IFB200: Stock Screeners, Cheap Stocks, and Great Businesses

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Dave: [00:00:00] All right, folks. Welcome to Investing for Beginners podcast. Tonight, we have episode 200, the big 200. We made it 200 episodes. So tonight, we're going to answer some listener questions. We have three really good ones that we thought would be a great learning experience for everybody.

So we thought we'd share those with you and Andrew, and I will do our usual give-a-take. So I will go ahead and read the first question.

So I have; Hi Andrew. I am a huge fan of the podcast and really appreciate all of the advice and knowledge that you and Dave share. I have a question about stock screeners.

I'm hoping you could help shed some light on I've created a couple of stock screeners using metrics you shared on previous podcasts to look for good value stocks to buy. Most of these picks have been great buys. I continue to hold them, and they have been doing well, but I have a question. What do you normally do when a stock you have previously purchased no longer shows up and the stock screener that you use to find it?

I'm assuming that means that it's no longer a great buy. Does that mean that it should be a sell

I'm just curious what your steps are to take that point. If the stock you owned any insight provided would much appreciate it. Thanks, lifetime subscriber, Dan. So Andrew, what is the question on the question? What are your thoughts on Dan's really, really interesting question?

Andrew: [00:01:17] Yeah, I really appreciate the writing in Dan, and I'm glad to hear you're enjoying all of the content. To me, it comes down to a big fundamental question is. What's my goal for this?

And I know that sounds kinda, you know, kind of Just very personalized, but really it's like if you are making a portfolio where you are buying cheap stocks and then selling them when they become fairly valued, buying more cheap stocks, selling them when they're fairly valued, then yeah.

Once the stock is out of your screener, if you have something better to replace it, then that's probably what you should do. And that can work for you very well over very short time periods. And on the other hand, if you're buying stocks that you're looking to hold for decades, that might not be the best way to go.

And so I think when you look at trying to buy good businesses over the very, long-term what looks cheap to you might or might not look cheap from the basis of a number necessarily compared to everything else, but it could still be a good price. And at that point, If you're really in as a business owner for the long term, it doesn't matter.

And it should not matter to you what the price is in the market because you know, this is something that you want to hold for decades. And so, you know, you know, maybe before we lose people who just started to tune in today, you know, what's a stock screener or a stock screener is something where you can put different metrics in, and then we'll filter a group of stocks with that criteria.

So if I want to take a very simple, like price to earnings ratio, which is one of the most common ratios that's used to approximate a price or valuation for a stock, you know, you can use a screener to say, Hey, show me only price-earnings ratio is below ten or below 15. And so you can get a list of a lot of the statistically cheap stocks in the market.

And so when you're doing that, you know, you'll find a lot of these stocks that get temporarily beaten up and out of favor, but you also find a lot of stocks that. They might not have great businesses underneath them, and that's why they are cheap. And so, you know, while Wall Street is emotional, it's also not dumb.

And so, a lot of times, there something could look too good to be true. And so you have to be careful with that. When you have positions in your portfolio, and you look at them, and they've gone up in price, the question does become. You know you want to look at the companies and, and think about. You know, are these companies, I can really see myself in for the long term.

And so, you know, when I try to think about what kind of a company does that, it's really going to be companies that can take your money and put it to good use. And so whether that's them giving it back in a dividend or through buybacks, or whether that's them reinvesting in themselves and being able to grow and compound, those are the things that you want to look for.

And those show up in the numbers. And the answer to whether a stock is a good business, I think, is a separate question from whether it's still cheaper or not. And that's an important distinction, but something that I think people should take into account,

Dave: [00:04:40] I agree with all that. A really good way to think about that as when you're looking at companies to screen, and you're looking to invest in them using the stock screener is obviously a great way to help you narrow down your choices, because when you start looking at the vast universe of companies that are available to buy. It's a lot. It's tens, if not tens of thousands in the United States, but it's, you know, thousands. And so, it can be overwhelming. So using a screener to help you narrow down those choices is a great tool.

One of the things that I think about, and Andrew and I have talked about this in the past as well for him, and I do this the same way is when you're thinking about whether the company is whether you want to keep a

holding it or whether you want to sell it. A great question to ask yourself is, has anything fundamentally changed about the company?

In that? Is it something that they've stopped making? Whatever it is they're making, have management completely turned over? Is the product or service that they offer completely become unrelevant? A perfect example, Kodak was the king for a long, long time. And then these little cell phone things came out, and then all of a sudden digital photographs were the thing and the old analog type of taking pictures and processing film that just kind of died a horrible death and Kodak didn't adapt.

And they got caught flat-footed, and boom, they're out. They're not out of business, but they're certainly not relevant. And at one point, they were one of the largest companies in the market. And now they're, you know, I don't know what, I don't know what their market cap is, but it's quite small. Anyway, that's a perfect example.

A company that fundamentally changed the universe in which they existed fundamentally changed. And so we needed to sell out of that company. You could look at some of the oil majors today, and wonder is something going on that would cause you to fund. We caused them to fundamentally change and that they, they either need to adapt or they're going to die.

It could happen. I don't know. It could, it could take a while, but it's certainly something to consider if you're going to buy an Exxon or a Chevron. But the flip side of that is like, Andrew was saying if your screen right now, you might see some of those companies and there'll be cheap. You think, oh God, you know, this is great.

You know, a five-star or a blue-chip type company like Chevron and Exxon is trading at the super low PE. This might be a great time to buy in, but you have to ask that extra question. Why is this so cheap? Why is this company that was so awesome? Five years ago, ten years ago. Now, so cheap what's happened?

And so those are some of the questions that you need to ask beyond just looking at the numbers, and obviously looking at the numbers are great. And the number tells you a story, and a low PE for a company like Chevron or Exxon is telling you a story, just like a high PE for a company like Adobe or Facebook is telling you another story.

And our job is to try to figure out how to decipher what those stories are. And that's what makes investing interesting and fun. And the challenge, because it's not easy to, to pick up that book and figure out what it's trying to tell you. You have to sometimes think a little bit between the lines. And so I guess my thought is for, for Dan's great question is.

When you're looking at the stock screener, and a company moves out of it, in some cases, that's actually a good thing is because the company is improving its metrics and it's becoming the market is starting to recognize; hey, this is a really good company and are starting to bid the price up. And so, your shares that you bought at a lower price are now worth more.

And so I guess it's your decision then is trying to decide whether you want to continue to hang on to that company or whether you want to take the gains and try to find another cheaper company and try to work that up. Really, there's no right or wrong answer to that. That really comes down to your personal preference and how much you want to do sometimes.

You do want to move on to another company because it's more interesting and it keeps you challenged, but I also challenge you to think of this. Charlie Munger said once that the greatest challenge to compounding is

not interrupting it unnecessarily. And so if you've got a great company that you've bought really cheap and that's going through the roof, then sometimes it's best to step away and get out of the way and let the thing do its thing. Until it gets to a point where you just don't feel comfortable holding it anymore, and then you can sell out of it. But anyway, those are, I guess, some of my thoughts along those lines. Andrew, did you have anything else you'd like to add to Dan's question?

Andrew: [00:09:43] I mean, I would think in just to give a tangible example of kindness, taking that second question over where you're asking, why is this company so cheap? I think you can look at something like I think I got an example is when I think of like, why I bought Cisco years ago, The numbers were all saying everything was fine.

It was just, people were, people were convinced that they were done like that, that for whatever reason, their technology was going to be obsolete, but the numbers are still there the backup that they were good. But like on another side, you can look at a company like. Where their revenues are going down, their profits have been going down, and so they have a cheap PE ratio.

So those are two very different stories. One is like; people think that they're over the hill, a second story they are over the hill, look at their numbers are falling through the roof. So it's not though it is very like an individual to what the stock is it doesn't need to be super complicated or complex.

Sometimes it can come down to something as simple as looking at which way are the numbers going? Also, understanding that Hey companies also go through stumbles. Like if you're a sports fan and you know that you have a player who's really, really good. And he goes through a slump; the team doesn't just trade them, you know?

And so you have to distinguish between, you know, what's a company looking like, what's their trend looking like, and then. You know, how does that compare with the whole picture? And so that's why I, like, I like the questions you're asking, you know, like is, is the best, the model obsolete has it fundamentally changed, right?

Big picture type of things. And the, and those are the things I think the similar type of questions that you can ask when you're wondering if you want to sell something that's gone up. Because I think in answering that question, you can get a lot of the answer to what to do with this stock

Dave: [00:11:40] Yeah, exactly, those are great insights. I, Dan, hope that helps answer your question. So I think, I think those are all things that you need to consider when you're looking at whether you want to buy, sell, or how you want to handle that. But those are, think of, think of those ideas, and I think that'll help you a lot.

All right. Let's move on to the next question. So I have I Andrew; with interest rates on savings at an all-time low investing is the smarter play for long-term value. However, is investing worth it if you need to cash out within a few years, and around two to three years, I will need to pay for surgery that has a likely cost of $50,000.

Assuming I can maintain my current rate of savings, I will still need to acquire a loan of up to 15,000 to fully pay for the surgery, plus all the savings I have accrued until then. A strong ROI could reduce the loan aid. But given the volatility of investments, building up a portfolio that I will be selling off in a couple of years could increase the loan while investments pay off in the long term given the short period that I will be

holding, I'm not sure if it's if the risk is worth taking for my capital. Any thoughts would be greatly appreciated; kind regards Cara. Andrew, what are your thoughts on Kara's question?

Andrew: [00:12:56] Definitely, timeframe does make a big difference on the likelihood that you'll succeed. I think it's easy for investors to look at the recent past.

There's a psychological term for it too. I think it's recency bias, but basically, it's this idea that whatever's happened in the past couple of years is what's going to happen in the next couple of years. So even like a perfect example is, and I fall victim to it too, just like anybody else. So don't think I'm better than anybody. But you know, we can look at the stock market crash in 2020 and how it crashed. And then it rebounded. So everybody said, man, why then everybody just buys the dip.

And I remember you can even go back into the archives, and you can listen. I mean, There was a lot of talk about it being the next great depression. And so, you know, we have this idea now that wherever the next crash happens, that it's just going to be another by the dip.

But what that is, is this a recency bias? That's not necessarily what could actually happen. And so that's what makes the stock market difficult is over a very, very long time period. You'll have it going up most of the time you'll have a dip and going up most of the time, but then every once in a while, you'll get this really, really bad five, maybe seven, even 10 or 13 years, time period where stocks just don't do anything.

People don't want anything to do with the stock market. And that's exactly what you don't want to happen if you have a big expense to pay. So even though probably nine out of 10 times, you might be okay investing in the market. It will just take that one time to, to, for the markets to turn against you.

And now, all of a sudden, you have to get into more debt, and I would never advocate getting into debt in order to invest. I think you really want to get your financial house in order. Put that foundation down, and then once you do have that, then whatever you're making from your investments is just icing on the cake.

You know, we don't want people to go mortgaging their homes and living in homeless shelters. So you can go get dividends. It's just; it doesn't make any sense at all. And if you think that's going to help you sleep at night, even in the safest investments, I don't think it will. So though it is, it does make sense.

Kind of logically, you have to think about really what the long-term history of the stock market has been, and what's the risk-reward, you know, and, and to me, it's not worth even a one in 10 chance that I'm going to have to go into debt in order to, to get a better return. It's just not worth it.

Dave: [00:15:22] No, it isn't. And in the idea of, I guess, trying to pick the company or the company. That could get you to the point where you want to be. It's a; it's a gamble. There's just no other way to put it there. It's taking a chance. You don't; there are no guarantees. Even if you talk about the big movers and shakers in the market, there's no guarantee that they will perform well.

For the period of time that you need them to perform well. And that's what makes investing and particularly investing in a stock market, so difficult. You know, granted, there have been some companies over the last year, or so that have gone nuts, and there have been some people that have done really, really well with those, but there's also a lot of people that.

Have not done well with those, depending on when you get in on a particular company, you could either be at the top of how the company has performed or not. And I'm not picking on Peloton, but if you just take the price of Peloton right now, let's say that you think that that's going to be the stock that will help get you to

the balance that you need to help pay for whatever it may be, whether it's a house, a car surgery, any, anything of that nature that you're trying to gather money for in a shorter period of time.

If you had a bet on Peloton, let's say. Prior to the pandemic, you could have done really well. If you would've sold out here in the last, I don't know, two months ago, three months ago, you would've done really well. However, if you had bought it, let's say in December of 2020, and you still needed another two years to get to where you're going to be.

Yeah, it might be a tough row to hoe with that company. I'm not saying that the company is bad. I'm not saying the product is bad. I'm not saying it's a bad investment. But what I am saying is, it is down 30 or 40% off of its high and to recover back to that high. And did you, can you go higher is unlikely.

And it's also going to have to do some serious, serious, you know, growth to get back to that level. And so it just kind of help illustrate. How challenging something like that could be, and if you pick the right companies, yeah. You could do well, but it's such a gamble, and that's certainly not anything that Andrew and I advocate for.

And it's just not a, it's not a prudent thing, a wise, I guess, margin of safety type thing to do because it's gambling, and there's just no other way to put it. And there's nothing; there would be nothing worse. I would hate to have somebody go out there and tell them to go buy all these companies.

And two months before they need to go pay for something important, like buying a house or a car or the surgery that the Cara was talking about, that all of a sudden, the stock market crashes two weeks before she's got to pay for everything and it loses half of its value. What do you do? I mean, it's, it's terrible.

And so that's why. When you're thinking about these kinds of things, it's better to figure out a way to do it safely and to be a little more prudent about it. And if that means putting the money in your savings account or putting it in a CD at a bank, or even looking at treasuries through Treasury.gov, but they're guaranteed that they're not going to lose value.

So those kinds of things could help you earn a little bit of money, but are still going to be safe. So those are options but putting all that money in the market in the hopes that you're going to. Accelerated that much is its chance, and that's not something that Andrew and I advocate for somebody because, like Andrew was saying, we don't want to, you know, putting all this money into the market and then you can't pay for what you want.

You lose everything. And then, you know, you're homeless, and you have to try to live off of dividends from a company. And that's just not the way to go.

It's tough, you know, because we go into the market wanting to make money really where big money is made in the market is when you're compounding that stuff over a very long time period.

So you're not talking about one year is not talking about two years, even after five years. I mean, the compact, you can start to see the ball rolling after five years, but really the magic happens ten years, 20 years. Yeah, exactly. Just from those little things, adding up.

It is. And a lot of people don't realize this, but Warren Buffett really did become Warren Buffett wealthy, like he is now until he goes around and around his seventies.

And he had been investing since he was ten years old. So he's been professionally doing it for 50 plus years, but he really didn't start reaching the, oh my God. He's a wealthy number until about the last 20 years of his life. So it's, you know, it's a slow burn. It's not going to be something where you're going to strike it rich overnight. You know, the Bitcoin billionaires are it's not a lot of people. So anyway, that's my thought.

Andrew: [00:20:51] What was that quote from Munger? He said the first a hundred thousand or the first million is the hardest was a hundred

Dave: [00:20:57] thousand, a hundred thousand. Yeah.

Andrew: [00:21:01] Cause, I mean, you think about like, if you make 10% on like a thousand bucks, that's not much right.

You make 10% on the million. Now you're talking about a hundred thousand. So, you know, again, as, as it gets bigger, it compounds on itself, and the dollar amounts become bigger. It's just when you're first starting. And certainly not in a couple of years; you're not going to be able to really move the needle unless you get into a Peloton before the pandemic. But we don't know how to tell you exactly how to do that for us any particular stock.

No, no, we don't. Nope. We do not have a crystal ball. Unfortunately, if we did, we'd share it with you. All right, so let's move on to the last question. So we have Andrew just started the IFB podcast from the beginning a couple of weeks ago, about 20 episodes deep, already.

I really, really appreciate the info. I do have a question that you may answer on the show eventually, but it's been killing me lately. I found a smaller cap company that hits every fundamental marker you have discussed. PE is below 10. The price to book is good. Cash is good. Everything looks pretty good.

The price of the stock is a little over $4. If this was a bigger company, I have no doubt I'd buy this as I'm using the value investor mindset. However, I'm not sure how to evaluate if this is a good buy as it is a smaller company that flies way under the radar. Any thoughts or advice, Andrew, what are your thoughts?

Yeah, so kind of going back to what we said at the beginning of the show, right. Let's what I would do if I was in, in; who was it? I think, yeah. Corey Corey shoes. Well, I would do I would go into the annual report, the 10 K, and let's learn about what this business does. And so, you know, is it a big fish in a small pond or is it a small fish in a massive pond.

So as an example, you know, if I dunno, give me, give me like a big tech company,

Dave: [00:22:56] Facebook,

Andrew: [00:22:57] Facebook. Okay. So if we have somebody who may like social media for pets or something, and, you know, they're, they had like maybe a hundred million dollars in revenue or something, which would be generous, right?

Maybe they have, like, I don't know, 1 million pets on their platform. Something, something really small, even if the company was cheap. I don't think I would want to buy that because all it would take would be for Facebook to say, oh yeah, we just added a pets feature, and they would be able to so much more cheaply move into your industry.

W versus you had to do this, like this, this other pet company had to do that organically. Right? Facebook could just make a tab on their page, instantly get all these users, and build their own. And so in that case, you know, I don't care how cheap the company is. I don't think I would want to play there. On, on the flip side, you know, some of the other good small companies I've seen are the ones where they're relatively shielded from the bigger players.

So whether they have like relationships with some of these, or they're just like, they're, they're, interconnectors, you know, if they have like distributor relationships, wherever they, wherever they fit. But if they are the big fish in their small pond, then I like that kind of a company a lot better because they're just, all they have to do is be the person who's, who's closest to them.

Like if you're, if you're running away from a bear, You don't necessarily have to outrun the bear. You just have to outrun the person who's next to you. So in certain industries, that's kind of how it is too. And you know, there's always a risk any kind of Amazon type company coming in and just, I, Amazon thinks they can, they can enter whatever business they want these days.

You know, that's always a risk, and that's with any business, but a lot of times you can figure out and you can, you can tell the difference between, you know, some really, really small company who's. Going up against huge, massive nuclear weapons, and they have little knives, and they're in their pockets. Or you can look at something where it's a little bit more sustainable, and they're actually could be a good competitive advantage.

And I think that has a huge factor when you're looking at small companies on if they have a good chance to succeed moving forward or not.

Dave: [00:25:17] Yeah. I agree with that. And I, I think the. The idea that you need to learn about the company, I think, is probably the greatest takeaway from what Andrew was just saying.

Because when you look at the numbers like we were saying earlier, the numbers tell you a story, but if you don't understand what the story is telling you, then it's hard to make a decision. To really understand those numbers, you really need to understand what it is the company does and how they make money and how they operate in the ecosystem that they operate in.

Because like Andrew was saying, if they're a small fish in a small pond, Then maybe that's not the greatest thing, but if they're a big fish in a small pond, then that gives them the opportunity to continue to grow and dominate that pond and grow beyond that pond. Whereas if they are somebody in a niche that one of the big tech companies operates in, it's quite easy for one of those companies eventually to gobble them up.

And so. I think that's a one. I think that's probably the greatest takeaway I would recommend is as learn more about the company read through the 10 K read through any financials that you can find listening to earnings calls, do some of that due diligence to learn more about the company, because once you know more about the company than a number, start to make even more sense, and it will help you make those decisions because that's the hardest part is, is trying to figure it out.

Yeah. Hey, I found this great company; it's, you know, all the screeners make it look awesome. But if we don't really know what the company does is really hard to think about how it can make money and how it could be successful as an investment. And I don't remember who said this, but it might've been Peter Lynch.

He said, when you think about a company, think about being able to describe it to a ten-year-old and how it operates. And if you can do that, if you can break the company down into a simple way that they can, you

can explain to somebody that doesn't understand anything about the business, then you really understand the company, and that can help you make your decision.

It doesn't mean you have to 10,000 different kinds of information about the company, but it certainly means you need to know a little bit about what it does and how it, how it operates. And I think once you understand those kinds of things, I think everything Andrew was telling you will start to make sense.

And, and it'll, it'll, it'll come a lot clearer to you when you think about it. All right, folks. We'll that is going to wrap up our conversations for tonight. I wanted to thank everybody for taking the time to listen as well as to send us these great questions; keep them coming.

And this is awesome. We are at episode 200. That is amazing. Thank you very much for continuing to support us and enjoy what we're trying to teach you and for learning everything we've been teaching you guys, and continue to go out there and do a great job. Continue to invest with a margin of safety emphasis on safety. Have a great week. We'll talk to you guys all next week.