



## IFB358: How to Define Your Circle of Competence

Alright folks, so welcome to Investing for Beginners podcast. Today we have episode 358. Today we're going to answer 2 great questions. So we got these awesome questions that we found online that we thought would be relevant to our listeners and thought they could be very helpful for you. So the first one is.

00:00:51 Dave

How to find your circle of competence? So I think this is a great question and I think this will be a lot of fun to chat about so.

00:00:59 Dave

Maybe Andrew, you could maybe give everybody like a 30,000 foot view of what a circle of.

00:01:03 Dave

Competence is I.

00:01:04 Andrew

Believe it was popularized by Warren Buffett and Charlie Munger. Basically, this idea that.

00:01:12 Andrew

We can only we all have our areas or zones of genius and so.

00:01:19 Andrew

If you can understand where your area of genius is in investing and the stock market, then you can increase your chances of success and there's a bit of humility there to say like it's too hard to know everything about every stock in the stock market. So you kind of draw this perimeter where you're limiting yourself to say, OK, I'm going to be.

00:01:42 Andrew

I'm going to be.

00:01:44 Andrew

Trying to be just as reasonable as I can to say I'm going to try to find an edge in a little in a little bit of expertise. That's kind of how I think about circle of competence.

00:01:56 Andrew

You know, do you kind of see it similar whether some of the benefits or are there cons to that approach I mean?

00:02:03 Andrew

It.

00:02:03 Dave

Well, it's a \$20 word or \$20 phrase, right? It when you hear circle of competence, you went wow, what does that mean it?

00:02:09 Dave

Just sounds very.

00:02:11 Dave

Like a big a big idea. And I think the way you described it is is a great way to think about it. It's a the way I look at it is it's an area that you feel comfortable.

00:02:25 Dave

Looking at companies and understanding what it is they do and trying to figure out who their competitors are and just how well you think the company will do, and I think there's pros and cons well, would there be cons? There's certainly pros to this where there's the better you understand where you are in the fringes of your circle of competence.

00:02:46 Dave

Not necessarily like the.

00:02:47 Dave

Core idea of like, hey, I can really understand retail companies for.

00:02:52 Dave

Example. I think that's pretty much a given. It's when you start to push the edges of the envelope, so to speak. So if you start to.

00:02:59 Dave

Try.

00:02:59 Dave

To understand, you know, defense companies or companies that work in the industry of the military, like, do you really understand how those companies work? And if you don't?

00:03:12 Dave

Then so the I guess the con would be if you stray beyond your circle of confidence, you could get yourself in a lot of.

00:03:18 Dave

Trouble if you.

00:03:18 Dave

Start trying to buy things that are outside of your area of expertise or.

00:03:23 Dave

Even just things that you don't understand, you could lose a lot of money very, very quickly if you try to to branch into things that you just don't understand. Like I think a perfect example for me of a con would be if I decided I wanted to invest in Exxon and I know nothing about commodities and how they work and because Exxon.

00:03:44 Dave

Deals with commodities, oil and if I don't understand oil and how that whole system works and the pricing of oil and how that can really impact Exxon, I could set myself up for some really large losses if I don't understand that. And so I think that's why.

00:04:00 Dave

Where you really need to understand, not necessarily your core competency of circle of.

00:04:05 Dave

Competence. But where?

00:04:06 Dave

Your edges are and. If you don't do that, yeah, buyer beware.

00:04:11 Andrew

And even past just businesses or industries, I think their circle of competence in the type of strategy you choose.

00:04:21 Andrew

Is your temperament or the things you find in the ways you behave doesn't match up with the types of stocks you're trying to buy?

00:04:30 Andrew

And the the way you're trying to go about it, you know, if you're a numbers genius who can write algorithms to, you know, take advantage of fractional differences in the market and that kind of stuff excites you like a Renaissance technologies, right, then maybe like a super high frequency trading algorithm thing.

00:04:50 Andrew

Is more suited to that kind of sales skill set versus some of the stuff that I like to talk about. And Dave likes to talk about is.

00:04:59 Andrew

Very long term and and a lot more passive. And so the skill sets, the things you're looking at, the ways you're analyzing things are all going to be different depending on what.

00:05:10 Dave

Area of investor style. You're trying to really use, right? So I guess the question when I think about circle of competence is number one, like how do you determine what your circle of competence is like, how do you think about?

00:05:25 Dave

That how did.

00:05:25 Dave

You maybe think back to the early days, 10 years ago.

00:05:30 Dave

Like, how did you determine what your circle of competence was or is? And I guess that would be interesting to discuss.

00:05:37 Andrew

Yeah, I'm bit unfair because my approach was a lot different back though than it was very numbers based and I was kind of trying to model some of the things I saw.

00:05:48 Andrew

From books like what works on Wall Street or the acquirers multiple.

00:05:53 Andrew

Idea of just buying the stock that's cheap, regardless of why.

00:05:56 Andrew

Cheap and that can win, you know, probabilistically that could win. But you also have to get your buys and sells, correct.

00:06:03 Andrew

And that's the.

00:06:03 Andrew

Hard part, so maybe you could argue that my circle of confidence then was more so like I was sticking to a certain universe of.

00:06:12 Andrew

You know, price, earnings price to book kind of thing. And so I did not.

00:06:19 Andrew

If there was a good thing I did at that time is I did not break those rules. I didn't all of a sudden buy a PE of 50 because everybody else around me was buying it and I wanted to.

00:06:29 Andrew

Be like them.

00:06:30 Andrew

I stuck so I had a system and I stuck to it. That was a good thing. I did. The bad part was it didn't fit with my overall goals for my personal life.

00:06:39 Andrew

And so that's why I had to change. What about you take take us back to when you first started investing and what was your first circle competence and how?

00:06:47 Andrew

Did you identify?

00:06:48 Dave

It. Yeah, that's a good question. I think because I was working in a bank, I think I gravitated towards financials.

00:06:55 Dave

And I think I had some misguided idea that I really understood them because I worked in the bank. I kind of took that Peter Lynch idea by what you know, and I kind of extrapolated that to a circle of competence. And because I worked at the bank, I felt like I understood them. And so then that became.

00:07:17 Dave

The thing that I looked at the most obviously reading through Wells Fargo's 10K, reading through JP Morgan's, you know, Epistle and trying to learn everything I could possibly learn about.

00:07:29 Dave

Banks and it did appeal to me because they were number based and there was lots of numbers you had to learn lots of ratios. You had to learn and that appealed to me. And so I really felt like those were an area that and real estate and insurance were two places that I felt like and mostly that was because of of reading a lot of Warren Buffett.

00:07:50 Dave

And because he talks about those endlessly in his in his shareholder letters, and if you want to learn how insurance companies work, read through his letters because he goes into a lot of detail.

00:08:03 Dave

To really help you understand how they make money and what they work for and what not to look for, and it could be very, very helpful. And so that to me was really kind of how I started and.

00:08:17 Dave

Like you, I kind of tried to follow the number game too a little bit and I probably wasn't as diligent about it as I should have been, but that was really kind of how I first started for sure.

00:08:30 Andrew

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00:08:41 Dave

So I guess.

00:08:42 Dave

Looking back on that now, how do you feel? Like you've morphed into what you feel like? You're So what confidence? Maybe now? Yeah.

00:08:52 Andrew

Still trying to push the boundaries as much as I can within reason. So I mean, you know, it's no secret I have the newsletter that I do. So every month there's a deadline. So I figure if I'm spending time to expand my circle of comments, I'm not saying this is the right way to do it. It's just how I do it.

00:09:11 Andrew

If I know I'm going to tackle a new industry or something that maybe is tangential, but.

00:09:16 Andrew

I haven't really done super deep dives on the companies in there. I'll try to make sure I have enough time before the end of the month.

00:09:24 Andrew

Before doing something like that, like when I dove into steel randomly, which ended up helping like two months later. But to me like having that and then if there's not enough time.

00:09:35 Andrew

Knowing that I do have a circle of competence in other areas that I can not steel firms, not the right word, but I can like pick I can pick and I can play in those fields and that works out for me and it kind of takes a little bit of pressure off to to know that. All right.

00:09:52 Andrew

Realistically, am I going to find a bargain deal every month? Probably not. So do I have these circles of confidence that I can, I can look and say, OK, out of out of all these things, I already know that I'm already confident in. Which one is the is the best relative opportunity out of those and be able to pick to that.

00:10:11 Andrew

That's because I do dollar cost averaging, which is something we have talked about endlessly on the show, but maybe somebody applying that who doesn't dollar cost average just kind of sits on their hands until they.

00:10:21 Andrew

Have.

00:10:22 Andrew

You know the bargain of the year or something so.

00:10:26 Andrew

I hope that's helpful in the sense that like that's that's kind of how I apply it, but it's very personal in the way I'm trying to invest the constraints I put on myself like dollar cost averaging and.

00:10:37 Andrew

Just trying to be realistic with working with what I have and I would definitely say that.

00:10:43 Andrew

This isn't something that I just figured out overnight. This has been just a process kind of going on behind the scenes that has naturally.

00:10:52 Andrew

Taking root just after lots of practice.

00:10:56 Andrew

Yeah, lots of practice. Yeah. What about you?

00:11:01 Dave

Oh, that's a good question. I think for me, it's been a journey of curiosity. So the big thing for me is trying to follow what I find interesting and I think alongside that.

00:11:18 Dave

I can operate under a bit of a different I guess method than you can because I don't have that pressure of having to come up with a, you know, something to do every.

00:11:28 Dave

Month and so I kind of operate from a different mindset in that I can follow my curiosity so I can go down a payments rabbit hole. I can go down a battery rabbit hole. I can go down a solar energy rabbit hole and learn all these things about these different areas. I can try to learn as much as I can about semiconductors.

00:11:49 Dave

Things like that that I can poke around on that may or may not have necessarily been part of my circle of competence originally, but because I can follow my curiosity, I can spend time trying to learn about those areas without the pressure of having to invest in.

00:12:05 Dave

Something I think gives me the ability to, I guess, broaden my circle of competence and to your point, there are times where, yeah, it could be frustrating, you know, because you desperately want to find something to invest in and you can't or you don't and you feel like it's wasted time or energy.

00:12:25 Dave

But it's not because it it knowledge that compounds upon itself so.

00:12:29 Dave

Builds on the more that you learn about how the electrical battery is built and the minerals that go into that has a direct bearing on energy and has a direct bearing on solar and maybe utilities as part of that, you know and adjacent to that. And so you can really kind of branch out from those different areas like if you really understand.

00:12:50 Dave

Paints than something like fintech, by and large, is going to be a lot easier to understand.

00:12:55 Dave

And and in theory, if you understand semiconductors then you should be able to understand, you know some of the other parts of that food chain as well as maybe a bigger picture idea of, I don't know, you know, computers or, you know, the Internet or, you know, cybersecurity or things of that nature and so.

00:13:15 Dave

I think all those things can build on each other and so that's how I've tried to approach it. I like the thing you said earlier about you went down this rabbit hole on steel and even though you didn't actually weren't, you didn't execute on buying something in that.

00:13:29 Dave

Street the first couple months it definitely helped you down the road, so that was knowledge that you kind of banked and then later when you came across something that was appealing that fit into that niche or closer to that niche, it it really can help you. So I think people, I would encourage people.

00:13:49 Dave

Not to get discouraged if you do all this work to try to learn more.

00:13:53 Dave

About semiconductors and then you end up not buying anything that's still knowledge. It's still useful information that you've learned that you can use. You don't know when you're going to be able to utilize it



in the future, but you will. And that's to me is one of the great things about trying to expand your circle of competence or push the boundaries so to.

00:14:12 Dave

Speak.

00:14:14 Andrew

Do you think that's something that you struggled with early on or maybe then intuitively understand about this idea of working to expand the circle? Competence isn't like the pressure to to feel you have to buy something while you're expanding the circle of competence. Is that something you struggle?

00:14:32 Dave

With early on or OK. Yeah, yeah, absolutely. That was not something that I learned right out of the gate. And it was not intuitive. It was something that, you know, over a few years, it probably was a combination of you and I talking about it, reading other things, seeing other things that people were telling us.

00:14:52 Dave

You know, and interviews and things of that nature. So it was something that it was an idea that built up a little bit over time. It wasn't something like I didn't wake up in the middle of the night at 2:42 and go, ah, but it was definitely a.

00:15:05 Dave

You know, a more gradual idea. And then once I once it, you know, kind of dawned on my brain. And then I was like, oh, yeah, yeah, OK, I can do all this work.

00:15:12 Dave

And it's not a waste.

00:15:15 Speaker 5

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00:15:35 Speaker 5

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00:15:47 Andrew

Right, it's hard. I mean a lot of other areas in life, you feel like you got something out of it, right? And and if it's not visible, that can be difficult for sure. All right, so.

00:15:58 Dave

Yeah.

00:16:01 Dave

We've kind of talked about a circle of competence.

00:16:03 Dave

And how you can find one how you can expand on it. Now let's talk about how do you find stocks to buy. So I think those kind of line up nicely. So how do you find stocks to buy? You mentioned earlier that you have this pressure?

00:16:16 Dave

To try to.

00:16:17 Dave

Find a new idea every month, or potentially a new idea every month. How?

00:16:21 Dave

Do you do?

00:16:22 Andrew

That I I do everything so I've asked like between like running a screen to checking out what other people are talking about to asking you to keeping my eyes open and like.

00:16:38 Andrew

All like jot down notes on my phone if I see something in everyday life that is interesting or catches my eye and then do the work later on when it's working hours. So listen, the podcasts read books, maybe shocked. I'm finding a theme more and more. You mentioned the scuttlebutt to me last week and.

00:16:58 Andrew

How powerful that can be?

00:17:00 Andrew

And I haven't done this like formally, but I feel like I can tie.

00:17:05 Andrew

So many of my ideas to like a person, and it's nearly not the same person. It's usually somebody different but kind of going to that circle of confidence thing. Certain people have better insights on the company than than others. So if you have a friend or a family member who you know works in construction or engineering, they might.

00:17:25 Andrew

Be a good source. I talked to a builder and didn't ask about the home builders but asked about like, hey, what companies are you buying from and like which of those are really good companies and that ended up being one of my stock picks because then.

00:17:38 Andrew

I got the lead if you will, and then started doing the work on the financials and was like, oh, I think I think we might be on to something here. So personally I'd like to know your thoughts on screens because I know in the early days like we were super heavy screens and we kind.

00:17:53 Andrew

Of.

00:17:54 Andrew

I want to say I'd move away from it, but it's less of a priority. But I do like returning to them.

00:17:59 Andrew

Every couple months.

00:18:01 Andrew

Because I feel like it it resets me a little bit and kind of helps me find things that are more value ish I.

00:18:07 Andrew

Don't know. Do you still use them do.

00:18:09 Speaker 1

I.

00:18:10 Dave

But not as I used to be very religious about it and now I am a little more agnostic about it. It just more when the mood strikes me.

00:18:21 Dave

Because I think in part in part for me it's because I'm in it every day now and.

00:18:29 Dave

And.

00:18:29 Andrew

Right.

00:18:30 Dave

I am, you know, I spend my day in the stock market and I don't necessarily look at the market every day like I haven't looked at My Portfolio in like 2 weeks and I don't watch, you know, the news and so, but I'm writing about it, I'm talking about it. I'm tweeting about it. Well, exiting whatever you want to say.

00:18:52 Dave

I'm talking about it on LinkedIn. I mean it's everywhere you and I do the podcast we, you know, we have conversations. So it's way more part of my life now. And so I feel like the idea generation.

00:19:04 Dave

Doesn't need to necessarily come as much from screeners as it used to, just because they didn't have that outlet on a daily basis to feed that need. If you will. And because I am.

00:19:19 Dave

Now I'm trying to instead of having to feel like I have to buy something every month, it's more about buy something new or may or phrase that I invest every month. But a lot of times it's either companies you're recommending or I'm just buying my own, you know, things that I already own in My Portfolio and so.

00:19:38 Dave

I don't have that burning need to find something new all the time and so kind of going back to the circle of confidence. I generally try to follow my curiosity about things so perfect example I was driving across the country a lot for a while and.

00:19:56 Dave

I would notice different things when I was.

00:19:58 Dave

Out on the road like.

00:20:00 Dave

Wow, I see a lot of, you know, O DFL trucks. You know, Old Dominion trucks. Yeah, I see tons of it. And.

00:20:06 Dave

OK, what do I know about that company? What is there? Nothing but man, they're everywhere and so maybe that's something I should look into. Or I'm stopping at all the same kind of gas stations. And so maybe looking into Casey's, for example, is something I should consider or.

00:20:24 Dave

If I think about, you know, my phone or something related to that, there's just I think, you know, you go to the grocery store, you see all these.

00:20:34 Dave

Packages on the shelves and go, huh. Everything's packed for gamble. Or I look at my, you know, even just looking in my, my little the shelf where I keep all my toiletries. Right. You know, they're all from the same company, like, OK, that's an interesting idea to look at. I'm not saying that these are things that I would necessarily buy, but it could be idea generators too.

00:20:55 Dave

Or if I notice that you know, my fiance always buys all her clothes from the same place. Well.

00:21:02 Dave

If she's doing that, that means other people are doing it too, which means it's popular, so that might be something you'd want to look at, and it's just those kinds of little everyday observations, like you were talking about.

00:21:14 Dave

That I think can lead to some really great ideas and to your point, listening to your friends talk about their companies, who they work for, what they do for those companies, and you can get a lot of great insights from all those places. So I kind of liken it to anybody who's ever played basketball. One of the hardest things to learn when you're becoming a better basketball player.

00:21:35 Dave

Is to dribble without watching the ball, and so I.

00:21:38 Dave

I kind of liken.

00:21:40 Dave

Looking for stock ideas like dribbling with your head up like? I'm not looking down anymore. I'm look, I'm looking around and trying to observe everything around me and I think that's a great way to try to find different companies to invest in and that and following my curiosity have really become my big things now.

00:21:58 Andrew

The Donald Doran, who said he had advice for people who were just starting out and like what stocks should I look at? And he said take like a journal for a day or a week or something and note everything that you spend time on and then.

00:22:12

Mm-hmm.

00:22:14 Andrew

You know how many of us use Google or Apple iPhone or, you know, Microsoft Excel? All these things, all those things, right?

00:22:19 Speaker 1

Matt.

00:22:20 Dave

Yeah, for a math. Yeah.

00:22:23 Andrew

And then, you know, I think you said like even if you spend like a dollar on something, jot it down and then after a week.

00:22:30 Andrew

You know, if these are the things that you do, they could very well be the things that a lot of other people do too, and that could be a great investment idea, I mean.

00:22:40 Andrew

I am.

00:22:42 Andrew

Just tripping on myself that I did not buy Chipotle stock. I mean, I guess it never was in my circle comment so it doesn't sting as bad because it's always been like kind of a growth guy's name to me. I was eating there like, you know, 12 years ago every day because it was one of the few places where you get good macros.

00:22:58

Right.

00:23:02 Andrew

Right. And it's kind of still like that.

00:23:05 Andrew

But it's like man, I'm like, I was all all over that in the early days, and I didn't take advantage or Costco like I literally grew up on Costco like my mom would take us there all the time. All of our, like, party food was always from Costco. And how long will it take me? Almost 10 years, like maybe eight years? Nine years until I finally like.

00:23:25 Speaker 5

Yeah.

00:23:26 Andrew

Yeah, I do know this business pretty well. So yeah, it's interesting. It's kind of like.

00:23:29 Dave

Right by the socket, right?

00:23:35 Andrew

You almost have to not make it so.

00:23:37 Andrew

Hard like like.

00:23:40 Andrew

The stock market can be endlessly complex, and there's so many rabbit holes you can go down, but sometimes.

00:23:46 Andrew

Sometimes the simplest ideas can be great wealth generators.

00:23:51 Dave

To your point, I cut, you know, the cord with cable back in 2007 or 8 and when was the first thing that I started spending the majority of my time, if I watch TV was Netflix. But did Dave invest in it?

00:24:06 Dave

No. Did I even think about it do.

00:24:10 Dave

And you know how many hours have I spent on?

00:24:13 Dave

Netflix since that time and never bought the company, just never even entered my radar. And so to your point, I think that idea that the motoring came up with is like, perfect, because it really.

00:24:28 Dave

Illustrates and you know very black and white, right, that you can see this is what I'm spending my time on and how many times have you? I know this has happened to me all the time. You're out interacting with something and then you go. I really like.

00:24:43 Dave

This.

00:24:44 Dave

And then you discover it's actually a public company, like who you know? Yeah, and.

00:24:50 Dave

You know, sometimes it can lead to fantastic investments and and opportunities if you just kind of keep your eyes open and and see what you interact with on a daily basis or what other people around you interact with on a daily basis, you know everybody and their brother is on a Samsung phone well and you're the only one in your group that has an apple.

00:25:11 Dave

Well, OK, maybe bears looking into Samsung. I'm not saying you should because Apple is clearly.

00:25:17 Dave

Better, but those are fighting words. I know, but I think there's a lot of opportunity. Screeners are definitely great, but I think if you pay attention to your general life and notice what you're reading and what you're seeing on, you know the media, whether it's social media, whether it's YouTube, I think you can find lots of great ideas from those kinds of places.

00:25:38 Dave

The last one is your newsletter. I mean, that's the.

00:25:43 Dave

It's true, it's it's an idea, general.

00:25:45 Dave

There there's lots of other writers that that we both read that we read in large part for to help us find and potential investment ideas. And that's the same way that I look at the value spotlight is there's every month, there's a potential opportunity for me to find a company that, hey, this is something I got to buy. And I think that's one of the.

00:26:06 Dave

Many, many benefits of of subscribing to that and that's why I've enjoyed it so much. I mean, I started following you in 2014 and you know, so it's been a long journey, but yeah, that's those are how I find it is, is, is those kinds of things and.

00:26:22 Dave

Look around you.

00:26:24 Andrew

Well, thank you. I'm tickled.

00:26:26 Dave

You're welcome. Hopefully it's not too ticklish. Alright, folks. Well, with that, we will go ahead and wrap up our show for today. I hope you enjoyed our conversation on the circle of competence and how to find investment ideas. If you have any questions.

00:26:41 Dave

By the way.

00:26:42 Dave

Please send them to us you can.

00:26:45 Dave

We'd love to answer them on the air. You can send them to us at newsletter at investing for beginners.com. You can also send them to us via Spotify on their app. If you listen to our show on Spotify and you can also reach out to us on the social media machines in particular X.

00:27:02 Dave

And so Andrew and I are both on there. Oh, we're also on YouTube as well. So that's a newer thing for us as well. So there's lots of avenues if you have questions. We want to help and reach out to us, send them to us and we'll be happy to read them on the air for you. So with that, I'll go ahead and sign us off. You guys go out there and invest with the margin.

00:27:18 Dave

Of safety have this on the safety. Have a great week and we'll talk to you next week.



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