Questions and Answers with David - David Phelps: Ep #406

Full Episode Transcript

With Your Host

Dr. David Phelps

[Dentist Freedom Blueprint] with Dr. David Phelps

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Welcome to the Dentist Freedom Blueprint, a podcast about freedom—freedom from expectations of society and the traditional path to success that has been ingrained in us from our early years, I'm joined by mavericks, renegades, and non-conformers to discuss an anti-traditional path to financial freedom, freedom of time, relationships, health, and ultimately freedom of purpose. My name is Dr. David Phelps. Let's get started.

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Alex Lerma: David, I'm excited to run some of these questions by you. These are some should-ask questions, is what we call them; basically questions that we found that folks can use to help create clarity … or I think the quality of questions that you ask determines the quality of answers that you get.

Asking great questions really comes down to becoming what you describe as your own financial advocate. And this is something that you've experienced in your own story.

What does that look like, David? To become your own financial advocate in a world of financial advisors, and on the other end of the spectrum, folks who are out there doing it yourself — what does it look like today to be your own financial advocate?

David Phelps: Alex, entrepreneurs, small business owners, that we all are, capitalists; we take a lot of risk. We get in, we learn the trade. We learn the technical aspects, we learn the operations of how to run a small business. That's kind of the American dream for a lot of us.

And we learn how to do that. We navigate the ups and downs, ins and outs. We really get in the weeds of it. We have what I call no separation of our money into that actual operation.

We are putting our money in, we're putting our time, we're maybe amassing some debt on acquisition or expansion. And we are in that business day-to-day, week-to-week, for as many years as we want to stay in that business.

And then comes a time during that career path where that operator, that small business entrepreneur starts to think, “How do I exit this? If I even want to start to taking some time off, or maybe I'm at a point where I'm getting offers to buy my business or my practices. Geez, what does that look like?”

And the big question comes, “Well, I don't know if I have enough. Enough capital after I sail and pay the taxes, do I have enough?”

Alex, we've had a number of people come to Freedom Founders who in my many years of experience, had ample amount of assets and equity after a practice, professional practice sale, business sale after paying their taxes.

But because they've never had any experience in actually working their money — see, they learn how to make the money in operations. That's what they learned to do. That's what I learned to do. You're going to get good at it or you're not going to have a business. So, that's almost a given.

But then it's like, “Okay, now, I'm at this precipice. It really feels good because I'm at the sale point. I've done well, but I've worked really hard over 30, 35, 40 years. And I'm just, gosh, I'm ready to take a break, and now I'm looking over this cliff.”

It's supposed to be this great retirement and the winner's clap and you crossed a finish line, and it's like it doesn't feel so good. Well, why is that?

Because they never learned how to make their money work for them. They made the money, but they don't know how to make it work for them unless they're back in the weeds of running the business again.

And the whole idea is eventually, to be able to sell a business after you created, you've gained income from it to fund your lifestyle for many years and take care of your family, all those things. But the end game at some point is, how do I take my foot off the pedal and make that money work for me?

And the problem, the disconnect, Alex, is that we abdicate, or I'd say the majority of people abdicate. I didn't, we don't in Freedom Founders. But the majority abdicate keeping their money working for them to financial advisors, to the financial constructs on Wall Street, that's the majority default. That's where everybody goes.

And the problem there is you learn nothing from doing that. Even if that worked to a point, if it worked to a point; still, I ask people, what skill sets have you learned from that?

I just learned that when the market goes up, it's good. And when the market goes down, that's depressing. Well, that's great to know that, but what are you going to do about that? See, no skill sets.

And learning to do that, I think for a lot of people, seems like that's very, very much a challenge because they just have been really brainwashed that they can't learn it, they can't do it.

Stay within your lane, do your trades, do your business, do your practice. But don't think about doing anything with the money because it's way too complicated.

Well, they (Wall Street) makes it complicated on purpose. And my whole mission in life is to take that away and show people who are interested that you can take control of your financial assets and go into alternatives besides that path into Wall Street, and actually have an outcome that's way better than you thought it was going to be.

Alex Lerma: David, I think that resonates with a lot of folks who maybe are tired of riding the rollercoaster of the markets, the volatility of the markets, and they're interested in alternatives, but it's a new world for them. It's very different from the conventional model of investing through 401(k)s or in Wall Street equities.

What are some of the advantages or disadvantages of alternative investments? Real estate specifically? Real estate certainly has some volatility in ups and downs in those markets. What are some of the differences investing in alternative investments versus riding the stock market?

David Phelps: The big difference, alternatives versus stock market financial products, is that alternatives are part of what we call, we define as an inefficient marketplace (inefficient). Well, why is that inefficient? Shouldn't we be efficient?

Well, efficiency is what the stock market financial market's all about. It's high-speed computer algorithms, which makes it almost impossible for the retail individual investor to ever get really what I call, value investments.

You are just riding that market. You're buying the market today, and whatever it is, next week or next month, that's what you get. You've got no play there at all. The inefficiencies of alternatives, in particular real estate, allows us, me, any of the people listening today, and individual to have a play.

Because even though big money tries to get in real estate, and to some degree they do through real estate investment trust and big hedge funds, but there's so much inefficiency that we have an opportunity either doing it our self or doing it with others. And that's a whole other strategy and skill set.

But there's a way that you can actually have more control over your investments and that inefficiency in the alternatives is what stabilizes those markets. Yes, every marketplace, every business, every investment to some degree is going to be affected by the cycles of the markets, no question about it.

But we see time and time again that the alternative space is much less volatile, particularly because we can choose specifically the types of asset classes geographically where we invest, and really mitigate that extreme volatility. This is what I learned doing this over 40 years.

I've ridden all these cycles and the real estate I've invested in where maybe it doesn't have the great appreciation during some market cycles, but it never has failed, Alex, to produce the cash flow.

And in the end, what we want our investments to do for us is to provide cash flow. It's all about the cash flow, not the accumulation. In the real estate I can say authentically, I have never lost principle in real estate, never lost principle.

And that principle is like the golden goose. As long as you maintain that golden goose, then those eggs of cash flow keeps producing on and on and on. And also, hedge to inflation.

Alex Lerma: When you talk about control, David, I think a lot of folks may be thinking, “Wow, that sounds like a lot of work.” We've all heard horror stories of real estate in terms of tenants and toilets, and contractors, and becoming what you like to call an accidental landlord.

Talk to me about how you invest in real estate today, and how you might recommend that a busy practitioner who is working full time in their practice could invest in real estate without taking that DIY, do-it-yourself approach?

David Phelps: Well, that's how I started. So, let me be fair and say that when a person's younger and has more time than money, which is where I was when I was 22-years-old and bought my first investment property, that being in the operations, being in the grit and the grind of learning how to do it made sense.

But as we climb that ladder and particularly, the people that we work with are in business, they're in professional practice, their time is much more valuable. Yet, most people see from the outside, they think, well, real estate alternatives is something that you need to go do yourself.

You go find the properties and you could watch the shows on HGTV and flip this house and they all look sexy and fun and great and looks like, “Wow, that's something we could do on the side.” This is not a hobby, this should not be a hobby.

This is something that you want to do with the same diligence that you run your business. Well, how can you run two businesses at the same time? Unless you have a whole fleet of people in your family, probably a spouse who's willing to get into the operations and maybe even some older kids, or you're willing to build that business, which I don't recommend because I don't think it's easy to do two things at once — then you need to find other people with whom you can invest.

And that's the collaborative aspect of what I learned to do as I evolved over the years. Going from do it yourself to doing it with. Finding and curating the right people in different asset classes is the key. It's the right people. I'll say it again; it's not the actual investment that comes first, it's the right people. I've made my whole life about finding those people.

I've been doing this again, for four decades, and I have found good people so that as I ascended that ladder and my time became more valuable, I wanted to buy my time back, instead of having to go out and find investments again and do the things that I did when I was younger.

Finding the properties, dealing with tenants, dealing with the contractors — that work that you talk about that somebody has to do, I'm much more willing to take a little bit less of a return because now, my time is not involved, but I have to still curate the right people.

And that’s a skill set, an art, and a science in itself. But it's something that we teach our members at Freedom Founders, first and foremost, we bring it to them, and then we teach them how to do it that way so that they are not involved in the actual operations, they're not doing the work, but they're still overseeing and having control where their money goes.

And that's what I call one degree of separation from your money. In your business, no degrees of separation. With these investments with alternatives, only one degree of separation. And that's in deference to Wall Street, which is many degrees of separation, which is why I've never been a fan of Wall Street.

Alex Lerma: When I talk to practitioners, David, one of the most common questions I get is about ROI. What's the ROI? What kind of ROI can I expect? And oftentimes, they're asking for a specific percentage. Is it 6%, 8%, 10%, 15%, can I get 20%?

And David, you often talk about ROI versus ROT (return on time), and distinguish between the quantity of ROI versus the quality of ROI. Talk to me a little bit about that distinction. What are some other considerations that we should have when we're looking at ROI from our investments?

David Phelps: Well, the number one rule, it really follows what Warren Buffet has said many, many times. Rule number one is don't lose your principle. Rule number two is don't ever forget principle number one.

So, when people are talking about ROI and what I call “chasing yield” or “chasing the return” on investment from a numerical standpoint, they are misguided in my opinion.

Now, I like to get good returns. I like to get returns that are fair for what the market gives me or gives us. The market's always changing. And so, to chase ROI, what's the promise? What's the target returns? Or we call it the pro forma.

Anybody can sing a song about a pro forma. Maybe pro formas that they had in the last several years, two or three or four or five or six years. But how can you be a good advocate for yourself if you don't know what kind of headwinds the market may be showing, what asset classes make sense?

So, instead of focusing on what the promises are on ROI, maybe one needs to look at the quality of the investment first and then start to determine ROI. The qualitative aspect goes back to what you said, it's return on time.

How much time do I need to put in this? What is my ultimate goal in making these investments? Is it just to get to pilea up more money? Is it just to get some ROI return of double digits or more?

For me, it's about buying back time on a consistent basis where I know that that investment, that principle is not going to be lost and it will return to me. The qualitative returns that the market provides and that's what makes a sophisticated investor.

You don't have to do it yourself to learn this. It's a skill set that anybody can learn. In fact, in our membership with Freedom Founders, we find our new members are very skillful at understanding this particular aspect within a year or less. And they become very, very discerning about their investments or learn to ask the right questions.

This is a skill set that I think most people don't understand and they don't think that they can understand it. Understanding why you should not focus just on the ROI but why the quality of the returns on investment are more important in the long-term.

Alex Lerma: So many of the members who come to Freedom Founders, David, they have a jumbled assortment of investment products that they've purchased over the years, maybe from financial advisors, or maybe real estate assets they've acquired in their local neighborhoods working with the local realtor or some such approach.

And some of these are performing okay to varying degrees of returns, but they're not really creating the results that this investor's looking for in their life.

Can you talk to us a little bit about having a clear plan for your investments in terms of what results you're looking for and how to ensure that your investing is actually accomplishing those goals in your life and having a real impact in your life and not just numbers on a spreadsheet?

David Phelps: I'd like to start with concepts. The concepts of what we are trying to accomplish and conceptually, what the actual investments will provide. Then go to strategy and then go down to the tactical.

What you're talking about, Alex, is so common is that most people take a very tactical approach to their investments, and that can be with or without any particular financial advisor.

In fact, many times the more financial advisors someone's had in their lineage over their lifetime, the more different products they have because that's the way Wall Street works.

Financial products, it's this product's supposed to do this, this product's supposed to do this. And then someone says, "Well, gosh, my friend said they made a lot of money in real estate so I need to go try that too." And it's very disparate investing and there's no strategy behind it.

Trying so hard to put this together from a tactical base is not going to get people where they want to go. You've got to start with the concept first. We start with blueprint days for our new members.

Blueprint days are about the concept, building the concept. Where are we? Meaning where is that member today? What assets do they have including their own time value, their practice, investments in their retirement accounts?

Maybe they have whole life insurance policies. They have annuities. They maybe have a few rental properties that aren't doing so well. That's usually the case we find; they did it with the best intentions.

And we look at these disjointed assets sometimes that are even more liabilities, but how can we turn those around and rebuild a concept that starts to move that needle towards freedom?

Basically time freedom because that's what they're looking for. They want time freedom, they want certainty, they want to make sure the principle's solid.

And we take away this disjointed tactical approach in Freedom Founders to help them build a construct that's going to give them what they want in typically half the time or less than what they thought they could do it in.

Alex Lerma: David, I think there are a lot of folks that this really resonates with that really like the idea of investing alternative investments and like a lot of the concepts that we talk about that you share about and teach about and are so passionate regarding.

One of the really common questions that we get all of the time is regarding Freedom Founders, and folks saying, “Hey, I like how all of this sounds, David, but I'm having a really hard time figuring out exactly what it is that you do at Freedom Founders."

David, I know that what we do here is difficult to distill down into just a short answer, but as best you could, how would you describe what we do here at Freedom Founders?

David Phelps: Well, Alex, that's actually the benefit of what we do at Freedom Founders. You can't distill what we do down to one thing, one name. We're not a commodity. You can't compare us to people who have family offices or financial advisors who do what we call assets under management. Or even people who sell alternatives like real estate and sell it from a platform of here's the deal of the day. That's not all we do.

Freedom Founders is number one, a community. It's a community where I stand as guard at the gate, meaning that I only want like-minded people within our group, like-minded on similar paths of looking to freedom, wanting to take a different path. Be contrarian, not follow that group think that herd mentality.

In the same token, the real estate alternative investments that I allow in the room have to go through a high degree of curation. This is where most people make a mistake. Well, I can find something out there, my best friend, my buddy. He invested in this or that, and I'll just piggyback on that.

Well, how do you know? Have you had a chance to compare? In Freedom Founders, we have education, number one. And then secondly, we have the implementation to make this investing on your own behalf becoming your best financial advisor very implementable. That's where the rubber meets the road.

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People say, “I want to do this, I want to be on my forefront, but do I do it by myself?” Well, yes, as I said, if you're in your twenties and you've got more time than money, you probably can do it yourself. And that's maybe not a bad way to go.

But when you're looking to buy back time, then you want speed to go and you don't want to make the mistakes that go along with doing things on your own.

So, Freedom Founders is really a strong community of tribe that really helps people gain their time back in a much short timeframe than they thought. It takes the assets they have and shows them how they can deploy those and gain much more in terms of that freedom and that certainty that most people have.

People often think that, “Well, maybe Freedom Founders is a place where you just go and people sell you those rental properties. Well, nope, that's not it. That's not it at all.

Some people think, “Well, it sounds like a lot of work. I'm going to go learn how to find rental properties and fix them up and find the tenants.” Nope, that's not it at all. We're not going to teach you any of that.

If you want to do that, there's other places you can learn to do that. If you want to come and find the highest caliber of real estate vetted, curated in a tribe of people where the social proof's there — so, you can say, “Well, I wonder if this will work for me.”

Well, you can see from the social proof of the hundreds of dentists and their spouses who we have helped along the same path who can say without exception, “Number one, this is the best investment I ever made. And number two, I only wish I had had come here sooner.”

Alex Lerma: Right now, the markets this year, there's just been a lot of volatility, a lot of uncertainty in the markets in terms of where things will go from here. And so, that has a lot of folks perhaps on edge about their future or just uncertain about what the future's going to look like and looking at other alternatives.

And one of the common questions we get is that real estate also has volatility, and people reference back to 2006, 2008. So, my question to you, David, is how can we hedge against market volatility in real estate, and ensure that we're not riding that roller coaster?

And you have a lot of experience with this, David, going back through multiple market cycles, you were heavily invested in 2008, and in previous market cycles. What did that look like for you?

And what are some ways today that we can hedge against this market volatility and create some stability or predictability for our financial future?

David Phelps: Well, again, I look at the sustainability of the cash flow that comes from the asset number one. Well, how do you do that, David? Well, I look at asset classes that historically, certainly over my four decades have always had a consistent tenant usage.

That starts with single-family houses. Again, well, which ones? Where David? Well that's what we do. That's what we do. We make a market for right assets, the right geographic areas. That's number one, sustainability.

We don't go for, I'd say, really niche type investments. You might say unique investments like hospitality, tourism, aspects like that that can be hot in one market cycle, but sizzle and fall apart.

Because we are so focused on the cash flow, we don't buy or invest based on what the market values are today. The market value for us always has to be based on the cash flow.

So, we follow that one, first and foremost, fundamental of cash flow first. Then it keeps us safe. Strong criteria, understanding what that criteria looks like. See, most people have no clue, they just keep buying in the exuberance of the market.

The market that we had for really the last 12 years and certainly the last two or three years, we've seen with the expansion of all assets really into bubbles because of all the money that's flown through because of the COVID pandemic.

It's exacerbated this exuberance in the marketplace. And so, you have the height of these markets, you have money just chasing the bubble higher and higher and higher.

If you have strong criteria and you know what that stands for in cash flow that keeps you from getting involved in investments that are going to deflate when the bubble hits. So, yes, as you said, I've gone through at least four major market cycles where, yes, real estate has been affected, but not my real estate.

When the market goes down and the values go down, my real estate properties never send me a message and say, “Hey David, by the way, do you know we lost 15% over the last three years?” Didn't blink an eye because the properties continue to produce cash flow.

Now, if I was over leveraged, if I'd been playing the greater fool theory, if I buy whatever price today and next year someone will buy it at a higher price, which is what's been going on.

Yes, then, I could get caught up and yes, I could be one of those people that you read the horror stories that lost a lot of money. Well, you can lose money in real estate, in stocks. You can lose money in crypto.

But if you don't have a fundamental asset that produces that cash flow on a regular basis, that's where people get tripped up. And that's why I really enjoy real estate because it keeps me safe and out of that volatility.

Alex Lerma: David, I'd love to hear your perspective on another really common theme that comes up, which is analysis paralysis. Some of the saddest conversations that I have with folks, David, are folks that maybe I've spoken with two or three years ago who were dissatisfied with where they were with what their financial picture looked like.

They were looking for something different, for something better, but they just weren't sure what that was and there was some uncertainty. And then fast forward years later, we reconnect on another call and not much has changed for them, really not much has changed.

They're still working hard, too hard in their practice and still uncertain about their financial future. And I can relate to that. I think there's a certain fear of making a bad decision that might set you back.

And I think that is something that I think especially is true for perfectionists, for folks who want to make sure that they're getting it right, making the right choices. Folks who are really conscientious about their lives. But the risk is that in action might lead to nothing changing for years.

And so, speak to us a little bit about that, David, your perspective on analysis paralysis, what you've seen maybe in dentistry and as a dentist with regards to that, and how we should think about that or how we could overcome that.

David Phelps: Analysis paralysis is a common theme, particularly in people that are highly-skilled, highly-trained, trained to do no harm. And so, I think that carries through to almost everything else in their life, and to some extent we have to take that hat off when we're looking at other things. Not to be cavalier about risk, not at all.

But I think also what ties into that analysis of paralysis, Alex, is a complacency. So, what happens is people get into a place where, yes, they think about it, they think I should be doing something different.

I kind of know inside my gut instinct says, “I've been around long enough to know that when it's all good, that means around the corner it maybe not all good, but still it's just like not enough to instigate forward movement.”

I've heard that over the last 6, 7, 8 months this year as we've seen the market volatility. And for the first time in really 12 years, we've seen some serious ups and downs that roller coaster of the stock market that really upsets people as it should.

Especially when they're getting to the point where they may be getting ready to take an exit or really dampen down their active income, and now, they've got to make that nest egg work.

And so, at that point they start to say, "Hey, I now I've got to do something." And that maybe after they've lost 10%, 15%, 20% in the market, which really, really hurts, but at least they make a move.

So, I think that aspect is when you have that inner feeling that you know, "I should be doing something," it's better to do it sooner, not wait until you're actually forced to do it and you feel worse about not making the decision.

The other side of it is oftentimes people confuse investment for expense. We all went to school to some level, and we know that going to school requires both time and some tuition somewhere, some kind of investment, or you could call it cost. But I think most people look at education as an investment.

And you're either going to pay a price in your decision-making in money or time. If you think certain things are an expense, then likely when I was younger in my twenties, I can make up for the expense I didn't want to pay or maybe I couldn't pay it by putting the time into what I want to do.

People that evolve down the road in their practices and get pretty good at their practices, but they're still thinking I need to do something different, they lose the fact that at some point, they put a lot of investment into learning how to be what they are in their business operations.

They put a lot of time, a lot of capital into that, and yet on other aspects of their life, they seemingly forget that there was an investment period, and that investment period pays off. But you have to be willing to do it.

Otherwise again, there's a price to be paid. And many times they pay that price in time that is taken away from them, which is really the end goal of why you got into business in the first place.

So, if you're running and you’re business and you're trying to do investments on the side and making mistakes there and falling backwards half the time when the market's not working, you really have cost yourself and probably your family a lot more than you thought you would. Even though you think you're doing the right thing, you're being prudent when really, you're not being prudent.

Alex Lerma: David, these are some insights that I have seen just have a tremendous impact on our members over many years now in terms of the way you think and the way you see the world, the questions that you ask and the way that you help our members find clarity through that.

So, thank you for taking a few minutes today to share that perspective with us.

David Phelps: My pleasure.

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