# Ep #341: Alastair J. Macdonald - Understanding The Full Market Cycle (Part 1)


## Full Episode Transcript

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**Dr. David Phelps**

**Dentist Freedom Blueprint with Dr. David Phelps**

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David Phelps: Good day, friends. This is David Phelps from the Freedom Founders Mastermind Community and Dentist Freedom Blueprint Podcast. Today is such an honor, such a privilege to have a person who's become not just a good friend, he's a mentor, a colleague in the entrepreneurial space, Mr. Alistair McDonald. Alistair, sir, it's so good to have you.

Alastair Macdonald: Thank you, David. It's my privilege to be here, for sure.

David Phelps: Well, the first thing people will notice that one of us has an accent. I'll say it's me because you actually speak the Queen's English. My accent is not so good to listen to. I think I'm going to ask questions and let you speak. The listeners will enjoy that a lot more, but hopefully I can ask some good questions of you today.

Alastair Macdonald: If I could just get my kids to be quite as compelled by the accent, my world would look quite different.

David Phelps: Well, Alistair, your background, your history, your life history is one that is just so expansive in experience and knowledge and wisdom, and you're so good about being able to articulate that to the people who care to share with and provide that wisdom and people who you lead at different aspects of your life. I could give some pieces of that. I think you probably told this story more times than I have, so why don't I give you a shot and just take us back to growing up in and the entrepreneurial background from which you come from, your parents, your grandfather, and just kind of take us through, bring us a little bit up to date, and then we'll carry on with our conversation today.

Alastair Macdonald: Yeah, so I'm originally from Zimbabwe in Africa. When I was born it was the country of Rhodesia, and Rhodesia was going through a torturous civil war as the kind of departing energy and influence of the colonialists, not just the British, but the Germans and Portuguese, et cetera, from Africa. In the '50s, '60s, and '70, it was this draining of interest and ability by European powers to continue to sustain and support these distant colonies.

As their capital and attention receded, those that were born and raised there, like myself, I'm a fourth generation Zimbabwean, being there the family's 120, 130 years, it was a fairly violent extraction. What was left was a very small minority of largely white, then Rhodesian, now Zimbabweans, and a large majority of black Zimbabweans, Rhodesians, that were as a function of this colonial legacy, there was a disparity of income, there was a disparity of education systems, and so on and so forth. So this inevitably manifested, interestingly enough, in a large gap between the haves and the have-nots. It was not unique to race, but it was definitely easily identified by race, which was unfortunate and civil conflict arises.

I saw just recently a beautiful quote by Plutarch, who in fact, if I could recall it exactly, it said that, "An imbalance between rich and poor is the oldest and most fatal ailment of all republics."

And sure enough, that's what I grew up with. So grew up through a bad civil war. In coming into the '80s, my family's long line of entrepreneurs and business owners, everybody as far back as I could see, worked for themselves. They didn't even work for each other. They just work for themselves. So it was almost assumed, at least in my mind, that I would eventually go the same route and start my first business, which I did at 18. It was a safari business.

I watched the post-war, postdoc, social mood era, and under the emergence of a booming economy in the '80s, and particularly in the '90s. And my safari business that I had started, picked up immediately, giving me one of the most dangerous things that success can give you, which is the illusion of your exceptionalism. And I did, I really thought that I was pretty incredible, only to later discover that the right timing, everybody looks like a genius.

The ensuing contraction in social mood, and civil strife, and economic implosion happened seemingly overnight. And before I knew it, I was living in a country with the greatest hyperinflation in world history, north of 18 million percent. By the time I had employees and so forth... Well, had employees at age 18, but it was a extremely difficult environment to navigate. If you went out for dinner at night, you had to pay for your food before it arrived, because it would cost more by the time it landed on the table.

So this environment, needless to say, isn't that easy to do business in. You end up with this rush to hard assets and you're often trading and bartering in hot assets. Nonetheless, I moved to the United States and continued. My safari business rolled into an investment business, which then led to me working on Wall Street, which didn't last very long, largely because I couldn't grow a dorsal fin. I didn't want to stick around and have anything to do with it. It really wasn't about investing at all. It was about sales, masquerading as advice, which I've since discovered is every way. So I'd enjoyed this great, very early success, expeditions with some of the most prominent organizations. National Geographic commissioned me for a source to see a trip of the Zambezi River. It was a cover story. But I got a little bored, amazingly. I could see boredom on the horizon.

And so I headed off to the United States and got caught up in another frothy frenzy of the tech bubble, paid the ensuing price, over leveraged, overextended, and under experienced for an American recessionary contraction, which is really where I went to the mountain, so to speak, to learn Shaolin, to really understand what I've come to believe is the most important thing for any entrepreneur to understand, is how to manage and thrive in the full-market cycle, the full economic cycle. So in that time, I've been involved in managed assets directly. I was fortuitous enough to call and anticipate the peak in the housing bubble. That bursting was very profitable for me. The financial crisis was the most profitable time of my life. And the subsequent recovery has moved me back into just direct work with entrepreneurs. And that's the longest elevator speech that could be given. It's a long elevator ride.

David Phelps: But it's perfect because so much of the experience that you just alluded to, the Plutarch's quote about the imbalance between the haves and have-nots, the chaos, the market volatility, where we are today, full cycle. And that's a term that I really first heard from you. Let's define that a little bit because people might not be totally clear what it means and how that relates to the market today. Let's just dive into what you mean by full cycle entrepreneur or a full cycle investor.

Alastair Macdonald: So we look at the oscillations of say, Apple stock inside of any intraday data set, what we see is oscillations, exactly that. We see these cycles at tiny degrees of scale. Those same cycles play out almost in a fractal type pattern in the broader economy. So we see the waxing and waning of GDP, of unemployment numbers, of taxes fluctuating over time, retroactively, trying to repair prior excess. We watch the expansion and contraction of credit. These are all what we would describe as to watch a full cycle.

So for example, today, as you and I speak, the S&P, just as a proxy for a market, we are outside of a very violent, but modest contraction in COVID, rapidly made up very, very quickly and convincing. We are really on the back end of what, granted, we've experienced a recession with COVID. But what we've seen, if you look at a chart of the S&P the last 11 years, 12 years is what I would call a half-market cycle.

So a full-market cycle includes both the boom and the bust. This is crucial. This is crucial because as investors, we fail to pay attention to where we are in the larger cycle. It's as if we set out on a journey at 6:00 PM in the evening, and we forgot that it can actually get dark because it's been light for 12 hours. Since I've been awake, it's been light and so therefore, I'll just sail out into the dark. This is dangerous for a number of reasons. And it comes from innate inability to really forecast anything. That's why I want to come back to forecasting. But the notion of cycles themselves, they'll show up at all different degrees of scale. So if we look at home prices, we've seen expansion and contraction in home prices. Political cycles.

A full-market cycle will look like one from say, 1925 to 1948. Inside of that, what we have is a full expansion and a full correction. So an investor, I believe, a full-cycle investor, which is to say a full cycle entrepreneur, because entrepreneurs are the most active investors in the world. It's not BlackRock and the big, hot money that's working arbitrage, squeeze trades, and so forth. It is the dentist who decides to add another office to their practice. It is the employer who brings on another employee. These are investment decisions and they're based on a forecast.

But nonetheless, back to this cycle. If we are going to cultivate an awareness of these cycles, which I've lived through now, this is my fifth complete market cycle, what we'll see is the best way to measure success is market bottom to market bottom, or market peak to market peak. Instead, what we do is measure market bottom to market top. It's a half cycle. So we bring half cycle sophistication to a full cycle phenomenon. The beauty of these cycles is, and I know you and I just got a chance to riff on this privately the other day, is that no opinion is required. No opinion is required. Nobody needs to make any sweeping forecasts to understand reversion to the mean.

So let's take just as we discussed recently, the case of a year-over-year home price index is up 22.1%. The historical average is somewhere in the order of 6 or 7%, going back to the full set of data. Well, how are we going to get back to a 6, or 7, or even 8% average annual increase on the heels of a 22% boom? Well, again, no opinion required. An average is made of the best of the worst, and the worst of the best. This looks like the best of the best. How do we correct for that? The gap between 22 and 8, or 22 and 6 is large. And that reversion to the mean is the mathematical term we might use for a full cycle.

David Phelps: Alastair, there are many macro trends that we can look at today and many which are don't show up in the financial data. But you and I, again, we talk about these often, the demographic changes, the generational shifts, the cultural changes, social behaviors that are again, moving through the economy, not events, but we would say processes happening over time. How does some of these shifts weigh into the way a full cycle entrepreneur could be looking at their position in the current market, and wanting to protect that position or protect the ability to grow and navigate this volatility? What's typically missing out there that most people, and certainly economists and pundits don't bring about, focusing on just small data inflection points here, there, or the other, and people get all tied up in small data points? We're missing, I think, the bigger picture.

Alastair Macdonald: Yeah. And that's a great question. And it's one that has my attention at all times. Historical precedent is super valuable, and particularly in the West, I've found, particularly in the United States. Which God bless the USA for having me. I mean, I continue to be the luckiest man you'll ever meet. If I ever get grouchy or miserable or feel hard done by, I just have to remind myself, "You live in America. You live in America."

But having said that, the United States, even the idea of democracy is a very new idea. The United States is very new in many ways. And so we are almost culturally, in my opinion, predisposed to disregard the full cycle of history. There are pubs in Scotland that are older than the United States. With that comes an almost institutional memory and understanding for the good times and the bad. A great potato famine feels like yesterday to someone in Ireland, even though it was 100 ears ago.

So what's that about? What's that about for us? This is combined with America's remarkable ability to reinvent everything all the time. So we have a entrepreneurial energy toward creation or recreation of new things, together with a very short, not just geologically speaking, but politically speaking idea of America. And that tends to make us overlook or disregard our elders.

For me, if there were one thing that I wish I could bring from Africa to the United States, it's what we do with and how we treat our elders. This is completely off the point. I'm sure I'll come back to what is it that we should look for. But I'm just setting the stage on the macro level. In Africa, certainly in the cultures, due to culture influences and so forth that I grew up among, there's an old saying that when an old man dies, a library burns. In the United States, when an old man dies, a new spot has opened up at the assisted living facility. And I think this is a tragedy. It's not a judgment. To me, this is a travesty.

Why do I mention all of this? It's probably of no real utility, except to set the table for our lack of respect almost, or lack of paying attention to the power of history. So historical context is incredibly valuable. Let's take for example, my own experience. As we sit, you and I, I have just as of four hours ago, five hours ago, closed the sale on a veterinary hospital that I bought five and a half, six years ago. When I bought this hospital, it was just a tiny little clinic. It was a one-doc, three days a week. It's now a six-doctor hospital, 8,000 square foot facility, et cetera. So it's changed. But I had looked at multiple practices to buy at the time. And most of them were priced at about, much like a dental practice, 70 to 80% of collections, which is to say in the veterinary space, about three times EBIDA. Everyone loves EBIDA. Of course, don't get me started on that.

But this was the historical average. Even inside of my own very tight historic experience, it's the first veterinarian clinic I've ever bought, six years ago, for about three times its EBIDA. And here I've just closed on, granted, it's a facility significantly larger than it was, at 13 times EBIDA. This is not about me, but it's about the importance of historical data sets. What is it that has changed in the veterinary industry in the last six years? Nothing. It's not as if dogs have suddenly grown two heads, or six legs, or no longer need medicines, or need more medicine. This is not the case.

What has changed is the cultural association of value to this industry. Why? Because it has shown historically, a degree of resilience in the contraction and expansion of the economy. The same thing in dentistry, where people feel like, "Well, we all need to go to the dentist." Yeah, that's true. Well, people love their pets like their own grandkids. Yeah, that's true. Believe me, I have the profits to prove how true that is. It's real.

Equally, while everybody needs a place to live, no one's making any more land. We all need a house. Everyone's moving here for the lifestyle. These are all stories that we use to justify logically, what is actually a purely emotional frenzy. Maybe not a frenzy, maybe a panic. While it's true that everybody needs a dentist, it's true that veterinary space has been doing very, very well for many years, does that justify 13 future years in my personal example, of income to be paid for it now? This is an extremely important thing.

I know docs, I've worked with dentists that basically were given a book of business 25, 30 years ago. How much has dentistry changed? Certainly technology-wise it's changed. It's officially become a business, not just as service. There's now marketing in it, that clients had said, "When I started, you didn't market. That was shameful." So a lot has changed, but the numbers haven't. The numbers of the numbers. So what the danger here is, the same with housing, these things are true. Yes, someone needs a place to live. But historically speaking, does this justify these current valuations? Is there historical precedent to support this?

Sorry for the ramble—

David Phelps: No, no, no. It's a great backdrop to look at it through that lens. So we have this massive distortion of the markets. We've experienced, those who can go back to the '70s, where we had a lot of inflation and we had interest rates because Paul Volcker came in as the Fed chairman, and it was beat-down inflation. And so the politics of that time, granted a person like Paul Volcker to come in and do what he did, he took interest rates and that basically took inflation down. And we've seen this reversion of high interest rates now to really bottoming out probably in this last year, would you not say, this 40 year cycle, this big cycle? And then amongst that, we've had just these massive increase of debt because of the shielding of the US economy global reserve currency kind of is given a free printing press or a credit expansion that allows the politicians and really the voters of the country to say, "No problem. No problem."

So as you would call it, hot money. Hot money, low interest rates, expansive credit, and so now we have this really distorted marketplace, where as you said, where's the real value? Again, I'm going to give that little bit to you. Help us kind of work through that. And again, as entrepreneurs, as small business owners, how do do we position for that? We have current assets. We think we might want to expand because right now, business is there. But then, not to throw another other widget in, but we have a hard time with labor right now. Do we sell right now and take some chips off the table, as you just have done very well? Where do we put that money? So there's a lot of questions there. I'll let you just take whatever you want to, and please go down any rabbit hole you wish. It's wide open.

Alastair Macdonald: That's tempting for me. So it's a dangerous invitation; your poor friends and listeners. At its root, the sense of what do we do? What do we do? There is an impatience that we've suffered in the West. It's that same lack of historical context and remembering something that I need to apparently be reminded of every week of my life, which is that I'm playing the long game. Certainly we have short game versions of it, but we're all inside. If everything goes well, whether we like it or not, we are inside of a long game. And so long games require long plans, long strategy, and a long respect for history.

Interest rates themselves are a great example of it. What's fascinating to me is when I notice these what psychologists call framing arguments, just as I shared just now. "Well, everybody needs a dentist." Yes. Does that justify 17 times current earnings? No. That's a framing, and psychologists will tell you this. You've come up with an emotionally limbic system-based impulse, but we feel kind of stupid saying, "I don't know, everyone's doing it and I want to get in on it." So instead, we say, "Oh, well, it's very defensive industry. And it's got these terms like EBIDA," which most don't even understand. I certainly don't understand the origin of EBIDA and what it's really about. These are framing case that we make.

Fascinatingly enough, and you and I are going to get to talk at length at the event next week, so I'm really looking forward to it, about specifically interest rates. And I think this is a conversation we'll look back on a time and say, "What was it that we were expecting, and why, at the time? What were we thinking?" So interest rates are another beautiful example of a full cycle. These cycles happened at all degrees of scale. Just as Apple trades in for a minute, so too, do interest rates trade around the world over centuries, literally centuries.

James Grant of James Grant Interest Rate Observer, a profoundly academic smart man, makes the case that interest rates are lower than they have ever been in two and a half thousand years. He's got data beyond data. That seems, at some point, you know that old Yogi Bear when something's not sustainable, it's likely to end. At some point, that'll end, but where and how it ends, of course, like the whole thing of getting here, will be a process, not an event.

So interestingly, to come back to this framing issue with interest rates, we see it even amongst those that we know, love, like, work with and respect, that well, I realize things are really expensive right now on a historical basis, whether it's houses or stocks or what have you. By any measure, we're at historical extremes. In fact, the case of uptake and monthly increase of 1.8%, you and I discussed the other day, in the month of May, eclipses only the prior peak of 1.5% interim one-month increase back in March of 2005. That's probably worth paying attention to because we know what happened following the '05 peak. Again, no prediction required, just a respect for historical precedent.

So here we have friends, mates, business partners, ourselves, saying, "We know stuff's really expensive, but money is so cheap right now. And so I should borrow, I should leverage, I should take equity out," or whatever their version is. There's no precedent that I can find, as somebody studies this and loves this and looks back as far as I can, for cheap money, which is what the narrative is. "Well, might as well borrow it now. Worst case, I've heard people say, "I'll borrow it and just sit on it and see what opportunities present themselves." That is a monstrously large arbitrage bit.

But I don't know of any period in history where the inducements to borrow money because it was cheap was not also offset on the other side of the balance sheet by completely unjustified asset valuations. Why? Because the one creates the other. There is a P to the P&L. There is an L to the P&L. There is balance to the balance sheet. This notion as an example that all the money cashes on the sidelines. What a preposterously incompetent philosophy, or even thought that is. It's not on the sidelines of anything. You have stock. I have cash. I will give you the cash. You give me the stock. The cash is still on the sidelines, it's just in different hands. So these types of things are again, all just examples of framing to justify what is really our own instinct to want to keep up with everyone else, the herd, and that is something you and I are going to really dig into next week.

I'm looking forward to this herding instinct and I'm approaching a point in my own personal philosophy, having been through the absolute vicissitudes and whip sores of social mood and its manifestations, that I have this burgeoning bone-deep sense that throwing back intellectual, philosophical, political, individual sovereignty could be the most important work that we do right now as a conviction to join the herd. Dogecoin is meant to be a joke. It was a joke, and yet it has valuation of... It's nothing and it's worth billions. That herding instinct is in us all. We all feel it. That's what fashion is. That's why certain things are trending. Anything with trending is that we finally have got algorithms to put behind what is really just the herding instinct. So we've become a way back. What should we be looking for? Historical precedent and paying attention to our own framing arguments in light of said historical context, and the herding instinct. Where is it getting us and how?

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