IFB334: Finding Investing Inspiration - Analyzing the Top Companies of the Year, Year After Year

Dave [00:00:00]:

All right, folks, welcome to Investing for Beginners podcast. Today we have episode 334. Today we are going to talk about draft classes. No, I don't mean football. No, I don't mean basketball. We're going to talk about the five or six best performing companies in a year and kind of talk about these particular draft classes of companies and see how they did, maybe, maybe talk through some ideas of how they did recency bias, how some of those things play into. There's a million different ways we're going. So without any further ado, let's just go ahead and dive into probably the draft classes, and then maybe at the end we can rank which draft class we think was the best.

Dave [00:00:40]:

Which one would you invest in? So we got 2016, and the companies in here are Nvidia, Amazon, bank of America, Google, Facebook, Meta, and Broadcom. So, Andrew, what are your thoughts on our first draft class?

Andrew [00:00:57]:

Obviously, the big winner in there is Nvidia. And it's interesting to me that bank of America is in there because I would not have thought of a boring bank stock to be one of the better performers of the year. That just would not have crossed my mind.

Dave [00:01:13]:

No, me either. I'm a little surprised by Broadcom. I know that they've been a strong company for a long time, but there must have been something going on with them that led them to kind of jump into this draft class, because I don't think of them, maybe wrongly, I don't think of them as one of the stronger semiconductor plays, if you will. So I guess I'm a little surprised to see them in the list.

Andrew [00:01:37]:

They were doing serial acquiring before it was a trendy.

Dave [00:01:42]:

Okay. Is that kind of their business model is to go out and buy other semiconductors companies or adjacencies, if you will.

Andrew [00:01:49]:

It was for a while, especially during that time.

Dave [00:01:53]:

Okay, that makes a lot of sense. All right, well, let's move on to the next draft class. So this is 2017 again, Nvidia, AMD AlGn. I'm not familiar with that ticker.

Andrew [00:02:06]:

That's called align.

Dave [00:02:08]:

Align.

Andrew [00:02:08]:

Okay.

Dave [00:02:09]:

Boeing, Micron, and win. This is an unusual mix, for sure.

Andrew [00:02:15]:

Yeah, it is. And if you take the performance of these stocks and extrapolate it forward, ND and AMD were awesome, but these other ones were not great. Microns, come back. But if you bought align tech or Boeing, especially Boeing and all the trouble they've had in the news lately, or if you bought win win, no matter what, all of those have not done well. And so that's kind of interesting because the first draft class, those were all great businesses, and I would say probably five out of the six of those have outperformed. So they crushed it and then continue to crush it. This draft class was a lot more mean. You had the huge winners with Nvidia and AMD, whose stories are still being written.

Andrew [00:03:07]:

These other ones, though, would not have been a good idea to buy, even.

Dave [00:03:10]:

Though they had just killed it for the wonder. Was Boeing, was that the time period where maybe they were releasing this new plane that they've had so much trouble with and maybe that's why the company did so well during that particular year.

Andrew [00:03:26]:

Yeah, I mean, Boeing is kind of one of those cautionary tales that one of the greatest american companies that we've seen can see things fall apart. And it can fall apart pretty quickly.

Dave [00:03:40]:

Yeah, very quickly. It's interesting how quickly sometimes the tides can turn or the fortunes can change for a company, even if it's been around for a really long time.

Andrew [00:03:50]:

Yeah.

Dave [00:03:50]:

All right, let's move on to the next draft class. This is 2018 class. So we got Amazon, Netflix, AMD, Salesforce, Square, now block and Adobe. So interesting class, I would say strong across the board. However, square block has been kind of a bust, especially since then.

Andrew [00:04:09]:

Yeah. And it kind of lends the question. We're having this discussion, and it was something you and Ian Castle had brought up when he was on our show, which is a great idea. I think it can be really easy to think about stocks from a batting average perspective. Like how many stocks did you buy that went up and how many went down, or how many outperformed the market, how many underperformed. But sometimes it is about slugging percentage, where you can have one big winner, which pays for a ton of bad picks, or you could have one big loser, which cannibalizes a bunch of great picks. And it's interesting to me to see the dichotomy in the draft classes, because in this case, I wonder, maybe more so in the last class, we just looked at 2017. But with block, depending on when you bought it, returns have not been good.

Andrew [00:04:56]:

And at least for this, Amazon, Netflix, AMD, Adobe Salesforce, they've all kind of had their periods of volatility. They haven't all been like Nvidia, straight up into the right. And so if you have a group of mediocre performers and then one bad group, that can really spoil the bunch, it's a very different investment result than, let's say, the 2016 class where you had everything was pretty decent, and Nvidia just took you over the top.

Dave [00:05:24]:

Right.

Andrew [00:05:25]:

It's one of those weird things about investing. I think. It's not intuitive, especially for beginners, is how much one stock can drive the entire performance.

Dave [00:05:34]:

Yeah, totally true. And it just kind of goes to show that what's on top now doesn't necessarily mean it's going to be on top the next year kind of thing. And that's what can make investing so complicated and so stomach churning is that you can see some of your favorite companies do really well one year and maybe not so great the next year. That can really mess with people's emotions and their ability to invest for a long period of time.

Andrew [00:05:59]:

So this is far from an all inclusive list. I'm surprised to see Netflix only on here once.

Dave [00:06:06]:

Right.

Andrew [00:06:07]:

And Amazon is on here, like, three times, so that's not surprising. But Google is only on here once.

Dave [00:06:13]:

Apple is only on here once.

Andrew [00:06:15]:

Apple's only on here once. Yeah. It's like, in my mind, I get this idea of these stocks that are just always winning. Right. Because you look back in hindsight and like, wow, look at the return over the last ten years.

Dave [00:06:28]:

Right.

Andrew [00:06:28]:

Then, in the meantime, people who actually had stocks that were winners at one point had to survive through a rough ride.

Dave [00:06:35]:

Oh, yeah, for sure. Yeah, very rough ride. And the next three years are going to kind of illustrate that, I think, very clearly. So if we look at the draft class for 2019, this one is strong across the board. You have Apple, Microsoft, AMD, Tesla, ServiceNow, and Lululemon. And this is. Keep in mind, this is all pre pandemic. So those are beasts.

Andrew [00:06:56]:

Yeah. That's your LeBron's and Yannis's and chicks.

Dave [00:07:02]:

That's the all star team. Exactly. So if we fast forward to 2020, that, of course, is the beginning of the pandemic. So we have Tesla, Zoom, Nvidia, Moderna, Amazon, and Peloton.

Andrew [00:07:15]:

Yeah, and that's a completely different set of outcomes.

Dave [00:07:18]:

Completely different. Completely different. And in 2021, we have Tesla, Zoom, Moderna, Nvidia Square, and Peloton. So a lot of the same names in 2021 that you had in 2020.

Andrew [00:07:29]:

And maybe if people aren't familiar with the history, how have some of those names gone?

Dave [00:07:35]:

Not good. If you look at two in particular, Zoom and Peloton. If you bought them late 2020 and didn't sell it, you're crying in your milk because they lost 90, 95% of their value. They dropped from. I think Zoom was in the. It's in around 20, and peloton is borderline bankrupt now.

Andrew [00:07:57]:

Okay, so we have a list of six stocks. Let's pretend, just to make things easy. One of them goes bankrupt. That means each of the other stocks needs to return, I don't know, 20% just to break even, something like that. And then you have to beat the market by that much more to make up for that loss.

Dave [00:08:18]:

Right.

Andrew [00:08:18]:

We didn't run the numbers, but I would assume that a class like this, even with a winner like Nvidia, probably still underperforms the.

Dave [00:08:26]:

Yes. Yeah.

Andrew [00:08:27]:

Because square and peloton went down.

Dave [00:08:31]:

Square not as bad, but Zoom and peloton for sure. And I think Moderna has not done well. Right, since the pandemic as well. I mean, it really kind of highlights if you look at those companies, especially the last two years of this draft. If you look at a lot of those companies, the only way that you would have made money is market time. Buy it at a low price and sell it when it got high. But unfortunately, most of us, anybody that was investing in those, the majority of people that were investing in them, they didn't do that.

Andrew [00:09:02]:

Can you make the argument that some of these will come back, like maybe a draft class of 2016 or 2017 did?

Dave [00:09:10]:

You could probably make the case for Zoom being a decent investment going forward, but it won't be what they projected it would be at the height of its powers, if you will. A lot of these companies, Zoom, Moderna, Square, Peloton from those two years, were all part of the COVID darlings, if you will, and everybody thought that the way we would do business or these companies would be foundational, and that has not proven to be the case.

Andrew [00:09:41]:

Do those years feel different than the other years? Or is that just our hindsight bias saying, oh, yeah, this is an obviously different crop of businesses?

Dave [00:09:52]:

I mean, I feel like in hindsight, that it just was a different time. We were going through a pandemic, and the feeling was that because we were going through something none of us ever experienced, at least for me, because we were going through something we had never experienced before, it wasn't that big of a stretch to think that the way we would all use our money, do business, travel, exercise, wasn't going to drastically change too.

Andrew [00:10:20]:

That's good insight. Yeah. It's funny how you can kind of divorce the two things, right? It's like stock market world's different from what happened in real life, but, yeah, it's all intermingled.

Dave [00:10:29]:

Yeah.

Andrew [00:10:30]:

We're all in a different mindset.

Dave [00:10:32]:

Yeah, totally. I mean, I don't know about you, but I never partook of the peloton craze. But I did use the, oh gosh, planet fitness gym memberships. I remember my fiance and I going to the gym during that period. And it was such a different experience because you had gone to the gym before and you were able to exercise fairly freely. Right. But then during the pandemic and even after it started to air, quote subside, you still had a lot of those same measures in place. And so it was just a different experience.

Dave [00:11:05]:

You go into places like that or a movie theater and you're not all sitting next to each other, you're spaced out and it just feels different because you've been conditioned to have it a certain way and now you don't. And so at least for me, it was real easy to extrapolate, this is different. So all these things are going to be different too. Like human behavior was going to change over a two year period compared to the last, I don't know, time memorial. The way we do things was drastically changing and it just felt different.

Andrew [00:11:34]:

So to kind of invert the idea, if the other years, 2016, 17, 1819 felt more normal, then this might sound like hearsay coming from a value investor. But does that become a pretty decent list? To find good businesses is just to find the stocks that have done so well in the past year? Because those draft classes are pretty good, right?

Dave [00:12:00]:

Yeah, they are. I think in hindsight everything looks 2020, right?

Andrew [00:12:04]:

Yeah.

Dave [00:12:05]:

But there probably is something to say for the fact that Nvidia and Amazon in particular have consistently done well over a longer period of time and it could be a good place to look for potential ideas. I don't know that I would necessarily just plunk down all my life savings just because it did great in 2016 and 17. That doesn't mean that it's going to do great in the next few years. There could be extenuating circumstances behind a certain company doing well, whatever that may be. And it doesn't mean that. Also, thinking about Nvidia, they've had some near death experiences even recently where the company wasn't doing great and the market sentiment was that they were going out and now they're the king of the kings. So the fortunes can switch. The sentiment can switch on a dime for sure.

Andrew [00:13:00]:

Yeah, good point.

Dave [00:13:01]:

That's what makes it hard, I think.

Andrew [00:13:03]:

I do find it interesting that there's at least one semiconductor in every trap and it's basically either Nvidia or AMD or broadcom.

Dave [00:13:15]:

Right. Notice until is not in there. Sorry. Bitter party for one.

Andrew [00:13:21]:

Right.

Dave [00:13:22]:

But I guess what do you extrapolate from this. Like, if you look at this kind of list, does it make it easier for you to buy into the narrative that an Amazon or an Nvidia would be a good investment, kind of, regardless of what's going on?

Andrew [00:13:39]:

Yeah, it does make you think. Know, it's interesting, like you said, to see how Nvidia and Amazon are on that list a lot and almost in lockstep in many ways. And so while that might sound like two coincidences, if you really take it one step, mean, Amazon's always been a great stock. But AWS didn't hurt at all, right? Once AWs and Wall street recognized it, and AWS really took off with all of its profitability, that's done wonders for Amazon stock. But who's also supplying those chips that are going in the AWS data centers? They're going in the azure data centers. It's also Nvidia. So it's not a coincidence, because we're kind of talking about the same emergence in the economy, which is this cloud computing thing. And I think that's something to pay attention to.

Andrew [00:14:35]:
And if I could go back in time, I would say, hey, this cloud computing thing is real. Pay attention.

Dave [00:14:41]:
Right.

Andrew [00:14:41]:
And so I wonder if whatever the draft class is for 24, 25, 26, is there something like that where a draft class over several years shows, hey, there's a big idea here, versus maybe like draft class 2017? Honestly, those all sound like random companies. A casino, a memory chip, plane engine, and I don't know what all kind of my takeaway there is like, every year is a little bit different. That was really shocking for me to see that you had big winners, but you also had big losers, and you also had years that made sense and years that don't make sense. And so it's almost to say, like, the draft classes maybe don't matter because there's so many things that could be contributing to them.

Dave [00:15:26]:
Yeah, there could be. And I think the idea that kind of looking at it over a bigger stretch in just one year, I think you're right, it does kind of show that there can be some bigger ideas that start to gain traction in the market and are things that maybe you should, like you said, pay attention to. It's easy in hindsight to look at it and see that. And I think the other thing that, a couple of other things that kind of come to mind when I look at these kinds of lists is the lack of permanence in the stock market and how great capitalism is. If you look at the top ten companies today, in Es and P and then look ten years from there back and then ten years from there back and ten years back. So you go 30 years, which in the grand scheme of things is not that long. You look at that and you can see drastic differences in the companies. There are some commonalities, Microsoft and Apple, but the rest of them, they changed a lot at T, GM, ge are no longer in the list now, and Chevron and Exxon are also not in the list now.

Dave [00:16:33]:
And so it just shows you kind of how capitalism changes and how the stock market can change. And it's not a permanent thing. And it's also, I think, to me, what highlights or showcases how hard it is to find a company that you can hold on to for a long time, because things do change and you have to be cognizant of

that. You can't just buy Amazon and put your blinders on and just go, okay, this is going to be it for the next 20 years. It could be based on its history. There's a better chance than not, but not guaranteed.

Andrew [00:17:02]:

Yeah, I think that's super key. It's not guaranteed. And I think it shows that trying to pick, trying to build a portfolio of the best ten, I'm going to get the best ten names and that's going to be my portfolio. It's just a fool's errand.

Dave [00:17:17]:

Right?

Andrew [00:17:17]:

There's no such thing as the best because it's constantly changing. So to me, that reinforces the ideas of trying to find something that's durable, that I can understand, that I can hold for a long time. Yeah, it might not ever make these lists. Top ten might not make the billboard top 40 hits, but it can still beat the market and compound capital in a very effective way. And trying to play the other game of trying to always hit on the top charts, that probably has more losers than winners.

Dave [00:17:47]:

Yeah, I think that illustrates that idea. If you're just looking at this chart, you think about trying to, okay, I'm going to pick the five best companies every single year. You might hit one or two if you get lucky, but good luck. I mean, as great as Nvidia, it hasn't been the top company until recently. So in 2016 and 17, it was at the top of the charts, but since then it was in the charts, but it wasn't the top one.

Andrew [00:18:14]:

Right?

Dave [00:18:17]:

Yeah, it ebbs and flows kind of to that point of timing the market, trying to. Okay, I think Nvidia is going to do great this year. I'll buy it at the beginning of the year. And I'll sell it exactly at the end of the year. Well, that may not get you the best return. It may stink the first five months of the year and then be awesome at the last seven. And so if you don't buy it at those times, then you don't get to partake of that, because this just shows how it did for the whole year, but not every month within that year, when you try to take into our emotions of, oh, God, I bought Nvidia, I bet big on it, and it's down 20% over the last three months. I'm out.

Dave [00:18:56]:

And then you miss out on it going up 200% for the year. Yeah.

Andrew [00:19:00]:

Do you think it's helpful for investors to look at stuff like this regularly? Not at all. All the time.

Dave [00:19:09]:

Once, I would say, my gut tells me once in a while, for giggles, it's probably not a bad idea to look at it. I think all the time. I think it would drive yourself nuts because it could be the FOMO factor. If you're looking at this on a regular basis, the FOMO factor would be huge. And trying to fight that down, which is one of the strongest biases that we fight, that would be hard. And I think it would be better not to put yourself in that situation than to try to withstand it personally.

Andrew [00:19:44]:

Isn't that just what Finn media does, though?

Dave [00:19:46]:

Yes.

Andrew [00:19:47]:

They're on the top charts, and then they're on to the next one. It's just a constant stream of making you feel bad that in 2018, you weren't smart enough.

Dave [00:19:56]:

Right? For sure. But there is this. I guess I've heard people say that a good place to hunt for potential ideas is looking at the top 52 week list. So look at companies that are trading at their top 52 because those are companies that are winning and are executing over a longer period of time. And you want to buy companies not to recommend momentum investing, but you want to buy companies that are hitting on all cylinders. And that's usually what you would find at that kind of range, though. So I've personally never done it, but I have read about people doing it that way.

Andrew [00:20:35]:

So what would you recommend? I think that's a great way to kind of have something tangible to take away from this. For a beginner who wants to maybe look at that idea, what would you recommend they do, and what things should they keep in mind?

Dave [00:20:48]:

Well, I think the first thing is I would probably ration how much you do that as part of your investment process, just because of the whole fomo thing. So depending on what your level of willpower is every three months to six months. Look at something like that to give you some potential ideas to look at. But you also have to understand that you can't just buy because it's on a 52 week hot. You can't just go, oh, hey, Nvidia is on a roll. I'm going to go buy it. And that's not a way to invest. So it needs to be an idea generator, not an investment generator.

Dave [00:21:23]:

I think there's a difference. Yeah, I think perfectly said, if you had to pick one of these drafts as like, hey, I want to put these in my portfolio, which would be your dream team, if you will.

Andrew [00:21:36]:

Oh, I mean, the one that jumps out of the page has two stocks I already own, and it has Tesla, which is just fun to have in your pocket anyway. So that'd be draft class of 2019. What about for you?

Dave [00:21:52]:

I might stir it up a little bit and go with 2018, even though it's got a dog in it. Amazon, Netflix, AMD, Salesforce, and Adobe, I think, is a pretty strong, pretty strong bench to work from.

Andrew [00:22:08]:

Yeah, I think some of these groups have been really great businesses, and I think that shows a power too, right?

Dave [00:22:15]:

Exactly. Anything else you'd like to throw out there, sir?

Andrew [00:22:19]:

No?

Dave [00:22:19]:

Okay. All right, I'll go ahead and wrap it up. All right, folks. Well, with that, we will go ahead and wrap up our show for today. I hope you enjoyed our conversation on draft classes and how you can look at the past to give you some guidance on the future. And with that, we will go ahead and wrap it up. You guys go out there and invest with the margin of safety. Emphasis on the safety.

Dave [00:22:39]:

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