5 Memorable Mistakes And the Lessons I Learned

By John E. Deysher

As a mutual fund portfolio manager, once a year I review the stock market mistakes I made during the past year.

It's a useful exercise. Mistakes occur for a variety of reasons including greed, fear and errors in reasoning, facts and judgment.

Once you realize you've made a mistake, your objective is twofold—first, to try to salvage the position and, secondly, to minimize the damage.

All investors like to talk about their winners, few about their losers. With this in mind, I'd like to share some of my most memorable mistakes I've made over the years.

Mistake #1: Bally Entertainment

One of my first trades as a young investor was the purchase of Bally Entertainment for $15 a share in November 1979.

At the time Bally, which also made slot machines, had just opened its Park Place Casino in Atlantic City where casino gambling had recently been legalized.

The Park Place Casino is a gem sitting atop eight acres at the famed intersection of Park Place and Boardwalk. At 2.2 million square feet, it's one of the largest casinos in town with a huge gaming floor, 1,300 hotel rooms and numerous shops, cabarets and eateries.

Having grown up in Philadelphia, about 90 miles from Atlantic City, I'd seen firsthand how gaming transformed the economy and skyline of Atlantic City.

While I didn't know much about Bally, its management or financials, I did know three things:

1) Park Place is a well-known brand with staying power (remember Monopoly?).
2) The central location of the Park Place Casino is terrific.
3) Millions live within a 100 miles of Atlantic City and some of them like to gamble.

So, in November 1979, I plunked down my hard-earned cash to buy some shares of Bally Entertainment at $15 per share.

About a year later, the position was sold at $17 per share for a small gain, after commissions.

So, in spite of picking a good company to invest in, I did not profit—I merely broke even. This taught me two very important lessons.

First, it is important to try to anticipate rather than react to major events that move stock prices. My guess is that the smart money was moving into Bally shares months before Atlantic City gambling was legalized. Getting in early earned them multiples on their investment. If gambling had failed to pass, they would've still owned shares in a darn good slot machine maker.

Second, Wall Street is a place where the patient take from the impatient. While Bally was a great company, it was priced like a great firm when I bought it. The shares had already had a nice run following the legalization of gambling in Atlantic City.

But even if I had not anticipated properly (lesson No. 1), I still could have profited if I had been more patient. My error was not giving the earnings enough time to catch up with the share price. Like many investors, I became impatient and sold early. Earnings per share eventually reached $3.20 a share, pushing the stock to $30 a share in 1981. By being a bit more patient, I could have doubled my money in another year.

Lessons Learned

1) Anticipate, rather than react, to events and news that move stock prices.

2) Be patient with your holdings, and allow stock prices and earnings to properly align when incorrect market expectations have thrown them out of kilter.

3) Don't go after "hot" stocks. Chasing a hot stock is a good way to get burned.

4) Stay within your level of knowledge and competence when analyzing companies.

5) Don't sell a stock too late, know when to fold. When management stumbles, a key signal is sales that either drop or do not justify management plans.

6) Don't sell a winner too soon. To avoid this, think: "buy value, sell growth." You can capture multiples on your investment when a stock transitions from value to growth, but it requires you to shift your way of thinking about your holding.

7) Stick to your convictions if you have some basis for thinking that a stock could do well.

Mistake #2: Onyx-IMI

Early in my brokerage career, I was caught up in the tech mania of the mid-1980s. Perhaps some of you remember that time. The American public was just starting to realize the power of the personal computer, and Wall Street was awash in hot numbers like Coleco, Commodore, DEC, Data General, Verbatim and Wang Labs.

An associate mentioned a company named Onyx-IMI, which made hard disk drives for personal computers. It was a start-up, launched to capture the burgeoning PC demand.

Without knowing much about Onyx other than they made disk drives (a hot area), I bought some shares.

Sure there was heavy competition from established players like Seagate, Quantum and Western Digital…

Sure, I hadn't the foggiest idea of why Onyx made a better product that would take market share and drive revenue growth…

Sure there were other disk drive makers coming public like Micropolis…

And sure, Onyx was a start-up firm that had never experienced a downturn…

So what?

All I knew was this was a hot start-up stock, just beyond it's initial public offering, and it was going UP, right?

Wrong.

You know what happened next. Onyx never delivered on expectations and became just another me-too disk drive maker that evaporated with the next tech slowdown.

While painful, Onyx taught me two valuable lessons.

First: Don't chase hot stocks in hot industries. The easy money has probably already been made. Instead, identify stocks you'd like to own for fundamental reasons, do your homework and be ready to buy when they return to reasonable valuations. Don't be caught up in a buying frenzy.

Second, stay within your circle of competence.

Back then, I didn't understand technology. And truth be told, I still don't. The rate of change is fast and the obsolescence risk is high.

Stay with what you know, and you'll improve your chance of success significantly.

Mistake #3: Open Plan Systems

A few years back, I owned a position in a small company called Open Plan Systems (PLAN), which refurbished workstations.

They would buy used workstations (cubicles) originally made by Herman Miller or Haworth, at pennies on the dollar, refurbish them and then sell them at a significant discount to new merchandise prices.

Open Plan went public in May 1996 at $10 per share. But because of several missteps and earnings disappointments, two years later the shares were at $2.

At this point, I bought a few shares because of their strong balance sheet and sound strategic position. It was encouraging when in June 1998 the board replaced both the firm's CEO and CFO with a couple of proven turnaround pros.

They were highly motivated, owning 4% of shares outstanding with options on another slug of shares that would give them 15% ownership if the turnaround succeeded.

At first the new management team delivered as promised—they fixed the business and restored profitability by reducing expenses and closing unprofitable sales offices.

However, the next step was to grow the company, and here management fell flat.

I'll spare you the gory details, but the fundamental culprit was an attempt to build a multi-brand platform with several plants and offices before the sales level justified the expansion.

Losses mounted, the balance sheet got leveraged and PLAN couldn't survive the collapse of the workstation market following the dot-com bust. The turnaround experts left, PLAN was liquidated, and shareholders got nothing.

Through it all, I held the shares—they were too cheap to sell!

The lesson: Now, I'm much quicker to sell merchandise that becomes impaired, as PLAN did. It's tough selling at a loss, but it's often your best choice for preserving capital.

Mistake #4: Metals USA

Metals USA (MUSA) was a Houston-based network of steel service centers that emerged from bankruptcy in November 2002 with a clean balance sheet and intact customer base.

The company had a new CEO who was making open market purchases along with several other executives. I spoke with him about his plans and liked what he said. In short order, a nice position was built at an average cost of $4.40 per share, a significant discount to tangible book value and potential earnings power.

The new CEO delivered as promised, and within months the stock doubled to around $9. The entire position was sold and I felt like a genius.

Well, the following quarters were better than expected and the shares promptly doubled again to $20 a share. Ultimately, Metals USA was acquired at $22 a share in 2005. Clearly I sold too soon and left some serious money on the table.

The problem?

I was thinking like a value investor instead of like a growth investor. Instead of worrying about what price-earnings ratio and price-to-book-value ratio the stock traded at, I should have been thinking about what price-earnings ratio a growth investor would pay for Metals USA's rapidly increasing stream of earnings.

That's an important lesson: Buy value, sell growth.

Now, once a stock starts to run, I replace my value hat with a growth hat and try to figure out what a growth buyer will pay. That's when you capture multiples on your investment: When a stock transitions from value to growth.

Mistake #5: Transkaryotic Therapies

Transkaryotic Therapies (TKTX) was a Cambridge-based biotech company that developed and commercialized human proteins to treat rare genetic diseases.

TKTX ran into problems in late 2002 when management turmoil, product development missteps and a bloated expense structure sent its shares plummeting. The shares fell below net cash of $7 to $8 a share, and Wall Street feared their excessive burn rate would devour the cash in short order.

The board replaced the CEO with a friend of mine, Mike Astrue. I'd worked with his father, Jim, 20 years earlier (he taught me about Graham and Buffett) and we'd stayed in touch.

Mike is one of the brightest guys I know, a Harvard-trained lawyer who held high level health-related positions in government and industry. I didn't know a thing about TKTX except that it was selling at less than cash in the bank so the downside was probably limited. What I did know was Mike probably wouldn't have taken the top job unless he thought he could make it work.

At this point, I should have bought shares when they were being given away. But, I didn't. Although I thought Mike had an extremely high chance of succeeding, I didn't understand what TKTX did and why it would succeed in a highly competitive field like biotech. My gut told me the stock was a winner with minimal downside but my brain ruled the day.

However, sometimes you must have the courage of your convictions and move ahead even if the outcome is not entirely clear—and particularly if the risk is limited.

You can guess the rest of the story—TKTX recovered as expected and was sold to another biotech firm for $39 a share in 2005.

Conclusion

These are a few of the mistakes I've made over the years. Perhaps you can learn from them as I did.

Winning in the stock market is often about not losing and keeping your capital intact.

One of the ways to avoid losses is to learn from your mistakes. All investors make mistakes, but the smart ones learn from them. ➤

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