Where Are We Now? Where Do We Go From Here? - Navigating the Turbulence of Market Cycles – David Phelps, Kandace Phelps, and Alastair Macdonald: Ep #415

Full Episode Transcript

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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.

David Phelps: Hi, David here. I'm going to change courses a little bit today on the podcast and share with you a conversation that was had very recently, in fact, in the last few weeks. We are right now in the first part of a new year, 2023 in January.

I'm going to share a conversation that I had with my wife, Kandace , and a good friend of ours, Mr. Alastair MacDonald.

Kandace , of course, is my better half and she has the financial background that I had to learn for myself. She actually has degrees in finance and MBA from Vanderbilt. Alastair MacDonald also comes from a world of finance and Wall Street.

And together, we spend a lot of time talking about navigating the current markets and the changes, the volatility, the upheaval that we have recently experienced in the last year of 2022.

It's my belief and the belief of the people that I keep closest to me, that we're going to continue to see significant upheaval, not only in this next year in 2023, but probably, the years to come.

Along with that, probably high inflation after we have a deflationary correction in the marketplace, which we're undergoing, in my opinion, right now. This conversation, we snipped out of a longer conversation that we had just for you.

To give you context; we talked about money as a non-negotiable. The fact that you have to participate today in some area of finance, economics, the marketplace.

But do you know where? Where is that? Where do you fit in? What model are you using? Is the model you're using today one that's going to work in the advent of what's coming in the marketplace in the future. I doubt it.

Full cycle versus half cycle. Many people are caught up in what they know only as a half cycle, an upmarket since the last downturn in 2008, 2009, and now, into the other side of the cycle, which we're entering right now.

What does that look like? What are the differences in a half cycle versus a full cycle? Why this time is different. Yeah, I'm talking about this time, not this year, not this even decade — I'm talking about the decades ahead.

How we've gone from a 40-year cycle, from 1980 of downward interest rates to now, heading back up the other way. Where does this go with the debt cycle we have in place right now? Sovereign debt, unfunded liabilities. But how does that change the dynamics of what we used to know in the past going forward into the future?

The advantages of the inefficiencies in the local real estate markets, what I'm a big fan of; alternative investments. How do you access those? How do you do that? How do you make a market there that others can't make a market? How do you have an upper edge against the multi-billion-dollar Blackstones and BlackRocks in the marketplace today?

There is a way, it's what we talk about, it's what we do in Freedom Founders. How you can become a much more sophisticated investor and why this is particularly important now, more so than it was in years past.

Why we fail to learn anything really on upcycles. When everything's good, when everything's going up, whether it's stocks, real estate, practices, valuations — we don't learn anything there. Where we learn is when we're going through the down cycle, where we are right now. This is a chance to really up your game and become a much more sophisticated investor.

And finally, what are the advantages of being part of a close-knit high proximity group? Your board of advisors, a tribe of people who are on the same forefront, who are advocating for your future and giving you a place where you can own your future.

Finally, we end up with all roads lead to income. That this whole game of expanding growth is fine, but how do you know how to turn the growth, your equity, your net worth — how do you know how to turn that into cash flow when you want the cash flow?

That's what keeps everybody on the hamster wheel much longer than they need to be because they don't have a model to take equity net worth growth and turn it into cash flow. It's what we do in Freedom Founders.

Listen in to the conversation. Hope you enjoy it. I'll pick this up with a small, short summary on the back end. I'll see you there.

Alastair Macdonald: Everything about our prior conversations, everything about how you guys have been in front of things for the last two years now, you know that old broken clock is right twice a day.

Well, you've paid a price for your concerns about the members' clarity and understanding about the risks that are inherent in any strategy. You either play or you don't play. You either engage or you don't engage.

The only way to assure yourself of zero reward is to have zero participation, which just has completely different consequences. Consequences still, but just different ones. Individuals that have chosen to do nothing, that's the only way to avoid any sort of a contraction.

So, you've been in front of it, boldly signaling your messaging, which I really admired. And here we are on the other side of the next half cycle is upon us.

As I say, non-participation is not really a choice. You'll meet these kind of woken broker as a friend of mine refers to them. They'll say, "Well, I don't trade, money doesn't hold any value for me."

Well, money is a non-negotiable. You have to participate. And its same is true in the marketplace of ideas and capitalism and so forth. So, if we're shepherding assets, we're just having to shepherd them through waters that look different than those which we've previously experienced.

So, I say that because having an awareness, surrounding ourselves with individuals that not only have had their butts kicked in the past, but have seen it done in myriad different industries and have the courage and vulnerability and authenticity to show up and say, “Here's what I've seen before. Here's where I've been caught. Or these are the likely risk nodes” is incalculably valuable.

And what's interesting, if we think about the role of a mentor, a shepherd, a guide, through the full cycle, this is really when the merit rises. In the strong upcycle, it's a matter of capital allocation because everything works. So, it's a matter of how do we want to select the allocation that we have?

It's on the other half cycle that experience really kicks in. Where people say, “Okay, now, the circumstances have changed and what are we going to do to get in front of the fallout of other individuals’ choices?”

This is the thing, is that when we are at this stage in the cycle as evidenced by, for example, BlackRocks private REIT, this 70 billion behemoth with halted redemptions and so on and so forth, there's going to be many more like that.

That lack of transparency, the can’t leave a disconnect that we have from the actual founders, the individuals that are driving capital, that are meeting with the tenants that are working on the pro … it's completely dislocated for most investors. And this is when it's most valuable. Proximity to the deal, proximity to the deal makers.

I mean, the three of us know how valuable it is and in the fullness of time, everybody will know. But this is one of the many drums you've been beating, and I just think it's a superpower and incredibly courageous, I have to say.

David Phelps: What I find is that when everything's going well, as you said, when we're in the first half of a cycle that's moving up and everything works out and all sins are basically set aside because the market takes care of it. I mean, that's really what we've had. And notwithstanding that people don't have to get out there and work and work a model, you do. I mean, nothing just happens out of magic.

But when we go through this turning to the second half of the cycle and we start to see some things break, things that we thought were not going to break, but we see the fallibility of certain models or certain investments — this is a time when every one of us, and I don't exclude myself whatsoever, from upping my game and becoming a more sophisticated investor, more sophisticated business person.

Because there's these times when we have to look at things through a different lens than we've had to before. We start asking different questions, better questions, questions with more depth than we had to before.

I mean, really did I really have to ask a lot of questions of people that I've been running with for quite a while in this, really, how is the model working? And really, if it's working well, it's working great. I mean, we didn't have to dig in.

And like I said, I say that for myself as much as I say that about the proximity of the people we have the privilege to work with. These conversations are only a benefit for all of us as we go through the cycle.

And I think again, having a community, a tribe of people who are willing to have these conversations, not hide anything, not push anything under the rug. But say, “Okay, let's get more transparent.” To your point, Alastair, “Let's speak about these things because that's how we maintain a level of trust.”

And we do want to stay in the game. We have to keep focusing on keeping our capital working for us. But it changes. It changes. And how do we know what those changes look like? Well, we have to ask the better questions.

Alastair Macdonald: That's the only time we do. Here's an embarrassing revelation of my own is, in ‘99, 2000, of course, everybody was so excited about the tech sector, everybody was late and everybody chasing the returns.

And so, I was privy to an institutional capital allocator that I knew and worked with. Wonderful guy had a friend of his that had broken off and started his own fund, specifically, early stage tech stuff, with the company used to be known as Robertson Stephens, Kandace will know them. They are no longer in business, at least not under that moniker.

And so, I took some investments that I had a pretty large allocation of my overall net worth at the time. And it was this kind of hush thing, “We can get you in on this fund.” This is of course, late ‘99.

But I adhered intentions to head back to the motherland where I was going to get married and then wonder around on safari for six weeks.

And so, I said, “Let's just call it a $1,000 because the percentages matter more than the total dollar figure.” So, I sent effectively a $1,000 early first purchase, the day of the fund became available, and I left for Zimbabwe.

And very quickly when I returned, that $1,000 was worth 2,000. And within a space of just a couple of months, it had quite literally doubled. Of course, that was exactly what I deserved because I was wise and timely and well-connected.

And strangely, that $1,000 that turned into 2,000 was very successfully turned into $300 in very short order. And it was at that point of course, that I wanted to know what had happened. How could this happen?

Looking back, I didn't have that same level of scrutiny when it went from a 1,000 to 2,000. I didn't ask, “How did that happen?” Just how it is that I took the 60, 70% implosion of original NAV, then I wanted to know the mechanics. It's ridiculous, embarrassing.

So, that was my first reminder that the cyclicality and manias boom and bust that I had grown up with is such incredible volatility, turned out to be true in America as well. I realized no culture was impervious to this sort of volatility and cyclicality, no level of scrutiny on the upside. It was because I was genius.

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David Phelps: Of course, we all want to believe that it's all about us. And yet the marketplace is such a big part in the upswing.

So, there's a story that you're very familiar with, Kandace , and Alistair probably you maybe a little bit in passing, and I don't tell it that often.

But back in 2006, I had made that decision to sell my practice. Actually, I made it before that, but I actually made the sale in 2006 because I needed out because of my daughter's situation. It was just all things looked like they were laid out just right.

Of course, when you want something to happen, then you tend to look askew or look away from those things that you should have seen as markers as to why not do this. Kandace knows it well. We got married, and a month later, I got the practice back in my lap.

Not in the same shape that I gave it out. That's the other part of it. I got it back in kind of shambles. And I remember going through all the emotions and anybody who's dealt with frustration, challenges, things that didn't go the way you planned, you know exactly what I'm talking about.

First you just get mad at externally to all the external aspects of why this happened to me. And then when you guys like come to think about it, it's like, "Well, actually how much of that was really on me and my bad decisions or overlooking things that I should have seen."

But here's the other side, and again, it feels bad when you're in the midst of it. It never feels good. But going through that process of having to dig back in, acknowledge and take ownership of what I still had.

I believe I had a responsibility to patients that had been coming to my practice that I built from the ground up for 20 years. I had staff; not all the staff stayed, some decided to leave, and I totally understood that. No judgment there.

But I had a responsibility. I could have walked away from the whole thing, could have just said, “I'm done. I'm out. I quit.” I didn't really need the practice at that point, but I decided to make a decision to stay in it and do the work out, which meant digging back in, doing the hard work.

I even asked a practice appraiser back during that time, just as an outside hope that maybe there's some value in this practice and I could wholesale it out. He said, “Uh-uh, David, no value. When you had the practice numbers, it went from here …”

On the down slope, he goes, “There's no value I can attribute to that. No bank will finance that. You're out of luck, pal. Either call it a day or build it back up again.” So, I dug in.

But the lessons I learned, and these were the good lessons. I learned so many things about the model of the practice that I thought always had to be dependent upon me. “Well, you have to do it this way. It only works this way.”

All the limiting beliefs that I had stacked up over the years were all of a sudden, being tested in a good way because I didn't want to do it that way anymore. I had a reason to make a change. And going through that change and getting to the other side, which was ultimately selling to one of the three associates I brought in.

Again, this took some time. This didn't happen in two or three weeks or even a few months or a few quarters. This took a couple of years.

But learning what I learned about better leadership about mentoring, teaching, about building a pathway to a real viable exit. Not one I just tried to throw together very quickly previously, the one that fell apart. But building something that had more intention to it, that had a runway and realizing I had to do the work.

But on the other side, all the lessons I learned have stayed with me. And I think even though I'm not in clinical practice anymore — I haven't owned a dental practice in some number of years. Just those lessons I learned about getting through that period, I mean, it was during the great recession.

The recession had nothing to do with my bad decisions or what happened, but it played a part because practices weren't being really financed during a period of time from 2008, '9, '10, really maybe '11 until the markets started opening back up again.

I got it resold the second time at the depth of the downturn in 2010 when banks really were not financing. Why? Because I'd rebuilt a model that was totally different than the old model, and was not dependent upon me.

So, that's a long iteration of the story, but I think it has relevance today because on the other side, we become, as I said earlier, more sophisticated in our understandings of how we are able to orchestrate our financial future.

And that's what people that are at Freedom Founders are about. They didn't come to Freedom Founders because they wanted a done-for-you: “Here, be my financial advisor, allocate my money for me, and tell me it's all good when I want to retire.” That's not who they're about.

They came because they want to understand how to be better advocates for themselves through a community. That we are all in there together and learning together. And I think that's where the opportunities come from.

Alastair Macdonald: A couple of things coming up for me and certainly on the heels of Kandace 's point, is the anticipation of others’ fears. Market peaks and market values are captured by crowding, the crowding to get in and then the crowding to get out.

And it's extremely dangerous. And it's dangerous in the same way as standing up in a packed movie theater and yelling, “Fire,” then standing in the doorway. You're going to get trampled. This crowding instinct of self-preservation overwhelms logic, it overwhelms valuations, reality, current cash flow.

So, the beauty of being in a small close-knit group where we can check our fears versus our reality is immeasurably valuable. I'm feeling afraid … a vast bulk, 90% of the brain damage we enjoy in both practice ownership and the investing world is entirely emotional. Very little of it is logic.

So, we owe it to ourselves to create these types of conversations that as I say, things are going so badly. First step, check yourself for blood. If no blood, continue on as you were. But we do that, “No, I'm pretty sure that I'm bleeding.”

And we need an outside source to remind us, “Okay, let's have a look at the actual facts.” We need somebody to shine a light under the bed when we're just four years old and having these nightmares to say, “I'm pretty sure there's a crocodile under the bed.”

Which is the case for me. I had crocodiles under my bed being in Zimbabwe. And the best thing that my dad could do is shine a light. Be like, “I've checked. Have a look. Oh look, okay, no crocodile, go back to sleep.”

I'm being ridiculous because we are going to be ridiculous. We are going to, we as a society on the downside of crowding in the valley, find ourself running for the exits with no regard for the vitality and cash flow and positivity of these assets that we hold.

This is not universally true, but it is universally true on the micro in the beautiful (as you guys have spoken about at length) inefficiencies of local real estate. These inefficiencies do not exist in public REITs where we're buying the Chrysler Building, or they don't exist. It's too much capital-chasing, too few opportunities, those margins such as squeezed. And now, we are stuck in the pack.

George Soros captures this with his principle of reflexivity, which very few people really understand. We act in ways to try to anticipate the changes which others are anticipating from us.

It's this, as he calls, reflexivity, almost a Mobius curve of self-reinforcing realities.

I think this is best captured in a way, strangely, by that beautiful Persian 12th century poet, Rumi, where he says, “I am not who you think I am, and I am not who I think I am. I am who you think I think I am.” This is phenomenal, this is phenomenal.

What Rumi was really describing is reflexivity. I'm not going to behave the way you think I am. I'm not going to behave the way you think you are. I'm going to behave the way you think I think I will ... I mean, it's fascinating.

It becomes this, as I say, this Mobius curve. Why does it matter? Because it comes all the way back to the number one source of all of our brain damage, which is misaligned expectations.

And I think one of the things in our conversations and work together, I don't even know how many decades of experience we have between us; what that really represents, if it's of any tactical utility for anybody else, is chapters of the book they've never read. Expectations that have not been inside their lived experience.

That is where we can fold time for others, which is to say, our primary role, I believe at this part of the cycle is to improve people's understanding of possibility in order to adjust their expectations, which reduces the frustration and brain damage.

All of the pain in our life comes from the emotional pain, whether it's in relationships or your business, is having these expectations and a different reality come to bear.

So, if we can broaden the palette and possibility of expectations, then our expectations are more relevant and in tuned to the market as it actually is, instead of the gap between what we expect and what actually is.

That gap is so wide, so wide, so many half cycle gurus. And reality is about to close the gap between expectations and what is, violently. Because they weren't having conversations like we've been having in the group, Freedom Founders, for almost two years.

We weren't talking about what a full cycle is. They weren't. I think it's critical. It's been most valuable for me, that's for sure.

Kandace Phelps: Well, I think part of it is in those expectations is people's view of time. This isn't the same thing as a financial advisor saying, "Just keep buying and we'll average down." It's not the same thing. You're talking about paper assets versus actual assets.

And so, the perspective of time with real estate is that it is a perpetual income producing asset that's not going anywhere regardless of what happens in market pricing. And even if expectations have to take a haircut in the near term, in the long term, they balloon back out.

That doesn't happen with financial assets. There's no guarantee of that with financial assets. Whether they're debt or equity, there's no guarantee of that.

But with an actual physical asset backing up, that undergirds what your capital is invested in, time is your friend — even if there's a little bit of short disappointment in the near term, it's entirely different.

And we all know that it's different, but sometimes we need to be reminded. For the folks in our community that don't have to watch the Dow every day anymore, they don't have to open their 401(k) account and look what's happening in financial assets as opposed to what's happening in real assets, there's still a piece there, even in turmoil that doesn't exist for people outside.

And so, it's a time perspective. It's like we're not averaging down, we're writing this out so that we can pounce on what's left after a shakeout. And a shakeout by definition is shaky. It's turbulent. Like he said, it's turmoil, and that's the definition of it, that's why it's called a shakeout.

But what's left after a shakeout is that all of the half cycle players, all of the inexperienced, the late cycle gurus, people that think that they're smarter than they actually are, are gone. Then what's left, are the people that can actually run a business.

And then that's where you get to see who the real studs are in the industry. And so, you just have to get through it. And what you don't do is abandon ship. That's the wrong thing to do.

If it were financial assets, then yeah, I would be a lot more inclined to just try and turn everything into cash and run, but not when you're backed with hard assets. We didn't feel it in 2008 and 2009 with the portfolio that we held. We didn't feel anything at all. It just was business as usual, and we weren't paying that much attention.

The only difference for you was that you weren't buying at the top of the market. That you were waiting until everything went on sale. Well, we're doing the same thing again. And the opportunity is going to be there, it's going to be brilliant.

And we want this opportunity. We've been waiting too long for this to happen, and they've been kicking the can down the road for as long as they possibly can because they all hate a bear market.

So, they don't want the market to correct, but the market needs to correct. And then when it starts to correct, then people start to panic. They can't panic. We've been wanting this correction.

It's time to embrace the correction and to have these conversations about what to do in the midst of it while we prep for all the opportunity that's on the back end of it.

This is an exciting time, and you don't want to go through it alone. This is fun if you go through it with the right people.

Alastair Macdonald: This is one of the merits of … we've spoken in the past, all roads lead to income, all roads. It doesn't matter what sort of assets you have, how aggressively you've grown them, where they came from, how large they are; all roads lead to income.

Jeff Bezos has an income problem, and everybody has an income problem. And this is the issue, the standard model of financial advice is purely about growth of your assets. Well, that's wonderful, but if you're getting a zero yield or a 1% dividend, it doesn't … you've got a billion dollars, okay, but that billion's not going to yield what a well-allocated capital portfolio would look like built for income.

And this is really a huge shift that you guys have shepherded clients away from. And just to get a sense of how important this is, the durability of income reigns supreme, and it reigns supreme whether your portfolio's gone to a billion or not. The durability of income is what we're concerned about.

Thank goodness there isn't a rolling ticket tape on every house or commercial property that you drive by because people would trade them the same way they do, the NFTs.

To give a sense of how astounding this growth at any price psychology can get. We've spoken about this, but at the end of last year, this was the last time I'd looked at it; Tesla was trading at such multiples that if it were a million dollar a year clinic, dental practice, it was for sale for 23 million.

Tesla was literally trading at 23 times revenues, times revenues. And we couldn't get enough of it. Everybody loaded up on it because of course, Elon Mask is going to take us to the promised land, in a spaceship actually. This is astounding.

Individuals that are income-seeking inherently have risk mitigation inside their philosophy. You're not going to buy that because you know that your best hope is to sell it when a greater fool comes along and is willing to pay 24 times earnings.

And then what, what are you going to do with that cash? Turn right around and go back to solve your income problem. All roads lead there in the end, and it just allows us to avoid this type of brutal volatility and downside risk.

David Phelps: Yeah. Many principles well-stated here this morning. Well, as always, it's a pleasure to have these conversations. I love the opportunity to move through and navigate through the challenges, the pivots that we all get to make and do it with people I love to do it with. So, got to thank you and thank all the other folks that we get to do it with.

Alastair Macdonald: That's the truth. Likewise, David.

David Phelps: Alright. David, back here again. Hope you enjoyed the conversation between myself, my wife, Kandace , and our friend Mr. Alastair MacDonald.

If you enjoyed this conversation, if you'd like to continue this conversation, if you have any desire to be on the forefront of being engaged in your own financial future in advocacy, we invite you. We invite you to jump in and have a call with us.

We only take new people to Freedom Founders by application. We want to make sure that it’s a good fit, but there's no harm in checking out to see where you stand and what you might need to do if you want to someday be a part of what we do in our tribe.

You can go to the link, which we'll put here in the show notes. That link is freedomfounders.com/discovery-call. Hope to talk to you soon. Take care.

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