public accountant.
- σ Even their personal lives matched: Lynch and Smith were considered dedicated family men, devoutly religious and willing to put in long hours.

Smith also had a history of success. From 1984–1985, he ran Fidelity Select Leisure, providing a total return of 78 percent versus 41 percent for the S&P 500. He then took over Fidelity OTC Fund, which is limited to small-cap stocks. During his tenure, the fund outperformed the Russell 2000 Index, garnering a return of 36 percent versus 10 percent for the index.<sup>3</sup>

However, Fidelity Magellan's investors never got much of a feel for Smith. A mirror of Lynch to the end, Smith resigned in the same fashion as his predecessor: abruptly and citing the intense demands of the

job and a desire to spend more time with his family. The difference was that Lynch spent 13 years at Magellan's helm; Smith spent two years.

The issue wasn't job performance. During his short tenure, Smith managed to top the S&P 500 with a return of 12.8 percent per annum versus 9.6 percent for the S&P 500.

Investors should wonder, however, whether the outperformance should be credited to Smith or Lynch. When Smith took over Fidelity Magellan, Eric Kobren, publisher of independent newsletter *Fidelity Insight*, noted in a *WSJ* article Lynch's picks would likely be the driving force behind the fund for a year or longer.<sup>4</sup>

### **Jeffrey Vinik**

Once Smith resigned, Jeffrey Vinik took his turn at managing the fund. As would be expected, Vinik took the reigns after posting a solid record managing other Fidelity funds, first running Fidelity Contrafund, then Fidelity Growth and Income. Lipper Analytical Services showed that combining Vinik's records at the two funds resulted in a total return of 108.8 percent compared with 62.1 percent for the S&P 500 over the same period.<sup>5</sup>

"We'll see how long Jeff Vinik can last," Morningstar's John Rekenhaller told the *WSJ*. "But if anybody can do the job, he can. He's the brightest star in Fidelity's firmament."<sup>6</sup>

Even Lynch himself gave a ringing endorsement of the fund's direction when Vinik, who also served as an assistant to Lynch, took the job: "Magellan is very important to me. I bought a couple thousand shares when I quit. And I'm going to keep buying more. I'm confident that Magellan will keep beating the market."<sup>7</sup>

Lynch's confidence was misplaced. Fidelity Magellan trailed the S&P 500 during Vinik's tenure, returning 16.2 percent per annum compared with 16.6 percent per annum for the S&P 500.

Part of the reason for Vinik's underperformance was his bet that stocks were heading for a decline. The fund, which had grown to \$53 billion by this time, had only 71 percent of its holdings in stocks. The rest was split between bonds (19 percent) and cash (10 percent).<sup>8</sup> His strategy backfired at the end of his tenure when stock prices rose and bond prices fell during the first half of 1996, causing the fund's performance to slow.

### **Robert Stansky**

Like his two predecessors, Robert Stansky took over Fidelity Magellan as both a Lynch protégé and a manager who had established a solid record with another Fidelity fund. Stansky managed the Fidelity Growth Company Fund, which had shown annual returns of 16.5 percent per annum since Stansky took the helm in 1987. Fidelity Magellan had returned 14.6 percent per annum during the same time period, which includes a few years under Lynch.<sup>9</sup>

Stansky was viewed as an aggressive stock-picker, much in the mold of Lynch. "He stays true to his style," Jack Bowers, editor of *Fidelity Monitor* newsletter, told the *USA Today* when asked about Stansky. "He will be a good match for what customers want."<sup>10</sup>

Count Lynch among Stansky's backers: "He's a careful, cautious, extremely skilled person."<sup>11</sup>

Stansky wasted little time in shifting the fund's holdings back toward stocks. By the end of September 1996, the fund had 89 percent of its assets in stocks, 10 percent in bonds and 1 percent in cash.<sup>12</sup>

Still, Stansky's maneuvering ultimately did not pay off, and while he lasted longer than his two predecessors combined, he resigned in 2005. During Stansky's tenure, Fidelity Magellan failed to beat the S&P 500 overall, posting returns of 7.0 percent per annum. The S&P 500 returned 8.2 percent per annum during the same time period.

"It's clear that he hasn't been able to deliver the performance they've been looking for," Morningstar's Christopher Traulsen told the *Washington Post* regarding Stansky's departure.<sup>13</sup>

## Summary

So could any of Peter Lynch's three successors — all of whom had trained with the fabled stock-picker — replicate his results? No, no and no. The return of Fidelity Magellan under their leadership —spanning from June 1990 through October 2005 — was 10.1 percent per annum, which trailed the 10.4 percent return of the S&P 500 for the same period.

If the legendary Fidelity Magellan manager, who had access to the top talent and could train them himself, cannot produce the next great fund managers, why should ordinary investors believe they can pick them?

<sup>1</sup> Peter Lynch, **One Up on Wall Street**. (Simon & Schuster, 1989), page 14.

<sup>2</sup> Jonathan Clements and Christopher J. Chipello, **Will the Next Manager of Magellan Fund Be a Home Run Hitter?** *Wall Street Journal*, April 2, 1990.

<sup>3</sup> Ibid.

<sup>4</sup> **How Two Money Pros Compare; Smith Nearly a Lynch Clone.** *USA Today*, June 4, 1990.

<sup>5</sup> Jonathan Clements, **Vinik, a Fidelity Star, to Take Helm in July.** *Wall Street Journal*, April 30, 1992.

<sup>6</sup> Ibid.

<sup>7</sup> Ibid.

<sup>8</sup> Edward Wyatt, **Big Shifts in Holdings Disclosed For Fidelity's Magellan Fund.** *New York Times*, November 13, 1996.

<sup>9</sup> Robert McGough and James S. Hirsch, **Fund Track: Vinik Quits Magellan as Stansky Steps Aboard.** *Wall Street Journal*, May 24, 1996.

<sup>10</sup> John Waggoner, **Magellan Gets New Chief; Insiders Deny Top Fund Is Too Much to Manage.** *USA Today*, May 24, 1996.

<sup>11</sup> Ibid.

<sup>12</sup> Edward Wyatt, **Big Shifts in Holdings Disclosed For Fidelity's Magellan Fund.** *New York Times*, November 13, 1996.

<sup>13</sup> Matthew Keenan, **Fidelity Manager to Retire; Flagship Magellan Fund Has Lost Half of Its Value Since 2000.** *Washington Post*, November 1, 2005.

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