IFB324: The Art of Portfolio Diversification and Stock Picking Frequency

Dave [00:00:00]:

All right, folks, welcome to Investing for Beginners podcast. Today we have episode 324. Today we're going to answer three great listener questions. So without any further ado, let's dive on in. So here we go. Old people problems. Lol. I'm 47 and just starting.

Dave [00:00:17]:

Would you be doing what you're doing if you were my age? I'm wanting to put at least $100 a week in the market, but sometimes I have a little extra money. Oct hope or November. I put $2,000 each month. I've bought Apple, Microsoft, Amazon, Google, TSM, Taiwan, semiconductor, Dick's sporting goods, Shopify and draftkings so far. I've decided just recently to follow your plan, but I'm not sure what I should do. Should I be getting as much money as possible into the market? Does it really matter if you put the same amount in every month? Any help would be greatly appreciated. Thank you. So Andrew, this is a great question and yeah, old people problems.

Dave [00:00:53]:

That's kind of comical. So what are your thoughts on this great question.

Andrew [00:00:56]:

Well, would you be doing what you're doing at his age?

Dave [00:00:59]:

Would I be doing it? Yes, I would be doing be. The more money that you can put in, the better because the faster the pile grows, the faster it can compound. And so the faster you could go, the better. I've seen studies where they show how much at certain ages, if you want to reach a certain amount, you have to put a certain amount in. I don't have those figures in front of me, but I know that if you want to reach a million dollars and you start at a certain age every decade that you get closer to the time you want to quit, you have to put more in. So kind of understanding that the more that you have available to do it, the better it's going to be. And following the plan, I think is the best way to do it. The companies that Andrew is picking every month are fantastic businesses that have long runways of growth.

Dave [00:01:49]:

And depending on where you are in your lifecycle, if you will, they can be fantastic investments. We've talked about before. We got this great idea from Laura Adams that depending on whether you're in accumulation phase or whether you're in the. What was the other phase? I'm sorry?

Andrew [00:02:06]:

Harvesting.

Dave [00:02:07]:

Harvesting. Thank you. Yeah. Old person brain. Whether you're in the harvesting phase, it really goes to where and how you want to invest. But bottom line is the more money you can put in, it really does matter and the faster you can put money in and it can build up and it compound because you're putting it to work in the market and all these great companies like they have already bought to do all the heavy lifting.

Andrew [00:02:31]:

Yeah, 100%. I wonder if people think they need more than they do. I feel like Social Security doesn't get talked about a lot when you talk about personal finance or investing, but that's there. You can pay off your mortgage. You might not need as much money as you think. So whatever you're putting in now, it doesn't need to become $10 million or anything like that. You could probably make do with less.

Dave [00:02:57]:

Yeah, for sure. That's a great point. It really depends on what you hope and what you expect for your lifestyle to be once you retire. If you hope to travel a lot, then obviously more money is needed. But if you are planning on sitting by a beach, buying a place, sitting by the beach and drinking pina coladas for the rest of your life, that requires a different amount of money. Or if you live in the mountains and you want to stay in the mountains and just enjoy beauty and read books, that requires even less money. It really depends on what kind of lifestyle you want to live and how you want to live. And yeah, the whole Social Security idea, too is depending on your income and when you retire, that can take up up to a quarter of your post retirement income that a lot of people, I guess, not necessarily plan on, but it isn't discussed as much.

Dave [00:03:49]:

I'm sure it is more so in retirement planning, but in the earlier stages of your life, most people don't consider it much.

Andrew [00:03:55]:

Yeah, I know I didn't.

Dave [00:03:58]:

No.

Andrew [00:03:58]:

Do you have thoughts on the second part of the question? Looks like he's trying to debate between putting in the same amount every month versus putting as much as possible. Does it really matter?

Dave [00:04:09]:

It does matter. And I would put in as much as you can put in, allowing for whatever your lifestyle is and what other situations you have with your personal finance, whether you have enough for your emergency fund or any other things that you want to fund. But I think at the very least, decide what a minimum is that you can put in and make sure that you put that in every month. And then if you can do more, then, yeah, that's great. I would definitely do more. And again, like I said, the more that you put in, the faster it's going to grow that mountain, which can compound for you, which is the benefit.

Andrew [00:04:47]:

Yeah, I'm going to assume that the question here is talking about putting in new money and not talking about putting in a big chunk of life savings. I know someone like my wife, when I first met her, she had a big pile of savings and wanting to figure out how much to put in there. So I think the conversation is different depending on what you mean by piling as much money as you can. But if you're talking about new money, I like the idea of doing the same amount every month because it gives you that consistency. It's almost like if you were trying to weight train, are you going to do 10 hours in one day and think that that covers you for the month versus doing a more steady amount every day or five times a week or whatever it is over a month's time? You'll probably make more progress by doing something a little more sustainable. So I would caution against this mindset that I'm just going to put as much as I can because there's a chance that that makes less of an impact. But if you already have that foundation down, like Dave said, where you already have this habit set up, you already have money coming in, you've set a minimum amount that you know you're going to invest. I mean, I don't see a problem with you got a bonus or you're on commission or whatever and you're piling money in.

Andrew [00:06:00]:
Yeah, no brainer, right?

Dave [00:06:03]:
Exactly. Can we kind of unpack something a little bit here, too, that I was kind of noticing as I was kind of looking through the question? So they're putting in $100 a week into the market. So I guess, operationally or strategically, how would you think about if you were adding money, like, you and I are doing it once a month? So if you were doing it once a week, how would you kind of try to approach that as far as, like, what kinds of things do I put it in? This is a different kind of dollar cost averaging. And so how would you think about strategically, maybe how would you allocate to that money? Would you try to stress about trying to find a new idea every week? So 52 ideas a year, that's daunting to me. That makes my heart race a little bit thinking about that. So what are your thoughts about? How would you try to allocate that?

Andrew [00:06:53]:
Yeah, I mean, I'm in the camp of doing once a month, obviously. It's interesting because we had a question very similar to this in value spotlight, which is premium service. We offer basically around the same idea, like, why not put more in when a stock that you're looking at is cheaper? And I just kind of go back to this idea that I don't really know what the market is going to do. Even though I might like to trick myself into thinking I know I really don't. And so, for me, one month is a good amount of time to survey the landscape with a fresh canvas every month, and then take time within that period to see what looks interesting, and then also give myself space to do more research, go deep, make a hypothesis, test that hypothesis, retest all the hypothesis to have that kind of a space there. So, I'm with you. Like, trying to make a stock pick as a stock picker once a week for 52 days in a week would be daunting. But there is also a possibility if you're just building a portfolio for the very first time, and maybe you don't care about driving the most optimal return as you can, and maybe you just want to be more diversified quicker, then okay, I can see that.

Andrew [00:08:07]:

But for someone like me, a stock picker, trying to optimize my returns as much as I can, I found once a month to be a good balancing point for me to be able to make good decisions with my money and still find good companies and good stocks at good prices.

Dave [00:08:24]:

Yeah.

Andrew [00:08:24]:

What about you?

Dave [00:08:25]:

I would do the same thing. I think the idea of trying to build up diversification quicker, obviously, is something that would be appealing. But I think, knowing myself, that the anxiety that would cause for me to have to think about trying to buy something new or add new money every single week, trying to decide, do I buy Apple or do I buy Amazon, would cause me a lot of anxiety throughout the week. I kind of like your idea of giving yourself a little bit of grace to figure out what's going to be the best bet. It doesn't mean that I would probably still put $100 a week into my brokerage account. And then when I'm ready to pull the trigger, then the funds are there. And once I make my decision, then I can pull the trigger and do what I want to do. And I think that's awesome.

Dave [00:09:14]:

But I think the idea of trying to pick something individual, even if it's something that's already in my portfolio, would still cause me some anxiety. Because to your point, is this the optimal pick? Is it better to pick this versus this? And should I put new money into a new company, or should I put it into something I already, you know, just the whole back and forth? I think, for me personally, would be too anxiety driven to execute on a regular basis. And I think doing it once a month would work better for me. I know a lot of investors. Our friend Braden Dennis, I know that's what he does. I think it's like the first Wednesday of every month, regardless of what day it falls on. I think that's when he invests and that's just what works for him ultimately. I think you need to find what works best for you.

Dave [00:09:57]:

The idea doesn't drive you crazy and doesn't drive up your stress or anxiety level, and you can invest once a week, then more power to you. I think it also would probably depend a little bit on what you're trying to do. If I'm buying an S and P 500 index or an ETF, that's a bit of a different game than if you're trying to pick individual stocks. So I think that has some bearing on it, too. But if I was going to be picking individual stocks, I would want to do it once a month.

Andrew [00:10:24]:

So what do you think of his list? I don't know if it's a he or a she, but what do you think of this list?

Dave [00:10:28]:

It's pretty awesome. Frankly, they probably killed me this year. What is it? 1234 of the magnificent seven companies in that list. And TSM is maybe not on the list, but probably pushing the boundaries on being on the list. And then they know the other three are fantastic businesses as well. So, yeah, it's a great list. That's a fantastic start, for sure.

Andrew [00:10:51]:

Yeah, I like the mix of a couple really fast growers in there and a good number of stable, cash flowing businesses. That's inspiring to me to see somebody who's saying they're just beginning to have a portfolio like this. I think it's cool.

Dave [00:11:05]:

Yeah. There's a lot of free cash flow generation in all those companies, so that's impressive.

Andrew [00:11:09]:

Well, maybe not all, but most.

Dave [00:11:11]:

Well, maybe not all, but most. All right, so let's move on to the next question. So we got Andrew and Dave in mid 2023, a fidelity manager contacted me post job change. His task ensures satisfaction with my fidelity held funds. Four hundred and one k. Four hundred and one a ira. Despite knowing my FIA version, he pitched a high cost fund. This spurred my self education in investing, leading me to your podcast.

Dave [00:11:37]:

I've been an avid listener since late summer, absorbing knowledge during workouts, chores, and in the car, driving my kids around. Turns out eleven year olds, girls are not your target demographic. No kidding. Xit at

Lehman Brothers. I'm an engineer with a knack for numbers investing since day one of my career into my four and 101K. Bravo. All right, so here are some questions he has. So this is from Rob.

Dave [00:11:59]:

So questions beyond familiarization. Does VTI or the value trap indicator, offer more than analyzing current holdings. For a stock from company a held over a year, converted to company b's after acquisition. Would selling now incur long short term capital gains tax? So, Andrew, what are your thoughts on Rob's great question here about the capital gains tax?

Andrew [00:12:22]:

Well, depends on what you're talking about for an acquisition. So, for example, Microsoft recently acquired Activision Blizzard, and that was an all cash deal, which means if you held shares in Activision, Microsoft was going to pay you. I don't remember what the number was. Let's say it was $60 or $80 a share. They were going to pay all the shareholders out for that. So if you were an Activision shareholder at the time of acquisition, you got cash in exchange for your shares, whatever your capital gains would have been on that. The way I look at it is the same as if you were to buy and sell a stock and you had profits in that. When you have something that's more of an all stock transaction.

Andrew [00:13:12]:

I did deal with it once. One of my energy holdings from 2020, Parsley Energy, I remember they got bought out in an all stock transaction. So basically, your shares convert from whatever the old company was to the company that's acquiring them. You're going to pay out of new shares depending on what that is. But that's going to be different because it doesn't necessarily trigger a tax event unless you're selling the shares after you receive them. So you could kind of defer your taxes, if you will, by just hanging on to those shares. If you receive shares, if you're receiving cash for your shares because of the acquisition, then you have to pay tax on that. That's the way I understand as a non tax professional.

Andrew [00:13:53]:

But an investor who pays attention to taxes, that's how I understand it.

Dave [00:13:56]:

Right. So can you maybe explain for people that out there that don't understand what capital gains are and how they're currently taxed?

Andrew [00:14:04]:

Yeah, for sure. So if I were to buy a stock and it's at $100 and it goes up to 150 and I sell, I'm going to owe capital gains on that because I made a gain and it went from 100 to 150. So that's $50 of capital gains. You're only taxed on that gain, on the capital gain. And the tax rate on that depends on if you've held the stock for less than a year or over 365 days. So those are two different tax brackets. Now that can change. The percentages can change.

Andrew [00:14:35]:

They have changed depending on the administration, the politicians. But in general, if you have a long term capital gain, your rate is going to be a lot lower. That's how it's been historically. And if you have capital losses, you can use those to offset some capital gains, but there's a limit to that too. So if you're speculating in options like I did a few years ago, and you rack up some losses, then you can use that to offset your gains. But there is a cap on how much you can do that. So you can google around or talk to a tax professional to figure out what that is. Depending on what year you're listening to this in.

Dave [00:15:12]:

I'm going to ask the dumb question. Does it matter what kind of account you hold the companies in? Like for example, if you have a Roth IRA versus a traditional or even versus a brokerage account, do capital gains, does that matter regardless of the account?

Andrew [00:15:28]:

Yes, it does.

Dave [00:15:29]:

Okay.

Andrew [00:15:30]:

So if you have a tax deferred, it's going to be different. Right now I'm just kind of talking on a taxable brokerage basis, something like a Roth IRA where your gains are tax free. You paid the taxes upfront. That would not count towards capital gains, capital losses for you. But for a traditional IRA, your broker should send you something that would tell you if you have capital gains that you need to put in your taxes. I haven't had a traditional IRA in a while.

Dave [00:15:54]:

Yeah, me either.

Andrew [00:15:55]:

It's been so long. But I do have a Roth IRa and I know that those capital gains do not go towards my taxes every year.

Dave [00:16:03]:

Okay. All right. Good to know. Yeah.

Andrew [00:16:05]:

I mean, if you're a beginner, and that sounds really all complex, your broker, if you have a good one, will send you the forms or tell you where you can access them. And those usually lay out what your capital gains and capital losses were for the year. So it becomes really simple to take that information and put it into turbotax or give it to an accountant to deal with. So I wouldn't worry too much about it. But it is good to think about how are we going to deal with long term capital gains? I mean, it's not the reason why I suggest not buying and selling like a day trader. But that is one big drawback to trying to go into day trading, is you do have to pay capital gains every time you have a gain. And if you don't have enough losses, that can start to build up. So you lose or you lose, right?

Dave [00:16:51]:

Do you want losses to offset your.

Andrew [00:16:53]:

Capital gains or do you want to pay a bunch of capital gains over and over again. It really restricts and slows down your compounding.

Dave [00:17:02]:

It probably is worthwhile for us to say that if you have any questions at all about this in relation to your portfolio and taxes, talk to an accountant, talk to a professional, get some professional advice. Andrew and I are not tax professionals, so these are things that we've experienced in our personal portfolios. But there are going to be a million different situations. And so something may come up that we just aren't familiar with. And so I think it would be behoove people to consider, if you have questions about this, to talk to somebody on a professional level, even just to just get some advice or guidance, whether or not they do your taxes or not, could be very helpful.

Andrew [00:17:40]:

Is that something you do?

Dave [00:17:41]:

That's what I do. If I have any questions at all, I'm talking to an accountant. I don't want to make a mistake and end up owing lots and lots of money because that's not a fun place to be in.

Andrew [00:17:50]:

Do you have advice for somebody who maybe wants a good accountant and doesn't know where to start?

Dave [00:17:55]:

Oh, yeah, that's a good question. The way that I have done it in the past was talking to family and friends, trying to find somebody that they recommended. And then, like lawyers and like financial advisors, you can sit down with an accountant and talk through. Most of them will give an hour of their time to sit down and talk about your situation and see if it's something that they can help you with. And in some cases, you can just pay them for a one time consulting fee to give you some guidance and some help. There's lots of, you can go online, of course, but I like to work with family or friends or people that I've worked with in the business world to get advice from them on people that they recommend, because I think that's a great way to go because you can find somebody that you can trust and that has some sort of track record that you can kind of rely on, that they're not going to be either not knowledgeable or not be able to help you in that particular situation.

Andrew [00:18:59]:

What about mean, I have an account I use for business, but that's good advice.

Dave [00:19:05]:

All right, so let's move on to Rob has a second question here. So this is a fun one. So as a novice in crafting buy sell checklist, what tips can you share? Oh, so many. Yeah. You want to take first dab?

Andrew [00:19:21]:

No, I'm going to hand the knife to you.

Dave [00:19:23]:

Okay. All right. So I came across this tweet the other day that I think really kind of helps drive the thought on starting a checklist. And even if you answer these five questions, it'll really get you a long ways down the path of really understanding what it is you're potentially looking to buy. And so kind of the whole idea revolves around this big rule, and that's understand the business. What do they do? And so these questions are, how do you make money? How do they make money? What does their product solve? What are the main costs of the business, customers and competitors? And if you can answer those five questions, you can go a long ways towards really understanding what it is that Amazon does. What are the costs of them doing what they do? How do they make money? What is the product or products that they offer to customers, and how does that benefit the know? You can create an app and you can create a product and put it online, but does that solve somebody's problem? And so something like Amazon prime, what does that solve for people? And what does their e commerce website, what does that solve for people? How does that help people make their lives better? And so if you can start answering those questions, then it really goes to the heart of what it is they do. And then when you start diving into the numbers, then I feel like it starts to make a lot more sense, because when you understand how Amazon makes money and you see that they make money from all these different products and services that they offer, it could be a little confusing and it could be a little overwhelming if you just kind of look at the numbers.

Dave [00:21:11]:

But once you understand what it is that they do to make money and how that benefits us and what it costs them to do those things, I think it becomes a lot more clear and it helps you understand the business. Now, if you go into Amazon is not an easy business to understand, but it's a little more straightforward. But if you go into something like crowdstrike, which is in the cloud security business, the technology behind all that blows me away. I start reading some of the stuff that they're talking about, and my eyes gloss over because I don't fully understand it. But their basic business is a subscription business. People are paying a monthly fee to get cloud security, and they have different levels and they have different products that they offer. But the basic function of the business, it's not that dissimilar to Netflix, where you're paying for a subscription and you're paying for the ability to every month you pay a little bit, and you know that they're going to cover your cloud security. And so without understanding the heck behind it all, the code that they have to write to do what they do, you can basically understand what it is that they do to make know.

Dave [00:22:25]:

And then if you simplify it even more, if you look at a business like McDonald's, it's a restaurant, it's a drive through restaurant. People understand what it is that they do and it makes it easier. So if you can answer all those questions, I think it goes a long ways towards really familiarizing yourself with a business. And if you can't do that, you got to move it to the too hard pile and move on. But that's kind of where I like to start. What about you, sir?

Andrew [00:22:49]:

Well, I want to ask you a question on that. So you mean that you have to have a circle of competence then, to do some of this?

Dave [00:22:55]:

Some of it, yes.

Andrew [00:22:57]:

That sounds a little discouraging for somebody.

Dave [00:23:01]:

I think you have to have a circle of competence. You have to have a range of things that you can understand. And even though you may not understand some of the technology of things like the cloud or AI, it doesn't mean that you can't understand other parts of the business or maybe understand how it is that they make money. And so your circle of competence may be a little bit bigger than you think it is. Let's say you work in retail. There's a lot of aspects of retail that you can really understand. There's marketing, there's payments, there's website design, there's retailing and inventory and distribution. So there's lots of different things that are associated with being a retailer that you may not understand intimately the distribution part of the model, but it should be a little more familiar with you because you've worked in the retail industry and you understand that people bring you stuff that you stock and then you sell and how all that plays in together.

Dave [00:24:07]:

So I think people's circle of competence can be a little wider than they think it may be if they kind of think a little bit outside of the edges of what they're looking at. And there are going to be things you just aren't going to understand. That's okay. Me, for example, commodities, I understand the surface level of it. But if I want to try into dive into the nitty gritty of oil and oil futures or copper and copper futures and things of that nature, it goes right over my head. And it's just not something I'm comfortable really diving into.

Andrew [00:24:38]:

What makes you more comfortable in diving into something like cloud security versus something like commodities?

Dave [00:24:44]:

Some of it is an interest level that will certainly drive. It's something I'm interested in. It's something I think I find intriguing. So that helps breed a little more, I guess, encouragement, that it's something I want to learn. And then I think for me too, it also kind of comes into just the knowledge. I've read a lot of ten k's of companies in that sector, and so I've familiarized myself, at least to a certain extent, with the terminology and I've read a lot of blog posts and really tried to, I guess, widen my circle of competence around those kinds of companies where, frankly, I've looked at oil futures, for example, and it wasn't something that super interested in me. And then the more I read about it, the more I'm like, yeah, no, I don't want to. At this point in my career.

Dave [00:25:36]:

It's not something that appeals to me.

Andrew [00:25:38]:

I guess the skeptic would argue, like, what if you don't have that exposure and you end up missing that train? And then what does that do for your relative returns?

Dave [00:25:50]:

You miss the train. We can't swing at every pitch. I was watching Professor Oswald the Motor and was interviewed with Scott Galloway the other day, and he was talking about Nvidia. And so Nvidia is one of the hottest companies in the market and I don't have numbers in front of me, but it's up 100% or more this year. Something stupid. I mean, it's just crazy numbers. And it would be real easy to fall into the fomo of, like, I missed out, I missed out. There's just no way.

Dave [00:26:16]:

We don't know what the long term returns are going to be for Nvidia, but I guarantee they aren't going to be 100%. So there is that. You can make money in lots and lots of different ways, and it doesn't mean that you won't have an opportunity to buy Nvidia at some point in the future. If something happens and the stock crashes back to earth and you still think it's a great business, you could still participate in that company at a future point if the opportunity presents itself. But there are lots and lots and lots of other opportunities. Mr. Market's going to show up every day with a different opportunity. And you do not have to swing at every pitch.

Dave [00:26:51]:

You don't have to buy Nvidia to be successful in the stock market. You don't have to buy ExxonMobil when oil is $120 a barrel. You don't have to buy Amazon when it's an IPo. There's lots of different ways to win, and you don't have to swing at every pitch.

Andrew [00:27:09]:

That's very well said. It's great advice.

Dave [00:27:12]:

So what are your thoughts on kind of crafting a buy and sell checklist?

Andrew [00:27:17]:

I think everything you said is good. I struggle to talk about my checklist because I've been, I guess, honing it for such a long time that I think looking at the checklist per se would maybe be a little overwhelming. But the way my newsletter is structured now, it almost has become a checklist without me trying to make it into a checklist. And so I'm looking at surface level things like in general, what's their pe or price to earnings ratio? So is this thing generally cheap or generally expensive? So I'm looking at that. I'm looking at how big is it? Is it 2 trillion in market cap or is it 200 million in market cap? And then I'm also looking at, does it pay a dividend? How long has it been paying a dividend? Is it growing? But it could go as deep as what's their interest coverage ratio? What's the interest they're paying on their debt, and how does that compare to their profits? What's their net debt to EBITDA? So I think numbers are very important to have. And then I also think equally important is thinking about the business and the industry dynamics with the business. What makes this business different from all its other competitors? And why couldn't I or Mark Cuban or Warren Buffett create their own business and compete and copy what you're doing? What's going to stop somebody from doing that? Because a bunch of people are going to try. If it's a business that's very successful and growing very fast, people are going to copy it.

Andrew [00:28:42]:

And so there needs to be a reason why this business can defend against that competition. And that's where the moat comes in, and that's where the basics of the business come in. It's like you can get endlessly complex with it, but then at the same time, you have to draw yourself back and go back to the basics and say, to your point, what are we selling? Why are people buying them? And why are people buying them from us instead of from somebody else?

Dave [00:29:09]:

That's fantastic. And I think one thing I think maybe we could talk a little bit about is I find that the checklist that I have and that I've been using is kind of a living, breathing document. It changes the more that I learn, the more that I adjust things or certain things become more important than maybe they were two years ago. And I think that people think that it's a checklist, it's a static thing, but it's not really because to your point, trying to determine what makes this business better than this business and what the mode is for this company versus this company, some of those things can change depending on the industry and depending on the particular company. And so I think you have to have some flexibility in there. What are your thoughts on that?

Andrew [00:29:51]:

I agree. And then I also agree to disagree. So it depends on what side you want to hear.

Dave [00:29:56]:

Right.

Andrew [00:29:56]:

I struggled for a long time about my checklist and even having a checklist for that exact reason because it was constantly changing the way I do it now, which doesn't mean it's the right way for everybody. But I basically start, and because I'm writing it, it really helps me to know my stuff and really think and double think and triple think about how do I feel about the business. Right. I basically start with what makes this business exciting and then what's their competitive advantage, and then trying to summarize the competitive advantage into a mental model that I could apply across different types of businesses. So as an example, the most recent one I did for December was a buyback machine mental model. And that's why I like this stock. And I've used that with other stocks, maybe didn't call it that, but that's essentially what I was doing. And then looking at risks, I think is always important no matter which business you're looking at.

Andrew [00:30:53]:

And then I'm looking at management and analyzing them, and then I have some numbers that I've followed. So I feel like I've gotten to a place now where my checklist feels pretty solid. And I don't think there's much that needs to change. But to your point, the way I'm going to hit on every aspect of that checklist is going to look different for every company because like you said, every company is different, every business model is different, every industry is different. But all companies have to face competition. They all have to have a CEO or two ceos, and they all are going to have risks. And if you're not honest with yourself that there are risks in an investment, then you probably don't know enough about the investment.

Dave [00:31:33]:

Yeah, for sure. Those are all great, fantastic points.

Andrew [00:31:37]:

Do you have thoughts on the sell side, like making a checklist for selling?

Dave [00:31:42]:

Yeah. To me it's a lot shorter, but it really boils down to has anything fundamentally changed with a business? And if it has, then I really need to dig into why and how I think that's going to impact the business going forward. I don't necessarily have a hard rule on, let's say, for example, gross margin has dropped from 45% to 42%. To me, that's not a reason to sell the company. To me, it's more the overall picture of what you're seeing from the company. If they've changed what they're doing, if management has changed, if what they sell is just not in favor anymore, and you're seeing a long term, gradual decline in the performance of the business, then I think those things to me are signals that maybe it's time to get out, because not necessarily would be a bad investment going forward, but it may not get the returns that I want, and so I could use that capital in a better place. What about you?

Andrew [00:32:44]:

I love the way you said that at the end, not that this isn't going to be a good investment, but that it's not going to get the returns that I'm looking for. And I think that's so key, because sometimes that's the argument for hanging on to a stock, right? Is like, I had to get rid of Cisco, and that was super painful for me because I've held that stock since 2015 or something, and they're growing and they're profitable, and they're in the IT space, which is not going away. So by selling it, am I saying that the stocks or this is a bad business?

Dave [00:33:21]:

Not at all, no.

Andrew [00:33:22]:

Sometimes it is, because you have better opportunities and you need to exploit those. But at the same time, if you're doing that every single month, you're going to drive yourself crazy because you think the grass is always greener and you're always jumping ship. So there's definitely a balancing act to that. But I like that idea a lot, and that's probably the mental model I've used the most. When it has come to, am I going to sell a stock? Has something with this business fundamentally changed? And I guess because I brought Cisco up, I can talk about them. And for them, it's not really even been a fundamental change per se. It's just been more like a slow, the way I've perceived it, as a slow decay in their competitive position, to the point where when there was finally a catalyst, which was, okay, orders are down, new orders are down, double digits, I'm like, okay, this is enough for me. So obviously, we could all answer that question a little bit differently.

Andrew [00:34:21]:

But I think being careful about pulling the trigger on when you sell a stock will help you go a long way, because you're not going to get rich buying and selling. You're going to get rich buying and holding. And really, you should be selling only because you think there's better places for your money and you don't think that this business is going to get you where you're trying to go.

Dave [00:34:43]:

Right.

Andrew [00:34:43]:

Some people would be happy with 5% a year, but I'm looking for a little bit more.

Dave [00:34:48]:

Right? Yeah, exactly. No, I think those are great ways to frame the idea of checklists. And the thing about Checklists is they don't probably get talked about as maybe as much as they should. But a lot of the best investors all have them. Some have really detailed, very long, organized, very thoughtful, thorough ones, and other ones have shorter checklists. And I think, really, I would encourage you, if you don't have one, is to start creating one. And the reason why you want to have a checklist is kind of twofold. Number one, you want to have a standardized or a set of things that you're looking for in almost all businesses, and you want to also have a way to say no quickly and so you can move on to another company, because there's nothing worse than spending a lot of time on a company.

Dave [00:35:40]:

You end up not buying it. It's not wasted time, but if you do that a lot, you can start to drive yourself crazy. And so I think having a checklist, and it also helps solidify your thoughts about a business, and it can act as a reference point when you're trying to decide have the fundamentals changed, you can look back at your checklist and go, okay, it had this, this and this and this. Now these have changed. And so that can help act as a reference point because we all think we have great memories, but we don't. So the things that we think really did happen don't always happen the way we thought they did. And that's what checklists can help, I guess, provide clarity and guidance for.

Andrew [00:36:20]:

I don't have a good memory.

Dave [00:36:23]:

Yeah.

Andrew [00:36:26]:

I'll give you a little secret, though. Just beat this horse one more time. For a lot of stocks I look at these days, I like to start at the risk factors, because you can find a million things of people talking positively about a company. I mean, most companies grow, right? So it's easy to find an optimistic viewpoint on a company. But if you start at the risk factors, where their lawyers are forcing them to disclose things that people might not want to know about the business, you can get to know a lot faster, and that helps you sift through more businesses. And I think that can help your results. If you're digging more, oftentimes you can find more treasure.

Dave [00:37:06]:

Right.

Andrew [00:37:07]:

So if you can save time doing that, I've found that to be useful lately.

Dave [00:37:10]:

Yeah, that's a great tip. Fantastic tip. It kind of goes to Charlie's idea of inverting. I think you're kind of looking know, like you said, everybody and a brother can talk about the positives of Amazon, but how many people can really talk about the risks? And that's really when you're investing, it's not all about the upside. It's also about protecting yourself against the downside. And if you don't understand the risks of investing in a company like Amazon, then if something comes along that does not go the way you planned, you could really be blindsided.

Andrew [00:37:40]:

Yeah. And then to your point, you might get returns that are like a couple of percent a year instead of 12% a year, right?

Dave [00:37:49]:

Yeah, exactly. I'm going to put in the show notes, a few references, or a few links to potential, to different checklists that we've come across through the years. There's lots of great investors that Charlie Munger had some checklists. Monish Pabrai has some checklists online. Phil Fisher has some checklists online. Brian Feraldi has. I know he has a big checklist. I wrote a blog post about a checklist that I created years ago.

Dave [00:38:16]:

There's the checklist manifesto. So there's lots of resources out there, but I'll put them in the show notes, so they're all there for everybody so that you can find the things. And a great practice would be to take all of those and find the ones that are going to work best for you and then just kind of create one amalgamation from all those. I mean, you just take those four or five investors, and you're going to get a really good start on a good checklist for sure. Yeah.

Andrew [00:38:40]:

Well said.

Dave [00:38:41]:

All right. Well, with that, we will go ahead and wrap up our conversation for today. I wanted to thank everybody for taking the time to send us those fantastic questions. Please keep them coming. If you do have questions you'd like us to answer on the air, please send them to Newsletter@envestingforbeganners.com and then we will go ahead and read them on the air, and you can get your answer, any of your burning questions answered. So without any further ado, I'll go ahead and sign us off. You guys go out there and invest with the margin of safety. Emphasis on the safety.

Dave [00:39:08]:

Have a great week, and we'll talk to you all next week. Bye.

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