IFB240: What Not to Buy the Dip On

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Dave

0:00

All right, folks, welcome to investing for beginners podcast. Tonight we have episode 240. And tonight, we thought we would talk about what not to buy the dip on in 2022, we thought we would go through a list of different sectors sections, different kinds of ideas that maybe you might want to avoid buying the dip on.

Because they may not give you the best returns over a longer period of time, because that's what we're all trying to do here. So without any further ado, I will go ahead and kind of start. So the first thing, I guess, section, if you will, that we wanted to talk about was expensive stocks. So this is something we do not recommend you buy the dip on and 2022. And if you're why would that be? Why would we want to avoid expensive stocks?

Andrew

0:43

Well, because when you buy expensive stocks, over the long term, your portfolio does not do well, especially when you have a time period like this, where the market is struggling to find its footing. And it's been going down for a while, there's two ways you can think about whether a stock is cheap or expensive. You have what's called relative and absolute relative cheapness would be there's several ways you could define it.

But you could look at a stock and say, Oh, it's at a 52 week low. So this means it's cheap. People will say that a lot, a 52. Week low means this is the lowest point the stock has been in the last 52 weeks. The problem with that type of an idea when it comes to whether a stock is cheap or expensive, is that's not how the market works over the long term. Unfortunately, sometimes it does work that way where you buy a stock at a 52 week low and it was a great stock and it was cheap, and then you do well on it. But sometimes it doesn't.

So you have to be really careful about that. And the reason is, kind of goes back to the basics a little bit where you invest in companies, because you become part owner of these businesses, that's why you're in the stock market, these companies will produce cash flow, some of that ends up coming back to the owners of the business in one form or the other, whether today or tomorrow. And so if you say I want to pay a million dollars for a company that I only expect to pay me $10 Over the next 10 years, that's too expensive, okay, I don't care if last year it was $10 million dollars. And now it's a million dollars. That's expensive. So you take that same logic, and you use it with the stock market. And that's where you get absolute valuation, and absolute expensive or absolute cheap. So you really want to be careful that you're not finding yourself in the relative,

Dave

2:42

I think this is cheap, because it's gone down a lot, you can get burned really, really badly. When you do that. Yes, you can. And the idea that I like to remember, as we talked about this a while back, and it's something that I know you've written about is this idea of when you the price you pay matters. And when you buy a company, and I'm going to pick on Cisco here for a second, if you had bought Cisco at the height of the.com, boom, in 2000, you still haven't returned to that same level of value. And this is what 22 years later.

And it still hasn't recovered from the drop that they experienced during that period, Microsoft kind of went through the same thing in 2000, it dropped and it went 1315 years, something like that before it started to prove again. And that kind of correlated with the new CEO coming in kind of changing the business around. But if you had bought Microsoft in 2000, you would have had to wait 13 years to see a positive return from that investment. And it's not to say that you couldn't have had a good return if you'd bought it in, let's say 2005. But the point is, is that it was really expensive in 2000. And it dropped in and it took a long time for it to come back to that same value. Even when it was back at the same price.

It was still cheaper than it was in 2000. Because of the value of the company. It's kind of like buying a Porsche in 2004 $100,000. You drive it off the lot. And now it's only worth $50,000. And then over the period of the next 13 years, the value of the car declines because people aren't into Porsches or whatever. But then you spend all this money refurbishing it. And then 1315 years later, you can turn around and sell it for more because now it's a collector's item. So if you look at stocks the same kind of way, you have to think about what it is you're paying and what the price is right now. And we're not talking like absolute dollar amount like

$100 is more expensive than $90. It's more about the value that you're buying the company for. And so you want to stay away from companies that are really expensive still, like Andrew was talking about earlier.

There are companies that have come off of COVID that are down 6070 80% from their highs, and they're still expensive. And there's still the value that you would get for buying that company now is arguably too expensive. And so you can either wait, or you can just pass and try to find something else. So those are, I guess, some ideas that I had for expensive stocks, do we want to move on to the next player value traps? What are your thoughts on value traps?

Andrew

5:19

So value traps is taking the opposite side of that, where these are actually absolutely cheap. Okay, so now we're kind of in the flip situation where it's like, instead of having to pay a million dollars, maybe I'm paying $10 for this business, that's given me good cash flow every day. But the reason why it's trading $10 is because it probably will go bankrupt tomorrow, or it's just like Braden has said, melting ice cube, you want to stay away from those type of businesses, because business made a certain amount of profit today, if they have something in their industry, or in their business model that's fundamentally changed. And now, every day is like a ticking time bomb, and they're, they're shrinking, and so they're getting bigger.

That's not That's not like good value either. Even though it might seem like a good value, price to earnings is a ratio, that's probably the easiest metric to start understanding absolute value, whether something's cheap or expensive, if you want to learn about it, you can go on our website, we talk about it, we've written about it, the trains is like completely left in here, but you have to be careful with very low price to earnings, and other kinds of metrics like that, if it's not looking forward, and if it's only looking backwards. So easy example would be the horse and buggy. They went through a time period where I'm sure being a horse and buggy maker was really, really profitable. And then the Model T came around.

And so you gotta bet in that timeframe. They were trying to wring out as much money as they could from that business until it eventually failed. So you see that a lot actually in the stock market, and you want to be very careful. That's why as much as I like to push people to look at the numbers, look at the business, use some cold, hard facts and numbers to determine value. You also want to notice if things have changed and see businesses where their future does not look as good, for one reason or the other.

Dave

7:24

Yeah, absolutely, that avoiding value traps is you know, the falling knife avoiding these companies that are in decline can sometimes be very hard and value investors we've talked about before, a lot of them fall in different camps, and one of the camps is looking for very cheap stocks and trying to buy those because the idea is is that you buy this cheap company that the market is ignoring, or is pricing incorrectly, and that it will revert to the mean. In other words, it'll go back to being where it should be, because the value of the business is higher than what the stock market is valuing that.

But sometimes, it's cheap for a reason you want to avoid it. GE is a good example of this, even some of the companies recently that have gone bankrupt, like RadioShack, you know, avoiding companies like RadioShack, Bed Bath and Beyond even a week ago, people were saying that, hey, this may or may not make it or not. The company is has been cheap for a reason. Because the business is struggling, even though there's lots of funny stuff going on in the stock market and regarding the company, but if you look at the basic value of the business, it's struggling, JC Penney, same kind of idea. If you look at the, you know, it's very simple to to sometimes just notice when you go to the mall, and see different stores that you go into. If there's nobody in the store, that's not a good sign, right.

And if you notice that in all the places that you go, that just nobody seems to shop at the stores. Well, that's an indication that something's happened in the business. And it's just not as appealing to consumers anymore. And I guarantee you, if you look at the financials of that particular company, you're going to see those results. Macy's has been struggling with the same kind of thing. Nordstrom has been struggling with the same kind of thing. And these companies are all cheap, because the business is struggling. And so the market is expecting them not to do well. And so it makes them cheap. And you have to ask yourself, why why would you want to buy a company like that, that appears to be in secular decline for whatever reason. And a few years ago, Sears was one of those companies that was cheap. And it was cheap for a reason because they were on the big struggle bus. And one of the next Warren Buffett's at Lambert came in and was supposed to, you know, resuscitate the company. That didn't happen, and it ended up going bankrupt anyway.

So sometimes you have to understand that it's cheap for a reason and avoid it. But it comes back to what Andrew was saying. You have to understand the fundamentals. And you have to understand the business model. And you know, a little insider tip if you see sales declining for 10 years or more consecutively, you might want to step away. So just something to think about

Andrew

9:57

groundbreaking tip thing. Yeah,

Dave

9:59

right. All right, let's move on to the next one. This one will be fun. So we have crypto and NF T's. So Andrew, I'm gonna tee that up one up for you. And you can take a swing at that first,

Andrew

10:10

oh, boy. Hopefully it's not like my golf swing. Hopefully better. I've learned enough about crypto to be dangerous. And I've dabbled enough to get a general sense for it. And I think there's a lot of opportunity in that space, I think the technology is truly revolutionary. And it appears that we're going to get the next Google, Facebook, whatever to come from the crypto world. And there's just so many potential use cases in the future because of the blockchain. Now, that all said, we've said this before, it is a minefield, and not to like rub people's faces in the mud. But there's been lots of fraud and hasn't stopped.

And a lot of rug pooling, people just basically saying whatever they want, and people putting money into it, and having no recourse over how that what happens to their money, and then then they lose it all. So you have to be careful, I think maybe it'd be helpful just to real quick just to give a basics of most crypto projects have been working so people can identify it and maybe have a better understanding of it. What I mean is we've talked before about dilution and buybacks. So this is a very common thing that stock market investors are aware of, it's basically when you dilute the shares of a company, that means you're giving ownership to more people just like the way stock options work. So your slice of that pie, that pie of the pizza is your ownership of the business, the more people are given that slice of the pie, the smaller your slice gets, we'd like to buy a stock, I like to buy stocks, where that pie is increasing, because the company is buying back shares, which means there's less people who own the stock. Okay, so the way that Kryptos have been paying these crazy aprs like, I can think of one off the top of my head still today, it's paying like a 33% APR. So they say you put our money in our crypto ecosystem, you're gonna get 33% interest on your money. The thing that people might not realize about that is the way they are paying for that APR is they're shrinking your slice of the pie.

And if you understood kind of the way the stock market works, you can see it in parallel in crypto land. So that's one issue is that that APR that makes it sound like you're getting a great deal is actually just them taking away your pizza and giving it back to you in little pieces. And the second issue is just in my mind, it's like there's no SEC regulation, there's no recourse, no accountability, it's like, they can really say whatever they want. And they posted on the white paper online, and you just have to take their word for it and a lot of the cases, so one day, maybe it will be legitimate.

But in the meantime, you're looking at the crypto and thinking that's cheap, because it's 95% down Think of what we said earlier with the expensive stocks, again, it's absolute terms. And a lot of these, the few that I've looked at, are still trading at like 1000 times sales, something ridiculous like that, right. So even if the financials that they're saying are in fact true, it's still crazy expensive, even after drawing down 80%. So be very, very careful. And I would not put there's just so much trouble you can get into in general in that space. And so I would be very, very leery and certainly not put a vast majority of your wealth into it. No,

Dave

13:27

no, not at all. Again, like Andrew, I've learned enough about it to be dangerous, and probably even more dangerous than Andrew. So the little that I've learned about it is really focused around web three and payments and some of those ideas. And even the people that are writing about it and that are far more rewarded about it than I am think that the space is in very early innings. And there's still a lot to play out about where the crypto is really gonna fit in. Whether it's there's still lots of questions about it there, whether it's going to be a actual currency, or whether it's going to be a store of wealth, or whether it's correlated to the markets or not. There's lots of uncertainty. And like Andrew said, there's no regulation at this point. I know that they're working on trying to get some, and I think that would probably be beneficial for everybody concerned. But I think right now, there's so much money going into it. And everybody's excited about the possibilities of it.

But the actual use cases are still yet to be determined and are still being worked out. There's a lot of smart people working in that space for sure. But as a general rule, having that being a very large part of your portfolio is in essence gambling at this point, because there is no sure thing there is no you know, I know that if I buy the crypto a this is going to be the next Google or if I buy crypto b this is going to be the next Facebook or Microsoft or whatever, you know, insert company name. They're just we're too early innings in this to really understand and where it's ultimately going to go, is going to have to have an impact, probably. But when is that going to happen? Is it going to happen next year? Or is it going to happen? 17 years from now, we don't really know. And nobody knows. And so I would encourage anybody like Andrew was saying, even though there's been a crypto winter recently, and there's been a few things that have gone bankrupt, and there's been a lot of stuff down a lot from their heights, it's still super expensive. And it's very speculative.

Even again, some of the people that I'm reading of that are trying to teach me these ideas about crypto are saying it's early innings. And it's very speculative, at this point, to be investing a large portions of your portfolio into crypto at this point, it can be dangerous, because you don't know what you're getting into. And it can turn on a dime very quickly, much quicker than companies can. And that's another thing that's kind of scary about it is, you know, the difference between a Ponzi and you know who's a winner and a loser and a Ponzi is, you know, if you're the one wet last one holding, you're the loser. So it's really hard to know in the crypto space, what's a Ponzi and what's not.

And for me, it falls into the to hard pile interesting to learn. And I'm trying to you know, to learn a little bit about it. But as far as investing in and it's just not my thing, there's far other greater things that I don't understand that I can lose money on as well. So I choose other thing, yeah, just be careful if you're going to dabble in is if you put a small portion of your portfolio, that's your choice. But if you're putting 50 60%, I would caution you to rethink that idea.

Andrew

16:28

That's very well said. So the last item on our list here IPOs, and Spax. So please enlighten us,

Dave

16:36

okay, IPOs, and Spax. So, this is a area that was one of the hottest things during the, I guess, the COVID period, if you will. So right after the market crashed in March of 2020, and it started to rebound, everything started going up into the right. And it just seemed like nobody could do anything wrong. And that was kind of the beginnings of the height of IPOs, and Spax. And really what what those means IPOs are basically initial public offerings of a company. So when a company like DoorDash, goes from being a private company to a public company that we can all go by, that's what happens, there's a whole process that they go through to become a public company, and they sell their shares on the market.

And now we can become part owners of DoorDash, for example. And so generally, what happened during that period with IPOs, in particular, is they all went crazy. And so a lot of these companies, when they would initially offer their shares, would offer them at let's say, I'll just pick on DoorDash for a second, I think they were initially offering it around 30 or 40 bucks a share. And it ended the first day like around 220. So it's just nuts, crazy nuts, numbers rivian, the electric truck company, that Amazon is a part owner of have went through the same thing when it when it went public the first day, they get ended up a little over 100 billion in market cap, which is bigger than Toyota, Ford and GM put together. And this is a company that hadn't produced a vehicle at the point at that point. So to say that it was speculative, it was an insult to the word speculative, and it has since fallen quite a lot from those highs. And if you look at studies, by and large, most IPOs don't do well, from the highs of their initial public offering.

They will go on to they can go on to become great companies, you know, Google, Facebook, Microsoft, they've all done it. But sometimes buying when it first comes public is maybe not the best idea. Now, you flip that to specs, and specs are going to blank on the what the acronym stands for. But in essence, so you may know

Andrew

18:44

Do you know, special purpose acquisition company?

Dave

18:46

There we go. Good job. Excellent. Wow, way better than me.

Andrew

18:49

So I will answer credit today you do you get an ice cream cone.

Dave

18:52

So we'll go to that favorite place down the street from where you live to have such good ice cream, we can take Jesse and you can get his little dog dog ice cream. Perfect, pretty awesome.

Andrew

19:03

I'm wearing headphones, because I don't want him to hear that.

Dave

19:07

So Spax were a another form of companies being able to go public. And they avoid a lot of the entanglements and a lot of the red tape that using an investment bank uses to go public. And they generally IPO at around $10 A share I believe it is so they're generally really, really cheap. And it's an easy, quick way for companies to generate liquidity for their businesses by selling their shares on the market very quickly. And these were the hottest things in the market. You could not go on financial Twitter and not see the zillion posts about this back and that's back in this back and that's back everybody trying to get in on the craze.

And you could see the general tenor of the enthusiasm or the I guess, you know, freak out of people just going nuts to buy these things and some of these things would skyrocket in value on day one. on Virgin Galactic was one in particular that I remember was there was just so much euphoria about It was nuts. I think it went from $10 A share to like $100 a share in a day, or something just obscene. And the company was is, you know, massively unprofitable. And it has since fallen to earth, all of these companies have fallen, most of them have fallen back to Earth quite hard to moth who is one of the more famous investors in Spax. And he was one of the big ringleaders again, the next Warren Buffett was going to be the king of Spax. And I read the other day that all the companies that he did public, which is quite a few, I want to say 15, or 16 companies.

During that period, he did public, those companies are now at 4%, down from their highs, when they went public, and they're all trading below, every one of the companies are trading below their initial offering price. And so they've lost, you know, huge, huge amounts of money. And the reason why is and was so a little bit gross is that people like Chamath, were making billions on retail investors. Because people were piling into these things, people were going on social media and pumping them and pushing them. And then they would be the first people to cash out and get out of the businesses and make hundreds or of millions, if not billions of dollars on these investments.

Meanwhile, US retail investors would be left holding the bag and we would lose our investment or all of it. Avoiding these things was and still continues to be something you definitely want to do.

Andrew

21:31

I have nothing else to add. Sorry, I took too much. It's all really good advice. I mean, if I could leave just with one parting thought that it doesn't have anything to do with Spax. But hopefully kind of just to double down on some of the ideas from the very beginning.

Dave

21:47

All right, well, after I get off my soapbox about IPOs and specs, we will go ahead and wrap up our conversation for today. Thanks, everybody, for listening. I hope you guys enjoyed our discussion. If there's anything in here that we talked about, that you're a little bit unsure of, are not quite up to snuff on some of the terms that we're using, please check out our website investing for beginners.com. We have a great search bar at the top and we have over 1000 articles on the website to help you learn more about investing in the stock market and everything that goes on that we're talking about today.

So there's it's a great resource to help you learn and get a little bit better educated on the things we're talking about today. So without any further ado, we'll 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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