IFB336: Navigating Investment Strategies - Diversification vs. Sector Focus

Dave [00:00:00]:

All right, folks, welcome to Investing for Beginners podcast. Today we have episode 336. Today we have four fantastic listener questions that we are going to answer. So without any further ado, before I jump in, if you have any questions like the ones we're answering today or anything else, please reach out to us at newsletter@eninvestingforbeganners.com we'd be love to answer your questions on the air and give you some help that you need. So we're here as a resource. And with that, let's go ahead and dive on in. So we got the first question. This is from Tito.

Dave [00:00:32]:

Hi. It would be cool if you could make a podcast about where to invest my first 1000 or 5000 or $10,000. Thanks. It would be great help for beginners. You could also recommend some online brokers as well. So Andrew, would you want to go ahead and take first stab at Tito's fantastic question?

Andrew [00:00:50]:

Sure. The question we get a lot, right? And I think it's the question every beginner wants to know. Where do I put my money? Especially if I'm starting. So I commend you reaching out. And I think the first step into learning is opening your mind and trying to find resources and asking people to get your question answered. I think that's the great first step. However, you got to think of this like a marathon, not a sprint. This is a life's journey.

Andrew [00:01:17]:

Your 1st $1,000 probably won't make you into a millionaire. And so you need to commit right now that you're going to make this into a habit. It's going to be a consistent habit that you're going to put in a consistent amount of money every month because that's what's going to make you a million dollars. It's not going to be

Andrew and Dave gave a podcast and told me how to invest a I'm a millionaire. It's going to be because you put in the steps month by month by month and over time that grew in a compounding fashion. So great that you reached out. I love this question. I love answering it.

Andrew [00:01:54]:

But I would say first put the mindset that, hey, this is something I'm going to work at over and over again and put money and save and invest into over and over again. And then with that mindset, you can come in. It's a little bit freeing to think, hey, I can make a mistake or I could not pick the perfect investment for my first $1,000. And that's okay. I'm still going to be fine if you come in with that mentality, you're going to learn and absorb so much more. And I think that's going to help you in your path to financial freedom to be able to put things into perspective and learn as you go, because it is overwhelming. I mean, we could probably spend 3 hours on an episode talking about the different ways you could invest $1,000 and we still wouldn't get you there. So think of it in a lifelong journey.

Andrew [00:02:40]:

If you put the steps in, that's going to be what's most important. Now, how would you answer the first 1000, 5000, $10,000?

Dave [00:02:49]:

Well, I think it all comes back to kind of the same process that you would have, regardless of whether it's $10 or $1,000. I think the first thing is you need to decide what kind of investor do you want to be? And if you're looking to be a stock picker, then you need to figure out, how much work do I really want to put into this? And that'll go. Just thinking about those kinds of ideas will drive what kind of investor you want to be. So once you kind of have that kind of figured out, the next thing is you need to figure out, you need to open an account. You need to go to an online broker. We like Fidelity. We also like Char Schwab. Interactive brokers is awesome as well.

Dave [00:03:28]:

So there's lots of different choices. And sorry, those are three more us centric ones. So I apologize to those outside of the US gates, but those are great places to start. Open an account, put money in it and buy one thing. Doesn't matter what it is, it's not going to be the thing. Like Andrew said, it's not going to be the thing that's going to set you. You're not going to be a millionaire by buying one share of Lululemon. It could be literally anything.

Dave [00:03:54]:

Whatever it is that you want, buy one thing, get some skin in the game in the market so you can understand how it all works, the ups and downs, the fact that you're going to want to check it 17 times a day at first to see how it's doing and to feel the emotions of the euphoria of it going up and the depression of it going down. And these are all normal everyday activities in the stock market. And a lot of people that really don't follow the markets think that it's a static thing. It starts at the beginning at one price, it ends the day at the other price. And unbeknownst to them that it literally can move quite a range, depending on the popularity and what's going on quite a lot in a course of a day over a long period of time. If you pick well, they will do well, but it doesn't always happen that way. And so I think the best way to really get your feet wet and really understand this is to put some skin in the game. And then once you have some skin in the game, then you can start deciding what kinds of things I want to invest in.

Dave [00:04:58]:

There's a million studies about putting it all in at once or dripping it in. I would like to drip it in because I think that idea does two things. Number one, trying to find, let's say, ten of your best ideas in one month is really hard. And I'm going to reference our friend Andrew here, who does a monthly stock pick, and you have no idea the amount of anxiety and stress that goes into picking one. So trying to pick ten of your best ideas is really tough. Number two, if you drip it in or do it in more slowly, let's say five months or six months, you're going to start building a habit. And that's really the more important part of it, is building a habit. Because again, when we're beginning, we're going to make mistakes.

Dave [00:05:47]:

It's okay. That's part of the learning process. And you won't hit it big with every single investment. No matter whether you're experienced or not, you will not hit it big with every single. Just. It doesn't happen. The greatest investor in the world, in history, Warren Buffett, made plenty of mistakes along the way, and he probably will make more. So, that being said, I think that's kind of how I would start on it.

Dave [00:06:09]:

Do you have anything to add? Anything maybe I missed?

Andrew [00:06:13]:

No. If somebody wants the easy button, they could just buy an S and P 500 index fund. And that's a great way to invest over time, also. But I would feel like I would be remiss if I didn't also recommend that in that process, you got to learn the history of the stock market. You've got to learn just at least the basics of how this whole investing thing works, how this whole stock market thing works, because it's not going away. The

stock market, I mean, I'm betting my life savings that the stock market will be here in the next 50 years, just like it has been in the past 50 years and 100 years, 150 years. So knowing that there are swings and there are times when the stock market becomes the hottest thing on the news. Sorry, Taylor Swift.

Andrew [00:06:55]:

Every once in a while. Stock market comes and takes your shine, just for a few days. And so if you can understand that, that's normal, that's part of investing. That's part of the stock market. Your investments are okay. Your 401 is going to be okay. Over the long term, you start to put some of that knowledge into your toolkit. I think it can help you a lot with the emotions and the anxiety that can come with investing.

Andrew [00:07:23]:

And when you're a beginner, that's all normal because you don't know better. But if you haven't had somebody to teach it for you, then you got to go out there and learn it for yourself. And tuning in, asking questions, doing the research, and like Dave said, dripping in over time, getting those feet wet, step by step by step, allows you the time to learn these things so you don't shoot yourself in the foot or something.

Dave [00:07:46]:

Yeah. So the last thing I think I want to say about this is give yourself some grace to make mistakes. Don't beat yourself up if you make a mistake, you pick poorly, buy something wrong, whatever, you're going to make mistakes. It's part of the learning process. And don't get discouraged. Don't get down. It's all part of the game. And I just want people to just cut themselves some slack.

Dave [00:08:10]:

You don't have to be Warren Buffett out of the gates, and there's only been one, and most likely we won't be. And that's okay. We can still be super successful by doing this. But just give yourself a break. When you get started, don't put the pressure of the world or Warren Buffett on your shoulders.

Andrew [00:08:25]:

You didn't start when you were eleven years old. What were you doing?

Dave [00:08:29]:

No, I did not. I was dreaming about playing center field for the San Francisco Giants.

Andrew [00:08:33]:

Nice.

Dave [00:08:34]:

Yeah. All right, so let's move on to the next question. So, this is from Nami. Hi. Do I need to really diversify my investments equally enough in most of the sectors? I understand some sectors do well in certain business cycles. My portfolio only has been spread out into five different sectors. So, Andrew, what are your thoughts on this really great question?

Andrew [00:08:58]:

Here we go. This one can be debated for a long time. Yeah. It's really a matter of preference, and obviously anything with investing and money, you want to make optimal returns. And so kind of going back to the earlier part of the discussion, it depends on what type of an investor you are and what you're trying to do. I would say, in general, getting as much exposure to as many of the sectors as you can is probably a good idea. That's certainly what index funds are doing. But even an index fund like an S and P 500, if you were to look at the weightings of that, it changes over time by a lot.

Andrew [00:09:38]:

I mean, tech went from 2020, 5%, 30% of the S and P 500. Real estate is not really represented much in the SP 500. Basic materials not really represented much. Energy has really fluctuated up and down between how much energy makes up of the market. So it's really hard to say. There'll probably be times where spreading out is the strategy that gets you the best returns, and there are going to be other times where that doesn't work as well. To give a non answer, that's kind of how I would first start to think about it. How do you put your mind around this question and how do you think about it for your portfolio?

Dave [00:10:18]:

Yeah, that's a good question. I think when you're starting off, if you're early in your journey of building your portfolio, I don't think I would get too excited about trying to diversify. In other words, don't create a checklist of the nine different sectors. And, okay, I got sector one, now I'm going to invest sector number two, and now I'm so on. Because one of the things about investing is you kind of got to go where the fish are too. So you can't just force a sector into your portfolio just because. Perfect example for me, commodities and me don't mix. So it's not that I don't want to, it's that I don't necessarily understand them, and it's not something that I have a burning desire to learn about.

Dave [00:11:05]:

And so because of that, I don't really have much exposure to commodities. I don't have any exposure to commodities. So I don't have anything in oil, I don't have gold, I don't have copper or anything of that nature. And so that's just not something that I've been really wanting to dip my toes in. So I guess I'm missing out on that diversification. But it doesn't mean that I can't maybe pick an adjacent industry. So maybe I could look at energy and I could do something in the utility space, which is maybe not directly related to commodities, but tangentially, it would be if I buy somebody that deals a lot in natural gas, for example. So because I own Berkshire Hathaway, I have exposure to energy, which means I have some exposure to natural gas.

Dave [00:11:48]:

So I'm kind of hitting a little bit of the sector, but I'm kind of doing it a little bit of a roundabout way and it sounds really deep and thought out. Frankly, it wasn't, but it's kind of worked out that way. And it's something I've learned as I've become more aware of building a portfolio and those kinds of things. And I guess also I don't get bogged down in I have to have 10% here, 12% here, 14% here kind of thing. I've kind of let it just kind of naturally evolve and pick things that maybe I will start looking in a sector because I feel like I need some exposure to that. But then I may not find anything that's appealing at that particular time, and then I'll go back and find something else. But it doesn't mean that I won't keep looking as part of the strategy. And at some point I will have an opportunity, because not everything is going to be like big tech and go up to the right all the time.

Dave [00:12:41]:

There's going to be changes and opportunities at different times. That's kind of how I try to look at it. Do you think about like I have to hit all the sectors and do you have more than five sectors in your portfolio now?

Andrew [00:12:54]:

That's a good question. It's funny, I have like one consumer defensive stock right now, Costco, and it makes up like less than 1% of my portfolio. And I wish it made up way more.

Dave [00:13:06]:

Right.

Andrew [00:13:06]:

I have r1 estate company, which I've talked about many times, the REIT, the infamous REIT, that one makes up like 15% of my portfolio. But then I have a very heavy exposure to basic materials and pretty heavy on

cyclicals and technology as well. So when I really tried to transform my portfolio back in 2020 and really shift my strategy away from higher activity, super bargain stocks, and the things that I could see myself holding a lot longer, I did kind of go through sector by sector, kind of like, to your point of what do I not have exposure to? But like you said, and I think it's very important in this discussion to reiterate, if you don't find anything in there that's worth buying at that time, you have to pass. Like, you cannot just lower your standards because you're trying to fill a sector or checklist, it's probably not going to work out very well. So I did end up kind of picking a lot of the different sectors and that's really worked out for me as far as feeling like I have a balanced, diversified portfolio. But moving forward now, that I have that foundation, it plays a lot less of a role than I've thought it would. And it's because if you're picking stocks the stocks themselves will drive a lot more than the sector in many cases. So that's something to consider too.

Andrew [00:14:35]:

Do you feel like the whole sector strategy kind of does it change for you? Has it been different like let's say a year ago versus now?

Dave [00:14:44]:

No, I don't think it's really changed much over the last few years, two, three years. I worry more about trying to find the best business that I can at the particular time as opposed to worrying about sectors. I will use the sectors as a way of trying to find the best business. But I won't just stay there just cuz but I will admit that I'm pretty strong in financials. Between banks, insurance companies, the payments industry I'm pretty strong in that industry. And so for me to consider adding something to that sector they got to be a I either am going to replace it one of the ones that maybe is not performing as well with that one or it's got to be the next Google or Amazon because I'm like I don't need more exposure to this sector so it's really got to be a beast for me to take it on. And then otherwise I try to kind of look in other sectors that maybe I don't have as big of exposure to and try to fish in those waters as well. But I never ever, well I wouldn't say never ever.

Dave [00:15:54]:

I don't generally focus much on the sector part of it. It's more about trying to find the best business that I can and worry about the other stuff later.

Andrew [00:16:02]:

I'm glad you added that too though because it sounds like you at least have a basic understanding too. So there is the idea of you don't want to be on the other extreme where you're 100% financials or if you're fishing where the fish are I can tell you you'll find low pe stocks and basic materials all day long.

Dave [00:16:18]:

Thanks.

Andrew [00:16:19]:

You don't want to be 100% of those either unless you have some sort of crystal ball. That is the sector right? So it totally is a balancing act and I'm glad you brought that up.

Dave [00:16:29]:

Yeah there are investors that are really concentrated but I think that's when you either have tons of experience or you really know those businesses well and that's not for me, at least not at this point. Maybe as I do this longer then maybe that will become the thing I just own visa and Mastercard and call it a day. But I think you kind of have to know your limits, and I think there has to be, to Andrew's point, you can't have 100% or 90% in one and then spread out the other four sectors and like 2-2-2. That's not going to get you where you want to go, but I think you got to have a bit of a balance but not go nuts.

Andrew [00:17:10]:

Yeah. All right.

Dave [00:17:11]:

Do you have, I guess, the last kind of tidbit on this? What would you say would be too much diversification in a particular sector? Do you feel like there's a threshold where like, hey, maybe you might want to consider looking other places?

Andrew [00:17:23]:

That's an interesting one. I haven't thought of that one before. If you're trying to be a stock picker, you're trying to beat the market. There is a certain point of over diversification where the return on your effort is not going to be quite high because you're diversifying that effort away. But for sectors, I think that's hard to also say because sectors have moved so much and my sector basket might look way different than yours.

Dave [00:17:51]:

Right.

Andrew [00:17:51]:

So maybe it's possible, maybe it's not. But I would kind of focus more on the individual stocks.

Dave [00:17:57]:

What about you? Yeah, I would do the same. For me, it's not necessarily a number. It's more of, I guess, a feel like these are the areas in finance that I think are really important. So I have this company for that SWAT and this company for that SWAT and so on. And then kind of the same with tech. Like, if I look at semiconductors, okay, I have this covered and I have this covered, and maybe I could go in this direction with that, but that would be it. To me, it's more about kind of knowing the sectors and then trying to find things that I think are going to be profitable for a long, like durable. And so try to find a company that maybe fit that particular slot and then kind of move from there.

Dave [00:18:41]:

And maybe as I get more into energy or utilities, maybe I would find several, two, three, four companies in that range that would fit those needs, if you will. But that's kind of how I look at it. I've seen other people say, you shouldn't have more than 30% of your stocks in this sector, and 20% in this sector, or 50% is the total exposure you should have to this sector. And you get more than that, and then you're over diversified or something like that. I don't necessarily subscribe to that, but that's kind of what I've seen.

Andrew [00:19:09]:

Yeah, I think there's some wisdom to that because these sectors go in and out of favor all the time. It wasn't in the last millennium, but this millennium when banks and financials were all the rage. And now look at those pes.

Dave [00:19:26]:

Right.

Andrew [00:19:27]:

Things can change. And so there is something to be said about diversifying across the sectors, because if the economy turns and we become an infrastructure heavy economy or something, then you would think commodities would rebound. But you do miss out if you have a better insight somewhere else. So you got to kind of pick the game you're trying to play, right?

Dave [00:19:46]:

Right. Yeah, exactly.

Andrew [00:19:48]:

All right.

Dave [00:19:48]:

Well said. All right, let's move on to the next question. So we have how can investors evaluate the effectiveness of a company's r and d or research and development investment in driving innovation and long term growth? This is an awesome question. So how do you measure r and D and its effectiveness?

Andrew [00:20:08]:

I'm going to pass the ball to you and let you go drive to the hoop first.

Dave [00:20:13]:

Okay, thanks. All right, so R and D is, for those of you unfamiliar with this term, this is the term where a company spends money to try to create new products or services. This is where the engineers are sitting in their cubicles, swathing over a computer, trying to come up with the greatest code to develop the next best thing. Or it's somebody in a lab trying to create the next breakthrough medicine or trying to create the next hardware that's going to win the day. And generally, the more money you spend on R and D, in theory, the more growth you should see from those new products and services that these brilliant people create. And so a good way to do this, the way I like to do it, is kind of look at the r and D margin. So basically what you do is you take the R and D line item from the income statement. So if we look at the income statement, it's broken into three different components.

Dave [00:21:15]:

The first part is the costs of producing a product or service. The next is the operations. So the effectiveness of the sales or the r and D or the administrative part of it, those are the operations of the business. And then you have the kind of the lumping in of everything else. So, like taxes, interest, expense, money that they spend on debt, those kinds of things. And that's kind of the bottom part, the middle part, the operations, is where R and D resides. And a lot of times you'll see a line item that says investments in R and D or R and D research or research and development costs or expenses. Don't get confused by all the different lingo.

Dave [00:21:58]:

It's all the same thing. And really what you want to do is you want to take that number and you want to compare it to the top line or the revenue growth or revenue of the company. And so by looking at that, you can get a margin. So let's say it's 29% for company b. So that's the margin that they're using compared to the revenue that they generate. And you can compare the changes in those. So you can look at year one to year five and see how much have they spent? What is the change in that? And then you can compare that to the revenue growth. And that can give you some sort of idea of potentially how effective the money that they spent on R and D has helped grow the revenue of the business.

Dave [00:22:43]:

Now, it's not going to be a straight correlation because there's a lot of other things that can be involved in that. But that's one way that I try to do it, is look at a five or ten year period. Look at year number one, year number five, look at how much they spent and the change. Do the same thing with revenue. Do the change and then compare those numbers. And that can give you some sense of how effective it can be. However, R and D spend does not always correlate with revenue growth, and it doesn't always correlate with a bigger number spent. Doesn't always mean that it's going to be better for the company.

Dave [00:23:16]:

Intel.

Andrew [00:23:17]:

So what's a company in your portfolio that scores well with that?

Dave [00:23:21]:

Oh, gosh. Well, Visa does really well with that. Microsoft does really well with that. Another company that's done really well with that would be Ajin. These companies have all done a really good job of efficiently using their r d to try to grow revenue of the companies. These are more heck heavy companies, but definitely effective for them. What about you?

Andrew [00:23:44]:

I don't use this method, so that's why I was asking you.

Dave [00:23:47]:

Okay. All right.

Andrew [00:23:49]:

How do you know for Visa, for example, that it's the R d that's driving the revenue growth?

Dave [00:23:54]:

I don't. That's the trouble with this. There is no hard yes answer. It's part of the equation of looking at the effectiveness of the capital spend. So, accounting statements, the financial statements that we look at, they're governed by a board of directors and the GAAP accounting rules, which are the rules that they use to generate these accounting statements, they are all made in the. So they're drastically outdated. And so R and D for a lot of these companies are really investments in growth. So when we talk about return on invested capital, which is one of Andrew and I's favorite metrics, that's generally calculated from the balance sheet.

Dave [00:24:36]:

And one of the things that Michael Mobison, one of our heroes has talked a lot about is trying to kind of change that. And I'm not going to go into all the nitty gritty of it, but basically Microsoft's R D investments are not really an expense. They're an investment that they're making to try to make azure better. And there's no exact science to finding out how effective it can be because I can't see exactly what they're spending it on and how much it's impacting the growth because those are all insider, confidential numbers. So based on the information that I can see, this is the way that I've tried to jury rig it, if you will, to try to figure out a way to sort of get a good idea. The other way to look at it is the ROIC, the return on invested capital. Look at that ratio or that margin. Generally, the higher the number, the more efficient the company is in generating profits from its investments.

Dave [00:25:33]:

Even though R and D is not technically part of that, it can certainly be an indicator of how well they're using their R and D. So it's not an exact science. There's a little bit of voodoo when you try to do this, at least for me, and that's how I tried to do it. But I wouldn't say that this is like I'm going to die on this hill kind of thing. This is an idea that I've kind of evolved over the last couple of years in particular.

Andrew [00:25:57]:

Yeah, it's interesting. I completely agree. I don't think there is any hard science to R D, and that's what can make it really hard to evaluate. But the same time you look at a company like Apple and their R-D-I would argue that that's been extremely successful and you can see it in your hands every time you update to a new

iOS. So that's kind of the R and D spend, very tangible that you can see, but that's not showing up on the numbers anywhere. And that makes it really hard. It is one of those very, if I would call it voodoo, but it's definitely not ambiguous. Perfect.

Dave [00:26:37]:

It's very ambiguous.

Andrew [00:26:38]:

It's ambiguous and there's a lot of judgment involved.

Dave [00:26:40]:

I feel there's a lot of judgment.

Andrew [00:26:42]:

Great way.

Dave [00:26:43]:

Yeah. You could use my method. You could simply just compare it to itself. You can compare it to other people's in the industry and get an idea of how the margins relate. And that could give you some sense of how your company does versus other ones. But that I'm aware of. There is no hard fast rule that you can go, this is how you do it and this is what you'll know.

Andrew [00:27:02]:

No, not like price to earnings.

Dave [00:27:04]:

Unfortunately, no. All right, let's move on to the last question. So we got how can investors incorporate qualitative factors such as management quality and competitive landscape into their valuation analysis? So I'm going to give you first stab at this one since I had to do r and D first.

Andrew [00:27:23]:

Yeah, I gave you the fun one, right? Yeah, right. I don't think it's a question of how in the sense of like, yeah, you definitely should be incorporating this. When you're looking, if you're trying to pick a stock and you're

trying to hold it for the long term and trust the management, trust the business to continue to grow, you have to include these. How can you do it? I feel like it's going to potentially look different for every company, but I also think you can start to build mental models for the different things. So for example, I wrote recently about Microsoft and Azure kind of piggybacking off of that company and those investments that they've made, they really have a scale economy, shared type of competitive advantage where the more people that are using Azure, the cloud services, the more utilization they get, the more they can invest and get even more infrastructure. And the more they invest, the more money they can save for everybody who uses their network. And so it's this virtuous loop where the bigger they get, the more customers they get, the more they save their customers and becomes a really tight plywheel. That same concept can also be used for Costco.

Andrew [00:28:33]:

Costco has a very similar thing. The more members that are under a Costco membership, the more volumes that people buy the Costco products, the more discounts Costco can get from its customers. And then they ended up sharing. That's the key part in both of these mental models is they share those savings with their customers. Microsoft Azure and Costco, they share the savings with their customers. So everybody win win, basically. And so even though those are two very different businesses, two very different competitive landscapes, once you can identify a mental model, you can see it play out in different industries. Then that's when you can start to leverage your experience.

Andrew [00:29:14]:

So there's some parts you can leverage that are going to be similar and leverage off experience. But other parts you just kind of have to know and you got to get in and get your hands dirty and figure out what makes this business unique. That's kind of the way I look at competitive landscape. What about management quality? How do you like to look at that?

Dave [00:29:30]:

Incorporate of? I think the easiest way that I do it generally is looking at, I look at the overall financial picture of the company. So if I'm looking at Microsoft, I'm going to look at how long has Satya been driving the bus, and then I'm also going to look at the overall financial picture of the business. And that's going to give me a pretty good sense of the management quality because no company can be run by anybody and it doesn't need to be. When I'm talking about the overall financial, I'm looking at are revenues growing? Are the margins expanding or at least staying the same? Are they reinvesting efficiently? So looking at a measure like ROIC and looking at those kinds of numbers can give you a sense of how well management is driving the company, because they're the ones that are not only setting the goals and the standards, but they're also the ones that are holding the people accountable below them for executing on their plans. So it's not just having

great plans, it's also being able to manage the people that work for you to get them to execute on your plans. Whether that's by being hard on people or whether that's providing a workspace that they can thrive in, there's lots of different ways, and we don't need to go into all that. But usually when a company is performing well, it's because management is efficiently and effectively a figuring out things that are going to be good for the business and they're communicating those well to their juniors, then they're holding those juniors accountable to get things done. And so whether that means it's in the warehouse or whether it's in the R and D lab, or whether it's in the sales and marketing department, all those components are being managed well.

Dave [00:31:20]:

And if one of those areas falls down, then other things start to fall apart. And so when you look at a company that's performing well, Amazon with Jeff Bezos, Microsoft with Satya, Nadella, Berkshire Hathaway with Warren Buffett, think about these great managers. You also think about great companies. I basically just look at the overall effectiveness of the performance of the company. And that will give me a really good indication, or should give me a good indication of how effective the management is. And then the last thing is just look for softer skills. So things like how do they treat analysts on earnings calls when they do interviews with other people, how do they react? Some of those things can go a long ways to you figuring out what kind of people they are. And it's a soft skill.

Dave [00:32:08]:

It's not something you can measure, but it's just something with experience that I would look at to help me give a sense of who they are.

Andrew [00:32:14]:

Any thoughts on the competitive landscape? Because that's an important one, too.

Dave [00:32:18]:

Competitive landscape for me, again, comes back to the numbers or the business and kind of giving you a sense of how each person is performing and then kind of comparing them across the swath of what they're doing. So if you look at retail and you look at big box retail, you have to look at Target and Walmart and Costco and maybe even a little bit of, you know, Home Depot and Lowe's and kind of lump all those together. And then you just kind of look at their numbers and kind of see where they are. And you can also do things like read publications for those particular industries, and those can give you a kind of a sense of where different things are for the competitive landscape. Know, you'll also just by observing behavior, customer behavior, when you go to the mall or when you go to Home Depot and see what people are buying and how

much they're buying and how full are their baskets when they leave, some of those things can give you a sense of what people are buying and how much they're buying. And that can give you maybe a little bit of insight into the competitive landscape of a particular industry. What about you?

Andrew [00:33:28]:

That's good. We could probably talk about it until the cow comes home. The cows come home. Michael Porter, if you can stand NBA type material. Michael Porter has written several books about the competitive landscape. And so he's talking really about looking up, looking down, looking to the sides. And if you think of looking at companies in that way, to me it helps to know how are these companies, know if companies are on equal ground. And a lot of them tend to be, you can have kind of a healthy ecosystem.

Andrew [00:33:59]:

And when things get out of balance, sometimes the smaller companies struggle. So those kinds of things you pick up also, and you can build mental models about that over time. But Michael Porter was somebody who really opened my eyes to that kind of stuff, and I found that helpful because once you see it, then you start to see it in other industries and it can be really fun.

Dave [00:34:20]:

Yeah, exactly. Yeah. Once you see it. It's hard not to see it, I guess, hard to unsee it, but that can be really helpful. A book that I read recently that really kind of helped open my eyes. The Michael Porter book is great, but like Andrew said, it's a little bit MBA level and can be a little drier. A newer one that I read that I felt like is really more accessible was seven powers by Hamilton Helmer. He's a professor at Columbia University and he wrote a book.

Dave [00:34:47]:

And he basically breaks down the same ideas that Michael Porter does, but maybe in a little more accessible way and maybe not quite so academic, I guess, is the best way of putting it. He does a lot of comparison studies with companies like Amazon and Netflix that really make what he's talking about really kind of make sense. It really opened my eyes a lot to kind of this idea of competitive landscape and kind of how you can start to identify that for different companies.

Andrew [00:35:11]:

That's awesome. I'm going to check that one out, download it on audible, and that's my next read.

Dave [00:35:16]:

Yeah, it is. It was an awesome book. All right, folks, well, with that, we will go ahead and wrap up our conversation for today. I wanted to thank everybody for taking the time out of their busy days to send us those fantastic questions. And hopefully you guys got something from our answers. And with that, we'll go ahead and sign us off. You guys go out there and invest with a margin of safety, emphasis on the safety. Have a great week, and we'll talk to you all next week.

Dave [00:35:38]:

Bye.

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