IFB340: The Pricing Power Debate and Investment Strategies for Beginners

Dave [00:00:00]:

All right, folks, welcome to investing for Beginners podcast. Today we have episode 340. Today we are going to answer four fantastic listener questions we got recently. So without any further ado, let's go ahead and dive in. Oop. Side note, if you have questions, if you are curious about something and you'd like for us to help you out on the air, please send your questions to newsletter@envestingforbeganners.com I will put that in the show notes. You can also reach out to me at IFB, underscore podcast on Twitter or at Dave Ahern on LinkedIn. So those are three places you can send us any questions you'd like us to answer on the air.

Dave [00:00:36]:

So with that, let's go ahead and dive into the first question. So here we go. So this is from Sean. Hi, guys. Love listening to your show. I am relatively new to investing and primarily invest in index funds. Fxaix is the ticker. Since I do not know how to fully understand data points like PE ratio, et cetera, would you recommend this approach starting out? Also, is there anything wrong with only investing in index funds, as it seems to be the safer route, albeit boring? So again, this is a great question from Sean.

Dave [00:01:06]:

So what are your thoughts on Sean's awesome question?

Andrew [00:01:10]:

Yeah, thanks for writing in, Sean. And there is absolutely nothing wrong with investing in index funds. I don't know if there was a quote on who it was, but something that investing is not supposed to be exciting, and if it is, you're probably doing something wrong.

Dave [00:01:26]:

Yeah.

Andrew [00:01:27]:

So it should be boring. I think index funds is a great way to go. And with the stock picking thing, if you want to shoot for a little bit more, then understand it does take a lot of work and you have to be really interested in it. And if you're not, then index funds are probably the best option.

Dave [00:01:43]:

Right? And we don't get style points for complexity or exotic. At the end of the day, really what we're going for is the best returns that we can get for what we want to do. And if your lifestyle or your life or your interests don't align with picking individual stocks, then go with index funds. There's nothing wrong with it. You don't get penalized because you use this ETF or that ETF. It's all about what kind of returns you can generate that work best for your life. We all are in a different path. We all have different interests and different ways that we want to go about growing our wealth.

Dave [00:02:18]:

And index funds are a fantastic option for many, many people. And highly encourage you, Sean. If you haven't started doing it, do it now, do it tomorrow, put down the phone and go open a brokerage account and start investing in the index fund.

Andrew [00:02:34]:

So would you say if somebody doesn't like, here's the PE ratio stuff and just kind of automatically gets turned off, do you think they should buy shares of an individual stock or just to kind of try it, or do you think they should buy index fund shares right away?

Dave [00:02:52]:

I think they should. Well, that's an interesting question. If they don't understand it and it's not something that interests them, then they should buy index funds. If it is something that they are interested in but don't quite understand it, then buy some index funds and buy one share of one company, $50 of something, whatever, Google or meta, doesn't matter, dip your toes in the water, put some skin in the game, and then all those things will start to become far more real. And so I think that's a great way to kind of get started, but it really depends on what your interest level is and how curious you are about those things and how much that really drives you. Because again, to my earlier comment, we all have a different game to play, and I think it's better to find out what it is, the game that you want to play. And if index funds works for you, then that's awesome. Go do something else.

Dave [00:03:44]:

Become the next Picasso. You don't have to be the next Warren Buffett. If you want to be the next Warren Buffett, then you're going to have to learn how the PE ratio works.

Andrew [00:03:51]:

Yeah, for sure.

Dave [00:03:53]:

All right, so let's move on from Sean's great question. So we got another one here. So this is, what are your thoughts on Pfizer? This is ticker symbol Pfe. He's asking if this is a buy and hold. So for those of you unfamiliar, Pfizer is a pharma company. So they were one of the companies during the pandemic that developed a vaccine that we are all taking to help us get beyond COVID and all that stuff. And so I guess, what are your thoughts on investing in Pfizer or just pharma companies in general?

Andrew [00:04:26]:

Yeah, I tend to avoid pharma companies, not going to completely write them off in the future. But as of right now, I tend to stay away from them because of the unique economics of pharma companies. What about you?

Dave [00:04:40]:

Yeah, so far I have stayed on the sidelines in relation to the pharma companies. I'm not talking about biotech to me, biotech is like completely, that is beyond my reach pharma. I feel like I have started to climb up the Mount Everest of understanding there. But I am far from the first station on the mountain. And so I have passed on Novodor disk and Eli Lilly. Those are two of the companies that I focused the most on, in particular, Nova Nordisk. And of course, it's doubled since I passed on it, so why not? But I didn't feel like I knew enough about the complexities of the industry and what goes into creating a drug like Ozembic and how long a shelf life that has. And what are the ramifications once that becomes a generic? Because once that becomes a generic, then Novonor disc is going to lose quite a bit.

Dave [00:05:39]:

Not lose, but the revenue growth and the profitability that they're achieving now from the success of Ozembic and Wagovi, for example, that once those drugs are approved to become generics, then that all goes away. And so I don't really understand the dynamics quite enough yet. And so I haven't really doven into the deep end with pharma companies. I'm not opposed to investing in them. But I think once I can get my head wrapped around the idea of patents and how all that works, when they create a drug, how long do they have license for it? How much does it cost them to make the drugs? How long does it take them to create these drugs? It can be a really long process. And there's also the whole pipeline of other drugs coming up that they're testing different stages of testing, and a lot of them won't pan out. And even if they do get approved, they may not end up being very popular. So I feel like there's a lot of ambiguity and maybe a little bit of luck in the system.

Dave [00:06:42]:

And I guess I have a hard time kind of, I guess, underwriting that risk of the luck, spending billions to create a drug, and then it doesn't become the next dozenbic. And how does that impact a company like Eli Lilly? And so that's where I have stayed away from those companies simply for that fact that it kind of falls in my circle, but it kind of doesn't. And so I feel like I still need to expand on my circle to invest in a company like Nova Nordisk or Pfizer, for example. And so that's why I've kind of.

Andrew [00:07:15]:

Stayed away from them, to give context to somebody who maybe isn't that versed in looking at businesses and or hasn't looked at the annual reports of these businesses, we're talking about companies that have a handful of drugs that are driving the vast majority of their revenue. So that's not normal compared to Walmart or grocery store with thousands or tens of thousands of different items they might sell, right? So when you mentioned Wachovi, that drug no longer becomes popular. You're talking about a terrible investment because it creates such a big portion of their revenue.

Dave [00:07:55]:

Right? If it generates, just for example, let's say it generates 40% of the revenue, and then after the patent expires, and it could be developed as a generic, then Novador disk loses all ability to market because nobody's going to pay the customers or the insurance companies are not going to pay for Wagovi when it could be distributed as a generic. And that's just part of the economics of the system and how it all works. But if you don't understand that, then if you dive into a company like, know, Pfizer was on top of the world when they were producing all those, the COVID vaccines, I'm blanking on the name of their particular one, but the government was buying them over fist, and Pfizer was making lots of money from that. And once that dried up, then what's next? And that, to me, is the hard part about investing in some of these firearm companies. And again, that could just be my lack of knowledge, is that it feels like it's kind of based on what's next. What's next? Okay, they got five or six year run of awesomeness with Ozembic, but once that runs out, what's next? And to me, that's what makes it hard for me to think about, okay, well, if I buy Novon or disc or Eli Lilly based on their Alzheimer's drug that's starting to come on the market, for example, then that may only be a five or six year window. And what's next? And I don't know that I necessarily want to invest on a five or six potential year window.

Andrew [00:09:30]:

Yeah. And I feel the same way.

Dave [00:09:32]:

To me, I relate it to investing in oil. It's a commodity. I could probably try to understand it, but it's outside of my circle and I just kind of stay away from it. Maybe a little struggled with, but also tried to overcome it is you don't have to buy everything and you don't have to invest in everything. And as much as it sucks to miss out on a doubling of Nova Nordisc, it's okay, it's part of the game. You can't pick every winner. And I think it's okay to not invest in companies if you don't understand them?

Andrew [00:10:03]:

I don't want to derail the conversation, but I guess that's what you say right before you do it, right?

Dave [00:10:08]:

Right.

Andrew [00:10:10]:

How do you balance sticking inside your circle versus trying to expand it?

Dave [00:10:15]:

That's a tough question, I think, for me. So there are certain areas of expertise or comfort zones that I think everybody's going to have, and they're all going to vary. So what may really appeal to me, financials, payments, companies, those kinds of things are kind of my jam that may not appeal to everybody. And the pharma industry may not appeal to people. Some people may love the airline industry, or they may love commodities, or they may love tech. I like tech, but I wouldn't say I'm super versed in tech kind of things. And so I kind of try to choose and pick and choose the things that I feel like I can maybe get my arms around. So I think you have to follow your interests because trying to read a ten k about J.

Dave [00:11:05]:

P. Morgan if you're not interested in banks, that is going to be the longest 240 pages of your entire life, because it's full of lots of jargon and lots of legalese, and it could be quite boring if it's something that you're not interested in. For me, I try to pick and choose. I try to stick in the areas that I feel like are things that I understand and like and know, and then I try to find other things that may appeal to me. The electrification of things, for example, is something that I think I find interesting and I find fascinating. I haven't at this point, found anything I'd be willing to invest in, but it's still an area that I continue to explore. Internet security, something like a crowdstrike, those kinds of things. That stuff fascinates me, and so it's just a matter of trying to learn, but I still haven't pulled the trigger because I don't feel like I know it well enough yet.

Dave [00:11:57]:

So I think you can try to push against the boundaries of your circle of competence. Understanding that there's going to be limits, and understanding that you don't have to swing at every pitch. Just because you do a lot of work on crowdstrike and you don't buy it doesn't mean it's a waste of time. It also doesn't mean that you can't come back to it in the future.

Andrew [00:12:17]:

Yep, that's very well said.

Dave [00:12:19]:

So how do you think about any of this stuff so kind of going.

Andrew [00:12:22]:

Back to the pharma idea. I'm trying to find the best returns I can find, no matter what the industry is. But with the caveat that if I don't see a path where something looks safe, then I'm going to trust my gut and turn around. So when I look at the pharma industry, I see it the same way you do, where it's like, okay, you made a blockbuster drug. That's great. My game is to try to buy something and hold it for ten years. If we know that drug is going to run out in five years, you better come up with something in the next three, four, five years to make that happen. And then just knowing the statistics behind how many drugs try to get developed and then fail does feel crapshooty to me.

Andrew [00:13:06]:

And so because of that, I'm not trying to invest in crapshoots. And so even though there's probably good opportunity there, the risk profile for me doesn't match up. And so that risk appetite might be perfect for somebody else, but for me it's not. And that's how I try to look at.

Dave [00:13:24]:

Yep, I agree. I think you need to stay within your circle, understanding it's okay to try to expand it. But know, I think to Andrew's point, think about what your risk profile is and understand you don't have to swing at every pitch.

Andrew [00:13:37]:

Yeah.

Dave [00:13:38]:

All right, let's move on to the next question. So this was going to be a fun one question for the almighty drip King himself. Good morning. I hope you guys are doing well. I want to start off by saying thank you so much for being dedicated to and helping people understand the market, getting us excited about investing for a future we want to see. My question for you. I am not super comfortable yet investing and valuing individual stocks accurately and confidently. I have just been indexing for the past few years, but after seeing a few of the indexes pay out a yearly dividend and reinvest it automatically, that got me really excited.

Dave [00:14:13]:

So I would like to shift some focus to a few more dividend centric ETFs. How do I compare a dividend focused ETF to a traditional S p index fund to see where I'm going to get the most value for my dollars invested? Funds in question are both a Charles Schwab funds SWPPX mutual fund and SCHD is the ticker symbol PS. Sorry Dave, but pizza pie is in fact superior. Wrong. Thanks Mike. So this is a great question for Mike. So dripking, I'm going to let you.

Andrew [00:14:42]:

Take the floor all right, ETFs can be tricky, right? Because whether it's Blackrock or Schwab or fidelity or whoever, they could market a dividend ETF, and there could be completely different companies in that index, in that ETF, in that basket of companies. And so it makes it really hard. One of the great benefits of this ETF thing is you don't have to pick individual stocks. And then the irony becomes these ETFs can look so different based on things that don't always make sense. And even some of these ETFs are rebalancing a lot. And so because of that, the stocks that are actually in the index are changing from year to year to year. I didn't look into what the know, you can read all this stuff about every ETF that you'd like and what kind of rebalancing strategy they're doing in any of that. But when I looked at the top holdings of SCHD, and I know that's one I've seen on YouTube, people like to talk about, because it has a high dividend yield.

Andrew [00:15:52]:

Three companies I saw was ABV, Merck, Abgen, pharma.

Dave [00:15:56]:

Right, pharma.

Andrew [00:15:58]:

So high dividend yields. But going back to the pharma thing, if someone like me or someone like Dave or Mike, maybe you feel similarly about the pharma industry, as Dave and I do, then you're getting a lot of exposure to pharma, and that's almost like what you're paying, the payment you are paying to be invested in a dividend ETF. So I say all of that to say, I think an S and P 500 ETF is. Chances are that's going to be a lot better than some random ETF that you might pick that is focused on dividends. Even though the dividend yield is lower, you're going to have a wider net of opportunities, and there's going to be some companies in there, like a Tesla or Nvidia or whatever the next big technological breakthrough company is in the next 510 years. And those will help drive the return. And so you'll get some dividends and you'll get some return. And I like that a lot better than trying to pick and choose different dividend ETFs.

Dave [00:16:55]:

Yeah, me too. And maybe to give a little extra context to what Andrew was kind of talking about. So the dividend yield for the SCHD is around three point four, three point forty five percent. The S and P five hundred is 1.38%. And the mutual fund he mentioned was 1.36%. So it was actually the lowest of the three. But here's where it gets interesting. If you look at the returns over the last five years and ten years for the last ETF that he mentioned, SCHD has returned 49% cumulative over a five year period and 113% over a ten year period.

Dave [00:17:35]:

Comparatively, if you look at the S and P 500, that has returned 81%. So almost double over a five year period, and 171%, which is 58 percentage points higher over a ten year period, which are like, okay, yeah, 58 points, big deal. But if you talk about ten year compounding at 58% higher than the other one, those are big boy returns. And so the longer that that can go on, the more that can overcome the higher dividend yield that you may get from the other return. So it's not just about finding an ETF that offers you a good yield or a dividend yield. You have to also equate into that the overall return you would get from partly the dividend, but also the return of the ETF overall. So let's say, for example, to make it easy numbers, if the ETF in itself is returning 5% a year, and you get a three and a half percent return from the dividend, now you're looking at eight and a half percent, which is, okay, that's not horrible. But then if you compare that to the S and P 500, which is giving you eleven to 12% overall return, then even though the other one has a higher dividend yield, you're getting a better return overall.

Dave [00:18:52]:

And that's really what's more important than the dividend number. The dividends are important. They're part of the return of the S and P 500. They have been over the last 100 plus years. And it's important to take those into account. But if you're looking at trying to get the best return you can, you need to look at what's going to give you the best return, not just the best dividend yield. Because if you do that by itself, that's not going to get you where you want to go. And so that's why I personally would go with, like, the S and P 500 SBY or something related to that, that Charles Wab has, that gives you a similar return.

Dave [00:19:30]:

And you can easily go to just about any stock market service, whether it's our friend Finchette Dio, or you can go to Yahoo Finance, you can go to seeking Alpha, you can go pretty much anywhere and find look at a five or ten year return for some of these index funds or ETFs and compare them. So you can kind of get a sense of maybe how they've done in the past. It's not going to tell you exactly how they're going to do in the future, but it could be an indicator of how they should do.

Andrew [00:19:56]:

What do you think has contributed to the S and p outperforming an ETF like Schd?

Dave [00:20:03]:

I think simply, if you look at the top ten companies that are driving the returns for the S and P 500 versus the top ten companies that are driving the return for SCHD, they're just more dynamic businesses that are really driving the returns for the stock market. You look at the magnificent seven of the s and P 500 today, those are driving, 28% of the return of the market is coming from those seven companies. Something monstrous. And so if you look at the top companies in the SCHD, very few of them are going to be companies. You're like Coca Cola. I'm not saying it's a bad company or a bad investment, but if you compare that to the returns you should expect from Microsoft, not going to be the same, kind of the same with Home Depot. Again, a great company. But can you expect the same return from Home Depot that you would from Google or Meta Verizon? Definitely not.

Dave [00:21:01]:

The component of the index is going to have a big impact on the driver of the return. Bottom line, at the end of the day, the ETF has individual companies in the ETF that are driving the returns. And so the better those companies perform, the better the index will do.

Andrew [00:21:19]:

Yes, 100%. So do you think. We're not giving personalized advice, obviously. But if you were first starting and you were really excited about the drip concept and the compounding effect of dividends, maybe not confident enough to pick individual stocks. Is there a middle ground somewhere?

Dave [00:21:42]:

Yeah, that's a great question. My first instinct would be to invest in something like the S and P 500. Spy or Vanguard has their own, Blackrock has their own, fidelity has their own, Schwab has their own. Try to find something, whatever brokerage that is you're using, try to find what they offer and see what kind of dividend yield you can get on that and look at the components of the index or the ETF and see what's under the hood, and then you can kind of make an assessment from there. I guess that's how I would go. What about you?

Andrew [00:22:16]:

Well, I would say if you have favorite investors that you like to follow, they might throw around stocks that they own, and if that has a higher dividend yield, and there's nothing wrong with not dripping, dipping your toes into a company with a higher dividend yield. So it doesn't need to be one or the other. You don't have to go 100% stocks tomorrow. Right. But maybe an option would be to look at a higher dividend yield that an investor you respect has recommended or has talked about that they own and start adding a little bit at a time and see if that starts to compound. I think that could be another way, too. I did find an ETF that I thought was interesting, but the more I thought about, as we were talking, I'm like, this ETF could have different names in it in a year. So just because the names look decent now.

Dave [00:23:07]:

Right.

Andrew [00:23:07]:

Doesn't mean it'll look great. And so many things can change in one year, two year, five years. So I'm resisting that urge to throw a dividend ETF number out there. But I don't know. That's an idea.

Dave [00:23:19]:

Yeah. I applaud what Mike is trying to do. He's trying to optimize his performance and his portfolio and asking questions and trying to learn what is the best way to go. And I think if you kind of think about some of the things that we talked about, they can kind of help you kind of decompose the returns that you get from the different things. And bottom line is, whether you pick individual companies or whether you buy ETFs or indexes, you have to maximize your return the best you can. And sometimes simple is the best. I've said this before, and I'll say it probably a million more times, we don't get style points at the end for complexity. And so if you are buying an SP 500 and you become the next Albert Einstein, I think you've had a pretty darn good life.

Dave [00:24:10]:

So you don't have to do what we're doing to be successful in the stock market. You can buy ETFs and index funds, and it's not just buy these. You can buy these kinds of investments and do great and have a fantastic life. That's really more important than trying to what is the best dividend ETF I can find? What's going to give me the best return overall and go from there?

Andrew [00:24:35]:

Yeah. That's why we're still friends. Even though you can't get on board with the pizza pie.

Dave [00:24:42]:

Yeah, I know. No pizza pie. Not so much.

Andrew [00:24:45]:

Thanks, Mike.

Dave [00:24:46]:

Yeah, thanks, Mike. All right, so our last question, and we'll try to keep this brief, could go on for hours for this one. So, in a high inflationary environment, pricing power becomes vital for businesses. What companies do you think have the strongest pricing power, in your opinion? Andrew Point. And I'll do counterpoint.

Andrew [00:25:06]:

I mean, I'm trying to find it every single day. Market's dynamic. Businesses are dynamic. I have shares of Apple. I love Apple. I think they have. Name me another company that, like, if I had to replace my Lenovo over there. Right.

Andrew [00:25:21]:

My desktop computer. How am I thinking about that purchase? I'm thinking, all right, one, $200, $2,000, whatever it is. But if you're looking at a new iPhone, oh, an extra $5 a month, they've ascended to the level of expense category. That is automobile payments, health insurance.

Dave [00:25:45]:

Yeah. Internet. Internet access.

Andrew [00:25:47]:

Yeah. You can't live without it.

Dave [00:25:50]:

No.

Andrew [00:25:50]:

And that gives them pricing power.

Dave [00:25:52]:

Yeah, I agree. Two companies that I think are probably pretty obvious are Coca Cola and Pepsi. They can raise the prices. I'm addicted to Coke zero. And if they raised a price to $17 a bottle, I would buy it anyway.

Andrew [00:26:05]:

Don't put that on the airwaves. Don't do that.

Dave [00:26:10]:

Sorry. I didn't say that. Forget I said that. But I think to me, those are two companies that kind of stand really high in the Mount Rushmore of pricing power, that people will pay whatever it is that they charge to consume their products. I think that to me, is kind of a no brainer.

Andrew [00:26:28]:

Do you think part of that's the fact that, know, what's another dollar? Like $3, $4, what's the difference? It's such a small percent of consumer.

Dave [00:26:38]:

Yes.

Andrew [00:26:39]:

Yeah. Charlie Munger talked about that in poor Charlie's almanac.

Dave [00:26:43]:

Yes.

Andrew [00:26:43]:

Decades ago that it's such a small price point and they sell so many, like millions and millions and millions of cans, bottles.

Dave [00:26:54]:

What did he say about that? Kind of on the other side of it, like if you have to have, how did he put it? If you had to have a seance for a week and try to bring in all kinds of prognosticators and have company wide meetings for a month to decide whether you can raise something $0.05, you don't have pricing power.

Andrew [00:27:14]:

Yeah. Well, I mean, you'd be shocked how hard it is to find companies with pricing power.

Dave [00:27:20]:

Yeah, it really is.

Andrew [00:27:21]:

I know he talked about, the question was asking about companies with maybe the best pricing power, but some companies that have decent pricing power is anything that's tied to the economy. So I think of a company like Visa, it's pricing power, even though they're not necessarily changing the price of the fee that they're paying, but the fact that the transactions are higher. I feel like that's almost like an embedded pricing power.

Dave [00:27:48]:

It is.

Andrew [00:27:48]:

Maybe thinking of it the wrong way.

Dave [00:27:49]:

But no, I agree with you. That was one of the examples I shared on Twitter when this person asked me that question, was that kind of the Visa Mastercard toll booth idea is they have unlimited pricing power because it's such a necessary part of the economy and the way we buy and sell things that they have the ability to charge whatever it is they feel like is going to be a fair price and people are going to pay it because they need to have access to their services. Yeah.

Andrew [00:28:18]:

If I'm spending $1,000 a year on my Visa card, next year I'm spending 1200 because I got a raise.

Dave [00:28:24]:

Right.

Andrew [00:28:25]:

That's easy revenue for Visa. And they didn't do anything differently. That's a nice organic growth.

Dave [00:28:31]:

Yes, it is.

Andrew [00:28:32]:

Home builders are another great example of this, the journey. There is a lot more up and down, but real estate as an asset class can keep up with the economic growth because people like to spend money and invest in where they live. And so the prices of homes have caught up with the economy for a very long time. And simply because you mentioned the different expenses that are so critical, a mortgage is right up there if you're a homeowner.

Dave [00:29:04]:

Yep, exactly. So what do you think about the, does, do you think a company like a Netflix or an Amazon prime has pricing power in their subscriptions?

Andrew [00:29:14]:

I say they both do. It's just a matter of one's probably stronger than the other.

Dave [00:29:20]:

Which would you say is stronger of the two?

Andrew [00:29:22]:

Amazon Prime. Amazon prime bar none.

Dave [00:29:24]:

Yeah. You think so?

Andrew [00:29:25]:

Yeah, I think of Amazon prime like I think of Costco.

Dave [00:29:28]:

Okay.

Andrew [00:29:28]:

It's one of those things that they give so much value to the customer, they both do it in different ways, but give so much value that you just have to re up your subscription.

Dave [00:29:39]:

Right.

Andrew [00:29:39]:

You can't live without it.

Dave [00:29:40]:

No, you can't.

Andrew [00:29:41]:

You can look at my front door and see how many Amazon packages come. Can't live without it? Not in this house.

Dave [00:29:48]:

Yeah, my fiance has gotten hooked on Amazon prime. And so, yeah, it's a good and bad problem to have. It's awesome because you get all these things delivered right to your door. It's not so great because you got a lot of money going out the door for. So there is that. What are some companies maybe outside of, maybe the tech world or the retail world that you feel like would have pricing power.

Andrew [00:30:14]:

Talked about this company before I own them. So take that for what it's worth a company called Martin Marietta Materials. Everybody loves bitcoin because the supply of bitcoin is shrinking over time. The things that Martin Marietta Mines is also a limited resource on this earth, which is kind of crazy. The stuff that they make goes into concrete and asphalt. And you've told me many times about the roads up in the Midwest, how often they need to be refreshed every six months. It's not just new construction, it's maintenance, construction. And these aggregates are just always in demand, and we're running out of them.

Andrew [00:30:59]:

So it has a lot of pricing power, and it has for decades.

Dave [00:31:02]:

Yeah, for sure. Anybody that grew up in the Midwest will understand this when I say that I 80 in Iowa had two seasons, winter and construction.

Andrew [00:31:11]:

Sounds awful.

Dave [00:31:12]:

It was. What are some other companies maybe that you could throw on the pile of pricing.

Andrew [00:31:22]:

Mean? Just go down the list, right? I mean, Wattsco comes to mind because, again, to the necessity. Basically what they do is they sell HVAC, their distributor for HVAC systems. And I don't know about you, but if my HVAC goes out, I want that replaced ASAP. And what's great about the new HVAC systems is they're all becoming more and more energy efficient.

Dave [00:31:46]:

Right.

Andrew [00:31:47]:

That gives them pricing power because they're saving customers money.

Dave [00:31:50]:

Yes, for sure. If you think about maybe the top ten companies in the S and P 500, does a company like Nvidia carry pricing power, do you think? Or does a company like Tesla carry pricing power?

Andrew [00:32:04]:

Yeah, I would say with Nvidia, as long as they can, again, save their customers money, they have pricing power. It's all about the value that anybody is really providing for Tesla. As long as the demand is there, they have the pricing power.

Dave [00:32:19]:

Right.

Andrew [00:32:20]:

So the jury's still out on if the stumbling in pricing power they've had lately. Is that a long term thing or is it just a short term hiccup?

Dave [00:32:27]:

Right.

Andrew [00:32:28]:

If I had to put my money on it, I would not bet against them. But we don't know. Anything could happen.

Dave [00:32:33]:

So pricing power definitely plays a part in a company's moat or their competitive advantage. They kind of have to go hand in hand.

Andrew [00:32:41]:

At the risk of oversimplifying something, I think a moat should give you either pricing power or the ability to take market share. And if you don't have either of those things, then your moat maybe is not as strong, but it can still be a good investment. You have barriers to entry moats, too, which may or may not have pricing power. It's a great question yeah. How do you look at it?

Dave [00:33:05]:

I guess I look at it. How would I describe it? I have this concept in my head, and I'm struggling really hard to put it into words. They kind of coexist, I feel like. So you can't have a moat without pricing power. And you can't have pricing power without a moat. So the competitive advantage that Costco has also gives them the ability to charge the prices. They can raise the price on a subscription and people will pay it gladly hand over fist because it has a moat. It has a competitive advantage that makes them successful, and that competitive advantage allows them to raise the prices on subscriptions when they want to.

Dave [00:33:46]:

And so to me, it's kind of a symbiotic. That's the word I was looking for. It's kind of a symbiotic relationship. That's kind of how I tend to look at it. Whether or not that's correct or not, I guess the jury is still out.

Andrew [00:33:58]:

Yeah. It's not a bad way. I think more often than not you should see both in place, I guess.

Dave [00:34:04]:

How would you identify a pricing power of a company? Is it super obvious or can it be more subtle?

Andrew [00:34:12]:

I think it's more subtle. What about you?

Dave [00:34:14]:

I would tend to. Yeah, yeah. Coca Cola is like a super obvious one, or Apple, their iPhones is super obvious, but something like Wattsco is certainly more subtle.

Andrew [00:34:26]:

Yeah. Like, just because revenues are up or a certain KPI is up doesn't mean there's automatic pricing power.

Dave [00:34:34]:

Right.

Andrew [00:34:34]:

I think of like a brick and mortar retailer, and I have one in my portfolio. And if comparable sales are up, I don't think that necessarily means they have pricing power. It could just mean the type of products that they sell are highly in demand at the moment, and that could eb and flow depending on the state of the customer or the state of the economy.

Dave [00:34:59]:

Right.

Andrew [00:34:59]:

I mean, I'd be curious your thoughts on this, but to me, I don't necessarily need pricing power to find a good investment, but I'm also playing a different game.

Dave [00:35:10]:

Yeah. I'm not going to not invest in a company just because it doesn't necessarily have pricing power. But it's certainly an added bonus if you can find a company that's really strong and also has pricing power in their industry that can really make or break a long term investment for the company.

Andrew [00:35:28]:

Do you think it's fair to say companies with pricing power have a longer staying power?

Dave [00:35:34]:

Yeah, I would say that, yeah. Because if you think about pricing power, we're not just talking about the ability of the company to raise prices next year just because they happen to have the hottest new fashion or fad kind of thing. It's more of a long term ability to continue to gradually, over a period of time, raise prices that allow them to organically grow revenue over a period of time, because that's really where the power of compounding can really come into. It's not just the ability to. This is the hottest new thing, and so they can raise double the prices this year, and then three years from now, the company is not in existence anymore.

Andrew [00:36:15]:

Right.

Dave [00:36:15]:

Or they get bought out by somebody else or whatever, and that's not pricing power.

Andrew [00:36:21]:

Do you think there's any popular companies right now, popular stocks that maybe don't have pricing power? Or you mentioned fads and trends. So maybe is there a certain industry where people might think there's pricing power when maybe they should reconsider?

Dave [00:36:42]:

Right. Well, two companies that kind of spring to mind. Granted, I don't know them that well and I don't know the industries that well, but when I think about them, that's something kind of pops into my head. One is Lululemon, and again, retail space, I don't know. And so that's not really my thing. But one of my concerns, potential concerns about the company, is that it's a fad. That it could be a fad. I'm not saying it is, but it could be a fad.

Dave [00:37:11]:

The other one that kind of springs to mind would be Airbnb, is that I am not 100% convinced that it's going to take over the hotel market, if you will. I guess I'm skeptical of that. And so to me, that lends it to self to like, do they really have pricing power? And I don't know the answer to that.

Andrew [00:37:32]:

Those are good.

Dave [00:37:33]:

What about you?

Andrew [00:37:34]:

Crocs came to mind. I have a pair. I love them. I just can't bring myself to invest and probably regret it because I just don't know. I think whenever it goes out of fashion, if it ever does, I'll be the last person.

Dave [00:37:52]:

You'll be second to last. I'll be the last. I will absolutely be the last. Yeah.

Andrew [00:37:57]:

Did you get your stanley cup yet?

Dave [00:37:59]:

I did not. Nope.

Andrew [00:38:04]:

I guess if I had to throw in another company, I'd throw in Uber and Lyft. I'm looking at them and I think at a certain point they'll probably be decent investments, but from a pricing power perspective, I don't know if they have it because anybody could start a taxicab company.

Dave [00:38:20]:

Right.

Andrew [00:38:20]:

And so I'm sure they're going to be great compounders for a long time. And if you buy at a good price, you'll probably get compounding returns. But I just don't see the pricing power because there's very little barriers to entry into doing what they do.

Dave [00:38:34]:

Right. Yeah, I agree. Those are great examples. All right. Well, with that, we will go ahead and wrap up our show for today. I wanted to thank everybody for taking the time to send us those fantastic questions. Please keep them coming. Again, if you do have questions and you want to reach out, go to newsletter@envestingforbeganners.com send us an email and we will get it and we'll answer it on the air.

Dave [00:38:55]:

So 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. Bye.