Ep #50: Volatility on Wall Street

Full Episode Transcript

With Your Hosts

Dr. David Phelps and Evan Harris

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You are listening to the *Dentist Freedom Blueprint* podcast, with David Phelps and Evan Harris. Navigating you through the uncharted waters of a turbulent economy with straight-forward advice to, transform your practice into a self-sufficient cash machine, compound your net worth assets, and multiply, multiply, multiply your passive cash flow streams.

Evan: Good day everybody, this is Evan Harris with my friend Dr. David Phelps. Today we are completing the second part of our two-part series on volatility. Dr. David Phelps, are you there with us today?

David: Evan, I am here, ready to rock and roll. Let's jump into this one. Both you and I pay particular attention to the markets. So what's happening on Wall Street and certainly also in the real estate markets because that's important to us, it's important to our families, it's important for the people we serve, particularly the doctors and dentists.

I don't necessarily have to give a date today but I will tell people this is early in January of 2016. I'm just watching the stock market this last week or so do some heavy gyrations. Today it's down about 400 points. Is anybody in your arena, Evan, been talking to you about that? Any concerns out there?

Evan: Absolutely. That's what really prompted the call, prompted the topic. I've had a lot of people asking. Thank you for your feedback of those who are listening to our podcast, asking these questions as well. Yeah, the questions I'm getting are, "Where are we going?" So many things now are so available to us on our smartphones. I have doctors that are literally watching their net worth go down significantly. They'll treat a couple patients, go back to their phone and they see they've lost a thousand bucks. So to them, it makes their day very challenging.

For you and I, we watch our real estate portfolio move in an upward position but in a more linear gradual position. The volatility in real estate, certainly in our experience, in my experience is not of the stock market and we can touch on a little bit of that of why. But the question that I have a lot of people asking is, "What's going to happen next?" How can they prepare for it? Do they try to cling on and hold? Do they let go and cut their losses? What do they do? Is there money safe?

So those are some of the things I'm hearing and I'd like to be able to have your input I think that peer-to-peer, doctor-to-doctor, investor-to-investor can really be valuable for our listeners to hear today.

David: Evan, you know and the people who know me know, I've got a definite bias. So let's just be frank about it. I started investing in real estate when I was in my first year of dental school for the very reason that when I was in college, pre-dental, I was already looking ahead and saying, "Well, how can I be a good steward of the income that I should earn as a dentist? How can I become a good investor?" Because I knew that was important.

I knew even though I didn't know that I would call it trading time for dollars, you know being in a transactional business, as dentistry is. That's great, that's fine, that's where it all starts, but how was I going to take care of the income I would earn, the discretionary income that I should be putting away and investing. So you know, I read books on the stock market. I read books on real estate and I came to the quick conclusion that real estate was something that made more sense to me and I felt like I would have more control.

Now that more control comes with some downsides in some respects because control means time. It means in some cases management. But let's just consider what's happening in the marketplace today, Evan. Every six to eight years, we see the same thing. So I'm not sure why people don't see it coming, they don't anticipate it. Maybe it's just put your head in the sand and as long as things are going up, as long as the market seems to recover, after it takes this downturn every six to eight years, people go, "Okay, well, I'm okay. The market is back up again. It's back to new highs."

Then bam. It's happens again, over and over, just look back over the last fifteen years. We had downturns about every six to eight years. It's just going to happen. For that reason, I am very biased against Wall Street. I just feel like, Evan, it's a place where you can't win as a retail investor, as we are as individuals. In fact, has anybody seen the movie *The Big Short*?

Evan: I just watched it.

David: Well if you haven't seen it, go watch *The Big Short*. It should tell you everything you need to know about what's happening on Wall Street and the fact that they call us retail investors. They call us marks. We're marks because we're the ones that they make the money off of by manipulating the markets and pulling money off the market when the market is tanking. It's run by those who have much more money than we have.

So the problem Evan is that those who look at the markets and know it's not a stable place, what are the alternatives? Well if you want to be really safe, you go, "Well then I just go to like the cash markets, the money markets, the CDs, bonds." But what's the problem there, Evan? What's the problem with being conservative?

Evan: Well, from what my doctors tell me, their money is not growing and inflation is just eroding it away.

David: Well, that's it. That's the other side of the coin is, if you sit in a conservative position, number one, you can't grow your wealth. You just have to keep working harder. And working harder, where that's not a bad character, how long can you do that? How long can you keep working harder? You know, higher regulation, decrease in reimbursements, harder to make a net profit at the end of the day. When you do make a net profit, you still got to pay tax. You've got to pay tax on the net profit so it's harder to get ahead.

Doctors have got to understand that you've got to get outside whatever your old comfort zone was and unfortunately the default, Evan, for most doctors is because we're not trained in the financial markets. We're not trained in how to manage money. We go to financial advisors, CPAs, money managers. That's always been the default position. I don't think those are bad people but I think they have only one way to help you to try to grow your money and that's with Wall Street because that's where they were trained, that's where they earned their money and most of them don't understand real estate.

They don't make money off of selling real estate so they stay where they're comfortable. That makes sense. That makes sense. The problem is where they're comfortable, in my opinion, is very shaky. It's like going to Vegas and just playing the slots. I mean, you might as well go there and have fun doing it and realize that your chances of winning are against you. If you do win, well, good for you. But that's not again a long-term strategy.

Same thing with your money that you're investing for the long term. Where can you put it in a vehicle that will allow you some amount of control without a second job and not have the volatility the stock market has. So I'm going to roll this right back to you, Evan. It's what we both love, what we both have learned over the years not only from our own experience but you know, from our mentors.

Some of our mentors, like your father …, you got to look over his shoulder as he was helping his clients for many years. Some of what you learned just by watching what he was dealing with. We both love real estate for a reason and that is we feel like it gives us a lot more control but we have to be somewhat active in it. So part of the question will be, how do we get doctors into that mode without having to take on that second job?

Evan: Sure. That's a good question. My father was a professional money manager and he would always laugh when people would talk about diversity for diversity sake. What he meant by that is that people would diversify and spread things out but only because they were all guesses. Meaning, they'd throw a little bit over here, a little bit over there because they weren't sure what was going to go down, so at least they'd be able to keep something.

The encouragement I'd have to our listeners is that don't just spread things around in all guesses but get to know something, or multiple things. For me, I found that the stock market in general I couldn't bank on the information that was given to me. Even when I did have good information, if investors got scared in a sector then the whole sector would go down. Or another company would go down in the same sector and it would pollute the company I was invested in. So for me, I feel like I had so little control.

But on the real estate side, I feel like that is an area that I feel I have much more control. I've been in it with my wife for over twenty years. Her parents have been in it for forty years. My father, my mother, were also involved in real estate and that was the area that I felt like we could harness control, understand the volatility, time the volatility. Volatility can be a great thing if one’s on the right side of that movement. In addition to that, we can carve out risk by being able to invest in what we know and know that really well.

Now for me to go and invest in Texas just because I know real estate well, that wouldn’t be a great fit for me because I don’t know Texas well. But in the environment where we invest in only a—I would say a two hour circumference by driving. That’s it. But we know that really well. So that’s what we invest in wholeheartedly. We know the products and we have people that work with us and for us that also know all the properties. They know the difference between one street, the difference between another street, that could be a whole other zip code, a whole other property value.

For us, we invest through trustees, where we are the bank. Where we have all of the upside without really the downside. We don’t have to handle the roofers and the plumbers and all of that. We are the bank where we get the payments, just like the bank does. If for any reason someone doesn’t pay us, we have the security of the house. Now, in all of our years of doing this, we’ve never taken a house back but I sure like knowing that myself, my wife, our investors, they all have the security of something tangible. Not just something disappearing like a company that happens to be in a wrong sector at the wrong time and starts to evaporate.

David: So Evan, let me toss a question back because I think this is something that comes up for a lot of people that don't understand exactly what you're talking about when you say you invest in trustees, that is you're acting as the bank. Well, first of all, why don't the people that are borrowing money from you, why don't they just go the bank? I mean, isn't that what banks are for?

[Laughter]

Evan: That's a good question. I would say that's a logical question but right now the banks are not logical. David, years ago, back in '05, maybe a part of '06, banks were pretty loose with lending money and they were lending money, typically taking about thirty days or longer. But they were lending to many people who were rehabbing houses. As you know, what happened in '06, '07, '08 and then there forward, just like *The Big Short*, the movie, their lending criteria now has tightened up incredibly so.

If any of our listeners are trying to refi right now or trying to get a mortgage, I believe they are experiencing the kind of scrutiny that the banks are putting them under even if they have amazing credit. Even if they are very well-to-do, they will have to jump through hoops oftentimes for ninety days plus. Reality? People who are purchasing a home for cash that need to be able to act fast, ninety days is not fast. That deal is gone. Most deals that our borrowers are purchasing are closing within fifteen days or less. That's why they're able to buy it so much under market is because either a bank or an individual, whoever is selling the property, they want it sold today.

David, if I try to sell my automobile, let's say on Craigslist and I put it on there and I was flexible, I'd be willing to sell it anytime within six months, I could probably wait for the right buyer with the right terms.

David: Right.

Evan: But David, if I told you, "I need to sell my car today. Today." Let's say we're at noon right now, do you think I'd probably have to take a bit of money off the table there to make that ad compelling and give people reason enough to buy my car today?

David: Absolutely. That's just the way the markets work. So your point is well taken that people like you and others that make a market in their geographic area, these are the people who have boots on the ground businesses and are going in the marketplace and buying the distressed properties. Sometimes it's from homeowners. Sometimes it's from other investors who get into trouble. Oftentimes, it's from banks, auction companies who are aggregators of distressed property, but all these avenues typically to solve the problem, that is take the property off the hands of, in this case, the motivated seller, requires speed.

It requires the ability for someone to make a deal quickly and the assurance of the selling party to know that that person can make a deal. So if you have a track record or you have a connection in the marketplace, buying wholesale today in any number of markets across the country it's easy for those people to do. Now the problem, Evan, is that I've got some doctors who—and I totally understand this because doctors, we're willing to study, we're willing to learn new things—but the problem I see some of them doing is they want to try to do this too.

In other words, they want to go make a market. Maybe it's in their backyard. Maybe it's with somebody they know, a friend, or it could be a family member in a marketplace where there's opportunity. But the doctor says, "Well, I want to go do this too." So the problem is they try to get involved in something that has a lot of moving parts and they become frustrated because with their excitement to get involved and do some deals, they buy more what I call "retail deals" in the marketplace.

Then they get tripped up with the contractors, the code, the inspections, all the issues that really turn what we're talking about as a boots on the ground. It's a real business. But being the bank, thinking about again what you said Evan, when you're the bank, does the bank have to deal with contractors, with code violations, with inspections, with all the nuances that go into rehabbing? The bank does not. In this case, we are able to invest in a market that has been created by a void that the financial, the institutions have left because of all the heavy regulation, the Dodd-Frank Consumer Protection Act that came as a result of the downturn back in '08 and '09.

All these things have entered in to create chaos and put in a niche marketplace and there's great people out there doing great things as you're doing, Evan. So teaming up with, learning how to joint venture, find the right partners, now that's a place for busy doctors to invest or to play in a marketplace. It gives so much more control than the stock market does. But it's all about in my opinion, Evan, connection. How do you connect to the right people?

I'm not here to be self-serving on this podcast but good communities like Freedom Founders bring those things together and allow a doctor to quickly find out how to do it the right way and how to find the right investing partners to get involved in the market. And now they have the ability to grow wealth without the volatility that we're seeing in the marketplace this month, the Wall Street marketplace that is.

Evan: Yeah, your mastermind group I think is so valuable to be able to connect people instantly to specialists in their area, other peers. That to me is such a rewarding atmosphere. My wife and I tried to do this alone for many, many years and yeah, we learned a lot doing it on our own but we also had the time. We didn't have children at the time, we had a lot more flexibility, we were able to make mistakes but now that there's a lot more riding on our time and our money, I'm so glad to have mentors in my life.

I'm so glad to have you in my life. I can run a deal by you before I even say yes to something. I have a network of people that we can be able to send it out and just get their feedback. To me, that reduces risk at such a high level that it's just invaluable to me. Anytime someone wants to do it on their own I want to champion them and give them all the ability to go for it but I would almost encourage if they want to do it on their own, great, maybe do a couple with some trusted advisors. If we are those advisors, great. Have them come out to your mastermind group and really see how it's done.

Maybe they do a couple of deals with you or with me and they can see it from the inside out. Then if they want to run and do it all themselves, I say great, go for it. When we have the interest coming in from the borrowers, we have the borrowers pay the investors all of the interest entirely to them. We just make the points in between. So they're really getting in my opinion, a really good deal for not having to deal with any of it. They're able to practice, they're able to have their life.

At the end of the day, they're getting mailbox money and I know the same is from you, is that they can stay in their core competency and still receive almost all the upside. But frankly, if they're just bored with what they're doing or they want to get out what they're practicing professionalism, I support that. If they want to completely bail that and go into real estate, I say do it but do it with a partner first.

Do it with some trusted advisors first. Then copy what they're doing. I'm happy to share what we're doing, we really don't have secret sauce. We just have great relationships and good systems. But there's nothing secret about what we do.

David: Yeah, exactly right, Evan. Piggybacking on other people's deals, people that have a track record, that know what they're doing is the best way for someone on the outside to take a look on the inside. As you said, when you get to piggyback on someone else's deals, you get a chance to look at everything they're doing. You get to see as much as you want to of what's involved because that's part of I think the education of an investor, is to show them what's involved so that they can appreciate number one the benefits that they have by connecting with someone who has access to good deals, knows how to put them together, knows how to take them to fruition.

So you have an appreciation as a more passive investor for what that looks like. Same token, if something that someone wants to get involved in more heavily, now you see what it looks like. Now you have a better idea of what you're going to have to put into place in terms of a marketing funnel and acquisition managers and sales team and rehab contractors and all those pieces that make it really a business.

So the best way to start is start passive. Be a lender. Learn the moving parts. Learn what that looks like. The other side of being a lender is being an equity owner, a turnkey rental owner. Again, by being a lender first, you get to see what's involved in someone who owns property, what the management looks like, and what markets to buy in and how you do due diligence on a deal. How do you vet a deal? What is a good deal? What kind of returns on money are available? What discount to the market should you be buying at or investing at so you have a margin of safety?

Which you can't have by the way when you invest on Wall Street. When you invest on Wall Street, you're investing 100 percent of what the market says the value of that stock or bond is today. You have no discount. With real estate, you're buying wholesale and investing at discounts to retail. You've got a built-in margin of safety there which again is what gives us control. That's what gives me the feeling that even when we have another reset in the housing market, which we're going to have, Evan. It will happen. I have no idea to what extent but I know the markets that we invest in and the way we invest.

The real estate market could drop thirty percent and I'd be okay. I don't think that will happen. It might drop fifteen, it might drop twenty in the markets we're in, but even if it does that, I'm fine. I can ride that out because we invest on cash flow. Every deal has got to have the cash flow margin in it so it makes sense.

So there's all these principles that come to play but don't try to figure it out yourself. Team up with someone who already has that in place. Invest with them. Piggyback on their deals and you'll get a look from the inside without risking your time and risking yourself on a deal that doesn't turn out to be so good because you didn't really know what you were doing and now you're into something that has a lot more moving parts than you really had in mind when you got started.

Evan: Absolutely. For those who are listening who are checking their smartphone, they're checking their stocks, they're on the hour, on the minute, please know that there are alternatives. If you love that, then awesome. Keep going with that but know that if you're looking for a way to build your wealth, please begin with your outcome in mind.

Where do you want to be? Ask yourself the question. Ask your spouse if you have one. Ask your kids, what are they into? What will it cost to create that lifestyle? By knowing that, then find the vehicle please that will get you there. If you don't know the vehicle, find the people that may already be living the life that you want to live or that you believe have the tools that if you activated you could be able to live the life that you want to live.

Well, David, I really appreciate all your insights. I believe our listeners will as well. As we have volatility—which is guaranteed—I hope that we know that volatility is not bad, we just need to be able to move with it. My biggest challenge is when things aren't moving, when things aren't selling, and when things aren't buying, there's really no business to be done. So I am thankful for movement. I just like to be on the right side of that movement.

For those of you who are listening to us on iTunes, please like us. Leave us a review. Tell us what experiences you're having. What volatility has brought into your life: good, bad, or ugly. This has been Evan Harris and Dr. David Phelps. We are two guys with a passionate mission to help you practicing professionals grow and not just survive, but to thrive.

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