IFB218: How to Get Started Investing When the Market Crashes

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I love this podcast because it crushes your dreams and getting rich quick. They actually got me into reading stats for anything you're tuned in to the Investing for Beginners podcast led by Andrew Sather and Dave Ahern with a step-by-step premium investing guide for beginners. Your path to financial freedom starts now.

DAVE Alright, folks, welcome to investing for beginners podcast. Tonight we have episode 218. And we're going to answer a couple of great listener questions we got recently. So, I will go ahead and read our first question. And Andrew and I would do our usual give and take.

So I have. Hi, Andrew. I'm 40 years old and feel like I'm extremely late to the investing game. Having grown up with parents that have always saved money and never invested, it took me a while to realize I had missed a big opportunity to invest my savings. Now I feel 15 years behind, but still, I have 25 years to be in the market before retirement. I have been researching for about a year, and I'm ready to enter the market, probably with ETFs to begin with and some mining stocks.

However, listening to your many expert investors over the last year, it seems the market is extremely overvalued and due for a correction in the coming year of anywhere between 20 to 80% down. So should I wait or just get investing? Thanks for the great podcast. I'm working with each one, Tim from Denmark. Alright, so what are your thoughts on Tim's question from Denmark,

ANDREW, I'd be curious your thoughts on the idea of 25 years to retirement,

DAVE My thoughts on 25 years to retirement are starting now. There's no better time to get into the market than it is today. The numbers show the sooner you start, the better chance you have to compound over a longer period of time. It also gets you over the inertia of not investing. The longer the wait, the longer you wait, the more inertia is going to work against you and encourage you not to start investing, and you're always going to wait for an air quote, the perfect time to get into the market, there is no perfect time to get into the market, your best bet is to start investing as soon as you can, and start doing it.

Any way that you feel will work best for you. And if ETFs are the way that you want to dip your toe in the water, by all means, dip your toe in the water; the sooner you can get started, the better off you're going to be in the long run. And 25 years is plenty of time to get where you want to go. As long as you start and start now if you wait another five years, if you wait for the correction whenever that may happen. The market

analysts have been saying that well, I don't know probably for the last ten years, since we had our last bear market, they've been saying that we're going to have another one, and we will.

But when is that going to happen? Nobody knows. I think the idea of waiting is not your benefit. And I think the sooner that you can get started and start investing now. They're doing it following all the things that we've talked about. You've listened to our podcast for over a year now. So you understand that we advocate for trying to find companies with a margin of safety emphasis on safety, finding good things that are stable, that will pay a dividend that will be safe and secure. And those are going to be great investments during the ups and downs. And there's also this little thing called dollar-cost averaging, which allows you to help smooth out any fluctuations that you will have when you buy stocks, whether it's an ETF or individual stocks. So there are lots of ways you can help mitigate some of the possible downturns.

The other part of that is, let's say you buy in now, and a year from now, the market does take the downturn that you're afraid of. That just means that the great companies that you're buying now are now on sale, and who doesn't want to buy things on sale? We all do. And so that's when you can make the most money getting into the market. So I guess that's kind of my initial thought. I'd like to hear what you have to think to say, Mr. Andrew,

ANDREW This idea that success in the market comes from buying low and selling high, the buy low sell a high idea is one of those maybe a little misunderstood, you know when you're running a race or a marathon, it's not about how did I look on mile one or mile two like nobody cares, right? Because you have a good pace along the entire way. And when it comes to investing, it's not about I invested, and now I'm out because, Okay, let's say you do sell early, and you feel like you got a good profit. Well, now what? Investing is a lifelong thing. It's a journey; it's your path to financial freedom. It's not like a game that you're trying to win; hey, we won the championship, you know.

So that's where dollar-cost averaging comes in, where you build this habit where you are investing a little bit every single month. And so when you spread that out, you don't have to worry about having this huge win or this huge period where you are the smartest person at the bottom and the smartest person at the top.

That's kind of impossible to do. You have this habit, and it's a part of you, and you're growing your money over time. And so, I think looking at investing, you never want to put all your eggs in one basket; you never want to put you know for talking about your entire life savings. You never want to put all of that in at once. It really well no matter when you buy. But if you talk about building an investing habit starting from scratch, trying to build something for your future.

That's gonna take continuous Steps, and it's not just one step, hey, we arrived, we won the game, it's step after step after step down the path to financial freedom, as you take those steps, guess what if the market goes down, sure your steps from two months ago maybe are down in value, but now you have an opportunity to buy at an even better deal. And then on the flip side, you know, they're always gonna say that the markets expensive, that's just kind of, if they don't say that they don't have anything to be on TV for. Right? Right.

So they need to say something controversial, so that they will say that, and so you know, you might buy and it might get more expensive and get more expensive. But again, you're building that habit, and you're getting this compounding to work for you. And really, at the end of the day, it's not even about where your money is going in and when it's coming out, but you're really partnering with the businesses you're buying. So if you're buying an ETF, you're partnering with those groups of businesses represented by the stocks and that ETF, or if you're buying individual companies.

And so you have to look at what are those companies that are going to be my partners, whether they gave me over the long term, what they're going to do is they're going to work for you and help build your wealth and compound it and hopefully produce free cash flow that can be reinvested and create growth for everybody. And so that's kind of the mindset that needs to happen. That No, you're never going to get perfect. And like so many other things, you just kind of have to get your hands dirty and just start and try and not worry too much about doing it all perfectly because nobody does it perfectly.

DAVE No, they don't. And I want to throw a few numbers at you to just kind of illustrate exactly what Andrew was talking about. So arguably, one of the greatest investors in the history of the stock market is Warren Buffett. And over a 50 plus year investing career, he has earned compounded returns of 20% a year.

But it hasn't been a steady 20%. Along the way, there have been some pretty serious ups and downs. So I'm going to read you just a five or six-year snapshot here of some returns he got in the early 70s. So 1970, his returns were negative 4.6% 1971 here and 80.5%. In 72, he earned 8.1% and 1973, negative 2.5% in 1974 and negative 48.7%. And then the next year 2.5%. So I guess my point with that is that I'm looking at his annual shareholder letter on the first page of his annual shareholder letter; he shows the returns of Berkshire Hathaway for that particular year for every single year.

And you can see them at the end of the Halley; it's a 20% return over all those years. But if you look at each individual year, there are some pretty wild swings, you got to remember, he's not buying Tesla, you know, he was buying Coca Cola American Express, these were investments that were maybe not the most glamorous and sexy, but I guess my point is, is that the returns that you can earn, you're gonna have fluctuations. And just like Andrew was saying, Those are steps that you can use to help you generate better returns because you can bet your butt when Buffett was having a down year; he was buying more things at a lower price. And then when the stock market turned, which it always does, then he earned an 80% return in a year or one year, year, and 129% return.

So just ridiculous numbers, you also are going to have years where you're going to lose 20 30 40% of your portfolio. We all saw that in March of 2022, or 2020. We all saw the market turn very quickly and very sharply. And it was kind of scary. I remember Andrew and me talking about it almost every day, you know, everything's red. But it wasn't; neither one of us panicked. Neither one of us sold out of the things that we owned, and we bought more things that were on discount and cheaper that helped boost our returns when the market returned. And so again, these are all part of the mindset and all kinds of mental gymnastics that you have to kind of put yourself through to keep yourself sane when you think about this because you are going to see ups and downs, and it's part of investing in the market.

And part of it is being calm and being rational. And understanding that, unfortunately, Mr. Market, Who's the one who generates all this, is not always going to be a sane, rational person. You just have to kind of ignore that and stick to the basics and understand what it is you're buying and why you're buying it, and what your end goal is because, like Andrew said, nobody cares how you did in year three have a 25-year track record. All you care about is where you finish at the finish line. That's all that matters. It doesn't matter what happens in between as long as you stay consistent and get to where you want to go. And that's I think the biggest thing you need to remember when you Think about this. So, Tim, I encourage you to dip your toes in, buy something tomorrow, right away, doesn't matter what it is one thing, just buy one thing. It's scary, and it's super fun.

But once you step off that ledge and you buy the one thing, then it's going to start to make a lot more sense; it's gonna become a lot more real. And you're gonna feel a lot more confident a lot better about it. I know. That's the way I felt. I think that's probably the way Andrew felt as well. But again, once you jump off that

diving board and get into the water, the warm waters, baby, it'll make you feel better. So that gets that's my two cents.

ANDREW That's great advice.

DAVE All right, so let's move on to the next question. So we have. Hi guys. I'm Matt from Philly. I'm a great fan of the podcast and purchase the VTi. This past year, I'm trying to diversify my portfolio with 80 to 90%, dividend value stocks, and the rest with Motley Fool rule breaker subscription recommendations. I recently read an article on closed-ended funds CFS; the two that the article pointed out are ticker in IE and ticker CLM.

These funds have huge dividend yields; anything over 6% should raise some flags. What are your thoughts on total nav return? And it's greater than the funds pay out the dividends being sustainable? So Andrew, what are your thoughts on Matt's first part of the question here,

ANDREW total nav return. So nav stands for net asset value. Closed-end funds, I'm assuming, are talking about either ETF or mutual fund, again, basically just kind of like groups of stocks that you can buy. And so I guess the question about nav, not sure if I understood it totally. But so what he was saying was paying the dividend that out. And if they're paying out more than they're actually returning on their portfolio is another red flag. And you can certainly think that it's hard to think how that would be sustainable if they're paying out more than they are returning over the long term.

And so I guess the question you have to ask yourself is, why is this the case at this moment? Are they just kind of continuing a path of paying a dividend or growing a dividend? And is it just a temporary problem where the returns are less than their funds being paid out? Or is it a longer-term thing? I don't buy CF; I don't look at tickers like this, like this Nia or the CLM. I look more at individual companies. And so you can kind of take a similar kind of logic with those where you don't want to have a situation where there are too many dividends going out compared to what a company is bringing in.

And so that's kind of how I would think of a situation like this as well; you really want to know what's going on here. And he mentioned that I guess at the time that he read his email that the dividend yield was over 6%, I would agree it would probably raise some red flags; you do want to be careful.

And I think it's a good thing to look at nav, because a lot of these funds, their prices that are in the market can sometimes fluctuate compared to the nav depending on how optimistic or pessimistic people feel about a particular fund. So that's definitely a good place to look. And I would be very cautious if something whenever you get like a kind of a red flag idea, it's always a good idea to be really cautious after you feel that way.

DAVE Yeah, I would agree with that. I think something that's interesting to think about with any sort of fund is understanding what's underlying the fund and what the fund is investing in. Because basically, what fun will do, whether it's a closed-end fund, an ETF, or an index, they look at a basket of stocks, and they invest in those. And so that's kind of how they created their structure if you will.

And so just really quickly looking at the NI e-portfolio, the top companies that are in this portfolio are Apple, Microsoft alphabet, Tesla, Amazon, Nvidia Mehta, Home Depot, Adobe, and JPMorgan Chase, those are all really strong companies, and most of them pay a dividend, but maybe most, but over half. So I guess, without knowing the ins and outs of that particular fund, it's interesting that the net asset value would be down for something like that. And I would hazard a guess that maybe the fees that this fund charges might

be on the higher end. And so that may be eating into the returns that the fund is generating. And so that would also drive down the price, which would drive up the dividend yield.

So as the price falls on the fund, the dividend that pays the yield would go up; my guess is happening is that the return for this fund is probably not doing as well. And so, if it's paying the same dividend or more, then it's going to drive up the dividend yield, which would make it look more attractive for dividend investors. But again, it goes back to knowing what you own, and I'll give you an example of an individual stock a while ago; completely different story now, but GameStop, at one point, had a dividend yield of 13 or 14% because they were paying a pretty healthy dividend, but because the price had dropped, so dramatically, the dividend yield had risen quite a bit. And so, a lot of dividend investors were flocking to that company because it paid such a great dividend. But the underlying business and the fundamentals of the business were struggling.

And this is way before the whole meme stock thing that it's become now; it's a completely different entity now, but I think when you're looking at any sort of index fund, or ETF or closed-end fund, a mutual fund, the first thing you want to look at, when you're investing in any of these are the fees that they're going to charge. And you want to find a fund that's going to charge you the least amount of fees that they can for the return because those fees are going to eat into your return over a longer period of time.

And I'm not an expert on closed-end funds or mutual funds. But my understanding is they generally tend to charge a higher fee than something like an ETF would, for example, and so I think it goes back to a little bit to what buying what you know, and seeing if those fees are eating into the returns for these closed-end funds, they may be great returns, they also tend to be a little more actively managed that Oh, well.

ANDREW This one has a Yeah, so if you look at there's this website called CF connect calm, okay, it says their management fees, 1% per common share, and then there are other expenses. And then within the basic information on the fund itself. Not only do they have a portfolio of equity securities, but they also have income-producing portfolio convertible securities. So they write call options.

And that's very, very different than your average vanilla ETF. That's just buying the stocks and holding them. And so you know, you kind of get clued in by the name of the fund, or they have convertible income in the title, you're really putting your trust in the management and their actual portfolio strategy more so than some of the other kind of factors that you might look at with a regular ETF.

DAVE That's a very good point. And I think anytime that you see an investment that has a higher dividend yield, sometimes you have to ask, Is that normal? And then I guess the other question you probably want to ask, too, is, is it too good to be true?

Is there a reason why it's this high? And out of the norm, then I guess that would probably want you to cause me to want to look under the hood a little bit more and see kind of what's going on and what's driving that.

ANDREW So, I mean, it sounded like Matt was kind of clued in already. He said he kind of figured out, yeah, the actual assets inside there are only making such return. And then they're paying out more than the return. And they kind of now you put the pieces together. It's like, well, they were writing these options, and then pay now a lot of that profit.

And so there, when you write options, you're not necessarily making as much return as if you just bought the stock on its own. Such a company like Google or, you know, one of those big tech companies you mentioned that are in the portfolio. Maybe they're not returning as much because they are writing these options, taking

the income instead of just buying the stock outright. So that it all makes sense, okay, this is why the dividend yields so much incredibly higher than the average is because you have all these other things in play.

DAVE Yeah, that's, those are great points. Yeah. Good catch on the analysis there. All right. Let's look at the second part of that question. So I also have a side question, but stocks like PS XP, MPL, X, and Sonico have high dividend yields as well with relatively low p ease. What are your thoughts on these stocks' dividend sustainability, I don't understand how you can pay shareholders this much and expect the stocks to grow if dollars aren't being put back into the company.

Mind you, these are energy or oil-based stocks. So growth may be limited as the economy changes. We may all be driving electric cars by 2050. Cheers. You guys are great, Matt. So Andrew, what are your thoughts on the dividend sustainability idea?

ANDREW Yeah, another thing you want to look out with the dividend payout and kind of going back to this idea of maybe there being too much of a payout. So you do want to be careful. I guess it's probably the majority of situations. If they're paying everything on the dividend, yes, there's no way they're going to grow. But you do have situations where a company can pay out most of the dividend, and they will still grow.

Like Home Depot is a great example of this where they literally just keep the lights on, the prices go up because there's always demand. So they literally just man, the stores, you know, barely man the stores this point, and the prices kind of go up on their own as the housing market goes up on its own. And so they pay. I think I looked on their cash flow statement the other day, and they pay out like 80% of their free cash flow back as dividends and buybacks. Wow. So they're still able to grow. And it's because same-store sales, and that's unique to their business model paychecks is another one, or like ADP type payroll company where they really don't need to invest much.

And they just grow as their market grows organically. But a lot of other businesses, especially if it costs a lot of money for them to create revenues, they most certainly need reinvestments to grow. And if yes, if they are paying all of those out, and a dividend is very hard for them to grow. And so you probably will see stock price stagnation at that point,

DAVE Yeah, you absolutely will. And one of the things that keep in mind with the oil companies, as well as the utilities, is there are certain cases where it depends on the business model. But there are certain cases where I'm going to blank and whether it was Chevron or Exxon, but one of those two companies was actually taking on debt to continue paying their growing dividend. Because they had built up such a cachet of being a dividend growth company for so many years, they're a dividend aristocrat, so they continue to borrow, even though they're losing money because the price of oil had dropped through the roof. And to continue paying the dividend, they had to take on debt to pay that dividend. And so that's how they continue to do that.

And so there are going to be times where a commodity type company like Chevron Sonico, any of those kinds of companies that deal in oil, which is a commodity, you're going to see wild fluctuations of the price of oil, and that's going to affect the profitability of those companies. And so then they're going to have to make capital decisions on how they want to allocate any capital or be what they want to continue doing in any company that pays a dividend, to for them to stop it is kind of like going to the moon, they just don't want to do it.

And so, for a company like Exxon or Chevron to stop paying their dividend, that would never be a good thing. And they would lose investors, and they would lose share price, and it would be devastating to them. So that's why management would make decisions that they would basically be planning that oil would

bounce back and that the company would return to profitability at some point again, in the future, the same kind of like the kind of did, it can't. Yeah, I kind of did, you know, it kind of worked out for him.

But as an investor that's looking at the balance sheet of a company like that, you see the company losing money, free cash flow, negative, losing money from accounting earnings, and then you see the debt going up and up and up, and you still see the dividend going up and up and up, you start to look at that and go ooh, you know, is this sustainable? You know, because at some point, those interest payments on the debt that they're paying become too big of a burden, and the company has to declare bankruptcy. That's where you start to draw a fine line on how much debt can the company take on? How much can they afford? And how much is it really worth continuing down that path. Now, Chevron and Exxon, in particular, BP, those big oil majors, have other sources to tap into, to try to generate equity, or to generate cash for the company outside of the operation. So it's a little bit of a different situation. But the same kind of idea applies.

Now, if you look at utilities, you have other things going on with utilities. So utilities do pay out a huge amount of their free cash flow as buybacks and dividends. And part of why they do that is because that is part of the return that you expect when you invest in utility utilities are, at least here in the United States, regulated by the government. In other words, they can't raise prices on us, the consumer, without approval from state and national governments. And so to do that, they have to go, and they have to make capital allocation decisions years in advance. And then they have to go to the state of Illinois, for example, where I live, and tell the state of Illinois, hey; we want to put in this, this and this. And we want to refurbish this, this and this, and it's going to cost us this much.

And to do that, we need to raise the rates of electricity and natural gas on our customers so that we can afford to pay for these and to continue to keep our doors open. And so, because those take time, it doesn't happen overnight. Some of these decisions that the utilities and the governments make together can take years to occur. Because of that, then paying a dividend that's three, three, and a half percent is going to be part of the capital return that an investor would expect from a utility. The other side of that equation is that because they have such huge capital outlay for the equipment and for the refurbishment and the running of the utilities, beyond just paying the people to run these, you know the power stations and all the things that go into creating a grid in the State of Illinois in a cheap.

And so those are big bucks that they're spending that causes most of these companies to be cashflow negative, but they're still generating enough returns that they can pay a dividend. So how do they do that? Well, if you're not bringing enough money, and you have to wait to raise your prices, how do you do that? Well, there are several ways they do that. One is they raise a lot of debt. And they also sell a lot of equity. And so they sell parts, or they do these things to raise money so that they can pay the dividends. And they can keep the lights on and do all the things they have to do. It's a balancing act.

But if you look at the financials of your local utility, wherever you if you're in the United States, and you look at it, it's not going to be sexy, it's not going to be, you know, 50% margins, like you're going to see with Adobe or Facebook, it's going to be like operating margins of like 4%, and net income margin of 2%. And you look at that, and you think, wow, that's those are tight. But that's just the nature of the business model.

And so you have to think about those things when you're trying to make a decision. But that is how some of these companies can afford to pay bigger dividends. Another example of this is REITs; REITs have, by law, have to pay out 90% of their earnings as a dividend every year. And so that's how they can pay these really high dividend yields compared to a company like Microsoft, for example.

So it's a good idea to look at the business model. And it kind of tries to wrap your brain around how the company operates, how they do what they do, and understand how they pay the dividends. But it also goes

back to what it sells, what it makes, the commodities of it, and things like that. But you also have to look at it; sometimes, if it's really high, there's a reason why. And if it's not normal, and if it's not part of the normal industry, then you want to ask yourself why?

ANDREW Yeah, it's a lot to think about. And it is a balancing act, I think takeaways, at least for me, and I don't want to put words in your mouth, Dave, but I haven't seen the utility business that I've liked. I mean, just the idea that they have to go to the government for approval, that's not a really great business model. And not generating cash flow is not a great business model, either—REITs, which stands for real estate investment trusts.

That's definitely a balancing act where you do get a high dividend, but they also create a lot of shares. So they dilute a lot. So it's a fine balancing act, and you have to know what you're looking at when you do that. And then you do have to be careful if a stock's dividend looks really, really high compared to everybody else's to make sure you know why that's the case. Sometimes it can be because they're just really cheap. Because as the stock gets cheaper, the dividend yield does go up.

But a lot of times, all for all the red flags that we've discussed today, and Matt, a couple that you mentioned as well, that can be flashing indicators to why Alright, there's a high dividend yield here, and it might not be sustainable. I think, hopefully, that sums up this question.

DAVE Yeah, I think it does way better than my verbal, you know, mind dump there. So sorry about the overload of information, everybody. Alright, I guess with that, we will go ahead and wrap up our conversation for this evening. I wanted to thank Matt and Tim for sending us those great questions. Keep them coming, guys. We really enjoy doing this, and we hope we get some good takeaways and learnings from all this stuff. And so, without any further ado, I'm going to go ahead and sign us off; you guys go out there and invest with a margin of safety, emphasis on the safety. Have a great week. We'll talk to you all next week.