IFB275: Listener Q&A Concerning Buildng a Portfolio and Maximizing Your 401k

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Dave

0:00

All right, folks, welcome to Investing for Beginners podcast today we have episode 275. We got some great listener questions from our friend Matz's the other day. And we're gonna go ahead and answer those here. So we had a great conversation with him the other night, and he asked some fantastic questions. So without any further ado, I'll go ahead and start with the first one. So we have Hi, Andrew and Dave, I've been listening to your podcast from day one. And it was a delight to meet both of you and chat.

This past year, I made more in dividends in the 401k than I put into the account that's to be applauded. Bravo. So his first question is, what is a half and or full position in a stock for you? I know this is usually up to the individual. And what are you able to save but curious for both of you personally. So Andrew, I'll throw that over to you first.

Andrew

0:49

I was awesome. Chatting with Matt's we had a little thing we had reached out to our email list, the free email list, we have an offer that opportunity, so it's cool to see and pounce on it. And these are some great questions to kind of further the discussion. Right. Right. I'd be curious to hear your thoughts first on this one. Okay.

Dave

1:09

So I guess my goal right now is, and this is always an ever evolving thing. My goal right now is to build each of the positions up to I have currently have around 16 companies in my portfolio, I'd like to get to 20, maybe 25. If I get to 20. My goal is to build each position up into around 5% of the portfolio, depending on how the company does. The idea being that if it performs well, it earns a bigger position in the portfolio, and adjust accordingly. So typically, what I do is I try to start building in positions, it depends on what the price is that the company is selling for. And it also depends on what I'm able to do with my budget. So right now I'm budgeting $200 a month to put into my portfolio. And so because of that, I have choices to make.

And one of the companies that I'll kind of give you an example of is Texas Instruments is a company that I kind of fell in love with. Andrew mentioned it to me a while ago, and it was one of his E letter picks. And it's a fantastic business. And so I've been trying to average into that position over a period of time, because I have other companies in my portfolio, that I feel like a good opportunities to try to build up as well.

So it started off as a smaller position for me, but I've been able to build it up to in the three and a half percent range or so. And I'll just continue to work that up until it gets to the 5% depending on valuation and everything else that goes into it. But that's I guess that's kind of how I approach it, I don't really have a hard and fast rule, like I have to buy 10 stocks, or 10 pieces of the stock. I'm comfortable doing partial shares and building it up over time. Because it allows me to be a little more flexible. And I like that. What about you,

Andrew

2:57

that's cool. So like you it's, it can evolve over time through different seasons. And I've had seasons where things were really tough and all all I was able to do is $150 a month. And then I've had other times where I was putting in more, I think having that consistent habit has really helped because it might not sound like a lot to put 150 in. But the compounding of that over the years adds up to a lot. And a lot of times I know I sound like a broken record here. But a lot of times when the market is down, there's a reason why it's because the economy is tough.

And so that's actually when a lot of people pull back their investing, which makes sense, like you're worried about losing your job, or you do lose your job. But if you can really like scrimp and save and sacrifice when it's tough, you can reap benefits later on. So that said, for me, my income can fluctuate a lot because of what I do for a living. So I have a base amount that I've allocated in my budget. And then when I have more than I'm used to, then I put more in. So that's like the personal finance, budgeting side of that discussion. But when it comes to what am I determining for a half or full position in the stock? I felt like in your answer, David, it seemed like you were kind of approaching this a similar way. I look at it as a different it's like its own discussion.

Like I'm looking at what's my total portfolio? And then how am I building a portfolio to have good diversification through that? And what are my percentages? So it's less about what are you saving right now it's more about where's the portfolio? And where am I trying to get it to? So there's no hard and fast rule for me to say this is a half position or this is a full position because I have some positions on my portfolio that are just one month's worth. Whereas others might be like one of the more recent Eli their pigs. That's eight months where In one pick.

So that depends on what's the opportunity? How deep do I think it is? How strong is this company? Those are all factors. So I can't give an exact answer the say, yes, there's $1 amount to this half position or full position, because it changes changes all the time.

Dave

5:17

Yeah, I think the interesting thing about building portfolios is that your conviction will change on different companies and your allocations for different companies will change. And maybe you're heavy in payments, raising my hand that you want to start to move away from trying to diversify the portfolio. So it's going to be personal.

Andrew

5:34

So I would ask that if somebody is a beginner, and this sounds really complex, I think you boil it down to some basic principles, knowing that like, you don't have to figure it all out tomorrow,

Dave

5:46

right? I think the first thing to really embrace is being patient, that you can't build it overnight. And it's okay to not build it overnight. And I think it's going to be an evolving idea that as you come across different ideas and companies, you may have stronger convictions on this type everything. But as a general rule, I think, trying to build a portfolio that has some diversification that you don't put all of your money into oil stocks, for example. And at first, you may love those and buy a couple of those, that's okay. But as you invest in other companies, is probably a good idea to start moving away from a concentration of different ideas unless you're Warren Buffett or Charlie Munger, which I am not.

And so I think moving away from and having a, as much as you can, a well rounded portfolio, I think is a great place to start that can lead you into six 810 companies that you can invest in, and then you can start to broaden your reach. From there, you can find other little sub pockets and things that you may think are great or whatnot. And it doesn't mean you have to follow, I guess I didn't look at it as like, I have to follow this checklist of okay, I have an oil company, I have a real estate company, I have something in commodities, I have something in tech, it doesn't have to be quite that structured, it's just more of like, this is the opportunity here. And then this is an opportunity here and just kind of keep evolving it as you go.

And you don't have to swing at every pitch. And I guess that's the other thing to think about too is just because you really need a real estate company in your portfolio to try to broaden it doesn't mean you have to just buy one, fit the slot so to speak. It's really more about taking the opportunities as they come. And then but keeping in mind that you want to try to widen your reach in with companies that you own over time.

Andrew

7:42

Yeah, safe to say this is turning into another stock pickers episode. Yeah, should have started with an escape hatch to say if this isn't all overwhelming to you just buy an index fund. And yeah, what about you? As far as like basic principles? Yeah, yeah. Patience, diversification. Long term that pretty much sums up to me. When I first built my portfolio. I wasn't diversified overnight. It took me almost two years to reach that 20 position. benchmark that a lot of people shoot for. Right?

Does that sound like a lot? It does sound like a lot. And what was I heavily concentrated for a while? Yes, I was. But what's my time horizon? We have a 20 year time horizon. What's two years to get diversified? Right. Now for me, it's not much but for other people. That's too risky. Buy an index fund.

Dave

8:33

Right? Yep. Good point. All right, let's move on to question number two, what is your rule for how much of your portfolio is in one stock position? If your drip exceeds this percentage, do you rebalance, start taking dividends and cash or keep the drip on. So I'll let you take this the first stab at this one,

Andrew

8:50

who is gonna be fun. And let's take the same theme of it kind of depends, I would say I'm a lot more cautious now than I used to be. So I used to have a 20% concentration, which means 20% of my portfolio is in one stock. And I used to be completely comfortable with it. And that worked for a little while until it didn't. So now I'm a lot more cautious about it. But as I gain more experience and different opportunities come my way, might I take a swing at the 20% position again, I'm not ruling it out. But I'm a lot more cautious than I was.

That's because I I burned my hand on the stove. So I don't think it's necessarily a great thing to have a rule there unless that guardrail makes you feel better. So maybe that's something for Matt's to consider for himself, right? Like what's my sleep at night tolerance. I'm not close to that tolerance, but I'm also starting at a place where my positions are pretty small right now. My biggest biggest my biggest is starting to creep up there but it's not near 20%. So I'm not thinking much about it being too big.

Dave

10:00

Right? So I guess how does the whole drip thing? figure into this? And that's interesting, right? What do you think? I think for me, it really comes into kind of going back to what you said, like, How comfortable are you with this particular company being a larger percentage of your portfolio? For example, I have two of my biggest positions right now are Berkshire Hathaway and visa. And they both take up between 12 and 13 14% of my portfolio, which some people would probably look at that and go home. That's, you know, that's really, that's really big.

And it may be but I don't, when I think of Berkshire, really, the only risk I see in that company right now is kind of the keyman risk, you know, whether Warren and Charlie are still at the helm. And because they're older, that is a unique concern to think about. And how will the company perform after they're not running the ship. So there's that but then if I think about VSA, beyond completely comfortable with their position in the economy, what they do and their impact and importance and blah, blah, blah, so I've talked ad nauseam about them, so don't need to do any more of that. But I'm comfortable with where they are and what they do. And as kind of the go back to that idea as the company improves their performance, it will take start to take a bigger portion of the pie.

And I'm okay with that. Until it doesn't, you know, I guess, kind of to that point, I'm not talking about market time, I'm more talking about where I see things that may be changed the business for a perfect example is Warren and Charlie are no longer running Berkshire Hathaway, that will have an impact on what happens with the company. And it's an unknown. And so it's going to be you know, a take it as it comes kind of idea, because I don't know how it will do. And nobody does, they could keep going down the same path. Or they may decide that they want to sell Pizza and Spaghetti and everything else goes out. And, you know, it completely destroys the business. But nobody, I don't think that's going to happen is that's an ingest, obviously, but my point is, is that nobody knows what the future will bring. And so that's a risk that at this point, I'm okay with, but I don't know what will happen. And I'll have to adjust accordingly.

At that point when there is, you know, a problem, but that's also the part of letting that winter run, and it gets a higher, higher and higher gap of margin of safety, if you will. So even if the company drops, 20%, I still made, you know, 80% on the business, I haven't made that much. But you don't want the numbers, it helps give you a cushion in case there is a turn. And that's the benefit of buying with a margin of safety and having a great businesses in your portfolio is it gives you time to adjust because none of this is going to happen overnight. And even if it does drop 1015 20% At night, it's still okay, and I can still get out and do well with the position. So I guess that's kind of how I try to do look at it. What about you?

Andrew

13:07

I feel like that was a really great way to answer it. Because you're taking that mindset of like, remember that the stock, there's a business under it. So I feel like the discussion goes further than drip, or dividend reinvestment. Because if a company is just being average, and let's say it's growing at seven or 8%, that's bigger than the dividend yield you're getting. So really, the discussion is are you trimming this position down? Not whether you're doing with the drip because the actual company growing and that stock price is doing more than the drip itself? So if you're uncomfortable with dripping into a you're probably have too big of a position size, right? Yep.

Dave

13:48

Yep. I think that's a great way to think about it. All right, let's move on to question number three. Is there a good table slash rule of thumb for dollar x per number of positions? Not sure there is a good chart out there. As I've seen, I've never found one. For example, I have 54 positions with various dollar amounts. So Andrew, what are your thoughts on like, it's kind of a continuation of some of the other earlier discussions?

Andrew

14:12

Well, I think what can be insightful and maybe helpful for people who are feeling completely in the dark about some of this stuff that was an exercise you and I did a little while ago, was looking at what some of the top investors are doing. And having that kind of shine a light, because I think it's interesting to see. So for example, we did all this on stratusphere.io. And I believe he had a section where you can just look up an investor and see their portfolio.

Yep. It's like everybody has their own rulebook. Yeah, they have their own like setup, kind of like every Cook has its own menu. Right. I thought it was interesting to see Warren Buffett has a few really big positions but Then like dozens of like, tiny, tiny positions, right? I don't know why he does that. I don't know what the logic is. But I will say this to add on to your point, piggyback on your point about the positions, the companies that you own that do well becoming more and more of your portfolio, if you think about having a portfolio with a bunch of average stocks, and then there's one stock that grows twice as fast as all the others, that's just naturally going to take up a bigger and bigger percent of your portfolio.

Even by year one, year two, year three, it's growing faster than the other ones. So it's bigger now lay that out for 20 years, then you might see something like Buffett situation where this businesses 2030 40% of a portfolio. So maybe I'm not trying to say that this is why he does this. But maybe that's a factor. Maybe that's why he has a lot of little positions, and then some that are just so huge, because maybe it was like, well, these little positions aren't really that great. But I took a flyer on them. I don't see enough to add more. I don't know it's and it's weird, because he has multiple people managing the portfolio to write. But I mean, there are other investors that have their own portfolio construction. Right,

Dave

16:14

right. Oh, yeah, for sure. There's, you know, Joel Greenblatt has hundreds of positions. And Charlie Munger has four. So there's all you know, Mohnish pabrai, I think in the US has one. And so it's all over the map. And I don't know that there's any per se right answer. One of the things that kind of keeps popping into my head when we're thinking about this is Peter Lynch talked about how most people spend a lot of time watering the weeds and ignoring the flowers.

And I think that's what a lot of people get into is they look at positions that are underperforming, and they spend a lot of time putting more capital towards those, as opposed to encouraging the winners to run. And idea can have this impact on your returns, like if you're so set on having 20 positions and 5% for each. And anytime one starts to get like 8% and other ones start to dwindle, then people will shave off 3% of the one and put it towards the ones that aren't doing as well. And just to rebalance and get back to even. And I'm not saying I'm not saying that rebalancing isn't the right thing to do, it really depends on the situation.

But I think a lot of people sometimes get so focused on concentration and position sizing, that they forget that, you know, letting Costco do its thing for 20 years and become a bigger part of your portfolio. That's awesome. And, you know, Warren has wet Apple run, mostly because it's run so much since he bought it. And that's why it's become you know, he didn't buy it at 54%. He bought it, maybe 20%. But because it's done so well. Now, it's that big of a part of his portfolio.

You know, I don't know if I have the guts though, something at 54% of my portfolio, but he's worn and I'm not. So that's to each his own. But I think you know, the idea of wedding winners run in, focus more on buying good businesses, and holding them for a longer period of time is really the one big advantage that we have. And I think worrying about position size. I'm not saying it's not important, it is important, but I think try not to I guess confine yourself to a rule just to a guardrail to keep it, you know, this position, size, this position, size, and so on. Even down the road, it may work for some people,

Andrew

18:37

I don't think it would work for me. So I hate to like kind of derail this and start down the rabbit hole. But I think it's kind of important, because there's a lot of reversion to the mean, in the short term. But over the long term, things work, like you are saying, like you are describing the problem is too many investors, I sometimes buckle myself in there, because I find myself getting trapped in this mindset and needing to like remove myself from this.

But too many investors are looking at what are my portfolio doing the last three months, what to do in the last year, and then like, Okay, I want to try to rebalance. And that kind of actually works a lot in the short term, but you're just doing so much activity in the short term that you're missing the forest for the trees. And you might do that in the short term. And it works because a lot of times last year's winners are this year's losers and vice versa. Over the long term, the winners will be the winners.

But in the short term, the stock prices can move a lot 20% 30% last year's winners can be the serious losers. So I think a lot of people might rebalance and move things around to even things out and that can work a lot. But it's funny because we don't see those investors over the long term as sustaining it. And that's so much more work than doing what you're talking about what Buffett has done and holding great businesses and letting those grow and not planting the flowers. Right? I just think it's interesting because yeah, it's easy to get lost in that activity and you think you're doing a lot of activity and you're doing well.

Dave

20:11

And that might work until it doesn't, right? Yeah, for sure. I guess let's explore this idea a little bit more. So one of the things that we uncovered when we were talking to Matt's last night was that he's done really well with his 401k. And he, in that particular investment portfolio, he has funds to work with. So the idea of rebalancing with funds, I think, is a little different than it would be with individual companies. What are your thoughts on that?

Because if you're thinking about rebalancing, Microsoft versus rebalancing an s&p 500 fund, because it's a collection of so many companies, and like you said, you know, last year is losers, Mehta is this year's winner. And so, you know, the impact it's going to have on a portfolio is going to fluctuate, but, you know, I think that, you know, rebalancing in your 401k has different benefits than it would in an individual stock portfolio. And because in that respect, you are definitely cutting some winners to water some leads, whereas with more fun, related type investments, and keep in mind, I am not, this is not my area of expertise.

This is just me theorizing. So take that for what it's worth, but I would speculate or hypothesize that rebalancing 401k, I think would have different and better benefits than it would with an individual stock portfolio.

Andrew

21:39

For sure. Yeah, that's a great point, depending on what your 401 K plan is offering you and what you're in. Right. I think one of the other things about 401k, which I don't know if he asked a question about this later or not, but you're gonna have different mutual funds. Right. So kind of going to your point about an alternative than 401k, which I think is good, because that was where the original conversation started.

Right. So your point about, like, having Berkshire Hathaway, that's very much like a mutual fund, like, Warren Buffett is in there buying stocks for Berkshire Hathaway, I would not rebalance away from Berkshire the say, Warren, you got too big in my portfolio. Because the reason why he got big is because him the underlying assets actually getting better. Right. But to your point, if we're talking about factors, like small cap versus big, which is basically small business versus big business, we know from long term data that those things go in and out of favor. So in that case, it's not that big companies are forever better than small companies that stuff cycles. So to your point, that's a great time to rebalance. I'm glad you made that distinction.

Dave

22:46

Yeah, the investment in Berkshire Hathaway, Chris Blum strand, who's probably one of the more foremost experts on Berkshire Hathaway outside of Warren Buffett Seido, he writes a fantastic letter every year, semper Augustus is the name of his fund. And it's definitely worth a read. And especially if you invest in Berkshire Hathaway are interested in learning more about that company. One of the things that he talks about when he thinks about Berkshire is he always thinks of it as a bond, or like a mutual fund, you know, that it's a collection of these businesses.

And it's not really like one business may not do as well as the other ones, but the other ones will lift that up. And so it kind of helps balance it out. And it's, it may not be as fast or to the moon type investment. But you know, the tortoise and the hare, the slow and steady is gonna win the race. And that's what he thinks about what he thinks about Berkshire and, you know, investing in other businesses can be a different idea. But yeah, I think investing in 401k is super important. And but understanding what it is you own and how you operate that is going to be different than how you operate an individual stock picker portfolio, because it's just the whole nature of what you're investing in the cost, the analysis and just the impacts that one can have versus other, you know, Berkshire doesn't do as well and the s&p 500, it's not going to have a huge bearing on your 401k portfolio, per se.

And, but if it's in your portfolio, and it's not doing well, it's going to have a much bigger impact. That's a great point. All right. So with that, we'll go ahead and do our last question from Matt's and then we'll wrap it up. So here we go. I'm hearing not much. Talk about the C F and your podcast of late reason. After reading the income factory, I've really added a few seven to my portfolio. Thanks again for the 401k discussion yesterday. Have a great day, Matt. So again, Matt's Thank you very much for your time last night. It was awesome. Our guy is doing a lot of great things with his 401k and he definitely needs to be applauded. So, Andrew, I'm gonna give you first stab at this question, if you will.

Andrew

24:47

Okay. C E. F stands for closed end fund. And for my small understanding about the whole thing is it's very similar to a mutual fund and I don't invest in me total funds because I like to be a stock picker manage my own portfolio. So I don't invest in mutual funds, I also would not invest in CF. But we did have a great discussion with David Stein, a few months ago, maybe a year ago about closing funds. So you can go back in the archives and check that one out if you're interested in in CF. But again, personally, I just don't do it. Because I like to be a stock picker

Dave

25:24

did on that I not a game I play in much that I understand about them. David is definitely the expert in that field and check out that episode. He really knows his stuff. And his podcast is great as well. He talks a lot about the different kinds of funds and everything that are available to investors, and he would be a great resource to learn more about that particular thing. It's really not my bag. So I prefer not to talk about something I don't know, just to

Andrew

25:49

throw a wrench into it, and maybe ruffle some feathers. There's a reason why you and I don't pick certain investments to get into right. And part of its circle of competence thing part of its we just don't think it's a good long term investment. So a good example is like we'd never recommend crypto, that as it is in its form right now, as a long term, stable investment. Where on the spectrum, does CF stand for you? Does it depend on like how much in control an investor wants to be? Or, you know, for the investor who's trying to optimize their wealth the best? Right? Where does it stand in that spectrum to you?

Dave

26:30

And that's a great question. I think it I think it really comes down to where you sit on the how much effort and energy do I want to put into growing my wealth, there are going to people out there that are like us, that want to be stock pickers are fascinated with the idea of learning more about businesses, and how they operate and the ins and outs and kind of how that whole game plays. And there's other people out there that have zero interest in that. But they know that they need to invest without knowing without knowing each individual's risk tolerance. And you know, other factors that go into all this, I think investing in something like a CF can give some investors a great measure of like, I'm in control, and they have options to choose from.

And they can pay great dividends. And that can be fantastic for people for the idea that they don't want to spend, you know, every night laying in bed next to their significant other reading financial reports. If that doesn't grab them, then I think something like this is probably going to be a more interesting and better option, you know, kind of lumping that in with index funds, ETFs closed end funds, kind of all that type of investing to me is that's kind of fits into that category. And then you have more of the stock picker category and the two can meet and the two can overlap for sure.

But it just depends on what it is you want to do and how much effort you really want to put into it. I think investing in a CF is probably less intensive than it is investing in Microsoft. And so you know, there's a balance you have to choose. And it really comes down to what I guess what people want to choose? What are your thoughts?

Andrew

28:16

Yeah, kinda like, do you want to change your brakes? Or do you want to change your engine? You know, to what extent or do you just want to have a mechanic do it for you? Right? I kind of look at it. Similarly, if you know, because I am so involved in being the stock picker, I am trying to get that extra performance as best as I can, while also staying margin of safety and long term.

So for me, that means considering things like that i i have like, close to no doubt in my mind that there are going to be CTFs and there are going to be mutual funds greatly outperform? And you could probably say that about any asset class. But do I think that that could be something that I could utilize to best manage wealth growing through a stock portfolio? I don't and that's the reason why I don't go down that rabbit hole.

Dave

29:11

Yeah, I agree with that. And I think it comes down to what it is I'm looking for and how much effort I want to put into it. And I think once you kind of answered those two questions, then you can really decide on what area of investment or what asset classes are going to work best for you. And then just go with those. I mean, I I think there's some people think that they have to do one or the other, you can do both. And you can do just as well. And it really comes down to what you want.

And in the world of investment, the world is your oyster, there's so many options, and so many opportunities to do things that I think the more important thing is invest and do it consistently over a long period of time and stick with a method that's going to work best for you. Just because Bob down the street is doing awesome. buying all these companies that are going to the moon doesn't mean you have to do that too. And And sometimes people just get lucky. And that's just unfortunately the way it is. And it's the way the world and it sucks, but doesn't mean that you can't be successful as well and doing it a different way.

So I think I would encourage people to just focus on the basics, invest, find something that works for you, and just do it until you're done. Perfect. All right. Well, with that, we will go ahead and wrap up our conversation for this evening. I wanted to thank Matt, again for sending this these great questions. And his time last night, it was a fantastic conversation. And he's a smart, smart cookie. And he's done a fantastic job with his 401k and really to be applauded, and I wish there were more people like him out there doing that, of course, then that means Andrew and I'd be out of a job, but the world would be a better place.

But anyway, the last thing I wanted to mention is we are running a survey, through our podcast provider airwave media. There's above two to three minutes of questions. It's to help us get better at our show, to find out what you guys like what you don't like, what you're looking for, and how we can improve the show. And if you love the show, please consider taking a few minutes to fill out the survey. If you do do that, you will be entered in a $500 amazon gift card giveaway through the airwave medium.

And so that would help out the show a lot. So we would appreciate it you will find the survey in the show notes as well. So with that, I will 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, and we'll talk to you all next week.