IFB234: Deciding to Dollar Cost Average into New Ideas or Current Portfolio

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Dave

0:00

Alright, folks, welcome to investing for beginners podcast. Tonight we have episode 234. We're going to answer three great listener questions we got recently; we're going to focus a little bit on dollar cost averaging. So if this is something that you are unfamiliar with or would like to learn more about, this episode is all for you. So I'm gonna go ahead and read our first question. And Andrew and I will do our usual give and take. So here we go. Hello, I am 35 years old. I know I have a little while before I retire. But I know you need an emergency fund. How much would you suggest to have before start putting some on the market? I've also been hearing a lot about the whole life insurance that gains interest and has a cash value.

I'm curious to what your thoughts are on it. And I just caught up on all your episodes on the podcast; I love it. I just need to figure out the formulas to evaluate the company's thank you for all you do in trying to better people's lives. There isn't enough of that in the world anymore. You guys do a great job of breaking it down into understandable terms. Matthew, as well. Thank you very much, Matthew; we really appreciate that. So Andrew, what are your thoughts on Matthews? Great question concerning the emergency fund and whole life insurance.

Andrew

1:04

Let me tackle the whole life insurance first. First, Matthew, Thanks for writing in; this was a great question. Glad you're finding our stuff useful; whole life insurance, you can get a bunch of people to give you all sorts of opinions on it. Basically, the idea is, if I were to die tomorrow, and I had whole life insurance, it would make sure that there's family leftover for my spouse and my kids. So that's kind of the big idea for life insurance. In my view, it's basically the difference between you investing yourself for your spouse and children or an insurance company doing it for you. Depending on your age, it's going to be different.

So somebody who's maybe close to their retirement might find great value in the life insurance policy; they answer the question and be like if I were to die tomorrow, would I have left enough money for my spouse or my kids? And if the answer's no, life insurance is a pretty small price to pay for that. I guess the younger you are, the more chance you have to kind of build that up. So maybe if I don't die tomorrow, but if I die into the three decades, do I think I'll have enough to leave to them. I guess it is kind of not only a math problem, and like a logical problem, but it's also an emotional problem too. Like, does your spouse have the ability to make money? What if you die? Or are they going to be having to go to school? And are they a stay-at-home mom having to go to school or stay a home dad having to go to school. So those are all kinds of factors into it, right?

So life insurance, in general, is expensive; you're basically paying the insurance company to invest for you. Ideally, you can invest for yourself so that you don't need to pay a life insurance company to do it for you. That's obviously better from a math standpoint. But there are other factors such as, you know, what's your personal situation? What's your spouse's personal situation? What's your kid's situation? Those are all factors that go into that decision.

Dave

2:57

Yeah, that's great advice. And I don't have a whole life insurance policy. But I do have a life insurance policy. And I took it out when my daughter was born. And that was kind of the advice I got. And I think that's less something that I heard when I was younger that until you have children, it's you should wait and get life insurance. I don't have really strong opinions. Either way, it's just something that I did to make sure that my family would be protected. Suppose I passed away before they were able to care for themselves. For all the reasons that Andrew was talking about, schooling having enough money for living expenses, and things like that. So that's why I did it; I will give you one word of caution.

Make sure you're healthy. And make sure you're younger than 50. Because once you get above 50, the rates go up. And if your health is not as great, so I'm a type two diabetic. So that causes me to have a higher life insurance policy. So just a little word of caution, take care of yourself, especially as Matthew, you're younger, you're 35. So please take care of yourself, not only for the life insurance policy but obviously for everything else in life. But those are some things to keep in mind as you're looking at any sort of insurance policy.

Andrew

4:05

Yeah, I guess you could go down the whole rabbit hole of whole life versus term. I don't think that's something we should do. If it's something you're considering, I would recommend doing more research. I know, in general, most people do not like their whole life. And they recommend term life because it's much, much cheaper. It sounds like that's what you did. So yeah, exactly. In general. I think that sounds like a good idea. I guess emergency fund. How would you answer Matthew's question on the emergency fund? How much should he have before starting to invest?

Dave

4:34

Oh, yeah, that can be a bit of a slippery slope. It really comes down to what you're comfortable with. I think the standard operating procedure is three to four months of living expenses saved up before you start to invest. I think everybody is going to be different in terms of personal finances personal. So it really depends on what you're comfortable with. And I guess it also depends on what your income situation is. What's your employment situation? As you know, where you are with any sort of debt that you might have, whether it's a home or student loans, credit cards, any of those kinds of other things that life throws at us.

So those, I think, all have a bearing on it. For me, I was comfortable enough to start once I had a couple of months' worth of it, and then I continued to build it up after that. But that was kind of how I did it. But, you know, again, personal finances personal. So I don't know that there's any hard and fast rule. I'm curious what Andrew has to say about that,

Andrew

5:28

I guess I have a bit of a different opinion in the sense that I know what it's like to not have money; I know what it's like to really struggle paycheck to paycheck from life circumstances. And so I know how difficult it can be to save up huge amounts for your emergency fund, like three to six months might sound outrageous. And if you're a person in that situation, it can be very hard to think you'll ever get there. And it could cripple you from investing for years. So I think if you're maybe in a situation where for one reason or the other, you have these huge monthly expenses that really make it difficult to save,

I've heard this is something from Dave Ramsey's podcast, just get to $1,000 emergency fund, which is more than a big percentage of Americans have, by the way, but just $1,000 that that will hold you over from, let's say, your car breaks down and or you got to blow out on the freeway or something, then you need to buy new tires, at least having $1,000 will help you keep from dipping into credit cards. And then you can build that up and then use the rest for investing. But if you're like really strapped for cash, and it looks like you're going to be that way for six months, maybe two years or more, at some point, you got to try to do it, you can at least get into the market. And then, hopefully, your situation will change later on.

But at least getting started just because the power of even a small amount can really compound to great amounts over time. $150 a month, as an example, can become a lot over time. So if you can do that and have an emergency fund where it's like, well, I might have to make some sacrifices if something bad happens to me, but at least I'm still making progress towards investing. I really like that because, in my situation where I was really strapped, it helped me get through that.

Dave

7:14

And that's great advice. I think those are really good suggestions.

Andrew

7:17

Cool. Well, let's move on to the next question. Hopefully, that was helpful for you, Matthew. So now we're gonna dive into dollar cost averaging. We got a couple of questions on that. So this one comes from Williams Z. He says, Hi, Andrew and Dave, in today's market, when every stock is down and on sale in quotes, how do I know when I should be putting my monthly money into a stock, I already own dollar cost average.

Or when I should be purchasing the new stock that meets all the criteria you guys have laid out to diversify my portfolio more. Thanks for everything you guys do. As someone that started less than a year ago, your teachings have been monumental, and keeping my head in a positive place despite the downturn in the market. Thanks again, William Z. Wow.

Dave

7:59

Thank you, William, that's really nice to hear I. We really appreciate that. That's why we're trying to do all this is to try to help everybody as best we can. Investing in the stock market is an important thing. It's not discussed enough. And sometimes, it can be a hard place to be, especially when there's lots of doom and gloom around us all the time. Seems like that's all we've experienced over the last few years, isn't it? But so we're hopefully getting on the other side of at least some of the bad stuff. So anyway, this is a really interesting question. And I think this is something that we could really explore.

So I think, again, this is going to be personal preferences. And I think Andrew and I probably will have a little bit different takes on how this goes. But I think for me, the way that I would look at it is I would look at, let's say, that I have a portfolio built, let's say it's 10 to 15 companies just for example. And I'm looking at, you know, putting my money in right now, everything is air quote down, and it's all on sale. And you know, there are lots of opportunities out there, the thing you have to assess, is you have to look at each company on an individual basis and decide whether putting more money into that is a better opportunity for you ten years down the road than investing in something new. And it's always fun to buy something new because it's a shiny new object, and you get super excited about the new company that you invest in. We all fall in love with whatever our new baby is. And I've fallen trap to that, you know, many times, and it's easy to get wrapped up in the excitement of a new company that you invest in. But sometimes you just have to kind of step up to take a step back and think about what it is that you're buying and why you're buying it.

And it kind of goes to being comfortable with what it is that you own and understanding where those companies are in their lifecycle and their business cycle in how they're positioned in the markets, how they're positioned in their sector, and just really understanding the business. And I think if you have a firm grasp on that, then you can look at other opportunities. But if you don't, if you don't understand kind of where your businesses are, and you don't know where they're gonna be in five or ten years, none of us know for certain. But if you don't have a good sense of how well the company is going to perform via their financials and then management and opportunities that could come along for the company, I think it's a lot harder to start venturing into other companies because you don't really have a firm grasp on what it is that you own it, to begin with. Now, if you do, then you need to decide what a better opportunity cost for my money is? What am I going to get a better return on? If I get to get a better return? I'm just going to use a couple of aid-named companies just to make it easy. Am I going to get a better return investing in Apple? Or an Amazon? Just as an example? This is not financial advice. But am I going to get a better return on Apple? or Amazon? And what do you think? I mean, Andrew, what do you think? What am I gonna get a better return on Apple? or Amazon? Which, you know, if you had to bet on one of them, which would you bet on?

Andrew

11:03

Yeah, obviously, Apple, since I've revealed a long-term holder of that, right. And I have not bought Amazon yet.

Dave

11:10

Yeah, exactly. So. And I think, you know, if you understand the apple business, and you understand the Amazon business, and you want to invest in Amazon, you have to decide, is that going to give me a better return than if I put my money in Apple? And if the answer is yes, then buy Amazon. If it is not, then you buy more of Apple if that's something you already own or vice versa. And I think that's kind of the easiest way to kind of work through it. I saw this great quote, on Twitter, from Andrew Kuhn, who is one of the guys that runs focus compound, a great podcast. And he talked about kind of how to configure your portfolio. And one of the things that he talked about was looking at your portfolio.

And if you look and see companies in your portfolio that you think are going to do worse over the next five to 10 years, but those high on the list of companies that you want to replace and other ones that you think are going to succeed really well over the next two 510 years, but those at the bottom of the list of things that you would want to turn over or change. And then you can kind of work from there. But it all comes back to kind of understanding what it is that you own. And if you've taken the time to build up a portfolio, chances are you understand them to a certain extent. If you haven't, too, then that would be a good time to look at those things. And if the companies are being beaten down, or if they're undervalued, then reinvesting in those is always going to be great for you in the long run. Because the more you can buy of a company that's going to succeed over the next five to 10 years, the better your position you're going to be. But it all comes back to opportunity cost and what you think in the long term is going to earn you more money in the long run. Okay, now that I've talked for a long time, I want to hear what Sir Andrew has to say.

Andrew

12:54

Yeah, that's really great advice there from Dave; I've really liked that concept of tracking your portfolio and thinking about which companies you want to replace because I'm looking at my portfolio all the time to see is there anything that's not fitting the bill? And how I can make my portfolio better. So I'll give my perspective. So first, I guess I have the luxury of being able to do this full-time. So I have a lot of time to get to know a lot of businesses. So I guess that gives me a certain advantage. I also have; I don't know if you call this the luxury or the privilege to have made some really bad mistakes as I was building my portfolio. So I'll give you two examples. One was American Eagle, and one was a company called Neville brands. And so I bought these in 2018 and 2019. If you're a subscriber either, you can go back and look. And so it's an example of companies where I maybe had more confidence in how I thought the future was going to turn out for them than what really ended up happening. So for American Eagle, they really took a hit during the pandemic; it was able to recover, and I was able to get out with a pretty nice game. But that was like probably the most painful game I've ever had. Because it was brutal to see that thing dropdown.

As far as it did. I mean, I think I went. I think I got out somewhere in the high 20s. But it got down to like $6 a share. It was so painful. I think I'll remember that roller coaster for the rest of my life. And I remember in Newell brands; it was really painful. And I did not recover from that in the sense that I had to sell at a loss. There was a big loss, and there was a lesson learned move on. So in both, what kept those examples, what they had in common was I had dollar cost average into them multiple months in a row. And in hindsight, that was probably not the best thing to do because even though I felt like they were great opportunities, they continue to be great opportunities. The fact of the matter is I ended up being correct on one and not correct on the other, And so, in hindsight, I wish I would have diversified a little bit more in that case, whereas if I had waited on the American Eagle, for example, I could have gotten that $6.02 years later, or a year and a half later, I instead kind of allocated all of it all at once and didn't have any more firepower to go back into it, if that makes sense. So when you're building a balanced portfolio, you really want to make sure everything's pretty even, depending on how strongly you feel about certain stocks and how strongly you feel about your own abilities and ability to be right. So it's a constant balancing act.

And I think there's everything they've said about like prioritizing your portfolio and reviewing it constantly. I think that's 100% True. And that's really where your focus needs to be; the only thing I would caution is that I would not buy Apple 10 months in a row, even though I feel super strongly about the company, because there's a chance there's something I missed, or something out of our control happens to apple that nobody can predict. And so that's why you diversify. So I use the examples of American Eagle and Newell brands to hopefully try to illustrate that it's all a balancing act.

So don't take one extreme, don't take the other, and try to find that happy medium. And it all depends on your own abilities, what you're trying to achieve, and how you're gathering information. And that's really how I would look at it. I think Williams's mind is in the right place here. I love these questions. And it's not easy to answer. Because, you know, today could be a great day to buy Apple. And then maybe next year, you buy Apple twice in a row. And there was a bad time, where this year could have been a great time. So it all depends. I know people probably don't like to hear that. But it really all depends. And that's why you just got to take it month by month.

Dave

16:51

Yeah, I totally agree that that's great advice. And I think those are all great lessons. And I think if you kind of listening to the whole answer for both Andrew and me, I think it really encapsulates how you can think about trying to build your portfolio, learn from mistakes that you make, and then also continue to, you know, do the work that you need to do to stay on top of what companies you own and try to find good ideas. And a lot of times, the best ideas you can find will be within your own portfolio. And yes, I would agree do not buy Apple 10 months in a row; that's probably not necessarily the best decision, but you know, there to each zone. Anyway. Alright, so let's move on to the last question.

So I have; hi, I am 52 years old and new to investing; other than I've been contributing to the 401k of the company, I work going back 15 years or so. Over this time, I've made substantial progress toward paying off my condo and have accumulated a pretty good chunk of cash. I would like to get serious about investing even though I only have 15 years or so until I retire. And right now, the timing seems right. I've been looking at historical trends regarding past bear markets to see if I can find any clues pertaining to how quickly or slowly I should be dollar cost averaging into the market. But these numbers may not be precisely right as far as I can tell. the.com crash bear market lasted for about two and a half years. And the housing crash lasted about one and a half years. It took over seven years from the start of the.com decline for the market to recover to its previous high s&p, and five and a half years for the housing decline. I am leaning towards taking a slow approach with this. Would you agree? So Andrew, what are your thoughts on this question?

Andrew

18:29

A lot to unpack, obviously speaking my love language and stock market history. I love looking at stock market history. I love seeing what we can learn from the history of the stock market. That all said, I would be highly cautious about looking at the past and what the markets did in the past and extrapolating that into the future. Because of the reality of the stock market, if we really take it back to the basics, the stock market is the economy. Basically, it's all the businesses in the economy. So the economy, even ten years ago, when there was a housing crash, was way different than the economy we have today. Back then, everybody thought it was normal to have two or three homes like that was just what you did. Everybody said housing will always go up. That's it could never go down because it never had.

But when you had too many people in the economy who thought that way, they bid up housing to this incredible amount. The banks just lent out so much money, and it became unsustainable. So if we have something like that today, in another area of the economy, it's going to be hard to say until the dust settles. And so we don't know if there's going to be a crash like there was in the housing. I mean, you can argue there's been a crash that has been really slow. But there are too many factors, right? There are too many things going on in the economy. We have a way higher technological economy now in the sense that so much has moved to the internet and the cloud, and you certainly did not see that ten years ago. You don't know If we did not see 10s of billions of dollars being made on the internet ten years ago. And so that means economic policies from 10 years ago aren't going to affect the economy the same way; you will see cycles, you see major trends, right of economies and stock markets. But you have to be very careful about taking that way too far and saying, Well, you know, this crash was two and a half years; last crash was one and a half years.

That means today's crash is going to be two years; you got to be really careful with that because there's no science behind it; there's really no rational way you could justify why that should be the case other than trying to take historical patterns and extrapolate that into the future. It sounds pretty, and it could potentially work. And people always find ways to try to make that we've had lots of crashes, lots of bear markets, I mean, I could go down the list, you know, 87, the 60s was not a great time, in general, late 60s. Yeah, the Great Depression, there are so many different crashes, you just you don't want to extrapolate it; I feel really strongly about that. Because I've tried to do that for so long. I'm just telling you, it's, there's just too many moving pieces, it's impossible to try to predict. So I would not try to make investment decisions based on past cycles and trying to predict future cycles, even though it's really, really fun to even like, talk about or think about. Do not make investment decisions based on that.

Dave

21:21

I would agree with that. Intellectually, it's a lot of fun to think about those things. It's a lot of fun to think about history and to think about the cycles and everything. And I know Andrew is fascinated with that subject. The stock market history is one of his untold passions. And I think he really enjoys learning about that stuff. But I think the thing I read this somewhere, I think the only thing you can really predict about the stock market is that at some point, it will go up. And at some point, it'll go down, we will have market crashes, and we will have recoveries. And I think that's really about all you can really predict. I could be wrong about that. But I think it might have been Charlie Munger that might have said something like that.

That sounds like something he would say. And I think one of the things that's interesting about the stock market is one of the things that I guess we've talked a lot about in the past; it definitely pertains to dollar cost averaging is timing; the market matters more than timing the market, none of us know what the future is going to entail. We don't know what's going to happen tomorrow. And there's just no way that we can predict what exactly is going to happen. You know, we've said this before, and nobody could have predicted COVID Nobody saw that coming. And all the impacts that it's had on the world since its inception. And none of us could have predicted it's still going. And it's still impacting the world. And none of us could have predicted that. And the impact that had on the market and the impact that the market crashed really quick and rebounded even faster.

Nobody could have predicted that. And now we're going through whatever it is we're going through. And again, nobody could have predicted that. So there are definitely people that could look at the trends and maybe see some of this coming. But you never know how deep any of this is going to be. You don't know how quick the recovery is. I mean, none of us thought the market was going to recover as quickly as it did in March 2020. I certainly did. And I thought the world was coming to an end. And I didn't think that anything was going to rebound that quickly. I mean, that was just shocking. But anyway, the point of all that is, is that investing is more about timing the market than timing the market and dollar cost averaging the whole idea behind it is to gradually put money into the market to work for you over a period of time, even though you're talking about 15 years, that's related till the time you retire. But there are a lot of studies that have talked about you need to continue looking at investing beyond when you retire, because most of us, oh, hopefully, a lot of us will live 30 years after we retire, then that won't be unusual. And so usual, I guess a way of investing, it might be changing because our living patterns are longer than they were 20 years ago, 40 years ago, and a lot of these rules were established.

And so there is some thought now that you need to think about to kind of beyond the time that you retire, and how are you going to continue to generate income beyond that. And whether it's through your investment portfolio, your 401k, or social security or whatever that morphs into, and you know, any other things that could be out there. So those are all things to consider. But I would encourage you to if you haven't started and if you want to start slowly and start with small amounts, by all means, you have to do what's comfortable for you. What's comfortable for me was the kind of flow Andrew may not be comfortable with for you.

That's okay. Inertia is always the hardest thing to get over. Once you take that step off the diving board and jump into the water, then it's a lot easier to get out of the water and keep doing it. But until you do it, it's a lot harder to do it, and so, study after study after study and study have shown the timing of the market matters more than timing the market. So I don't know how many times I can say that, maybe five more. I think that's something that you should, you know, consider all the history is great. And understanding it is awesome. And intellectually, it's a lot of fun. But I think coming back to the just kind of the basic idea of the sooner you get started, the sooner you're gonna get where you want to go.

Andrew

25:20

I think that's great advice. There is, I think, a risk in a lot of investors will talk about the tuition risk of there seems to be this recurring pattern of people who and I fell victim to it just like anybody else, thinking that the stock market was easy, getting walloped by it, getting humbled by it. And then either, at that point, you either quit or you continue on and maybe become a better investor. But a lot of investors will talk about this tuition. And so when you're starting out, and you're in your 20s or 30s, you don't have much to lose; that tuition potentially won't be that costly. If you're in your 50s or 60s, and you're investing your entire life savings, you throw it all into a firm or something like some crazy company like that, and your entire life savings is in there, and you get whacked, there's no recovering from that.

So I think a shorter time horizon might be a little more tricky. And there's no shame in going to find other people who are more experienced than you. And leveraging their resources and their knowledge, and their experience. Because the stock market's really similar, the I love people out there like to play poker, I like to play poker, if you're a poker player, you can put a lot of your money into a hand. And people do that. And if the odds could have been bad, you could still win the hand and feel like you're a genius. But that's probably not something you wanna do with your life savings; you probably want to, but you only want to make bets that the odds are with you. And so doing so, when you put time horizons into the mix, James can all have a really great illustration of this. And I hope I get that right. But it confirms I've seen similar findings in my research too. But he said, you know, if you're looking at the stock market, in a day, there's like a 5050 chance that you're going to make money. If you expand it out to five years, there's a 75% chance you're gonna make money. If you expand it out to 20 years, there's a 100% chance you're gonna make money. So in 15 years, you're not quite in that 100% chance. And I think the bigger chance is not so much what the stock market does, but what you do if you get punched in the mouth, so you have to be very careful that if you haven't paid that tuition yet, whatever that looks like, be very careful about putting your entire life savings into the stock market and being way too aggressive with that. And there's no shame in finding professional help, particularly if this is huge stakes for you.

Dave

27:45

That's great advice. I think that is something that everybody should listen to. And there's no shame in asking for help. And that's what Andrew and I are here for. But there are resources out there that can help you as well, especially if you're in a situation like the last question that we answered. And I agree with Andrew and cautious, and the tuition is something that, unfortunately, we will have to pay sometimes. And being cautious is always a better way to go about it than throwing it, you know, gambling the whole life savings into one company. Unless you're Charlie Munger or Warren Buffett, that's a hard way to go.

Andrew

28:19

Yeah, I was just gonna like make a hypothetical. Like if there's like a hybrid of the two pieces of advice, we gave, like, a third example would be somebody who sets aside enough, you know, where doesn't need to be overly cautious or overly aggressive. Okay, do it. I think the biggest thing we're trying to get listeners, the takeaway here number one time in the market, means way more than timing the market. So the longer time in the market you can afford to have, the better your chances, the better your odds, and the better your results; because you give the companies the best chance to let your money compound at the same time, you have to be careful on the other side of that, that you're not making terrible mistakes that you can't come back from, I think a happy medium, the way I kind of see it.

And if I was in this person's shoes, I would look at how much can I afford to lose? And what's that number? So as an example, let's say it's 50%, right? 50% of my life savings, I could keep maybe in a savings account or in bonds and know that no matter what happens in the stock market, I can support myself, let's say ten years of retirement. Okay, maybe that's 50% of my life savings. The other 50% I don't necessarily need in the ten years for retirement. So maybe I know that the time horizons are longer because I've just said I have enough money for ten years during retirement until I'm 75. So now I have 50% of my life savings, which now has a 25-year time horizon, right? If I'm all, I guess in his case, 52 has a 23-year time horizon. That sounds really nice even compared to 15 years, and So that could, in my mind, the way my mind thinks, and based on what I've seen, I would feel really, really comfortable knowing that, alright, for a certain percentage of my life savings, I know that has a much longer time horizon, I can really let that thing ride, let the stock market do its thing. In the end, I'm so covered for the first ten years, whatever that number is for you, that you have enough saved for that. I think that could potentially be ahead of the meat breed hypothetical. And I think that's a really good way of thinking about it. It's not kind of one or all; it's to be a mixture of different strategies to help you get to where you want to go.

All right, folks. Well, with that, we will go ahead and wrap up our conversation for tonight. Want to thank everybody for taking the time to send us those fantastic questions; keep them coming. Those are awesome. These are a lot of fun for us to answer, and hopefully, you guys get some good takeaways and some good information from all of this. 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.

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