Ep #281: What's Happening in the Capital Markets with COVID-19 - Part 2

Full Episode Transcript

With Your Host

Dr. David Phelps

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David Phelps: Welcome back to part two of my conversation with three gentlemen greatly involved in the capital financing markets and how they see the effect of Covid-19 on our economy, on investments going forward. And you'll particularly like the question I asked them at the very end, it has to do with their family, their legacy, and how they see things going forward.

Let me ask you guys this. My concern is that, and you're right. Same things I talked to other people in the different markets that the price points are not coming down. There's a lot of activity on the retail and investor side. So far so good. I'm wondering how much of that is because the markets overall have not really realized the effect of the shutdown, the stimulus, it's come out and poured money into the pockets of the unemployed workers for the next three months, I guess, all the way through July, if their unemployment goes that long. We have PPP loans and idle loans from the SBA, Small Business Association, that's put money in small business owners. And so that's kind of keeping things up so far.

My concern is there's a lot of small businesses that aren't going to come back online. They're already saying, restaurants, they're just not going to do it, can't do it. Some will try to come back online, and I think those that got loans, again, that's kind of kick the can down the road. So my concern, gentlemen, and I'd love to hear your standpoint on it is, right now, things seem to be good and people are still buying and still consuming to the extent they can being kind of shut down and shelter in place. But what happens when finally the fed and the government says, okay, we've stimulated all we're going to stimulate. Right now they're saying there's no limit, but there's got to be a limit. So then what happens? Where do we look for fallout? Is there going to be fallout? Do you guys have concern there that we're only seeing the top of the iceberg, and what's really down below is still to come down the road, nine months, 12 months? That's that's my question. So you guys take it from there.

Aaron Chapman: Oh, hell yeah. There's definitely going to be some fallout in this because think about, I don't know how we've able to keep this going to begin with, right? Because they've been stimulating the economy, adding some sort of stimulus since the beginning of 2009.

David Phelps: Yeah.

Aaron Chapman: January 1, 2009 is when they started the MBS quantitative easing. They taper back at the end of 2017. So we can look at that. Right, you went all the way up until 2017, putting in, what is it, $85 billion a month from the beginning of 2009 til the end of March 2010. Then they tapered it down to averaging between 10 and 20 billion. Then they pull back where by May of 2018 we're at

100 billion dollars, if I remember correctly, I could be off on my dates, but you saw the interest rates jump up one full percentage point from December of 2017 to May of 2018, and it completely changed the dynamics of how things were looking. And then you had the feds start thinking, okay, well, are we doing the right thing by doing the quantitative tightening?

If we couldn't get the economy on track to an extent that they would pull out completely out of the stimulus piece at that point, and now we have a blank check, there's a massive worry. I don't know what the end result's going to be, but you can't keep feeding the monkey like that and the monkey not just kill you when you stop.

David Phelps: Justin, what are your thoughts?

Justin Bunch: Agreed. It's kicking the can down the road. I don't see how at some point the craps not going to hit the fan on this.

David Phelps: Yeah. And so what does that mean to you? When it finally hits, where are we at and how are you, again, with beefing up your underwriting, and I get all that, but how far do you go? We still have to stay in business. We still have to keep some kind of commerce going, but there's risk all around. How much can we still mitigate going forward?

Justin Bunch: Yeah. I just think a lot of it depends on if a vaccine comes out or if there's a second wave of this, there's so many unknowns right now as to what's going to happen. But at some point the government's going to rip the bandaid off here and just are going to be unable to help people. And it will inevitably create foreclosures. These small businesses, they may not have, the further this thing goes on they may not have a business to come back to. And you're inevitably going to see some distress sales and a potentially depreciating market. But right now, it's just too early to tell. There's not enough data. Out here in LA there's still sales. My three biggest markets are LA, Arizona, and in Southern Florida, and there's still sales, they're still moving their properties, they're finding ways to make their deals happen. So it's really, really tough to say. I honestly don't know, but I'm with you that the longer this thing goes on the government's eventually going to pull back and they are going to be some businesses that are inevitably going to be significantly impacted by this.

David Phelps: Stuart.

Stuart Denyer: When the funding stops. That's when, and that's what kept it going. If you remember, even if we go pre-Covid, there were companies that were massively, massively in the hole yet they had valuations that were just unbelievable. There's a good argument to say this is a little bit more than just what's going on here. There's a mentality that you can keep pouring money into a hole and keep pouring money into a hole and keep pouring money into a hole, and the valuation of the company goes up, even though it never gets a profitability and never gets ... there are companies on Wall Street that have multipliers that are so unreasonable, that it is just unbelievable. And so when the funding stops, when they stop printing money, and when someone says, pay me, that's when the rubber hits the road is my take on this.

But it's more than that. It's more than that because it's the way that we create and go about valuing and structure business today. I remember a long time ago sitting on a panel and these companies were far, far larger than us, and you all have heard of them, and my colleague was sitting on the table, and every single one of them had been in business for something, I want to say between three to seven years. And they said, we're hoping in the next three years to be profitable. And that's an unusual concept. Maybe it's not an unusual concept. It's an unusual concept for me. I'm a small business owner, it's an unusual concept. At some stage, I've got to turn a profit. At some stage, I've got to pay the man, so to speak. And until that happens, as long as we allow that situation to continue to exacerbate, then all you do is create a massive unraveling at some stage.

And that is not a matter of if that is a matter of when. And I'm not talking about this particular recession, I'm talking about even further down the road, end of 2020s, beginning of 2030, something when someone puts up a hand and says, pay me, return what you owe, and people just cannot. It creates a lot of opportunity as well. So in my opinion, when does this all come to an end? When the money stops.

David Phelps: Yeah. So let's talk a little about the opportunity, and for businesses that are transactional, they got to get back up to speed. They got to make things happen. I get that. For a more passive investor, who's looking at opportunities in the marketplace, what would you say to that person? You say, sit on the sidelines a little bit, watch? Yeah.

Stuart Denyer: I would say be patient. I think Warren Buffett is sitting on about $140 billion and he says he cannot get anyone to call him. That is the go to guy in these times. And the phone is not ringing because it's ... I think that a lot of people get caught in a mindset, which again, I think I've spoken about a few times with you David or when we've been together, some people feel the need to always have their money in play. I've got to have my money out there. It's not earning anything. And that's a double edged sword. Sure, you want your money to be earning something but better to have that money than to have it tied up in something that is not necessarily what you want to be in. So patience is hard for investors, but it's also a smart thing. There's going to be opportunity. And just have the patience to sit around.

Your money's not in play, you're not getting your 5% or whatever you're trying to achieve, or whatever it is you're trying to earn. But then in two deals you get a 20% rate, and it easily gets you back up to where your expectations, what you're trying to achieve. So I think with everything in investing, patience is the right thing. You may see nothing for years. I personally haven't done much investing for years and years and years. And people keep asking me because I don't feel the need to have it at play at all times. Everybody's different and how everybody handles things is different, and their risk appetite is different. I would continue to have patience because it will happen.

With that said, I think that there is an awful lot of cash out there. A lot of people have made an awful lot of money in the last, if you're in real estate probably 10 years. And so even when the opportunities do arise, you should expect to have competition. It's not like it was in 2008. People have cashed today. We haven't really seen too much of a breakdown in a lot of our other business protocols because there's so much cash still in the system. So patience for everything in investing pretty much always, but an ability to maneuver and move quickly when the opportunity does arise. Because I still think that even though all these things we're talking about, there's still going to be a lot of competition when it does. When that opportunity comes, if you're trying to figure it out, there's still plenty of people out there.

David Phelps: Yeah. As an investor, you have to have your own philosophy. You said, what's your risk tolerance? What are your goals? And I think to understand what is an opportunity, what is a deal, that's going to change and one has to really be focused on an understanding of where their focus is. What assets? Know your marketplace, right? Learn it. Learn it well. Don't be running all over the place to try to figure out whether there's a deal here because somebody said there was a deal.

Stuart Denyer: It's so simple to turn into a magpie and every shiny object, you know?

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

Stuart Denyer: If you have a strategy or a method or protocol that you do, and it's starting to feel like you've been out of the game for a while. And then all of a sudden you go to a shiny object and you don't really understand it. So stay within the confines and be disciplined. Discipline has so much to do with this real estate game. And it's one of the hardest things to achieve.

Aaron Chapman: Og Mandino said at one point, I think it was in, I can't remember which book he put it in, but he said, "Tactics and strategies change with the situation, but it's principles that endure." Get your baseline principles in place, live by those, but be prepared to adjust your tactics and your strategies depending upon the situation. As Stuart kept talking about, it depends upon what market you're looking at, what deal you're looking at. Yeah, it's okay to be on the sidelines, but be suited up for play. There's nobody gets on the highlight reel unless their ass is on the field. So be prepared to be on the field and be ready to play because deals are going to still be out there. Opportunity is still going to be out to regardless what the market is.

Now when you're talking about Warren Buffet, yeah, he's put hundreds of billions of dollars aside because he had so much money tied up in certain things. He's also not looking, when you're talking about single family investments it's a different world then when you're talking about the market. Right, so it all depends on what market you're looking at, where are you putting your capital? How are you housing your capital? Are you putting in a checking account? In the bank? Are you putting it into life insurance policies? Where are you holding your cash? Leaving it right there sitting in a checking account isn't all that wise either with what's going on right now, with where your ability to tap into that cash. Have your money sitting someplace where you're earning 0.03% in what John Williams claims is a 7.3% inflationary environment nationally. You consider all of these things, you've got to be wise of where you're putting it and how accessible it is.

David Phelps: Justin, put the lens of a passive investor on. In real estate, how would you judge the same thing? How do you measure opportunities? And you can do it in a single family, whatever you want to, but how would you measure that through the lens of your experience, but also as a "passive investor" who wants to invest either in the debt or equity side?

Justin Bunch: I think I'm in agreeance with what Stuart and Aaron are saying. I think just cash is king right now, preserve it right now. I think that it might be a little too early to strike. I think there's going to be a lot of really good opportunities that are going to be coming down the pipe here, whether it's a month from now or a year from now, but there will be some great places to invest. I just think that that now may not be the wisest time to jump on that. In fact, at Genesis right now it's the same thing as what Stuart's saying, I know a lot of passive investors like to keep their money working, and it's the same thing with our borrowers. Many of our borrowers will run low many times on their liquidity. And that's our number one focus right now. And I think that's what the focus should be for the passive investors right now is just maintaining a certain amount of liquidity, whatever that is.

But at Genesis we're, we're implementing some pretty, pretty significant hard gates as far as liquidity covenants that we've never done before. It's led to some challenging conversations and some deals that have not been able to fund in May or June or July, or at all, because they just have too much money out. They like to keep their money working. They like to keep it invested. And those are the guys that could potentially be hurt. So hope that answers your question, but basically the summary of it is preserve your cash because there's going to be a lot of opportunities coming up.

David Phelps: Aaron something you started to bring it into the equation a few minutes ago at the earlier part of our talk today, people often say follow the money and I've kind of come up with the moniker, follow the debt because the debt is what the economy has been built on. And we've seen the massive accumulation of debt, as you mentioned in the last decade, and now we're just blowing it up. So let's talk a little more about that and Stuart also was alluding to what happens down towards the end of the decade. Again, we have no magic crystal balls. I'm not asking you guys to do that, but with your knowledge of the capital markets and with the massive amounts of debt that we have on a global basis, national basis, consumer basis, where do you see things going, and do interest rates go back up at some point? When Stuart said, well, when the person demands pay me up, pay me now, what happens? Just give me your best shot because I don't have a crystal ball either.

Aaron Chapman: Well, my best shot, if we're really going to get ugly with it is dependence is what we're building here. And when a person is having to live off debt to begin with, and they're using debt for leverage everywhere, now there's good, like Kiyosaki said, good debt and bad debt. Depending upon what it is, if you're using it to leverage a longterm investment and you've got somebody who's willing to accept the exact same dollar amount for 30 years, and you've got a renter in there paying it for you and you're keeping the spread, well, that's not debt, that's called asset. If you're at a point where you need debt for everything else, which I know that the average American consumer does, 72% of our GDP is consumption, and people are going into debt for consuming things. Well, now you're building an environment of dependence.

You're in a position, this is an Aaron Chapman philosophy like you said, when we have the average person that needs somebody to give them something to exist, now you're completely stifling any sort of entrepreneur environment. You're putting a person where now you're, I hate to say it, a servant of the state is what it really becomes. And that's like the ultimate end goal that none of us want to ever see. That's a completely different structure as a national, as a nation really. So to try and avoid something like that, if we try and keep going with the type of environment that we have, the type of economy that we have, yeah eventually we're just, I think the worst there is going to see that we're going to see the rates go up. We're going to have people have to go on some sort of form of being able to, I don't know if as bankruptcy or foreclosures, and then having to recover back from that. It's going to be financially detrimental to the average person in a big, big way if they have not kept their personal finances in check.

When you're talking about the companies who went heavy into debt, I'm afraid that they're going to get consolidated. We're going to start seeing those companies that were trying to be profitable in three years, that weren't profitable, those who carry the notes will own those organizations. And doesn't necessarily mean they always know how to own it. I was working for Countrywide back at the time they got taken over by Bank of America. And if there's one thing about Bank of America, they know how to be a bank. You don't know really how to be a mortgage company, that wasn't their primary thing. So they took over a company that was centered around doing mortgages, it was not the same organization. You had to become a banking entity and take your mortgage knowledge and try and apply it. I had to leave because it didn't apply. What I did, did not apply there.

So just seeing how that went down and seeing how things will get consolidated that way, the nature of those businesses and how they operate will not be the same. We're going to be seeing a whole new world operating under the heads of a few rather than the independence of the many.

David Phelps: Yeah. Great. Stuart, your take on that question. Looking down the road, following the debt as an individual, as an investor, as a business person, what do you portend that we could look at and how do you, again, set yourself up to best deal with the waves that may be coming?

Stuart Denyer: Well, I will happily say that I think there is, I do believe at the end of 2020, maybe the beginning of 2030, there will be a reckoning. I think negative interest rates and low interest rates are a very dangerous thing. How you pull yourself out of this? It has been something that's been very, very hard to do. I think it's playing with fire. So how do you manage that inequity? Carefully, would be what I say. I would be choosing, pick your execution strategies and read the details very carefully in all of your debt. Again, depending on what you're looking at and how the vehicles are structured. So I would make sure a lot of it, I think as with every real estate cycle, a lot of people get into real estate that really can't afford to be in real estate and that's problematic. And that hasn't been as much in this window, but obviously in the previous window it was very much an issue. But the debt shifted to other places because there's more debt now than there was then.

So you really need to look at the damage that I think is created from having very, very low interest rates and the exit from that, and monitor that very, very closely to come up with a strategy for how you're going to manage and how you're going to create your strategy moving forward. I'd love to see someone write a really good paper on how you get away from a negative or a very low interest rate, and read it and spend some time going through it, and read through some theory, because I'm not sure if there is a passage climbing back. If these interest rates stay this low for a long time, is what I mean. If they go back quickly, which I hope they do, probably isn't what everybody wants to hear, but I do personally, then I think a longterm low interest rate strategy is a very tough one to overcome.

David Phelps: Justin, what's your perspective on that?

Justin Bunch: I'm in line with Stuart on that. Yeah, it's tough to say. With the low interest rates, it creates a lot of opportunity, but when they go up it's going to impact and hurt a lot of people. So I don't have too much take on this topic as good as these guys did, but just in general, the lower and longer they stay low it's when they go back up it's going to get ugly.

David Phelps: All right, my last question-

Stuart Denyer: Back up, would be my, if you have a low, low, long period of low interest rates, pushing anything back up, because the impact it's had across the network, it's so hard.

David Phelps: Right.

Stuart Denyer: And so if it's a short term window, which it hasn't been, that's something different, but I don't know how you can incrementally, you've just got to be so, you can't go back to a normal rate. You can't just go from zero to five overnight because everything's going to go into default. Anything that's got an adjustable is going to have, anything that's got an arm attached to it. And so you're almost setting companies up or setting people for such a problem. How you clamber out of that is a very long, laborious, and contingent on so many other uncontrollable factors for the average investor. It's something that everybody should be looking at if they've got a long term strategy in place as to how they can manage those scenarios and those situation going forward.

Even if I go to the macro level, I really don't know how if you have longterm low interest rates, you can move out of those and get back to what would be a normal rate, which would probably be six, five, six, something like that. So that's the problem for me, and that's the part that people have tried to explain to me, and I think anyone on this phone call could pick holes in pushing an interest rate from zero to five or six in a short window of time and the impacts that it would have. Devastating.

Aaron Chapman: It's no different than a drug addict, really. My wife's in the medical profession, and they get somebody in there who's been a drug addict for years, you hit them with Narcan right then, it's painful. It's ugly. It is one of the most devastating things in the world to take somebody off something like that and hit those receptors that way. That's exactly what we're dealing with. They've been chopping coke for coming up on 12 years for us now. And when they cut them off saying no more free coke, what are we going to have? You take America off his coke you're going to see what's going to go down, and it's not going to be friendly times.

David Phelps: And that gets into the political ramifications. That's a whole other rabbit hole that we won't go down today, but you're absolutely right. All right, my last question, gentlemen, and this will think help hit home with everybody. You all have kids, and kids that aren't out fully grown and adults on their own, per se. Let me start with you, Justin, how are you instructing? How are you educating through your eyes and your wisdom and experience? How are you helping set up your kids for the future in America? In a country that's been known for freedom and opportunity, and yet we see the things that are happening. Words of wisdom, how are you helping them?

Justin Bunch: Well, my kid's three, so he's just learning how to talk.

David Phelps: Great chance to have had a lot of influence though, yes?

Justin Bunch: Yeah, absolutely. It's interesting. And this may not be answering your question exactly, but this whole situation, out here in LA, we live in a nice area, but the schools are terrible, right? You have to put your kid in private school as far as where I live. We were set to buy a new house in April, canceled the transaction, just because we wanted to see what would be happening. We were going to make a pretty major step up as far as our monthly expenses and private schools and all that. And that completely changed. Now we're staying in this house. We are still going to put my kid in private schools and all that, but basically we had to make the position to stay downsized for now and kind of ride this out.

David Phelps: What do you think you want him to understand as he grows older about the world and about being resourceful and adaptable and flexible? Because no longer can you just go and get the best education somewhere and expect that to do it for you. Degrees today are basically worthless because they're outdated by the time you walk across the stage with the diploma. They don't pertain because we have so much volatility, turbulence, uncertainty. How do you want him to grow up and see the world? I guess that's kind of my question. If you could just, in a few sentences, how do you want him to see the world as you're raising him?

Justin Bunch: My answer to that, I want him to make his own decisions, go his own funnel. My whole family's in show business. I was the black sheep that went into real estate and into business. I want him to make his own choices and just be a go getter. Get out there and figure it out for himself. And I think that life experiences moreso than education is going to lead to success.

David Phelps: Aaron, you do a lot of teaching I know, and what ages are yours right now, Aaron?

Aaron Chapman: 22, 20, 19, and 13. And as early as, I think it was 20, 18, 15, and 10, I had them sitting down, we're going over investment opportunities for us as a family because what I wanted them to understand is where me and their mother were putting our capital, how we're building the trust with the future, and also setting some ground rules. They had to actually start following a plan that we set or they set, they present the plan to us for their personal finances, how they go about their expenses, and how they go about saving their capital, minimum of 10% per year, and they have to prove it to us and show us on the regular and show their siblings what they're doing with their savings as far as that 10%. What they do with the rest of it, we don't care because we're not going to dive that deep into it. This is not a dictatorship, but I want them to show how they're handling things.

Otherwise they don't get the windfall that I leave when I pass. Because when I die there's going to be millions upon millions of dollars, it's going to go to, granted everything is, we don't have a complete collapse of everything, but when that happens, then need to know how to handle it. I am not going to well fund a bunch of little entitled assholes to run around the country and just make the world more miserable, right? So we've set that in place. Now at first we were setting it to where it was very, very much a dynasty type trust and keeping the spouses out of it. But then I got to realizing you don't need to create that type of a unity in their relationship.

So my oldest daughter is married. We brought her husband in on this kind of thing and said, you need to buy a life insurance policy. You need to start the infinite banking strategy. You need to start with X per year. Here's the first thousand bucks to get you going. I gave 1,000 to her, 1,000 to my son alone and to my daughter. And when they get married, I start them out and they have to participate otherwise he risks her position in the trust if they don't collectively work together. So that's one of the discussions we have when they're dating, making sure that this is the type of person that they are.

The other thing is I preach frugality, and I heavily preach self-reliance. You got to have enough to take care of yourself no matter what happens for at least 90 days. You have the capability to go for a year to be able to sustain your life for a year, then that's when you know you're in really good shape. I'd be lying if I told them that I'm not long on precious metals, such as copper jacketed lead, man, get as much of that you can. That's a good commodity to have. So that's the basic generality of things. And if I want to sum it up in anything, it's just self-reliance. Be able to take care of yourself because in reality we're all alone in this world. If we get ourselves up and get ourselves moving it's because we do that. If we sit still and do nothing it's because we do that. Nobody can move you. Nobody can motivate you. You got to do it yourself.

David Phelps: Words, all right, Stewart, you and I talked before we jumped on here today, but just for the benefit of the audience, the ages of your kids, and same question to you.

Stuart Denyer: I have 16, eight, six. I just give them your book, David. I just tell them to get a good read on this and everything will be sound as a pound if they read this through thoroughly. That's been my strategy so far, it's working out great.

David Phelps: Perfect, perfect. All right, Stuart, Aaron, Justin, thank you guys so much. People may follow you, they may want connect with you, best place to do that. Stuart, let me go to you first.

Stuart Denyer: Stuart@ShermanBridge, S-T-U-A-R-T, at Sherman Bridge, S-H-E-R-M-A-N, like the tank, ShermanBridge.com, real easy.

David Phelps: Very good. Aaron?

Aaron Chapman: AaronBChapman.com. Two As, one R, B as in boy, C-H-A-P as in Paul M-A-N dot com. You see a redneck like this sitting on a porch of a cabin like that, you've hit the right spot.

David Phelps: You got the right one. Okay, very good. All right, Justin, to you.

Justin Bunch: Well, my email is Justin.Bunch@GenisisCapital.com, but I think the easiest way to get in touch with me is just Facebook, Justin Bunch, and just private message me.

David Phelps: Perfect. Gentlemen, I really appreciate the time today. Thanks for your conversation. Thanks for your wisdom, foresight, and the experience that you bring. I'd love to jump back on with you in a few months and see where we are.

Aaron Chapman: Appreciate it.

David Phelps: Have a great day.

Justin Bunch: All right. Take care.

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