Ep #179: Kandace Phelps – Risk Management

Full Episode Transcript

With Your Host

Dr. David Phelps

[Dentist Freedom Blueprint](#) with Dr. David Phelps and Evan Harris

You're listening to a special edition of the Dentist Freedom Blueprint podcast. This four-episode summer series is your all-access pass inside the closed doors of the Freedom Founders mastermind. You'll hear special presentations from your host, Doctor David Phelps, and some of his top trusted advisors as they give straightforward advice to transform your practice into a self-sufficient cash machine to compound your net worth and to multiple your cash flow streams with hassle-free real estate. These never-before-released presentations were recorded live from inside the Freedom Founders mastermind in Dallas, Texas. More at freedomfounders.com.

David Phelps: I sometimes do have difficulty articulating what I'm trying to get across. It's in my head, it's clear to me, but sometimes it's ... how do I make that relevant to the people I want to help? My team does a great job helping with that because they'll come in and say, "David, we're not quite clear," or "They're not quite clear, so dig a little bit deeper." Well, another person in my life that's really good at that is my wife Kandace. Whenever there's a concept or something that I am frustrated about because they just don't get it, she goes, "Talk to them this way. You do it this way." She takes my thoughts and she translates. So I thought a good thing to do this morning would be to get my number one translator, the love of my life, up here to start the thing. So you actually have a concept of where I'm coming from. I'll come around the back side and if I screw it up, you will have the real concepts on the front end. So that's how we're going to do this one. I think it's going to work out really well. See, I'm in a safe place now, because whatever I do, it doesn't really matter, okay? So would you please give a big hand for my beautiful wife, Kandace Phelps?

Kandace Phelps: So hey guys. Looks like my apple pencil is low, so I'll have to do it with my fingers. I'm going to talk about risk management this morning. It's been a while since I've spoken to this group. For a lot of you, this'll be the first time that you've actually heard me speak or talk about any of my background. And a lot of you have heard me do this before, it's not going to look like the prior ones. When I've done this before, we were talking about finance. The subject of finance. And that was back when the model in this room was largely real estate. We were trying to teach dentists how to do real estate, trying to figure out where the sweet spot was where we could really serve all the professional practice owners. And so when we would do that, I would come out and talk about some real estate concepts and grab a financial calculator and show you some whiz-bang math. And people loved it.

But as we progressed through this model, what we realized over time was, you are way too busy to have time to become a real estate professional. And so David, in his testing brilliance over time, along with the tremendous team at the back of the room, have perfected this model to create a win-win in this room, where everybody brings a specialization of labor. And so now it's not going to be a presentation that's targeted about how to teach you about net present value, or how to teach you about granular stuff. This is not a tactile presentation. It has to be strategic, because he's taking about market recess and that's a very big deal. And if that doesn't spook some of you, it should.

So we're going to talk about risk management from a more strategic point of view. By way of information about me, for those who don't know, my background is finance. That's what I did. I did an undergraduate degree in accounting, and with no offense to the accountants in the room, when I got into the upper level classes I looked around and I went home to my parents and I said, "I have a problem." And they said, "What is that?" No parent wants to hear that, right? And they said, "What is that?" And I said, "Well, when I look at all the upper level classes" and this is no offense to the women in the room, "All I see are skirts. And if I want to make any money, I got to be where the men are. And they're all in finance. I have the wrong degree." And they said, "Okay. You can stay in school." So I got the finance degree. So I have two undergraduate degrees. I don't have a double major, I have the second degree, which is in finance.

And then after working in business for about a year and a half, I followed an objective, which was to go back and get an MBA, whoo, sorry. I know they get dissed a lot. But that was to a finance-targeted school, so it was top 25 business school, I went to Vanderbilt. But it was called a little Chicago. It was a very finance-oriented program, and because I had all the undergraduate everything in business, I got to jump straight to the upper-level stuff. And so I have a really decent finance education. And then from there I ended up, by process of elimination, eliminating everything that had a glass ceiling in it, and I ended up in the only place where I saw people could be creative and have a lot of fun. And that was on Wall Street. So that's what I did.

So it's kind of funny actually, because the man who hates Wall Street has been married twice in his life to brokers. Right? My background was institutional. So for those of you who understand the different, I didn't do private client. Private client is where your granny gets a call, or the rich person in the room is targeted by a lot of people who want to add you to their book of the business. I did B to B. I called portfolio managers, I called analysts, I called Fidelity and Dreyfus and T. Rowe Price and people like that. So it was a very interesting relationship because you were calling a client that expected the call and you were also calling a client that frequently was better educated, better informed, or smarter than you and you had to fake it until you could make it when you were starting out doing it.

So I learned a lot. I was always learning. Always learning. Because a lot of the people I called were ... they knew more than I did and you had to learn how stock trade. And you had to learn how the market really worked and you had to learn fast because you were talking to sophisticated people. And what we're always trying to do in this room is to help you guys to become sophisticated investors without having to get granular because you don't have time. We're in here for speed, aren't we? Isn't that a big part of what we come here to do? It's a win-win-win. Everybody wins in here, it's a triangle. We win because he gets to do what he loves and to teach and to pass on what he knows. The professional practice owners win because you get to come in here and find that speed and to mitigate risk by doing business with people who are experienced in their trade craft. And the trusted advisors that are in the room get to find not only the ability to leverage their businesses with capital, with people that have capital that are lower risk because they're also being educated and they're becoming sophisticated all the time. Everybody wins. That's the dynamism of this room. That's the power of the room.

So this presentation is not designed to target anybody in terms of getting too tactical, it is very much a strategic kind of thought stream that I have when I look at things, because my perspective is different. The stock market is all about risk. It's hard to figure out. When I got hired into the business, actually the first person that hired me said, "There's something about this business that it takes two years to learn how to do it." Well, I got news for you. It takes longer than two. Why? Because it's like a vapor industry. It's paper built on paper built on paper built on paper, it's ideas. It's concepts. The widgets are under there if you're selling a specific stock. We were always in the energy business so we always talked about things like drilling rigs. Well, I love big iron. I think drilling rigs are fat. They're so cool. You ever been on one? They're gigantic. And I love that stuff. But on top of that, there are layers of paper. There are derived securities and layers of other instruments and to understand those and how those operate is not the same thing as being able to sell a box of Qtips at Target. It's not the same thing.

And it takes time to learn how to do it and it takes time to develop a gut about what makes it work and what doesn't matter. It's on the margin, what are the three or four or five things that will really take this stock down. And it's not what they're saying. So my perspective about things is skeptical. It has to be because when you look in that kind of a world, you're going to be inundated with information. And if you guys don't feel inundated with information right now, with everything that you see on the tape and all the spin that you see in the news, knowing that we have a liberal media country that lies habitually to deceive people and that most of the time it works, you guys are the 1%. You're the 1% that is looking for what I call the Effervescence Theory. What's bubbling to the surface that actually has a grain of truth in it that you need to pay attention to? Because those are the things that'll kill you.

And those are the things that'll help you outperform the market and that's we want.

So that's why we're all very discriminating, 1% to 3%ers in here. You guys are very smart people. And so I want to continue to challenge the way that you think. There isn't anything in here that's going to be formulaic, that's going to say, "Here, take this thing." We do that with the Freedom Blueprint. That's how we outline that. This is not going to be formulaic, in terms of the thoughts. What it's going to be is, rather, to get you to think outside of the box, to kind of challenge the way that you think a little bit and to put away the obvious stuff and to look at some of the less obvious stuff that'll end up being your lunch.

So on that note, I have a share for you guys. Am I up? Yep. Everybody was complimenting my rig yesterday.

Speaker 2: I liked your rig.

Kandace Phelps: Yeah. Wait a minute, how did it go away? Why am I writing on my screen guys? Oh, there we go. There we go. There's my share. This is this. So these slides, I'm sure, will be available afterwards. So for everybody that's looking for gadgets, it's always kind of the model to come in with a share, isn't it? So there's one. There's the nice plastic rig on the back of this that keeps you from breaking it. Why does it keep doing that? And then number three, the keyboard that goes with it. Hang on, it's not going.

Fellas, I don't know how I'm doing this wrong. I'm just, I'm trying to go over with my pencil and it's not clicking for me. Is that working? Yeah. There's the plastic thing, there's the keyboard, I'll just use my finger. I think my pencil died, sorry guys. So. Yeah, we got it, thank you. Okay. Sorry about that.

So I'm going to read you a little quote. I couldn't find the attribution, so I'm just going to read it to you. "The longer a market trends, the more confident people become that tomorrow will look like today and what they forget is that the single most important consideration in investing is your starting point." K. What does that say? That says that people argue that what was true yesterday will be true tomorrow. And so they'll build rigid models to try and forecast and predict and to build financial plans or strategies or whatever. And that's not how things work. So let's look at this first concept of the efficient market's hypothesis. I have a great finance education, I'm going to denigrate everything in the education. This is the kind of junk they teach in business school that takes markets down.

This is my education, okay? Efficient market's hypothesis is a model that was developed in the 60s by a guy named Fama, Eugene Fama. And what he basically said was that all information is reflected in stock prices. Yes, I'll get to the real estate, but hang on tight because markets are markets. Okay? He says that all known information is reflected in prices, okay? It tells us it's too risk to try and outperform the market because you have to take too much risk to do it. It says that what was true yesterday will be true tomorrow. It says that the market can be predicted. And so that you can build model that doesn't have to look at all those exogenous risks, because they don't really exist. So if you just build a good quantitative model, then you can figure out how to get some good returns by arbitraging things that are not going to act irrationally. Does that make sense? Like bond prices. K?

This went on to a situation that I'm going to show you in just a second. Here's a street euphemism that I learned, stocks don't trade on fundamentals.

And the question is, what do you think about the stock market right now? K? What does that mean, that stocks don't trade on fundamentals? Well, I've got a chair here for a reason, I'm not going to sit on it. When a public company does an IPO or a secondary offering, they issue a prospectus, they do a press release, they talk to the street, they do an earnings report, they do anything like that. They tell you about everything that's cool about it, right? Just like when you're buying a house, they're going to tell you about everything that's good in the house. Can the trusted advisors give me an uh-huh? Yeah?

They don't tell you about the stuff that's broken. They don't tell you about the stuff that they know about that's not working. And they don't tell you about the stuff that they don't know. So they'll tell you all about the padded seat and how many sits it can take before the seat won't be padded anymore and it's how many sit will this take? Kind of like the, whatever the count on like a carpet or something. They'll tell you about the back, they'll tell you how much weight it can support, they'll tell you about the legs and the veneer and that you can get your feet on this feet rest if you're 5 foot 6 or taller and blah blah blah blah. They'll sell you all the benefits, everything that can be seen and understood.

What is it that eats your lunch? Can you see my hand? It's all the stuff they don't tell you, it's all the negative space. It's all the holes. They'll deliberately cover it up or they won't tell you because they don't know. This is the kind of stuff that eats your lunch. They'll always package what's knowable. And they'll sell it on the features of what's knowable. But when you trade stocks, it isn't the knowables that will make a stock go up or down, and that's what you have to get a gut about. And you cannot fake it. It's very difficult, when you do what I do for a living, historically, where you call somebody up. Y'all, how do y'all feel about your own investment portfolio and your assets, your money? You're protective, right? It's painful, right, to think about losing it?

Some of you have lost a lot of money in the market. Some of you have lost a lot of money in real estate deals with shady people. Some of you have taken some risk and it hasn't paid off. Some of you have trade commodities and it hasn't worked. You've traded gold or silver, something like that, and you lost money. It hurts, doesn't it? We've all lost some money. That's what the trusted advisors in this room all have in common, they've weathered some cycles. And they've lived through them and that's why they're here. If they hadn't weathered some cycles, we can't have them in the room because we don't need any Pollyannas in here. We need people who know how to build a risk-averse model, or at least a risk-managed model, so that they know how to keep enough cash in the bank and all that kind of stuff.

Stocks don't trade on fundamentals, neither does real estate. It's not rational. It's emotional. It is so emotional. When people are looking at a stock, a public company can come out with a press release and then they can offer some earnings guidance for the coming year and they can tell you about all the features and they can point to it and they can show contracts and they can do all this kind of stuff. But the street is already 6, 12, 18 months past that. They're looking at trends in the industry, they're looking at all this other kind of stuff. They can come out with a really bullish earnings report, give you a great conference call and they stock'll be down. And they'll be a whole bunch of idiots out there that're flummoxed. Why? But the truth is, if you understand on the margin what the three or four or five things that you need to really care about are, then you begin to be very able to predict, no, that's not good news, and here's why.

We always point to Walter, but Walter's such a great example because he knows his market cold. He walks into a house and somebody wants a number for the house and he just looks at them and says, "that's not the right number." Why? Because he knows. He has a gut. And you can't fake gut. Gut takes time, and there's a reason that I'm telling you that. There's a reason ...

Kandace Phelps: What's that?

Kandace Phelps: Yeah, that he's down 20 pounds. And he's sick, so he's going to lose a few more while he's here. Yeah. So, yeah, we're all working on that, aren't we?

But it takes gut, okay? And so when we're talking about real estate, part of the benefit, again, to this room, is you don't have to have the gut. Trusted advisors have the gut. Trust your trusted advisors. That's why they've survived cycles. Right? That's why we want to keep you guys in this networking relationship because it's so important. So let's talk a little bit about what can happen in the market? Has anybody ever heard of a firm called Long Term Capital Management?

Wow, not one hand. Really? Okay.

Kandace Phelps: Huh?

Kandace Phelps: Yeah, he ... John knows. Long Term Capital Management was a firm that was built on modern portfolio theory. Had a bunch of Nobel Prize winners in it. K? No bells, that's what that means. They went on to earn some Nobel prizes right before Long Term Capital went defunct. They built it on portfolio theory, they built it on black and white thinking. They built it on financial models that didn't leave any room for exogenous risk and they got creamed. They almost took the market down, it was in 1998 and 1999. They came out of Solomon Brothers, they had a big bond arbitrage shop and they were really successful. And then the head guy over there, John Meriweather, lost his job because some employee did something whatever, and he got fired. So he went out and he raised a bunch of private capital and they started a firm and they went gangbusters for years. They were up like 40% year over year, they were up to 145 billion in assets under control, they had like 5 billion dollars to the bottom line or something like that at their peak. They were making money hand over fist.

But they were way out over the tips of their skis because they built a model that wasn't built for rational, or irrational, markets. They built a rational model. Well that doesn't work. And they almost took the market down. What did it? A Thailand debt default that went down to Indonesia, Philippines, Malaysia, South Korea, kind of like a financial tsunami. And then it sucked Russia in. And what you can't read on the back is one of John's favorite terms, on the bottom rather there is black swans. Okay, it's stuff that you can't predict. It's this. It's the unknown unknowns. It's the unmeasured unknowns. It's thinking that you know more than you know. It's one of the most dangerous things you can do.

You want to be number one at risk management, the first lesson is don't think you know things you don't know. It's stupid. Because as soon as you get cocky, there's like a boomerang theory, comes right back around and clips you. You just can't afford it. That's why we're in a teaching environment, that's why we're always educating and pressing you guys to learn, because it's the stuff that you don't know that will eat your lunch. If you try and take what you see looking over the shoulder of a real estate professional in this room, take it back to your market, and start duplicating it, you're going to find out real quickly what you don't know. They make it look easy. But that's because they've weathered the cycles. That's because they've paid the price just like you've paid the price in professional practice.

They're not going to come in and try and work on your mouth and drill your teeth and they're not going to try and do all that kind of stuff. You don't understand what they do either. That's why it's a specialization of labor. That's why it's a network that's worth more than you having to go out and amass this amount of information and this gut. You don't have time for that. And you don't have to, that's the beautiful part of this room. You don't have to. That is a big piece of risk management in this place. It is because we help you to get there by professional relationships with professional people who know their trade craft. You know yours and they know theirs and you guys exchange. And it's a good exchange, it's a healthy exchange.

so let's talk about the market today. Those who don't learn from history are doomed to repeat it, right? So let's talk about derivatives for a second. Derivatives is anything that's derived. If I sell you this from the back of my car, I'm going to ask you for $30 or something like that. There's no derivative between me and your wallet. This gadget for your money. There's no derived anything except for the currency itself. A derivative is every other thing that gets layered on top of the market, starting with securities. We don't securitize in here for a reason, because we want you to be backed by an asset. Here's the derivatives market. This is the only latest estimate that I could find, which is like 2015, that the number of the derivatives market, notionally, is 1.5 quadrillion dollars. Can you tell me how many zeros that is?

Kandace Phelps: 15. That's 10 to the power of 15. That's a big number guys. That's built on top of whatever the base of the fundamental is. That's no different than quantitative using digital money on top of no gold standard. It's exactly the same. Layers and layers and layers and layers and layers and layers of scrapes and swaps and all kinds of interest-derived stuff on top of the market. And a lot of it isn't even benched to a unit, it's benched to the interest rate, which isn't even a widget. It's a metric. It's speculation, pure and simple. And until it blows up they'll keep doing it. Long Term Capital was speculating, it took 3.6 billion dollars to bail them out so that they didn't start a whole … because they had sold stuff all over the world. They had involved all of the bold bracket firms. And so the Federal Reserve, Allen Greenspan got them together and they put together a bailout package and they bailed them out because it was better to bail them out than to have all those debts come due. Because it was much more than 3.6 billion for them to settle the debt, it would have been like a trillion dollars. It would have killed everybody.

And they couldn't afford it. So he had to step in. So of that 1.5 quadrillion, what's actually potentially at risk? Notional value means that when you're looking at, just use a couple of different things, when you're looking at two instruments and you're doing an arbitrage, it's the little skinny margin across the top, it's spread. But if you can't fulfill on the spread or if you, for some reason something goes completely negative or goes to zero, you have to fulfill the other side of the contract. What's actually at risk? Enough to say that the real risk is probably somewhere in the neighborhood of 600 trillion dollars. That's still a boatload of money. 1.5 quadrillion is like 20 times the GDP of the entire planet. We're talking about gigantic financial numbers out there, right? 75 trillion on their balance sheet alone. If they have a .01% failure, it will wipe out their capital. Wipe it out.

What about the United States? The big banks of the United States have 200 billion, 77% of which are interest-rate based. That's a metric guys, not a widget. .1% will wipe out all the too-big-to-fail banks. These are real numbers and that should scare you a little. This is risk we're talking about, so let's look at what the risk really is. Because I don't want to spook you across the board, but there are some things that you actually need to be appraised of and you're never going to hear this on MSNBC. Right? You're not.

So let's talk about inflation for a second. We've talked about inflation in this room, you all know it's there. You know a pound of hamburger costs more, you know that your car costs more, you know that all of the CPI indexes, they've stripped out everything that's meaningful. I'll give you a perfect example. They started to modify the CPI years ago and what they said is people will adjust their spending patterns. So instead of eating steak, they'll eat hamburgers so they have started to adjust the comparable basket down to include some sort of behavioral pattern or something like that. So they use behavioral financing reasoning to strip the basket.

So to this point, now, if you look at beverages in the CPI, you know what they count as beverages? You think it's Coca-Cola and coffee? Oh heck no, that's too easy. They took those out. Is it the orange juice that you feed your kids? No, it's Jack Daniels. They had to have a liquid in there. Seriously. That's what they do. That's what they do to all of the metrics. You can't trust those metrics. You know in your heart they're not real. They're not real. You can feel the inflation, and even more because you guys are wealthy people or at least ... No, you are upper white or the small percentage, okay? You're the 5% of the population. You're the 3% or whatever, in terms of income. It kills the middle class. That's who it eliminates. It eliminates everybody that lives check to check and when gas prices are up, that carves into what they can afford to buy in the grocery store because it eats their budget, it annihilates the middle class. And it is completely not represented by the metrics. They're hiding it. Why? Because they don't really want the interest rates to go up for all the reasons that we talk about in here. Okay?

So inflation triggers interest rates, that's why we don't want to talk about what the real number is. And interest rates are a measurement of the real risk. So if you conceal it in the interest rates or you suppress them, then people think there's not as much risk out there as there actually is. So let's talk about a definition of risk. Let's start simple and add complexity because risk can be started with a very simple definition. It's real easy to overcomplicate something like risk and we don't want to do that, okay? The good way to think about doing this is to add some in, but don't try to get it all in there or you're basically indexing the model. The market. You don't want to do that. You want something two, three, four, five things on the margin that actually really are important to you, that affect you, okay? So we'll start with the simple. You see the chair, the risk, there's the knowns and there's the unknowns, okay?

The difference between expectations and realizations, when we're talking about financial stuff, a measure of uncertainty surrounding a current or future event outcome or state of being, the price of projecting incorrectly on poor assumptions. That you get a different and what you really don't is an … outcome. Okay? So we're always looking forward with finance, with real estate, trying to project a future outcome and then build that outcome favorably or hedge against an unfavorable outcome. We're always looking forward. Risk is getting it wrong. Risk is how do you price for getting it-

Kandace Phelps: Risk how do you price for getting it wrong, and you hedge, and you build protections in for yourself. That's what risk is.

What's the belief about real estate risk? If you read pundits, market-based MBAs, you know, really whiz-bang people, they'll tell you that real estate is an inefficient market. They'll argue that the Wall Street is an efficient market because all information is immediately reflected in prices, which I can tell you, that ain't the truth. My brain is not big enough to hold the whole market, that's just crap. That's just not true, okay? Also that it's capital-intensive, and that it's durable, so it's location-vulnerable, that it's a hard asset.

So here is an investment period... pyramid. Sorry, I don't mean to choke so much. If you see real estate, it is right in between limited partnerships and put and call options. Does that sound right to you?

Audience: No, I don't know.

Kandace Phelps: Okay, doesn't that seem a little high to you? But that's what happens with a business school. That's what they teach. If my pencil was working I could draw you a chart. But on a chart, they'll put in everything that you see from the bottom up. They'll put in all the treasuries, they'll put in commercial paper, they'll put in all that stuff, they'll come up the curve to bonds, they'll come up to equity, and all the way out on here on the margin on the Pluto end of the curve, they'll put real estate. All the way out here. Why? Because market people don't understand real estate. They only understand paper. They only understand derivatives. They don't understand hard assets. And they don't know how to do it, so they don't recommend it.

How many of you guys have ever been to a financial planner, and they don't have any allocation in your portfolio for real estate. It's cause they're stupid, they don't know how to do it. They only know how to do stocks and bonds. Seriously, I come from the market, I can say it. So... I do it for a living. So they don't know how to do it. They're not going to recommend it. They don't want to release 25% of your money and let you go out and invest it in somewhere else because they're taking a shave off of the assets under management that they've got with you. They're not going to recommend that you go do something they can't control. That's not how they operate. They do what they know. They teach what they know.

We have tried, I have tried, with my background to take some of the stuff he was doing. I remember one time I sent a text to the group over with, what's his face, Fidici University, who is that guy? Dave Ramsey. Dave Ramsey. When he was recommending that the real estate strategy that you should have was to short-sell real estate. And I'm sitting here watching over him do all this stuff at the wholesale level, and I'm going, "That's stupid. What a pain in the butt. Then you're still dealing with banks." It's like, "there's a much better way to do this." I called them, they sent me a very polite decline. They weren't interested in that.

We had this guy locally in our market that was talking about all this stuff. He would, you know, do mailers that come in and all that stuff. So we met this guy for coffee at Starbucks one time, to try and talk about how this side of the market looked, and what he actually does. And he just glazed over. Seriously. He had no interest. He didn't know what we were talking about. So, they don't understand, therefore they put the wrong risk measurement on it, because they don't understand it.

So for them it is risky. But not for you. Not in this room. Not with David, not with the trusted advisors, not with people that have survived cycles. Not in this room. This is a very unique room.

So, not saying we agree, but if real estate an inefficient market, is that bad?

Audience: No.

Kandace Phelps: Not at all. 'Cause what happens in an inefficient market?

Audience: Opportunities exist.

Kandace Phelps: That's exactly right. Did you all hear that answer? Opportunity. That's exactly right. Who wants an efficient market? Seriously? There really is no chance to make money in an efficient market. Come on, you might as well buy treasury bonds. Boring. And you can't make above market returns. So it's not true, but it's also not bad. Right?

Capital intensive. Well, aren't we investing? If you've got money in the market, and your stock is up, can you eat off of that? Not unless you sell some. Where's the cash flow on that? Is it riskier or less risky to have cash flow coming in every month when you've got payments on some kind of a note, or some kind of a property, and it pays your grocery bill and your gas.

And what's wrong with durable? What's wrong with having something that's tied to something real? What's wrong with that? Yes, there's some risk.

I'll give you another tip. You guys can go out and read papers, you can google stuff. Separate commercial from residential. Every egghead in the world is going to talk about commercial. Because they're trying to get tenured, they're trying to talk to people that are going to tenure them at big universities, they're trying to talk about how you can move gajillions of dollars overseas. You're not those people. You don't have to worry about that. You can work in a market that's local, local, local, local, local, and make a killing? Why?

Because you're not... unless I'm grossly misunderestimating this room, or overestimating, you guys are not billionaires, are you?

Right, that's not really our problem. Our problem is to be fruitful in this market, without having to go to a reep. Without having to go to some kind of an institution or something like that. It's how to bring it back in house to you, to make it yours. To own it, to take personal responsibility. And I would ask you this question: How many degrees of separation do you want between your investing and what you're investing in. 'Cause you can go buy put options all day long. There's a big market. Knock yourself out.

If you know what you're doing. I've lost a lot of money on options. I've made money. I've lost money. I've done both. It evens out in the end, because it's actually not that easy to do it. Because there are always people who are sort of pulling the market this way and that for reasons. They have reasons.

And things happen, and you just can't ... it's a random walk, you can't predict it. But this is something that you can have more control over. It's one of the things that David has always loved about real estate, is you can control.

So let's reiterate. Cleaner than the pyramid. What are your investment choices really? If we're talking about investing, what are they? You've got cash, you've got metals, treasuries, munies, bonds, stock, real estate, or consumption, which is none. Or you can do derivatives. We're not even going to talk about derivatives. We're just not even going to go there. You can do that in here.

So, those are your choices. Those are the mainline choices. Are there some other stuff? Could you collect art, and old bottles of wine? Sure. Whatever. Good luck with that. Talk about illiquid. Real estate, we like because it's a hybrid. It's a mix of a physical asset and a financial asset. You get both benefits. Because you've got a physical asset that's backing up a transaction, there's a gold standard there. And even if the market fluctuates, it's not going to do this.

The beta is not like a derivatives market, the beta is not like a stock market, the beta is not like the commercial real estate market, the beta is residential. And people always need a roof over their head. That's why we don't buy $400 thousand houses. We buy three two-twos, or four two-twos, or four three-twos, or whatever. Why? People always need a roof over their head. They'll always make a way to have a roof over their head. Whether they're buying or renting, they're always going to need a roof over their head.

So you get physical and financial, you get a physical plus a bundle of rights, including transferabilty, and in this room, is real estate fungible? Who knows what fungible means? Mary Hart does. Fungibilty is the ability to get cash out of something really quickly. Cash is perfectly fungible. Unless you're in a foreign country. And then you have to find a booth. But real estate is fungible in this room. If you need to get something done quickly, it can get done in a financial friends network. Like Walter's also building. It can get done amidst a group of financial friends. If somebody's going through a divorce, or something like that, and you need to get something done, if somebody is in some sort of health crisis, and you need to get something done, if somebody has some sort of cash flow problem that they need to solve, it can get solved in this room. Why? Because we're here to help each other out. We're here to see each other through the times where things don't exactly work exactly like we thought or something happens.

So, let's go back a little bit to the finance theory for just a second. Is any part of it salvageable for our conversation? Well, I'm going to take you to the capital asset pricing model. It's a really basic, simple model that tells you what an asset should yield based on its risk level relative to market rates of return.

In finance, the capital asset pricing model, CAPM, is a model used to determine a theoretically appropriate required rate of return of an asset to make decisions about adding assets to a well-diversified portfolio. And basically what it says is that you take the risk-free rate of return, and then you put a beta on the difference between the market-average rate of return and the risk-free rate of return. And if your stock's beta is 1.2, which is greater than the norm, then it's going to be a little bit higher. And if it's 0.8 and it's Coca-Cola, it'll be a little bit less than the norm. And that's the rate of return that you want on that asset.

What it also leads to is a portfolio theory concept that you can diversify a portfolio. How many assets does it take to actually diversify out company-specific risk in a portfolio? 15-20. It doesn't take that many. I would argue that the same thing can be true of a house. The only key to this is that we are not using highly correlated assets. Which is why you have a bunch of different people that you can do real estate business with in this room.

That you can do all different kinds of business strategies. So that you don't have to pick any one thing. So that you can have different markets, you can have different timeframes, you can have different payment streams, you can have different financial instruments and investment types, somewhat some different asset classes within, that's diversification.

So, here's diversification. It's a risk management technique that mixes a wide variety of investments within a portfolio. Different kinds of investments will, on average, yield higher returns and pose a lower risk than any individual investment found within the portfolio. The benefits of diversification will hold only if the securities in the portfolio are not perfectly correlated. So we give you opportunities to different stuff in here. So that that's another way of looking at risk. Don't put all your eggs in one basket.

Street euphemism number two. From one of my people that mentored me in the years, named Bob Macy. He said, "Always hedge". Now, when he was talking about hedging, he was talking about picking up that deadly telephone, calling a portfolio manager, and trying to pitch them on an idea that we were covering, an energy stock or a retail stock or a financial stock or whatever, whatever, whatever. Remember I told you how when you think you know everything, that's when you need to be really careful? You always hedge.

Now he was talking about verbal. He was talking about presenting ideas and not overselling. But it's also true of everything that we look at. You guys risk manage every day of your life. Risk management, simple case-in-point example is driving too fast in the rain. Risk management is also re-calibrated when it's driving too fast in the rain but your pregnant wife who's about to deliver a baby is in the backseat. It's personal. It gets re-calibrated all the time.

There isn't anything that a model can tell you that the supercomputer between your ears can't process a lot faster. You're much smarter than that. You have a super computer beyond imagining. The synaptic numbers of transactions that are firing in your brain every minute is just off the charts. So you are constantly recalibrating for risk. Should I smoke that cigarette? Should I eat that piece of cake? Should I say that to my husband? Always hedge.

Limiting or offsetting the probability of loss... from fluctuations in the price of assets, commodities, currencies, securities, is transferring risk to something else. Flies work better than vinegar, or honey works better than vinegar, right? So, how do you want to present it? It's always risk management, risk management, risk management.

And in portfolios it's equal and opposite positions. It's also inflation protection through high yield instruments, metals, or real estate. Not my quote. Real estate, okay? Known versus unknown risk, there's a spectrum. Real estate known risks, myriad but easily identifiable. If you want to know what the obvious real estate risks are, just ask the trusted advisors if you haven't learned it by now. It's vacancy, it's pricing, it's rental rates, it's property risk, it's a 2-bedroom or 3-bedroom. Well, 2-bedroom has a higher risk for it to be a mon-oc 'cause it's harder to sell, blah, blah, blah blah blah. You can get that from all the trusted advisors in the room, they're experts in their trade craft. They can tell you all about it. They've been through it.

The less obvious risks are more qualitative. And this is the stuff that you guys have to factor in when you're doing this. Speed. It's not just the time value of money, it's your time. He's always talking about time. It's speed.

There's opportunity cost. What do you have to give up to buy one thing. If you lease the Mercedes, you can't lease the BMW. If you buy the BMW, you can't buy the house. What are you giving up? To get what you want, can you postpone current consumption, to defer it down the road? Are you willing? Because there's an opportunity cost of your decisions, and that's part of your risk measurement for yourself. That's part of what you have to figure out. What's important. What's more important. Because there is a measurement that goes into it.

Legislative changes. Okay, I call it the federal overreaction. That's called home cooking. In the stock business, if you had some big client that came in, and they wanted to sell 150 thousand shares of a stock, you'd put that on the floor of the exchange, but at the same time you'd go out and call everybody that you knew that owned the stock in the hopes that you could sell that stock in-house. That you could cross that stock at the trading desk, and then you've got both sides of the trade. It's kind of like a real estate broker that gets the whole 6%. It's called home cooking. You do it as fast as you can.

We've got a size seller of Microsoft and everybody looks, "Who do I have that owns Microsoft that might want to buy some more?" Bam bam bam bam bam. In the hope that you can cross that stock. The federal government cooks up problems that they can solve. Home cooking legislation. To do what? To erode private capital rights in this country. Because they think efficient markets work too and it's called socialism. How's that working for you? Does it really work? No. And the empirical evidence doesn't seem to matter. Until we implode on ourselves, we'll repeat the errors of the past. Over and over and over and over again. Over and over again.

The company you keep. Look around, give each other a clap on the back. This is good company to keep, absolutely.

And behavioral signs of investing. What they're finding out when you don't have rational markets is it is behavioral. What did I say about it? It's emotional. People are very emotional about money. Even if they're a fund manager and it's not their money, trust me, I've been yelled at when we were wrong. It's not fun. It's kind of nerve-wracking when you call somebody up and you recommend that they should buy stock and they go out and they buy a position in some company that you recommended, and they buy 500 thousand shares of something at 40 bucks a share, say, what is that $20 million? And then stock goes down 10%. And they're down too. You think they don't care about that? That'll keep you up at night. That'll make you sick. That's a bad day. 'Cause he's not the only person you have to call. That's a bad day, when stuff like that happens. And trust me, it happens.

So people, people, people, people. It's always emotional. Do people in a house do what they say they're going to do? Guys like Glenn Stromberg know. Do they do what they say they're going to do? Big no, right? "Not at all," is what he said. So you always have to price in a residual risk for behavioral stuff. This is not quantitative stuff, guys. It's qualitiatve, it comes from experience. This is part of risk management.

So we've got the market, we've got black swans, we've got bombs. When I was in L.A. recently at a conference, we were in Pasadena, and one of the things that they said when we were there, they were making a big hoop about Kim Jong-un in North Korea. And you know, he wants to be his grandfather. But he has these nukes, right? And what they were saying at the time was his first target was revealed to be L.A. They were a little spooked. Wouldn't you be? They were talking about it. They were a little spooked. That stuff will take a market down. Don't you think dirty bomb, nuclear, in L.A. takes out Hollywood. You think that might be a little bit of a problem for the market? Of course.

And then triggers. There are just triggers in the market. People hate Trump, because he's not part of the cabal. So, they might just take the market down just for kicks, because they want to tear apart the administration of someone they cannot control, and make him look like a dud. To make him impotent for the rest of his administration. Could it happen? I don't know. I know they were blaming the market's decline on Wednesday on what's coming out of Washington, but I don't totally agree with that. I subscribe for the effervescence theory.

The market was down 1.8%. Goldman Sachs was one of the leading decliners, and it was down 4. And at the same day, George Soros and the Soros Fund Management group was out saying that their recent 13F quarterly filing that they had upped their position in Goldman Sachs stock by 40%. Well, that's supposed to be a big, bullish reinforcement of, "Buy some Goldman when it's down 4%. It's a great company. We're going to stand behind our Goldman Sachs," right? Their position went up to 86 thousand shares. That is literally 0.007% of the market cap of Goldman Sachs. Who gives a rip? That doesn't mean anything. That's a rounding error. It's not even a rounding error. That doesn't even get us to the 0.1 decimal point precision. Why would they do that on the same day?

Well, maybe there's actually something wrong with Goldman Sachs. Maybe there's actually something fundamental in an inefficient market that they say is efficient that's not efficient, that somebody who's done a little bit of research has figured out. And people are selling. I don't know. I don't know what it did the rest of the week. I know that there is always a nugget of truth that you need to pay attention to, and it isn't that Soros Fund Management bought another 20 thousand shares of Goldman Sachs. Whoop-de-do. Seriously.

So, risk mitigators. This is a list of things that you can do to think about, "What is risk mitigation?" What is risk management? Well you can avoid it, and stick your head in the dirt. You can diversify, we've already talked about that. You can insure. When we're talking about properties, we're talking about health insurance, we're talking about any other kind of insurance. Insuring is a way to mitigate risk. You know all this stuff. You can offload. You can do that through contracts, you can pass or transfer risk to other people. You can limit. Nonrecourse financing is a limit. You're going to limit you personal liability.

You can hedge. Hedging is whatever you want to call it. It's owning stuff in different markets. It's working with different trusted advisors, it's not putting too much money into one geographic area, it's not failing to buy some gold if you think gold is the thing to do. It's... you know, we don't ever tell you not to diversify outside of real estate.

We're not in here telling you to put 100% of your assets into real estate. If there's a couple of companies that you know you want to own over the long haul, and leave those stock certificates to your kids, over the long haul it'll probably work out. Own it. Just don't own it with 100% of your money. And don't buy just mutual funds and then go to sleep on it.

Educate. You're here to be educated. We're always educating you. Education is critical. Know the market, well that's what your trusted advisors do. They know their market. That's what you're counting on them for. They know their market. Better data. No Zillow. Ask Walter. No Zillow.

Experience. You come to this room to gain some, to get that gut. To know what you really want to be doing in terms of risk management, what's right for you. And you also learn and absorb the experience of the people that are professionals in this room. You want to talk about asset management or structure and trusts and all of that stuff, you're going to talk to Mary. Don't ask me. There's experience in this room. You go to the person that knows.

Economies of scale. That's what happens when somebody has a legitimate business, like Wayne and Tom. It's a legitimate business. That's called economy of scale. Walter does a lot of housing in this market. That's called economy of scale. They gain benefits. Yesterday he talked about the dental practice management company. That's economies of scale. Purchasing power. With Patterson and all the other suppliers and all that kind of stuff, they can get discounts on stuff. Economies of scale.

Lower level of property risk. Which is what your trusted advisors do. And then pricing residual risk, which is different for everybody, 'cause it's always personal.

So what happens here? Network. Net worth, we talk about that all the time, it's a win-win-win room. Why do we push you? Because I'm talking to the professional practice owners now. We always want you to move up the grade in terms of your understanding. We don't want to hold you in some static position. We're always trying to lift you to another level, because there are standards that even though this is not a regulated room, and this is not an SEC-regulated room, we still want to press towards the substance not just the form.

So let's talk about some of the rules. Accredited investor. An accredited investor is basically somebody that can buy securities that are not regulated. So you can buy private placements. So it's qualifying somebody to be sophisticate enough, according to the SEC rules and law, to be able to buy something that is not a public offering or something like that. To be able to buy private placements. The definition of an accredited investor, to my knowledge, I could not find that it had ever changed.

Wow the part that you need to be able to read, you can't read ... I've got it backwards. Anyway, the number is a million in assets and a million for the last couple years and the foreseeable future doesn't include your private residence. And then $200 thousand a year in income for one person, or 300 for a couple. And it has to have been 300 or 200 for two years and it has to stay that number for the foreseeable next one or two years that it can't change. That's what qualifies someone, technically, mathematically, to be an accredited investor according to the Securities and Exchange Commission.

Now that standard is not something that we have to enforce in here, but those are the numbers. And they haven't changed since 1980. Do you think things have changed since 1980? This is a low barrier. Which for the young people in the room, that's actually really helpful. But they have considered changing this on a number of occasions. We want you to not just be accredited, but to have the mind of a sophisticated investor. That's why we educate you all the time. That's why we put you at round tables with the trusted advisors. That's why we encourage you to start by doing a deal and learn while you earn.

Because we want you to constantly be more sophisticated in what you do. That's why this room is a community. It's very important. There's also suitability. Now suitability is a test that a private client broker will do with someone that they're going to win as a client. It's basically to walk through every question about your timeframe. Got kids that are going to go to college? Do you have debt on your practice? Do you still have student loans? Are you an ender, are you a beginner?

In real estate, we do the same thing and there's a whole spectrum that we can talk about. The kid that's starting out in the real estate business has no money but they've got a lot of energy. And they need eat money. The guy at the other end of the spectrum, David, he doesn't need the eat money. He can let them have the eat money all day long. He wants the tail. He wants the tail that's deferred for tax reasons.

So the needs are everywhere on the spectrum. That's why we take you through the freedom blueprint. This is something that you have to constantly be revisiting for yourself, because you are becoming your own advocate in your financial life. That's why you're here. If you're not here to do that, then this is all academic.

Our goals in here. Preservation of capital. Number one. We don't want you to lose what you've got. You don't want to lose it either. That's why you're here. Some of you have lost some of what you had, you're trying to make up for it. Preservation of capital is critical. You don't want to be eating into the base, you want to be adding to it. Second. Hitting pro-former rates of return. That means that we don't want to oversell stuff in here. We want things to be priced correctly. So that you understand what the risks are. Because if there is a market reset, Harry Dent's been speaking since the fourth quarter of last year, I think fourth quarter, it was before December anyway. He's been talking about how he thinks the real estate market's going to get cut in half again.

Now, we know how to invest in here to survive these kind of things, but that doesn't mean that the equity value of a real estate portfolio that some of you currently own couldn't be down 15 or 20%. It's not going to be like betting everything in Las Vegas or Phoenix or California or something like that. But that does not mean that an asset portfolio can't be down. It'll be down less than the extremes. But you cannot control systematic risk. All you can manage, in a portfolio of any asset, and you have to invest somewhere, is what is specific to a house or a security or something like that. Systematic risk is the market risk. If they drop a bomb on L.A., it is an exogenous event, nobody can plan for it. Good luck with that.

You only have certain investment classes that you can pick. One of which is cash. Or you can put it in foreign exchange, you can do something like that. But there are only so many things that you can do. You've got to be invested somewhere. Because the dollar is tied to, for one, petroleum. The petrodollar is still the currency that oil is denominated in. If they take it off of a U.S. dollar denomination, all bets are off on the dollar. That's a very big deal.

So things like that can happen. And you don't know when they're going to happen. That's stuff that's called a black swan for a reason, it comes out of nowhere. They don't predict it.

Kandace Phelps: It's called the Black Swan for a reason, it comes out of nowhere. They don't predict it because you can't possibly know. There are some things that you can know, but there are a lot of things that you can't. Cash solvency. We always want you to have cash coming in the door so that you never have to do what long-term capital had to do. They couldn't meet their margin calls. He talked about margins yesterday. We are at an all-time high of buying in the market on margins. It's a very scary thing. Not only that, but the public companies are out there issuing debt in this low-interest rate market, and they're buying their shares back in the open market at all-time highs, at the same time that the CEOs, and CFOs, and the leaders, and the boards of directors are selling their personal positions. Spooky. Okay?

Mortgages, or excuse me, debt to corporations is at an all-time high. It's at like 30%. That's like record highs. They're doing a really stupid thing. As soon as public values of stocks or anything goes down, what happens?

That's all dilutive. That's all been a diluted buy, and they're still left with this entire parcel of debt. They have a cash solvency problem. You bet they could. Contraction in a market, when people get spooked, do they stop spending? Yeah. I would even bet that some of you guys have curbed your spending pattern since you joined this group, because you want to invest more, because that sounds better. Spending the monthly cash feels a lot better than spending the base. You want to put it to work. Educate, train you to be sophisticated all the time. We're never going to let up on it. It's important. We've got to continue to press you into this stuff.

Sometimes I've heard my husband make comments and stuff about what you guys might be thinking and things like that. Part of the reason that this presentation is appropriate for this point in time is because it's the stuff that you don't know and we're always trying to protect you, like putting the badge system in place. This leadership team has no idea of the wisdom that they do. I watch them and I'm kind of amazed because it's like, look, we're not trying to preclude you from getting to something that you want to be doing or need to be doing. We want to make sure that whatever it is that you do, you're ready to handle the risk level of that thing. That make sense? Some of you get really excited about the big financial ideas that they talk about in here and you want to go out and try them, but because you don't really know it, it looks really great. It's whiz bangs, me with that calculator, la-di-da.

You can buy funds in here that are in 10% and 12% without taking any of that kind of risk. The guys that have people like that and the affordable housing community funds for the mobile home parks and all that kind of stuff, you can buy that stuff, get that same yield without all of that personal liability, without being in long-term capital and speculating on stuff that you know a little bit about, but not enough. We don't want you to get in trouble. We want you to take it slow, there's time. You can put money to work in here without getting head of yourself. You don't have to get out over the tips of those keys. We're trying to protect you because our number one goal is preservation of capital and to build and maintain trust relationships, which is critical to us.

That's why if something's not working in this room, we want you to tell us. Please don't go all dark on us. If something's happening, then communicate with us because we're your advocate. That's what we're doing in facilitating this room. Due diligence, that's another biggie that we always talk about. There's property, contractual and people, and people is about the role that they're applying, the ability and the willingness to preform. You need to ask your own questions. Remember, you're your own advocate and that's the number one thing that you can do in risk management is not to go to sleep on yourself. Pay attention to your own stuff. That's what happened when we all had the 401Ks in the corporate world, or at least I was, of 20 years ago when you farmed it out and they offered you like six mutual funds and you picked two and you invested 15% in this and 15% in that.

Then you never looked at it again. That didn't do any good. We want you to be involved. The Freedom Blueprint, we want you to do this every quarter. Some of you think that you've done it and it's old and you don't necessarily want to keep doing it, but look, things change and they change really fast. They change fast for you even without an exogenous event. They change. You could be a dental … that sees another practice come up in your market that you want to acquire the customer base and nobody seems to want to buy that practice and that old dentist is getting more and more frustrated all the time. You go over and you say, hi, I'll buy or book your business for half price. You didn't know that the last time you sat down and did this, that changes things, doesn't it? The next time you walk in, that Freedom Blueprint looks a little bit different because you found an opportunity cost of capital that's higher over here and consolidated in your market than it is necessarily to buy another house right now or two.

You have to make constant decision adjustment. This is personal, it's so personal. Asset allocation, time horizon, risk tolerance, asset allocation. These are all personal decisions. Your risk tolerance level is a personal decision. The timing in which you need that money is a personal problem. Are your kids going to college next year or in ten? It's personal. Did they just get out and all of a sudden you're going to have a windfall of cash. It's personal, okay. Use the tools. Financial leverage, we're always recommending to use leverage wisely in this room. It's not too late for some of you to go out and to borrow some money at 34% in this tape and to put it to work, but if you're doing it here's what they'll tell you, don't … 50% on a property below so that if you get a cash call if the bank calls the note you can afford to pay off that 20% or less, or be it 80% or 90% so that they call you, you say, "You know what, you can have the house because I'm not buying you out at 80%."

Don't be in the middle where you have the fight for the 50 because then they're pulling the strings, then they're calling the shots. Use the financial leverage, use it wisely.

Relationship leverage, you all know that. Be humble, be teachable, ask questions, don't get cocky. Nobody in here is cocky, I don't know. You all could walk up and argue with me about this presentation afterwards, just be nice. I'm not in the market anymore. I had to do research to do this to make sure I'm current. Cashflow, cashflow, cashflow, cashflow will solve a lot of problems. Small businesses go under all the time not because they don't have a good business, but because they can't continue to capitalize their business with working capital. It's a cashflow problem and when you don't have a cashflow problem you can survive an awful lot of market cycling, you really can.

Keep pressing to sophistication, if I hadn't pressed that point enough, you just tell me. Stocks don't trade on fundamentals. Give yourself time to get a gut and keep learning all the time. Keep learning and ask your trusted advisors because they'll teach you, they're so generous. Pay attention, that means pay attention to your own stuff. Pay attention to your own portfolio. Stay in community with seasoned investors. When there is a reset, that's not the time to leave, guys. If there's a reset and some of your equity stuff is down 15% when the market is down 40, that's not the time to get spooked and bail. That's the time to come back in here and say, "I need strategy, what do we do," and start asking David and asking John and asking Glenn and asking Lane and Tom, and asking Mary and asking every other trusted advisor in this room that has been through a cycle that knows a good response. That's not the time to go dark. That's the time to dig in because most people that make an absolutely killing make it in a down market, do you know that?

I'll give you a little tip, it's a freebie. The market hates a bear market way more than you do, way more. That's why they'll suppress news. That guy in the big short, that doctor that had the right bet, almost went broke. Why? Because they didn't want what he said to be true and so like, shut him up. How can we keep covering this over? How can we manage this? Long-term capital didn't tell people they were having problems until it was something they couldn't hide anymore. That kid that was trading over at Barings in London, they took them down, Nick Leeson or whatever his name was, he lost a billion dollars before they figured it out for crying out loud. And why? He started with a small loss and he kept trying to cover it and they weren't paying attention. All of a sudden they were a billion dollars or something like that in the hole and they were done.

It was all over with. Stay in this community, you're going to need them. When things get tough, that's when you need them the most. Everybody looks like a winner in a bull market. The rising tide lifts the turds too, everybody looks smart in a bull market. Seriously, I've met them, trust me. Keep some cash handy for a crisis. When we are in crisis, that's opportunity, that's when you want to be buying assets. We bought a ton of assets after 2008, a market reset is not your enemy, it's your friend if you will stay in the community and be ready to have some cash to do something cool. The last slide I've got is that risk is personal. It really is, that's why you have to be your own advocate. Your formula for acceptable risk is yours, it is private, it is like your face in the mirror. It doesn't look like somebody else's, it is very personal. That's why we are, we teach and we network with seasoned investors who have survived market cycles.

You can't learn how to do this unless you learn it from people that have already done it. All of those guys with the portfolio theory almost took the market down on multiple occasions with fury. Academics don't know, people that are on the street know. I have a great finance education, I took that to work in the street, but I learned the street on the street. That finance education only went up that far, and it was a really high octane finance education, but I learned the street on the street. It's gut, and so it's something that you have to learn from other people that have already done it.

This is a very important community to be involved in. We and you can be nimble, we can be fast, we can be liquid and we can be risk-wise in an asset class that other people deem to be high risk, and that's an opportunity because it's not true and it can be liquid in this room. That is the risk management strategy that we follow, that's what we teach. Why? Because of what we do. These are the things that we do. It's not a battle formula, it's not black and white, these are the things that we do, okay? Thank you very much. That was nice.

David Phelps: Well done.

Kandace Phelps: Thanks, guys.

David Phelps: Well, I would say you translated it perfectly for me, thank you so much. We had a conversation last night after dinner and I said, "This is what I want to convey," and about 45 minutes she had this done, so she did very well I think. I had some slides too, but I don't think I need them.

Kandace Phelps: Did I go over time, probably?

David Phelps: Do I still have a job? They're saying, "We're not sure." By the way, Phil wants the rising tide on the back of his membership card. Alright, let's take the catch box and let's bring this thing home. I think there's a couple of people that have some ideas. John Grim, we'll take John and we'll just, David.

David Phelps: Kandace, outstanding, outstanding. I mean, we've all known you were smart and everything, but the grounding it and bringing it back in with the risk management and tying it all together is just awesome, awesome. I'm just really, really excited for it. That's all.

Kandace Phelps: Thank you.

David Phelps: David, that's all? Speechless.

Kandace Phelps: Thank you.

David Phelps: Wow, yeah, that was a lot and beautifully done. I wish we were just talking about a real-estate cycle and I really wish we were, but gosh, to hug the monster on this, what do you do when this monster bubble that we're in is, everything is valued in cash. Cash isn't really money anymore, it's not linked to gold. The bubble is cash and all the equities are higher than they should be and the interest rates are lower than they should be. How do you manage that? All these models, the models, the Black-Scholes pricing model, all these things. They work very well within two standard deviations, but any of these big events and there's going to be some, whether it's oil or a reset of gold and the dollar, it's going to throw things off and there's going to be a lot of hats on the ground and there's going to be great opportunities, but trying to anticipate where they're going to be is an issue. I don't know if you can react to some of that.

Kandace Phelps: Let me give you an example. When I was in graduate school, one of the last classes that I took, I had two jobs at the same time I was doing, so there was one class I knew it was going to have to be a forfeiture. I knew what industry I was going to be in already, so I could forfeit a class in my last semester. I took one particular class where I just said I'm not going to throw the effort at this one, this is going to be my sacrifice because I just didn't have enough time. I had this professor and the professor of this class, his name, well, I won't mention that. He was what was advertised to me when this finance program was pitched to me. He was supposed to be some big highfalutin guy. He was one of these ivory tower academics and he was supposed to be publishing and he was this and he was that and he was just a rockstar that they were talking about.

I'm in this guy's class, and at the same time I'm working for a securities firm in town and I'm also doing some equity analysis for a local bank, so all in the industry that I ended up doing. I left my jobs, they were a lot more educational than this man. We were supposed to pick a portfolio and what he basically did was gave you a fictional 100 grand to go out and invest and he promised that at the end of the semester he was going to pay out the proceeds of a textbook that he was publishing. He was going to give a financial reward to somebody that had the best investment strategy. Me, being me, already working at a securities firm with about six, seven, eight analysts, something like that, I just walked around to the analysts in my firm. I asked them for their top two or three stock picks. When the thing was due, we just random sampled ten out of the pick, put ten thousand dollars in each one and gave my hundred thousand dollars of TED stocks and then put it up against everybody else's big swinging trades.

The guy that won put auctions on the Deutsche Mark or something like that, with 100% of the money. Stupid, really stupid. I mean, if you're gambling with fictional money, that's the only time it makes any sense. He gave out all the awards and he got to the end and then he was befuddled. He had to give this one final award. He couldn't stand it and he said so because it was such a traditional conservative approach. My stock portfolio in three months was at 33%. He bought me a bottle of wine. I still own that bottle of wine because it's a trophy. It will never be opened. It's still on the shelf. It's a trophy, it's a reminder. What did I do? Was I brilliant? I pulled people. I pulled people who knew their trade craft and that's what I would recommend to you.

You're not going to have all the ideas. You cannot, even though this is a supercomputer, you cannot possibly pick up every bit of effervescence that you need. You're not going to be able to know what Glenn knows about his own market. You're not going to be able to know what John knows about taxation and about structure. You're not going to be able to know what's coming down the pipe in terms of legal things that Mary is going to understand about estates. You're not going to be able to know what the professionals in this room know, but if you're constantly pulling them and then you let this gut siphon out what's right for you in your own risk management strategy, you find out what people you respect are doing, that's what Napoleon Hill did and we're still reading his book. He went to Carnegie, he went to all these other guys. Don't try and be a supercomputer on too much data, you'll make yourself crazy.

You have to set some limits, your brain can't handle it all. Pull people that you respect, that's my recommendation to you and out of that will bubble up and culminate this strategy that makes the most sense to you, that doesn't wake you up in the middle of the night, and that's really a good proxy. If something is waking you up in the middle of the night, you need to pull some sort of exit strategy and get out. That's not how you want to live your life.

David Phelps: A specific question about you, and you showed all the derivatives in just the monster that's riding on top of this thing. Whenever there's a big adjustment, that monster's going to be huge and is going to create a cash crunch, maybe a cash lockdown. How do you prepare for that? What do you do knowing that the banks aren't going to be able to give everybody their cash and they're still not going to have enough-

Kandace Phelps: Wait, what are we talking about? Are we talking about lines of credit and financing an investment portfolio? Are we talking about the 25 thousand dollars you have on your checking account?

David Phelps: Yeah, well, all of the above. I think if there is a major event, then that's a risk. It's great having cash, but if it's sitting in a checking company, they won't let you draw it out. What kind of things would you do, knowing that there could be that kind of cash crunch?

Kandace Phelps: My answer to that is, it goes back to what's systematic and what's unsystematic. Unsystematic risk is the stuff that you can manage for. It's the stuff that's asset-specific or asset class-specific or something like that. Unsystematic risk, you're not always going to be able to control, but if you're in a room like this and you own assets and they're not all 200 thousand dollar assets, you've got some that are 25 thousand dollar and you've got some that are 75 thousand dollar assets and you've got some if this, and you've got some of that, you can find liquidity in a place like this, can't you? You've got cashflow to eat on because that problem will correct itself. Trust me, they'll try and fix it as fast as they can because the market hates a bear market a lot more than you do, because that's where they make their livelihood.

That's why they try and cover all this stuff up. That's why Trump is such a risk, because the cabal depends on the confidence of everybody else in the cabal and if one guy becomes a rock-the-boater he can tip the whole thing. That's why they bail at long-term capital. They don't want this market to go down. They will fix a correction as fast as they possibly can. Even if it takes a couple of years, if you've got eat money, that type of stuff will recover itself. The most important part with cashflow, which is why we have tremendous respect for Dave Steck. Dave Steck comes in and he's got a data library that's unparalleled. He talks at Harvard until he's just bored doing it anymore because he's a brilliant man at what he does. He can go in and he can make big cap appreciation bets in a market.

He makes a lot of money and it works really well, but we're thinking more practically for us at the level of, "That's great, but how do I not have to sell this property?" Cashflow. How do I not have to liquidate a portfolio in a tape where I'm going to have to take a big hit on the asset? Cashflow. Dave Steck has a lot of cashflow, so he can take that bet, and trust me he's still managing his assets so that he's never going to run out of cash so that he can take that big bet in that one market. For most of us, that's not how we're going to do it. We want to mix. We want a physical and a financial asset. We want cashflow and we want some appreciation. If we had to choose, cashflow is very sexy.

David Phelps: I think to your point, David, yeah, you want to have some very liquid assets. You might just want to have some cash under the mattress. You want to have some ammo, whatever, silver, trading sardines, right, Walter? You need to be able to make it through a certain period of time, but as Kandace said, the fix will be back in, so you've got to buy yourself a little bit of time.

Kandace Phelps: We've also bought bags of silver like dimes. You don't want … barge, you can't trade that for a loaf of bread, that's stupid.

David Phelps: You want stuff you can trade.

Kandace Phelps: But if you have like real silver, dimes, like pre-1967 or whatever it was when they changed it, you can buy that junk change all day long and you can trade that for food.

David Phelps: Lots of stuff you can trade, just thinking about-

Kandace Phelps: Bullets, bullets.

David Phelps: Yeah, there we go, there we go.

Speaker 3: Kandace, thanks for that. Just wanted to add about inefficiencies in the marketplace and how it actually provides far more opportunity for us as investors. As an example, short sales weren't really a popular thing until the market tanked and everyone took advantage of them, but we still see inefficiencies in the market today. In Kansas City, where we're at, and I think across the nation, banks are still discounting what they're owed to get rid of property off the courthouse steps. That's where we're really taking advantage and it makes no logical sense, which is why you talk about the rational and the irrational. When you have inefficient markets, you would think in a rational time a bank is owed 100 thousand dollars on a 120 thousand dollar asset, they would try and get as much for that as possible, but banks are not good at real-estate. What they're commonly doing is setting their minimum reserve at 20 thousand dollars just to get cash on the day.

They would advertise it months in advance and try and hold a big sale to get as many people there as possible, but that's not what's happening. They announce their opening minimum reserve, sometimes 12 hours or 24 hours before, they're wanting you to show up the next day with cash on the courthouse steps. It seems idiotic, right, but that's the reality of what's happening. We're there to take advantage of these inefficiencies in the marketplace. I don't live in a place of fear of what's happening because I know that when you surround yourself with successful people, inefficiencies in the market and tanks in the market will open up a wealth of opportunity. You can't control the control ... You control the controllables and everything else you leave to God.

David Phelps: That's right, that's right.

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