Peter Lynch Learning: Avoid Investing in 2 Types of Companies

Description

While it is important to know which companies stocks to invest in, you should also know which companies stocks to avoid. It may happen, the stock was a good investment when you purchased, but over the years, its growth stagnated. Famous investor Peter Lynch gave two important lessons. First, know what you own, and second, why you own it. I talked about the first lesson in my previous article . Here I will talk about the second lesson.

Peter Lynch: Stocks you should *not* own

Buying a stock is just half the battle. What sets good investors apart is how they manage their portfolios. Periodically review your portfolio and learn to let go of bad investments. Sometimes you've got to take the hit. You can recoup the losses by unblocking your funds from bad stocks and reinvesting them in stocks with growth potential.

But this doesn't mean you take out money from good investments and invest in something you feel could be a turnaround stock. Warren Buffett has admitted to many mistakes, and the biggest one is using **Berkshire Hathaway** shares to buy Dexter shoes in 1993.

From the books of Peter Lynch, here are two types of companies you should avoid having in your portfolio.

Companies with not-yet-proven big plans

One of Peter Lynch's famous quotes, "Behind every stock is a company. Find out what it's doing." There is something called the founder's trap. When a company is incorporated, founders are excited, aggressive, and have many plans to grow their business. But as they do the business their plans become more realistic and less aggressive. Such are the companies worth investing in.

Read the company's growth strategy and roadmap and measure their outcome with the earnings. If the company fails to meet its target consecutively and its growth strategy is unclear, you know it's time to exit. The company could be stuck in the founder's trap, or there could be gaps in implementation.

Companies with over-diversified operations

Another sign of aggressive planning is over-diversification. A company's management might make some decisions that may take the company off track. For instance, a company could make a non-strategic acquisition with little synergies or venture into too many products, which it can't handle. This over-diversification comes at a cost. You can easily spot it in the income statement. The operating expense would surpass revenue for several years.

Advanced Micro Devices: A turnaround story

Before Lisa Su took over as CEO of **Advanced Micro Devices** (NASDAQ:AMD) because the company lacked a realistic product roadmap. It had hands all over the place, developing too many products. This over-diversification delayed product launches making its technology obsolete. The company had the right talent but not the right strategy.

Lisa Su restructured the business and made some hard choices, streamlining operations to focus on few products. All of this took almost two years to show results. But when it did, AMD became a turnaround story. Before 2015, AMD was not a buy. But after 2015, it was a hot stock.

AMD was a bad stock turned good. Let's take another scenario where a good stock turned bad.

Facedrive: A story to avoid

Facedrive (TSXV:FD) launched its initial public offering in September 2019 as an eco-friendly ride-sharing company. It made several acquisitions: some relevant, some irrelevant. It marketed them under the name "planet first approach." Facedrive has six different businesses; e-commerce, e-social, contact tracing, food delivery, ride-sharing, and vehicle subscription. And all these businesses in just five years of being founded. This over-diversification has widened its losses.

Facedrive stock surged almost 400% between November 2020 and February 2021 when it made most of its acquisitions as it looked promising. But it could not turn its growth plans into profits, pulling the stock down 96% from its high. Rather than blocking your funds in this stock, you can book the losses and invest in a company with a more realistic business plan.

Portfolio management is about balancing losses with higher profits. Hence, review your portfolio at regular intervals.

CATEGORY

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TICKERS GLOBAL

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2. TSXV:STER (Facedrive Inc.)

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