IFB279: New Investors Mistakes and How to Avoid Them

[This transcript was generated by artificial intelligence. Timestamps are not 100% accurate depending on the platform used for listening].

Dave

0:00

All right, folks, welcome to Investing for Beginners Podcast. Today we have episode 279. Today, Andrew and I are gonna talk about some common new investor mistakes. So we got this great list, I found this great list on Twitter. And we're gonna go ahead and talk through the list here today a little bit. So we'll start off with the first one. So here we go, we got day trading. So what are your thoughts on day trading?

Andrew

0:24

I hate it, I've tried it. I've dabbled with options. And it's a lot of fun if you do options, because you can see it really move really fast in just a few minutes. But I don't recommend it, because I'll tell a quick story. So when I was dabbling in it, I was buying options waiting for a pop and then selling and then just repeating the process. So you know, basically picking up pennies in front of a steamroller.

And that's literally what happened. So I was, you know, basically this big experiment, I have a spreadsheet that was recording all my profits from doing this because it sounds easy, right, you just buy an option wait for like a tick or two, it will have point 1.2%. And then you can sell out at a 10 20% gain. So I did that for I think it got up to like 27 days in a row, I had a profit. And now on the 28th day, I lost all of the profits and more in a single day. So it's a perfect example of that a lower of being able to take advantage of those little swings in the market, it is literally picking up pennies in front of a steamroller. That's what happens when you use leverage when you day trade. When you use options, all of those things kind of I see in the same group I've

Dave

1:39

never day traded in, it looks way too hard for me. And if this sounds very stressful, and I already have enough stress in my life, I don't need more. The way that I best fits me personally, and fits the way that I want to try to grow my wealth. And day trading to me sounds like a real easy way and a quick way to lose money, especially, particularly if you don't know what you're doing.

There are people out there that are very skilled at edit, and have spent a lot of years working on it, and developing their craft and whatnot. But I don't think it's something that you can just decide I'm going to be an investor I want to day trade and be successful at it from day one I get up probably work through a lot of mistakes and a lot of losses before you get to where you want to go and whether or not that even happens or not. I remember there's a percentage of like 99.5% of people, all people that day trade are stopped within like a month of doing it or something. It's something really crazy because it is very, very hard.

Yeah, it's easy. I just sit at a computer and I buy it when it goes up and I sell it when it goes down. It's not quite that easy. So and especially for new investors, that's very expensive lesson to learn in the markets.

Andrew

2:54

It's tough because it is kind of random. Like the way we try to talk about stocks is you buy something and when the business grows over the long term, the stock grows over the long, it's a very logical kind of one to one thing, right. But when you take any given day in the stock market, it's a complete Zoo.

That saying that I think it was Graham or Buffett, I can't remember. Yeah, in the short term, the markets a voting machine in the long term. It is a weighing machine. Right? I think that kind of sums it up. Because what moves stocks in a day? I don't know, did some fund manager just have a bad day and decided to move a bunch of positions? You really don't know what could happen in any given day. And so I don't know how to trade off the one to one logic there. I just don't even see it.

Dave

3:42

Yeah, I don't either. And it's it's beyond my skill set. And so it's just something I choose to avoid. And I would probably recommend that most new investors stay away from it. Alright, so the next one is using lesser citadel. Yeah. All right. We're not in? Not at all. All right, so you mentioned in your first opening remarks leverage. So it's how was that a mistake for an investor,

Andrew

4:05

similar concept where you can really blow yourself up. But to me, it's even more basic than that, when you use leverage. And I'll even though many people do this anymore, I guess you hear about it on Robin Hood. But obviously, the concept of leverage is you can invest $1 and make $10. And you know, you're basically moving a bigger pile of money, and that's going to higher percentages, you're going to make a lot of money really quickly.

But the problem with leverage is that you're paying for the privilege of using it. So even besides the fact that you probably will blow yourself up. It is literally a ticking time bomb because you have to make interest payment on this leverage. So not only do you have to be right on whether it's going to go up or down, which is very hard already. It's not great. It's it's barely above 5050 odds. Elena, you have to be right on that. You also have to be right on the timing and In that timing that you don't lose so much from interest payments to have made a total loss after you make a profit. So there's just too many too many cards stacked against you, I again, I don't see where I see the lower, but it's really tough. And it would be really hard to do. And I don't see myself doing that.

Dave

5:21

I don't see myself doing it either. And I think I see the allure of it, it's a, it could be a way to get rich, fast, if you get lucky. And I think people get attracted to this idea of using leverage from the stories of the one or two people that do get lucky and hit a big with those things. And, you know, great for them. But for the other 99.98% of us that don't get lucky with that it can be dangerous.

So you can really put yourself in a very, very, very bad position. And that was one of the things that kind of during the pandemic was kind of a little bit offsetting about Robin Hood was they were allowing new investors to use leverage to trade options. And they were falsely promoting how it was impacting different returns. And one gentleman thought that he had put himself in debt for life and ended up killing himself. Even though it wasn't actually true, but what the app showed him a long story short, he was using leverage, and it blew up on him.

And he chose to end his life and because he was so distraught about what he was facing financially, and that's probably the extreme example of how leverage can can be a horrible thing. But you know, I understand the allure of it, but staying away from it, especially as a new investor, is something you really need to consider. I think these two ideas of day trading and using leverage are really kind of the idea of I can get rich, easy and quick idea. And most investors in the market make money when they invest for a long, continuous period. And it's boring, it's not exciting. But that's how you get wealthy by using the stock market. And these two ideas of day trading and use of leverage, I think, appeal to people that that want to get rich, fast. And yes, you can get lucky. But overall, it can be a very dangerous thing to get into. So I would highly encourage new investors to stay away from this stuff. Alright, so let's move on to the next one. No diversification,

Andrew

7:25

this one's kind of, I'm starting to feel like the grumpy grandpa in the room. This one's a little bit less like kinda think you're hot stuff, I think, where you start to think that you know all the answers. And so when you don't diversify, you're basically putting all your eggs in one basket, you're saying I'm right, the markets wrong. And I'm gonna roll the dice, I think it should be obvious why that's not a good thing to do, because the world is uncertain and things happen. And so if you don't spread your money out, you will get hit by the randomness bug. And that can wipe you out if you're not diversified.

Dave

7:59

Exactly. And this idea of like, I can really backup the truck and put all my money into one company, is something that will certainly work for Charlie Munger or Warren Buffett, because they're so smart. And they really have these amazing insights to these companies in these investments that are not Warren Buffett, and I can't, I don't, I don't have that confidence or that ability that they do.

And so I have to spread my bets and diversify. And I think any new investor, as they're coming into the market, having that as one of your foundations, I think is very, very, very important. Because like Andrew was saying, it can lead to ego, and thinking that you know more than you do, and that can be just as dangerous because that can lead you to really back up the truck into Company A, and it's only doing well for a very short period of time for one specific reason.

And then everything turns, you look at look at what happened to peloton and kind of the fallout of that. And the company is really on the struggle bus. And probably some people really backed up the truck and put a lot of money into that when it was at the height of its powers, if you will. And they've suffered since then. A lot of new people got into the market, but all their money in peloton and unfortunately, it's turned since then. And it would be that's the downside of diversification. Yeah, I'm starting to feel like the grumpy grandpa in

Andrew

9:24

the room. Well, that makes two of us. So I guess the next point on here is timing the market? Yeah. Why not?

Dave

9:33

You can't I mean, it's, you know, timing the market is impossible. It indicates that you understand better than everybody else in the world. What's going to happen, when it's going to happen and how you can benefit from that knowledge. And there's, it's always obvious in hindsight, right in the rearview mirror, it's always obvious that hey, this is when the recession started. Hey, this is when Apple stock fell 30% and started to rebound. On, in hindsight, it's always 2020.

But in the moment, it's impossible to see that Netflix, which dropped 20 Some percent in one day was going to start to recover. You didn't know that nobody knew that. You know, at the time, everybody thought that Netflix was a dying dead company. And that has not proven to be the case. But that day, everybody would have thought, hey, you know, on out because Netflix is dead.

And you know, in hindsight, it looks like that would have been a perfect time to buy Netflix because it's, it's gone. It's up at some percent since that time. And so timing the market is kind of a fool's game, I'm in the market is far more important. Now, the biggest thing for me is, you hear people who are making predictions about where the markets gonna go next year, stuff like that. But you never hear somebody who's done it. It's always some new guy. It's never somebody who's predicted the market over and over and over again. So that tells me the stock market's been around what since before the Civil War, and yet we don't have somebody who's written a book. This is how you market time successfully.

Andrew

11:10

There's a reason for that. Yeah, there. There really is.

Dave

11:13

A think about Michael Burry. Right. He, he was successful in predicting what happened during 2007, the great financial crisis. And ever since then, whenever he makes a prediction, people jump on it. And then in hindsight, it turns out to be wrong. And it doesn't mean that Michael Burry is a he's an idiot, or dumb person are from it, and he's brilliant. And he's had a great career investing in stocks.

But even he admitted not too long ago, that I think was about six months ago, he was selling but sell everything, sell everything we owe, it's all going south. And you know, a few weeks ago, he's like, Well, apparently I was wrong about that. So, you know, it's, it just goes to prove that timing the market is it's impossible. It's more important to be in the market than to try to

Andrew

11:58

time in. Yeah, for sure. So the next one on the list. Speaking of peloton, buying hot stocks, avoid this problem. What's the problem with hot stocks,

Dave

12:09

most of the time, when you're getting into the hot stock, it's already been priced above or beyond where it really should be. All the gains that you could have gotten from buying the air quote, hot stock have already been realized. And you're going to be the backside of what's going to happen to the company peloton is a perfect example. Zoom is another example.

There's a dozen or more hot stocks during the meme crisis, if you will, that everybody in your brother wanted to buy but when you are buying them is on the wrong side of when you should have been buying them. And it generally when there's a euphoria about a company or an investment, that's probably when you want to stay away from it. Because it's being bid up so high, that it's it's almost impossible to make money on the investment. But what happened to GameStop? You know, that whole Gamestop mean, when the price got pushed up to I don't remember what it was at $1.34 thousand, or something crazy like that. And then a drop. So the people that were buying the absolute top lost all their money, so avoid buying hot stock.

Andrew

13:15

So how do you differentiate between a good stock and a hot stock? Because there are some good stocks that start to look like hot stocks? So how do you differentiate the difference?

Dave

13:24

For me, it's it comes back to understanding the fundamentals of the business and understanding what's driving the success of the business. The hot part of it really comes back to media for me, whether it's to CNBC, and every every talking head talking about peloton and this is the time to buy it, or is social media, propping up the stock and everybody getting super excited about it. That's when the kind of the euphoria kicks in, you know, understanding the business of peloton and what they're doing and their financials and the overall economy, the overall market that they're in the history of those kinds of stocks, that's where you can find okay, this is a great company, and this is a good time to buy it.

And then also understanding the value of what you're buying. Kind of like, you know, everybody wants a Tesla, but everybody pay 150,000 or a $45,000 car? Probably not. But that's kind of the same analogy with buying a stock, you know, would you pay $300 for a company that's really worth 50 bucks. No, I mean, I wouldn't. I don't think any rational person would and that's why, I guess that's how I kind of differentiate between a hot stock and a really good company that's going to do well.

Andrew

14:35

Yeah, that's great. Yeah, good points. Next one here, panic sell at 10% pullback. It actually kind of leads in from what you just answered is you gotta know what you own. And so if a 10% drop in the stock price scares you where you don't want to hold the company anymore, then you probably didn't know enough about the company. because when you're buying stocks, in the way that we teach and describe, you're gonna do it for the long term. So there aren't going to be very many companies that just go up into the right the entire time you hold them, when you buy a stock, you want to look out, you know, maybe five 710 years, if you can and try the picture.

Can I see this business still succeeding with what it does? Do I see it still maintaining a decent amount of growth? Why do I think that is? Is there a moat or not, and those those questions and those ideas, once you start to internalize them, you build these mental models about the stocks you own. That gives you perseverance, to hold on through, like something like a 10% pullback. Oh, I bet if you see like a 20% 25%, it can make you nervous. And you go back and you revisit the thesis. But going back to the original thought, and I see myself holding this for 10 years.

A lot of the time, the answer is yes, we're just maybe impatient, or we want to over optimize. I mean, you rewind to our conversation earlier on Tuesday, like that kind of encapsulated the that kind of thinking that he helped me draw me away from that. But really, it's if you're really looking now at the stocks, and I'm going to try to hold them for 10 years, then a 10% drop tomorrow does not change that it's literally nothing to do unless the 10% drop was something that was something that really made that show that the business is struggling.

Like if for whatever reason tomorrow, they said, Hey, by the way, we lost $15 billion on some acquisition, okay, maybe that's cause for concern, because that's new information. But if it's a 10% drop, because they missed earnings estimates by three cents a share, or something like that, but they're back in perspective, zoom out, look over the 10 year period, and use it as an opportunity, it will maybe learn more about the business instead of worrying about, oh, my goodness, I feel like I just lost money because you really didn't, you don't lose it until you sell.

Dave

17:07

Right? You don't. And I love that idea of knowing what you owe. And I think that's as new investors, that's something that really needs to be drilled into new investors is standing what it is that you own, because it will help you avoid so many of these new mistakes that we're talking about. And it will also help give you confidence that like Andrew said, it dropped 10% Because they missed earnings by one cent or two cents, okay, big deal, it might actually be an opportunity to buy more.

So that's where really understanding and knowing what your what it is that you own. Likewise, if the CEO found out that he's been embezzling, you know, billions of money and manipulating financials or his own financial gain, well, then that's obviously something that if you understand the business, and you see that happens, well, that could if it's really like a key man driving the bus kind of thing, like if it's a founder CEO, and you find out that all of the things he's been professing and doing are the exact opposite, then that would obviously, okay, if there's only dropped 10%, hey, I can get out here.

Now, it really all comes back to knowing what that will really take you a long, long ways in investing. So let's, I guess next talk about the next one. So buying based on a high dividend yield, this one

Andrew

18:23

comes down to kind of just looking at numbers, and you're buying solely based on a number that you like, and I get it, it's appealing. High yield means you're getting more dividends, and those will compound faster if they're growing just as fast as everything else. But you just really have to be careful because yes, some of the best opportunities have happened when stocks have gotten really cheap.

And so that can make their yield go up. So it's like you get a double, a double bonus, you get the cheaper stock with rebounds, plus you got the higher yields, or app purchase, which obviously is very nice, too. But I feel like you've said this several times on our show before turnarounds are kind of rare. So you do want to be careful. And sometimes the highest dividend yield stocks are the ones that are most in need of a turnaround.

So you do have to be careful with that. I would just throw in the idea of looking at the stocks payout ratio, and then also look at what's their growth rate been. And if you like the payout ratio, and you liked the growth rate, like the revenue growth rate, is there a reason to believe in 10 years that revenue is gonna grow at a decent amount. And if the payout ratio is okay, and you have a high dividend yield, those are all great signs. But if it's a high dividend yield, and the revenues keep dropping, and the payout ratio is super high,

Dave

19:43

be careful Buyer beware. Very much Buyer beware. That's kind of what Gamestop before it became the meme. The meme poster child was kind of the value investor poster child. And one of the things that I remember a lot of people were touting a bout Gamestop that, I think attracted to a lot a lot of investors too it was they had a high dividend yield at a time it was eight, nine 10%, something crazy like that it was really high for a little while. And that has turned out to be, you know, a kind of a siren song. And it was not a great investment. It wasn't a good investment for me.

And that's why I sold it a while back. But the, like Andrew was saying he turnarounds for it rarely turn. I think that's what Warren Buffett said. And a lot of times these companies, they are in desperate need of a turnaround. But it's really, really, really hard to do. It's rare that companies can do it. Microsoft is one of the companies wasn't necessarily complete turnaround, but it certainly was a reversal of the direction they were going and has really kind of reversed it. But that's kind of a rare thing.

But it all comes back again to knowing it knowing what you own and buying based on a high dividend yield. If you don't know what you own, like Andrew said, buyer beware, it can be very dangerous.

Andrew

20:56

All right, we just touched on this in a recent episode watching way too much financial news.

Dave

21:01

Yeah, avoid this, like the plague. The news is designed to do one thing, it's to make you create emotion and make you act on that emotion. They create buzzwords, titles, hysteria, for a reason, because they want you to come back and watch the show. They want you to get addicted to watching the personalities on the shows. And they're trying to generate controversy, because that's what unfortunately draws eyeballs. And that's how they make money.

And so watching too much financial news, I try not to watch any financial news. But I understand if you can, but you have to learn, I guess, kind of like I've had to learn what is your tolerance for it? And how much can you? How much can you watch it without being emotional about what they're saying? Because they can not necessarily mislead you. But they can mislead you by talking about, you know, getting you so excited about something that ends up really being a nothing burger.

And, you know, like Andrew was saying earlier, you know, else, you know, Google missed earnings, you know, stock down 10%. And then you look at the actual earnings results, and they're off, like two cents or something. And it's like, are they miss they missed their earnings. And, you know, they projected that they will grow earnings by $1. And they came in at 99 cents. Okay, you know, the hysteria doesn't necessarily match the information they're relating. And so I guess I try to avoid the news as much as I can, because it can be very distracting and make you do things you really wouldn't want to do. If you're thinking rationally I guess.

So what would be the better alternatives? What would be the better alternative? For me, the alternative is to focus on the things that I can control, which is understanding the businesses and reading the information that comes directly from the companies as opposed to what CNBC is telling me. So, for example, if I am following Google, and it's a company that I've invested in, then I'm going to read the financial reports, the financial news from Google, I can set up alerts from Google to send me any sort of pertinent news. And then I will read their news, I'll read the earnings calls directly from Google, as opposed to what the news is saying about them, because they won't have the same.

You know, it'll just be an earnings call release, you know, March of 25th 2023. And that's it. There isn't any sort of like, you know, hysteria about they missed earnings, they missed revenue, or any of those kinds of things. So that's how I do it, I guess, how do you do it?

Andrew

23:51

Yeah, same, I use this tool called bam, sec, ba, m s, e c.com. And I like it a lot because you type in the ticker. If I type in Apple, it shows me. In gritted fashion, I can see where the 10k, the 10 Q, the A K, which is the press release, like you're saying the earnings releases, I can look at the proxy, it's all right there in a click, and I pay for the premium. So I get alerts, whenever it goes straight to my email, say, Hey, Apple just released this press release.

And then I can click on there. I don't have to get anybody else's dumb opinion on it. I can make my own. And that's, it sounds really simple, but it's actually really powerful. And I think you you get a lot more information that way. Maybe when you're a beginner, it helps to have some of the kind of translating that for you. But as you build that experience, the closer you can get to the source of the data, the better. Yeah, yeah, exactly. You can

Dave

24:51

use stratosphere.io has kind of a similar function for free that you can do. You can set up alerts for companies that you Follow. And you can do the kind of similar thing with Seeking Alpha, I know that they have, you can sign up for alerts for different companies that you put in your watchlist or your portfolios. And they'll send you updates on different news events. Sometimes I have gone to actually the investor relations, I did that with the SEC, for example. So I signed up for awards through their investor relations.

So I get everything from visa. And it can be a lot sometimes, but it's all there. So if I want to read about it, I can read it. So it helps me avoid CNBC in particular, not to pick on him, but I got a

Andrew

25:32

bone to pick with them today. Like them, sir.

Dave

25:36

Do you Okay. All right, so the last one we got. So this was the last mistake that new investors should stay away from buying the same stocks as an online guru? Well, it

Andrew

25:47

depends on which one you're talking about, right? Obviously, I have a newsletter, I feel like if you subscribe to what I've got an you read the information that gives you enough to be able to buy something and have conviction with it. That's the whole idea of the newsletter. But yeah, I, you know, you want to get to know, the people that you are trusting and their opinions that you're trusting.

So if it's some anonymous person on Reddit, who doesn't have a profile, they don't have their picture up there, they'll have their first and last name out, they don't have any information about themselves, you can go back and see what do they think, how do they operate, then? Yeah, of course not. I feel like the internet's changing. And there are a lot more good people out there who are offering great advice. And so I think it helps to be open minded to some of that. But you do have to be really careful, because it's so easy to be on the internet pounding away on your basement, from someone on the Mr. Cow, and, you know, feel like there's no consequences. And I think most people are smarter than that. So probably it doesn't even need to be said, right.

Dave

26:53

I agree with everything that Andrew was saying. And I think really understanding who the people are and what they're, how they're presenting the information is really about presenting the information and how they present the information. When I read this question, I'm thinking of the, you know, the pitchman, or the hype, people that are out there talking about Company A, and how great it is, but then when you really kind of try to dig into what they're telling you, they don't really give you any sort of information, they're just trying to hype it up.

Because they have some benefit, they reap on the other side of whatever happens with the company, maybe there, maybe they have options, they go back to options and leverage and maybe they have options to leverage on the business and they're trying to get, you're trying to get enthusiasm, try to for people to buy or sell the company so that they can benefit from it, profit from it. And when I think about that, it's it kind of comes back to, you know, what Andrew was saying is really understanding who it is, and what they're doing and in the basis of the knowledge that they're passing along, as opposed to something that's more disingenuous, and is really just trying to do something that's gonna benefit them, as opposed to, you know, really presenting information in a logical form that everybody can read and go, Okay, I understand why you think this is a good investment or not a good investment.

And that's what I feel Andrew does with his as he presents all the information in a logical way, so you can understand why he thinks this is a good company to invest in. It's not just like, hey, buy these top five names, as I said, so those are the things you need to avoid. Alright, folks, well, with that, we will go ahead and wrap up our conversation for today. I hope you guys enjoyed our conversation on common mistakes that new investors should avoid.

These are all great things that new investors even more experienced, investors can fall fall victim to. And just kind of understanding the ins and outs of what it is that you're buying can go a long ways towards success over a long period of time. And you can really do well in the stock market if you just kind of follow those simple principles. So that'll wrap up the show for the week. Don't forget to subscribe to our show on your preferred podcast app if you enjoyed our little podcast. If you would kindly consider giving us a review it greatly helps the show and don't forget to browse the incredible materials we've created for you at investing for beginners.com.

Lastly, continue growing your knowledge as an investing for beginners insider with insights and educational tips delivered right to your inbox for free. Sign up today. Don't miss out. So with that I will go ahead and wrap us up 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.