Value Investing Secrets: From Berkshire to Micro-Caps with Daniel from All-In-One Investing

Welcome to Investing for Beginners podcast. Today we have Daniel from All In, who's also active on Twitter and LinkedIn. He's one of my favorite followers and a smart guy with lots of great insights.

Dave: Daniel, welcome to the show and thanks for joining us today.

Daniel: Thanks for the intro and thanks for having me. Welcome to all the listeners. I hope I can provide some value today.

Dave: Let's start with an easy one. Why do you invest in stocks? We have so many choices to invest in - gold, Bitcoin, oil, bonds, real estate. What about them gets you excited?

Daniel: Initially, it was the naive thought of getting rich without doing much work - just spending money and making more money. Pretty soon, this idea gets tested by the market when you realize it might not be that easy. Most people get into the market, especially when they're young, with this naive thought of just making money. Stocks are probably the asset class where most people feel that's easy to do.

Of course, you have these legendary asset classes like gold that supposedly always go up, but stocks have a certain magic to them. That magic got me into it, although I actually started learning about stocks when a teacher of mine in school talked about them. It wasn't about getting rich quickly - I took his advice and thought maybe it would be more interesting if I could beat the market. That's how I started learning more about investing.

Dave: Do you remember your first investment? What was the first company you bought?

Daniel: My first investments were during the COVID era, after the stock market crash. I made good returns, although I bought some terrible stocks - mostly biochemistry stocks and big names. When building a portfolio starting out, Apple seemed like a must-have. I also invested in Berkshire Hathaway because I knew about Buffett. Berkshire was actually my best performer for a long time as it was my longest-held and largest position. While I was naive enough to invest in various questionable stocks, I wasn't naive enough to think I was some kind of investment wizard. The risky positions were small, while Berkshire was my major holding.

Dave: What was the turning point that made you realize Berkshire was going to do well and the others weren't? What prompted you to dig deeper?

Daniel: It was all about studying. Before that, I only knew a bit about stocks and watched occasional Buffett interviews on YouTube. Then I realized I needed to dig deeper and start reading the essential books. I made mistakes there too - my first book was one I didn't understand at all. I just went to the library looking for books with "investing" or "security" in the title.

I ended up reading "The Intelligent Investor," which I think is a great book. Many people today say it's boring and the ideas are outdated, but I disagree. While some examples may not apply to today's market, it's more about the philosophy. For me, it represents value investing. Benjamin Graham's portrayal of intelligent investing and value investing philosophy is still relevant today.

The biggest game-changer for me was Peter Lynch's book "One Up on Wall Street." This was the first book that made me realize you can beat the market as an individual investor - maybe even because you're an individual investor. The big institutions and money managers are prone to make the same mistakes because they need to answer to their investors. That was when I first thought it actually makes sense to try beating the market, as being a small individual investor could be an advantage. You don't have billions to manage, so you're not forced to invest only in the biggest companies - you can go wherever you want.

Dave: Why do you think "The Intelligent Investor" gets such a bad rap now?

Daniel: I think it's because it was the first book on the topic. When you're first and put all these ideas into a book, others will copy those ideas and showcase them in more engaging formats like videos and podcasts. Many people have already heard the ideas Benjamin Graham presents in "The Intelligent Investor," so they think they know it all and find the book boring compared to modern content. It's similar to what happened with Daniel Kahneman's "Thinking Fast and Slow" - it might be the best book I've ever read, but people say it doesn't offer anything new, simply because it was the first.

Dave: I agree. I have "The Intelligent Investor" on audiobook and I listen to chapters 8 and 20 every year. It's a ritual I started many years ago because Buffett has said repeatedly that those are the two most important chapters. The ideas behind margin of safety and Mr. Market are timeless. I know there's a popular meme on Twitter showing investors throwing their copy in the trash when they see some meme stock going to the moon, but to really grow your wealth in the market, you have to follow these timeless ideas.

Daniel: Those chapters 8 and 20 alone show the entire value investing philosophy, something that will never get old. One thing many investors, including myself initially, get wrong is thinking they need to be in the "right" companies - the Magnificent 7 or the top 20 of the S&P 500. There's this urge to find the next Apple, Microsoft, or nowadays, the next NVIDIA.

That's a misconception because there are hundreds, maybe thousands of stocks that can be great investments at certain times. If you're focused only on the best companies the world has ever seen and hope to find another company that can compound over decades like them, you'll likely be unsuccessful. Finding such companies is immensely difficult, and if you study their histories, you'll see they all went through phases where they could have gone bankrupt - there was a lot of luck involved.

That's what we call survivorship bias. I think people should focus more on learning about companies and different industries, tracking them, and watching for when they become interesting. When is the hype over? When can you buy these companies at a cheaper price? When do they deliver more value? That's what people should focus on rather than trying to find the next Apple or Microsoft.

Dave: And another important point is that if you're looking for the next NVIDIA, you might have to wait 5, 10, or 15 years. Think about the opportunity cost of not investing in something else. If you have all that money sitting in a savings account, you're losing money. Even just buying an S&P 500 ETF would be better than waiting to find the next unicorn.

Daniel: Absolutely. There's an interesting debate about the S&P 500 and NASDAQ. Looking at their top five companies over a 20-year horizon, these companies typically change. But what we've seen recently is different. I don't want to say "this time is different" - Howard Marks would shake his head at me - but maybe we should consider that many of these companies have competitive advantages others never had. The social media companies, for example, demonstrate how deep a moat can be nowadays. As you said, if you're waiting for the next Facebook or Meta, it could take many years, with significant opportunity costs, and you probably won't find it.

I think focusing more on understanding companies and getting a feel for their proper valuation is more effective. Many of us know the story of Monster Beverage - a company that doesn't sell software, just beverages, yet outperformed Apple significantly. Often, you don't need to find the next shining NVIDIA; you just need a company selling at a good price, even if it's a boring business.

Dave: Exactly. A company I don't own but have followed for a while is Jack Henry, which does the plumbing for the banking industry. They've earned about 18-20% CAGR over the last 15 years, and nobody knows who they are. It's expensive, of course, but it's a fantastic business that flies under the radar. As my friend Peter Sligers from Quality Compounding says, all roads lead to Rome - there are many different ways we can invest.

You mentioned digging deeper and trying to learn about companies. How do you approach that?

Daniel: I think the most important point is understanding how the company actually makes money. Take NVIDIA for example - even if I dug deep, I might not fully grasp how the company works or where their competitive advantages lie. Everyone knows Apple makes money because we go to the Apple Store and buy iPhones - that's an easy business to understand. But many big businesses are so well diversified with multiple segments and complex technology that it's very hard to truly understand them.

With these big stocks, you're mostly analyzing their earnings reports and trying to project how things might look in five years. But that's not really understanding the business. Understanding a business means knowing what goes into it, what they invest in, and how different scenarios could play out. The bigger the company, the harder this becomes.

Smaller companies usually have one main business, and in their earnings calls and reports, they'll tell you what they're investing in and what factors might cause success or failure. If you want to understand the business, you should be able to answer these questions, and it's not easy at all.

Dave: How would you go about analyzing a company? Like those biochem companies you invested in early on - how do you try to determine how the company makes money?

Daniel: Well, back then I didn't try to determine that at all. The first thing you should do is look at the products, then examine how they sell these products and who their customers are. Taking Apple as an example again - we are the customers, the end consumers. But for many companies, including biochem companies, they don't necessarily sell to end customers but to other businesses along the way.

You need to understand what products they're actually selling, who they're selling to, and then figure out production costs and what impacts margins. Is it something that can mostly be done in-house, or are there external materials that could be affected by supply shocks? That's what I mean by digging deep - it's easy in theory to say what you need to know, but actually getting that information and understanding how things could play out is very difficult. Even with the companies I own, I don't know everything about them. You try to go as deep as you can and then see if the potential reward outweighs the risks of not knowing everything.

Dave: That's a great point about understanding the business model. One thing I've learned over the years is that if I can't explain how a company makes money to my teenage daughter in a way she can understand, I probably shouldn't invest in it.

Daniel: Exactly. Peter Lynch talks about this in his book - if you can't explain it to a fifth-grader, you probably don't understand it well enough yourself. And there's nothing wrong with that. There are thousands of companies out there; you don't need to understand all of them. Just focus on the ones you can understand.

Dave: Let's talk about portfolio concentration. You mentioned having Berkshire as your largest position. How do you think about position sizing and portfolio concentration?

Daniel: Portfolio concentration is probably the most discussed topic in value investing circles. Everyone has their own approach. I started with maybe 20-25 positions because that's what you read everywhere - diversification is important. But over time, I realized that wasn't working for me. Now I have around 8-10 positions, with my largest being about 25% of my portfolio.

I think the key is finding what works for you personally. Some people are comfortable with just three positions, while others need 30 to sleep at night. There's no universal right answer. What matters is that you're comfortable with your approach and understand why you chose it.

Dave: How did you arrive at that 8-10 position sweet spot?

Daniel: It was mainly through experience and realizing that with 20+ positions, I couldn't keep track of everything properly. I wasn't doing justice to my research process. With fewer positions, I can really focus on understanding each company deeply. Also, when you have fewer positions, each one matters more, so you're forced to be more disciplined in your analysis.

The 25% maximum position size came from studying other investors I respect and considering my own risk tolerance. It's large enough to make a meaningful impact if the investment works out, but not so large that a single mistake could devastate my portfolio.

Dave: That makes a lot of sense. How do you think about geographic diversification? Do you invest internationally, or do you stick mainly to U.S. markets?

Daniel: I invest globally, but it wasn't always that way. I started with U.S. stocks because that's what everyone talks about, and the information is readily available in

English. But I realized there are great opportunities everywhere. Currently, about 40% of my portfolio is in U.S. companies, 30% in European companies, and the rest spread across other markets, including some in Asia.

The key with international investing is understanding the different risks involved - currency risk, political risk, different accounting standards. But these risks can also create opportunities. Sometimes markets get oversold just because they're not U.S. markets.

Dave: Let's talk about micro-cap investing. That's an area where you've done quite a bit of work. What attracts you to that space?

Daniel: Micro-caps are interesting because that's where you can find the most inefficiencies in the market. Large-cap stocks are analyzed by hundreds of professionals, but with micro-caps, you might be one of only a handful of people really looking at the company. This creates opportunities.

The challenge with micro-caps is liquidity. You need to be very careful about position sizing because you might not be able to sell quickly if you need to. Also, the quality of management becomes even more important because these companies often don't have the institutional controls that larger companies have.

Dave: How do you manage the risk in micro-cap investing?

Daniel: First, I limit my overall exposure to micro-caps. They make up about 20% of my portfolio. Within that allocation, I diversify across different companies and industries. I also spend extra time on due diligence, particularly looking at management's track record and insider ownership. With micro-caps, you really want to see management having skin in the game.

The other key is patience. With micro-caps, you often need to wait for catalysts to unlock value. It could be a sale of the company, a new product launch, or simply the market finally recognizing the value. You need to be prepared for these investments to take longer to play out.

Dave: That's a great point about patience. Speaking of which, how do you think about holding periods? Do you have a target time frame when you buy a stock?

Daniel: I try to think in terms of years, not months. When I buy a stock, I'm thinking about where the business could be in 3-5 years minimum. That said, I'm not dogmatic about it. If a stock reaches what I think is full value sooner, I'll sell. Or if my thesis proves wrong, I'll admit the mistake and move on.

The key is having a clear idea of why you're buying something and what would make you sell. Too many investors buy stocks without really thinking about their exit strategy.

Dave: Let's talk about risk management. How do you think about risk, especially given the different age groups listening to this podcast?

Daniel: Risk management really depends on your personal situation. If you're young and just starting out, you can probably take more risks because you have time to recover from mistakes. If you're near retirement, you need to be more conservative.

For me, risk management starts with position sizing, as we discussed earlier. But it's also about understanding your circle of competence and staying within it. One mistake I made early on was trying to invest in industries I didn't really understand, just because stocks seemed cheap or were trending.

Another aspect of risk management is having some cash on hand. I typically keep 10-15% in cash, which serves two purposes: it provides a cushion during market downturns and gives me the ability to take advantage of opportunities when they arise.

Dave: That's really important - having dry powder when opportunities come up. How did you handle the COVID crash? Did you deploy that cash?

Daniel: Yes, that was actually a great learning experience. I had cash available and was able to buy some great companies at fantastic prices. But I also learned that during a real crash, it's harder than you think to actually buy stocks. Everyone talks about being greedy when others are fearful, but when you're in the middle of it, with headlines screaming about the end of the world, it's not easy to pull the trigger.

The key lesson for me was having a watchlist of companies I'd love to own at the right price. When the crash came, I already knew which companies I wanted to buy - it was just a matter of price.

Dave: That's a great point about watchlists. How do you maintain your watchlist? What kind of information do you track?

Daniel: My watchlist is pretty detailed. For each company, I have what I consider a fair value and then different price points where I'd be interested in buying. I also track key metrics like revenue growth, margins, and return on capital. But perhaps most importantly, I keep notes on why I'm interested in the company and what could go wrong.

I review the watchlist regularly, especially when companies report earnings. This helps me stay familiar with the businesses so when opportunities arise, I can act quickly.

Dave: Let's talk about mistakes. What are some of the biggest investing mistakes you've made and what did you learn from them?

Daniel: My biggest mistakes usually came from straying from my process. Either buying something I didn't fully understand or letting FOMO drive my decisions. During the meme stock craze, I bought a few stocks just because they were moving up rapidly. That was pure speculation, not investing, and it didn't end well.

Another mistake was not selling when my thesis was clearly broken. Sometimes you get emotionally attached to a position and keep hoping things will turn around, even when the evidence suggests otherwise. Learning to admit mistakes and move on is crucial.

Dave: How do you avoid those emotional traps now?

Daniel: I have a written investment process that I follow strictly. Before buying any stock, I write down my thesis - why I'm buying, what could go wrong, and what would make me sell. This helps keep me honest and provides a reference point when emotions are running high.

I also try to maintain perspective. No single investment will make or break my portfolio if I maintain proper position sizing. This makes it easier to admit mistakes and move on.

Dave: That's really valuable advice. As we wrap up, what final advice would you give to someone just starting their investment journey?

Daniel: First, focus on learning before doing. Read the classic investment books, study successful investors, and understand different investment approaches. Find what resonates with you and fits your personality.

Second, start small and learn from experience. You'll make mistakes - everyone does. The key is to make them while the stakes are relatively low and learn from them.

Finally, develop a process and stick to it. The market will test your conviction many times. Having a well-thought-out process helps you stay the course when things get difficult.