IFB317: Listener Q&A - Navigating Market Turbulence with Long-Term Investments

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Dave [00:00:00]:

All right, folks, welcome to Investing for Beginners Podcast. Today we have five fantastic listener questions that we're going to go ahead and answer. And as a side note, if you have a burning question that you're dying to ask us, by all means, please reach out. We would love to help you answer it on the air. I know that Spotify has a great resource, the ability to ask questions, which is where we're going to answer. All the ones we're going to answer today came from. You can also go to newsletterinvestingforbeganners.com and send us a question there as well that we can go ahead and answer on air.

Dave [00:00:33]:

You can also reach out to us on LinkedIn and Twitter as well. So there's lots of options for you. So let's stop delay and let's get into it. So here we go. First question. This is from Lily. What is the most profitable business to do and start? So, Andrew, what are your thoughts on this intriguing question?

Andrew [00:00:51]:

Yeah, if you have the answer, please share.

Dave [00:00:53]:

Yeah, I'd love to know.

Andrew [00:00:56]:

Know we joke, but even the smartest guys in the world are trying to figure this out. Every single day you look at the history of a company like Microsoft. The guys at Microsoft were brilliant. And I think even Bill Gates might have been one of the guys who was really trying to push Microsoft really hard into competing with iPhone and trying to get into the phone space. They ended up stumbling around and ended up in the cloud space, which is arguably even more profitable than if they would have succeeded with the phones. But it just goes to show you that the most successful business guys, the most smartest guys in the room, they don't know what the most profitable business is tomorrow. That's not something we could answer for you. And so I wonder if we're talking business to start perspective, I wonder if you need to find the business that's right for you instead of what's the business that can make me the most money? Because nobody can answer that question of what's the business that will make you the most money.

Andrew [00:01:53]:

Too hard to answer.

Dave [00:01:54]:

It is too hard to answer. And I think that is probably if you're wanting to start your own business, I think you need to figure out what it is that you're excited about and what you think is exciting and what you think is fun and figure out a way to make money from that particular idea. Because if you go into it with I just want to make money and I want to make a lot of money that can lead to if you've ever seen the Wolf of Wall street, that can lead to some pretty bad places. And sometimes the incentives don't always align with who we are and where we want to go. So it's always good to kind of keep that in mind. But if it's something you're super passionate about, like if you love baseball cards, for example. I do. Then you could figure out a way to do something with that on the side, trading baseball cards or collecting them.

Dave [00:02:42]:

And there's lots of different ways you could go with all kinds of things. If you're a musician, you could figure out a way to teach guitar lessons online, for example. With the Internet now, there are so many different ways that you can go. And the technology is easy. A lot of it's cheap, and there's lots of ways to get started

now that we didn't have available when I was a kid, when I'm 56 now, and when I was 20, a lot of these things didn't exist. Literally didn't exist. So I think the opportunities are far, far out there. And if you're already in business, then I think it's just figuring out what is your business model and how can you make that more profitable.

Dave [00:03:23]:

And there's two basic ways to do it. One is to cut the costs, and the other one is to figure out a way to drive more revenue. So if you can figure out either one of those, you can build a more profitable business. But just remember that you can only cost so much, and some point something has to give in that respect. So that's something to consider when you're analyzing businesses and you're looking at buying a company and they're talking about being more efficient and cutting costs, that's only going to go so far. SO those are, I guess, probably the best ways to do it. And again, Lily, if you have the answer to what the most profitable businesses do and start, we are all ears.

Andrew [00:04:02]:

I guess the only thing I would add to that is figure out what problem you're trying to solve. People don't give money just because they like giving you money. People are going to give you money because you're solving a problem that they're dying to have solved. And so that applies just across all sorts of businesses. So if you focus on the value you can give to other people rather than how much money can you make, it makes a lot easier to drive revenue.

Dave [00:04:23]:

Yes, exactly. That's very on point. All right, let's move on to the next question. So this is from Nami. Is it really necessary to spread our US investments across all sectors. I came across this business cycle approach where each sector is performing better than others in each business cycle. So Andrew, what are your thoughts on this kind of interesting question?

Andrew [00:04:43]:

I love this question. I feel like first you have to identify Are you a stock picker or are you just going to try to buy the entire index? Obviously, if you like the passive approach and you just want to own the entire stock

market, then yeah, you're going to own all the sectors and you're good to go. If one sector outperforms the other, you'll still get exposure to it and you'll be good to go there. As a stock picker, I take something in the middle. I don't spread across all the sectors, but I also don't enter a sector just because I don't have it or just because I feel like I need exposure to it. I feel like some sectors and some industries are just fundamentally better than others. And you could hurt yourself by including those businesses that aren't as great just because you're trying to get exposure. So I do understand that they can outperform, underperform and there's a time and a place for a lot of different companies and sectors.

Andrew [00:05:40]:

I feel like you can leave returns on the table if you do it too much of an extreme again, if you're stock picking.

Dave [00:05:46]:

Yeah, those are good distinctions. And I think really deciding what kind of investor you want to be before you start investing is super critical. And if you want to put in the time and effort that's required to be a stock picker, then I think trying to spread it out as much as you can is probably a good idea in that fishing where the fish are. In other words, don't plug a hole just because you feel like you need to plug a hole if that's not the best investment at that particular time. And I think as you build your portfolio over time, you can spread it out over sectors. But I also would hesitate to recommend that somebody really go into commodities just because they feel like they need to have a commodity and they know nothing about the commodity industry. It's a tough game to play anyway. And if you're just trying to plug a hole because you feel like you need to have it, then I think that would do you more harm than good in the long run.

Dave [00:06:44]:

And the idea of trying to chase business cycles as they ebb and flow, I also think is probably a real dangerous game to play. I'm not saying that people can't do it, and I know there are people out there that do that and do well. But that is a much harder game than I'm willing to play. And it also includes learning and understanding those particular sectors as those cycles are doing better. And a perfect example is recently utilities or energy was doing well. And if that's not a sector that you're super familiar with, or really understand oil or natural gas or electricity, or even how utilities work, trying to play in that sector would be very difficult. And so the challenge that comes into really trying to chase business cycles is that you really have to understand those industries that are doing well and the ones that aren't doing well. And I think the

better idea is to think about kind of building diversification as you go along and trying to find the best companies that you can.

Dave [00:07:54]:

Not irregardless of sectors, but understanding that as you build a portfolio, you will kind of naturally, hopefully diversify. Hopefully you'll learn from the mistake that I made of really concentrating on payments in particular. A few of those have done really well, and a few of them have been kind of bummers. And that's the risk of really concentrating into sectors like that, even though they could be areas that you really understand well, it doesn't always necessarily translate to stock returns, because just because you think company A is the greatest thing ever, the market may not, and sometimes that can last for a really long time before they air, quote, recognize how great a particular company may or may not be. And so I think, is it necessary? I would probably agree with Andrew. I think kind of splitting the difference between trying to know some diversification, a good amount of diversification, but not necessarily just plugging holes, just to plug holes. I think that would be a danger.

Andrew [00:08:58]:

It's so hard to just provide a framework or just to say this is what the model should be. But do you think there are general rules of thumb when it comes to spreading across sectors?

Dave [00:09:10]:

I think I would probably say that you need to try to find the best companies you can find in the sectors that you can understand. I think most of us with a liberal education, liberal arts education, can have varying degrees of understanding of quite a few industries. We may not have the specifics to understand, maybe the banking industry or the commodity industry, but we can certainly understand retail because we all live in that world. You can certainly understand things like a grocery store, or you can understand construction, or you can understand real estate to a certain extent, because we all have to live in it. I think there's general rules that you can probably understand more sectors than maybe you think you can. But I would also argue that maybe some of the more technical things may be things that may have to be learned if they kind of fall outside of your general rules. What are your thoughts?

Andrew [00:10:08]:

When I was transforming my portfolio in 2020, I guess I was pretty fortunate because there were a lot of sectors that gotten beaten up. But I did look at what was in my portfolio and are there gaps that I can fill? So I guess to contradict what you were saying, it was more in the sense of like, okay, here's four companies and four industries that are good prices, right? The stocks are good prices in all of those industries. So let me identify which one I think is the best. And if there's an industry that I already have a lot of exposure to, maybe even though I think there's stocks that are good there, I'm going to look at these other industries. And so that got me into stuff like insurance and defense and even the whole paychecks thing I feel like was a good thing to have at the time because it helped me buy my time and have a better opportunity to gain conviction on an idea. So I think you could limit your damage by spreading out. But also there is dewarcification. So I don't know.

Andrew [00:11:10]:

It's a tricky one.

Dave [00:11:11]:

It is. It's not really an easy question. And I know you can go online and you can find a list of all the different sectors or assets that you should have. And I know that there's a temptation to just kind of work down the list, so to speak, and that could be dangerous. And that's why I guess I would probably hesitate to say, okay, here are the nine sectors you need to have an investment in, kind of go from there. And I think that's why I like the idea of trying to kind of fish where the fish are, but with the idea of understanding that you don't want to get too concentrated, you don't want to do the Dave and get six companies in the payments industry at the exact wrong time. I think it's better to kind of do what Andrew was doing where you kind of look at your portfolio and go, okay, here's some areas that maybe I don't have filled, but then you can spend the time to try to learn more about them and not just rush in and plug hole B with Company A. Just because I needed an insurance company, I have nothing in that industry and I really need to buy one.

Dave [00:12:22]:

But you don't know the first thing about how to analyze prudential, for example. Then that to me is where you could get dangerous. I mean, of course, you could absolutely get lucky, but I would not encourage somebody to go and buy an insurance company without really understanding what premiums are and how the whole industry works, because if you don't understand that, then it's going to be kind of a tough road to hoe. But

you could argue, too, though, that if you learn about tech companies, you can learn about other things. And if you can learn about insurance, then you can understand the banking industry because they're not that dissimilar. And so those things, the knowledge you get from learning one sector can also carry over to others that you may not necessarily think correlate, but the knowledge will.

Andrew [00:13:05]:

Yeah, great point.

Dave [00:13:06]:

All right, so let's move on to the next question. So this is from Alex. I'm seeing a lot of news about a recession or another air quote, Black Monday, says the Wall Street Journal. What's the best way to write out turbulence like this? Should I sell or hold on for dear life? So, Andrew, what do you thought? Should we sell or should we hold on for dear life?

Andrew [00:13:26]:

Well, what are you doing?

Dave [00:13:28]:

What am I doing? I am holding on for Dear life the way that I try to play these kinds of things. First of all, this has probably been the most anticipated recession, arguably, in history, because they've been talking about it basically since the pandemic, and it hasn't come to pass yet. And it may not. And for sure, it's not a fun thing to ride through at all. But I think the way that I try to think about it is I'm not buying companies to try to time when a recession is going to come or when it's going to go. I'm trying to buy the best businesses that I can that I think are going to produce profits for a long period of time. And sometimes when the tide goes out, it's going to take all the boats down. And that includes a great company like Visa or Berkshire Hathaway.

Dave [00:14:19]:

And unfortunately, it's part of the game. And Warren Buffett and Charlie have talked many times about having 50% or greater drawdowns on Berkshire in the three or four times in the 50 plus years that they've held the company. So it's not out of the question or out of the ordinary that that could happen, but that also gives you an opportunity to buy more of Berkshire at a lower price, which means you'll get a better return when it does return, because when the tide comes back in, it's also going to raise all the boats and the ones that are really performing it's going to raise even more. So that's why I would hold on for dear life and try to find the best investments you can or the best businesses that you can, because those will sustain for a long period of time.

Andrew [00:15:06]:

Amen.

Dave [00:15:08]:

All right. Nothing to add, sir?

Andrew [00:15:10]:

No, that was good.

Dave [00:15:11]:

Okay. All right. We'll do the next one here. So here we go. This is from Monkey Bear. How do you measure your returns accurately? I'm in my accumulation phase and add $400 a month. It seems when in a bear market I beat the SP, but in a bull I lag. I attribute it to the phase that I'm in.

Dave [00:15:29]:

This is a really good question. So, Andrew, what are your thoughts on Monkey Bear's question here?

Andrew [00:15:33]:

I definitely related to this at a lot of different times, and that's one of the problems of being a conservative investor, is this can happen to you where you underperform the market when things are going crazy. And I don't know how to solve that. And it really depends what bull market you're talking about. The way I interpret this question is I wonder if, and I could be wrong because this is a short question. I don't know this person. I wonder if there's too much focus on what your returns are versus the S P when it's just doing you more harm than good. So first I'll answer the question. I use a calculator called DinkyTown Net, and I didn't realize it was as funny of a URL until I had to pull it up.

Andrew [00:16:20]:

But they have an annual rate of return calculator. And what it does is it allows you to add dollar cost averaging when you're calculating an inveStment. So if my account grew by $1,800 because I put $150 a month, that doesn't mean I returned anything. That means I put $150 a month into it. And so that calculator will take your time period into account and it'll take how much you've put in and give you like an accurate return number. And I think Fidelity and some of the other brokers may or may not do that. I can't speak for that, but that's the calculator I use every month. And I'll tell you, it's getting pretty annoying to have to do this every month.

Andrew [00:17:02]:

It's the thing I have to do as part of doing the newsletter. But I really feel like it does more harm than good to have to see those numbers every month because it just swings so much and it doesn't tell me anything. NewsFlash your stocks are going to go up and down. Newsflash. The market is going to go up and down. And so unless you're measuring over multiple years, I don't know if looking at returns every month or every couple of months is doing anything. All it's doing is creating extra anxiety. And maybe that's something I need to outsource.

Andrew [00:17:35]:

I don't know.

Dave [00:17:40]:

That's probably not a bad idea. I think the idea of it kind of goes to watching what your stock does every day. It's kind of the same when you're measuring your performance on a regular basis. Like you were saying, the market is going to go up and down, so are your investments are going to go up and down. And we have seen, I guess over the last three years in particular, we've seen kind of a compression of bull bear markets in a very short amount of time. That is unusual in history. Some of that could be PEC related, that we just have more information faster. And it also could just be kind of the crazy nature of what we've just all gone through a pandemic and then everything after that.

Dave [00:18:27]:

So there's been a lot of craziness over the last three years for sure. And so I would probably argue that that's probably contributed to a compression of these bull and bear markets. And I guess the other thing, too is a lot of times it depends on what your investments are. And I know Toby Carlisle talks about this a lot because he's very much a value investor. He's very much a deep value investor, which means he's really looking for bargains. And he talks a lot about how sometimes the way that he invests doesn't do well for periods of time. And in other periods of time it does great and that kind of ebbs and flows. But he doesn't change his style of investing based on where we are in a market, whether it's a bear market or bull market.

Dave [00:19:17]:

He keeps doing his thing because kind of, to Andrew's point, really, it's not about the month to month, it's what it is at the end. And that's really, I think, probably more important to worry about is where am I going to be at the end? And if you're buying companies that are great companies that I don't know that this is a fact, but a company like a Visa or a Mastercard, for example, they may not do great in bull markets, but they may do great in bear markets. And overall, they may or may not. Different times, they may or may not beat the market, but it doesn't mean it's a bad investment. It just means that over the long time, over a ten year period, if they beat the market, then that's what I'm hoping for and that's what you want to see. But if they only beat it in three out of the ten years, but they still beat it over the ten year period, then you're still winning. So even if you don't do as well over the next seven years, that's a long period to struggle through mentally, for sure. I get that.

Dave [00:20:17]:

But I guess my point is it's more about the end result than it is on the short term result. And like Andrew was saying, it can cause a lot of stress and anxiety if you're trying to measure it on a shorter time, know he has to

do it because of the nature of his newsletter. I don't because I'm not running the newsletter, so I don't have to pay attention to that, and I don't very often. And so every once in a while I'll be curious and I'll try to look it up, but it's not something that I pay a lot of attention to. It's more about the companies I own and making sure that I have the best companies I can and then just kind of worrying about the end result at the end result. I've said this before, we don't get style points for how creative we are. It's more about the end result. And somebody was saying the other day that there's way more 401K millionaires than there are probably other investors that we don't know about.

Dave [00:21:10]:

And those are pretty boring investments. You don't have to be sexy to get to where you want to go. I mean, yeah, it's exciting to invest in all the high flying tech and the shiny new objects, but that isn't always what's going to get you the result. And I think that's probably more important.

Andrew [00:21:24]:

Last thing I'll add, and maybe somebody will find it encouraging. Basically, if you didn't own Nvidia this year, decent chance you underperformed the market. There's a period of time. If you didn't own Tesla, there's a decent chance you underperformed. There's a period of time if you didn't own Netflix or Facebook. And a lot of those stocks have come back to earth where it's not necessarily like they crashed, but they're not fueling the market like they did. So it's very hard, almost impossible, to figure out what's going to be the next flavor of the month, and that can really drive the S and P's return sometimes. So, like Dave was saying, think about it from a business perspective.

Andrew [00:22:04]:

Think about it over the next ten years rather than the next three months.

Dave [00:22:09]:

Yes, exactly. I don't know if this is true or not. I did hear somebody say the other day that if you did not own part of the Magnificent seven over the last year or two, that it would have been impossible to outperform the market just because they drive so much of the returns of the, of, to your point of the Nvidia, which is, I think, a really good point to consider.

Andrew [00:22:32]:

Yeah. And Jerry's still out on what, the future of that, right?

Dave [00:22:36]:

Exactly. Exactly. All right, so let's go ahead and answer the last question that we got today. So this is from Dylan. So he asked the current position on REITs and any advice on Investing in them at the. So, Andrew, I'm going to let you take first serve on this one.

Andrew [00:22:51]:

All right, bring it. Bring it. So I talked on the show recently about my position in Crowncastle. They are a REIT. REIT, standing for Real estate Investment trust, and basically just being a vehicle where a company will buy a lot of pieces of real estate, usually using debt to do so, and using the rent payments from that real estate to pay back the investors. So REITs have been crushed right now, and a lot of it has to do with interest rates. If a REIT has a bunch of debt and it's coming due and they have to refinance, they're refinancing at higher rates, and that's really hurting the final net income from what your investment is. So that's part, and I would say there's probably a lot of calamity across the entire industry.

Andrew [00:23:42]:

And office is getting hit really hard. Certain pockets of commercial are getting hit really hard. A lot of the industry in general is getting hit hard. It's almost like if any stock is a REIT right now, it's been crushed year to date. I mean, -35% -40% is not out of the norm for some of these positions. And so you really have to be careful about the particular company you're looking at. And what are the long term secular tailwinds? Are they there? Are they not? Does the company have enough liquidity to make it through this refinancing struggle? Because the banks aren't lending to some of these players, and so you are seeing a lot of this stuff get washed out. So I would ask if you're looking at a REIT rather than trying to paint it with a broad brush.

Andrew [00:24:34]:

What's the long term viability of this business? What's the short term? Are they going to be able to withstand six more months of this, a year of this? And then from there, is there any reason why somebody else can't come in and steal their lunch? Is there a competitive advantage attached to that? And so I did have a couple of commercial real estate REITs in the past that I sold because I don't know if the moat is as clear as it used to be before Gmail was A thing or Google Maps, but there's a lot of different types of specialty REITs, and some of those can still have moats. So it really depends. It's obviously a terrible time to be holding one of these, but you could argue it could make for a good time to invest, but it's also a very dangerous time if you pick the wrong one. So the range of outcomes here, I think, are very high. There's a lot of great value in the sector, but there's also a lot of value traps. So you have to trade carefully, very carefully.

Dave [00:25:40]:

So if I can ask you a couple of questions kind of along these lines. One of the things that you mentioned was the interest rates, and that they've gone up and they've really hurt REITs in particular. Could you look at past results when interest rates maybe were higher to get an idea of maybe how some of those particular companies have done? Because you could argue that at some point this will, I guess, normalize off of the lows and get back to air, quote normal, whatever that really is. And could that give you some maybe sense of how some of these companies could do in this new rate environment going forward?

Andrew [00:26:22]:

Yeah, I love that idea. I haven't done that yet. That's a pretty good idea. I do remember, I think it was Sam Zell or somebody built a really impressive rate business during a rising rate environment. So it's possible people have done it in the past to build real estate empires even though rates are rising. But, yeah, I think getting historical comparisons is always a good idea.

Dave [00:26:46]:

Okay. And then I guess the last question would be, I know there's a lot of specialty REITs out there. Are there any that you feel like may be ones that maybe people should kind of be cautious of right now, or that maybe they should wait before they decide to buy something in any of those particular sectors?

Andrew [00:27:11]:

I guess, yeah, it's a great question. I mentioned office. I think that can be tricky. And I think malls can be a little bit tricky, too. I almost would just kind of think, make it stupid. Simple is the type of real estate, is There going to be more of it, or is there going to be less of it? And I wonder if that's a decent framework to do. Like, when I look at malls, there's some that I can see the future of. Some of these outdoor places are really cool and people are going there, but then there's other malls that are just dead and dying and not nearly as popular as they appeared in stranger Things.

Andrew [00:27:51]:

Maybe that can be a simple check. Just, is there going to be more? Is there going to be less? Look at offices, right? Are there going to be more people in offices or less? Well, a lot of people are working hybrid now or remote, fully remote. So that's tough. It's tough to work through that. Not to say that there won't be winners in that, but that your ODs might be lower looking in that space.

Dave [00:28:15]:

I guess the last question for anybody interested in investing in REITs, maybe, what are some things that you should look out for or consider when investing in REITs that maybe you normally wouldn't think of?

Andrew [00:28:33]:

That's a good question. I just wonder if balance sheet. Looking at a balance sheet is a lot more important than looking at a balance sheet of a different stock. Not to say balance sheets aren't important when you're looking at any stock, but I think it's easier to ignore the balance sheet of a consumer products business than it is a REIT business. So I would look for that. And then also, you're really making me think here, I like it. I don't know. I would just look for nuggets of information that you think could be helpful.

Andrew [00:29:06]:

So one of the things I like to look at is you can look at how things are contractually set up, so you can kind of see a runway of how much money a lot of these REITs are owed. Because if I sign up with a landlord, I'm promising to pay them however many millions for however many years as a business. And so a lot of the REITs will report that information, and you can do a compare contrast. And so with Crowncastle in particular, I could be wrong, but I feel like they have more control over the properties and over the next three to five

years than some of their peers. So that makes me think they'll take market share, but it doesn't mean that that's necessarily what's going to happen. And so I think you can use that framework with a lot of different types of REITs to just try to come up with pieces of information that tells you, okay, this REIT has a lot of trouble coming up, or this REIT has great runway coming up, and try to use that along with your other observations of the industry to think about if this is going to be a good investment or not.

Dave [00:30:18]:

Yeah, it's a good answer. Those are very good answers. And I think would you say that investing in REITs would be something that people should consider now, even though the interest rate environment is rising and in likelihood, I think the expectation is that when you invest in something, you see a return right away. And I wonder if REITs may offer a little more delayed gratification in the next couple of years before you start to see some bettering improvements in that industry.

Andrew [00:30:52]:

Yeah, I think that's a spectacular way to think about it because it doesn't appear to be getting brighter anytime in the horizon. And so you're going to get a lot of volatility anytime you buy into that fear. That's a good way to look at it. At least with a REIT, you're getting paid a pretty high dividend. So that's some small Band aid for the pain you might feel on it, right? But if you think about the long term of it, most of this real estate we're talking about, it's going to be used, or Crown Castle people are going to use their phones. We can't function without cell service. These things are going to be used. So at a certain point, the cycle is going to play through.

Andrew [00:31:31]:

The weaker players are going to get washed out, and sometimes that's how the stronger get even stronger. And so if you can have the fortitude to buy when there's blood in the streets, it can be really good. But again, be careful that you're not buying into a secular downtrend.

Dave [00:31:45]:

Perfect. I think that's the perfect place to wrap up.

Andrew [00:31:48]:

All right, so with that, we will.

Dave [00:31:51]:

Go ahead and wrap up our show for this week. Don't forget to subscribe to the show on your preferred podcast app. If you enjoyed our little show, if you would kindly consider giving us a review like the ones we got today from Spotify greatly helps our show. And don't forget to browse the incredible materials we've created for you@envestingforbeganners.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. Do not delay. And with that, we will go ahead and sign us off you guys go out there and invest with the margin of safety.

Dave [00:32:23]:

Emphasis on the safety. Have a great week, and we'll talk to you all next week.

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