Understanding Market Cycles and Investing in Tangible Assets – David Phelps: Ep #438

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.

David Phelps: Hi, David here, CEO and founder of the Freedom Founders Mastermind Community. I may go a little bit longer today than I normally do on a video blog, so stay tuned if this is something that interests you.

I have the distinct advantage of not only my age, which I'm not going to tell you how old I am, but let's just put it this way, I've got more than a few decades of experience in the world of business and investments.

I also, have the privilege of being involved in kind of the backstage, if you will, of quite a few different business owners, high level influencers, thought leaders, and investment platforms.

So, I'm privileged in that regard and I certainly, keep information that I have confidential, but I can speak in broad terms very easily without naming anybody or any particular person or giveaway identity, which is what I have to do.

I like to give information to people based on my perspective. And realize it's my perspective, it's my bias, and I admit to that.

But again, I do have many years of experience and the path that I have taken in my life, while it's never been a straight line, it never is. It certainly has provided me with the benefits that I speak to so strongly in my communication to people that I want to help to serve.

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Whether it's my Freedom Founders community or outside of that group, the next generation who I think really going to have a much heavier lift than I did coming out as a young adult in the late ‘70s and early ‘80s, where no doubt, we had a different economy at that time than we have today. But there's a lot of similarities into what we're seeing starting now.

So, there's a 40 year span from when I really got started as a young adult in really 1980, let's call it. We're now, 43 years later in 2023. And the dynamics of the last 40 years are changing dramatically.

Notwithstanding the fact that there's always going to be market cycles that typically span about six to eight years. The last one went about 14 years if you include the extra push or propulsion that we had in the post COVID helicopter stimulation money, the trillions of dollars that the Fed added to their balance sheet to maintain the economy. It's what I call a faux economy.

They did it and there's going to be a payday. There's always a payday for when you steal from the future, which is what debt is. You're stealing from future production. And that falls on everybody probably to a greater extent on the next generations coming up.

So, you can tell, I care a lot. I care about this country. I care about the people I serve. I care about my family, but my family is only as good as this country is.

And so, if I can serve in getting a message out that some people will listen to and put themselves in a better position so that they can figuratively, fight back, then that's a good thing.

So, let's talk a little bit about what we do in Freedom Founders and where I built my freedom plan, or what I call escape the chair. When I was able to leave my dental practice back in the mid-2000s after my daughter had suffered and survived both high-risk leukemia as a very young child, epileptic seizures thereafter.

And then at age 12, she was in end stage liver failure. And subsequently, by the grace of God and the kindness and generosity of a family who donated the organs of their child, who passed away in a terrific, horrible automobile accident, my daughter survived to this day.

But that was the time when I really realized that having a plan B or having assets besides myself … I consider myself, you should consider yourself your primary asset because all investment, education, adding to your efficiency, value proposition, the problems that you can solve in this world for other people, that's where our value comes from.

And certainly, getting the training and the education that you need to do that on whatever level you need to, that's important. So, that's where we start.

But if everything relies upon what we do, trading our time, our expertise, our skillset to solve other problems, if everything relies on that, then we are vulnerable because at some point we will run out of time, we'll run out of energy, we'll run out of capabilities. We want to be able to slow down at some time.

When we're young, we've got that time, we've got that energy to give and that's where we should give it. The faster we can learn to build or acquire assets … and I'm talking about tangible assets, you may like to have some of your investments in financial products, that's fine. I'm not going to put those down.

I'm just saying I like the control of tangible assets. And particularly, I like business and I like real estate.

And if I didn't enjoy real estate, I would probably be more of an active slash passive investor in businesses. But because I learned very early the tenants of real estate and how to utilize it as a vehicle, not just to make more money, not to create more wealth, but to create more time freedom.

That's really what it's all about. That's what the chase is about in our lives. It's about gaining time freedom.

When you have financial freedom or financial independence based on you're not having to go to work to trade time for dollars, where you have assets to produce the income you need to live your life, then you have financial independence.

Well, what does that give you? Well, some people think it's more materialism. And if that's what it is, that's fine. I'm not going to judge that. But what I really want in my life is I want more time freedom. I want to have the time to do what I want to.

Does it mean I lie on the beach or play golf for 10 or 7 days a week? Of course not. I want to be relevant.

But I was able to change or shift gears at a mid-career point where most people would say, “How could you leave the profession in which you sunk a lot of time and capital investment in, David? How could you do that?

Well, why not? Would be how I would come back. Why not? See, most people in society would never look at going through your career path that way. Most people think you get into a skillset, a career, a business, and you run that all the way to quote “the end.”

Well, what's the end? Well, that's what we usually call retirement. That's somewhere in your 60s where conventionally you retire to go live the life you've always meant to live all those 40 years that you were working.

Well, I think that's out of balance, out of whack, and a lot of people today have had the wake up call during COVID to realize that's the very case for them. They’re realizing that we're all mortal. That every day globally, a $100,000 … let's start that over again.

That globally, every day, somewhere around a 100,000 people pass away, across the globe. They probably, most of them did not know that that was their last day. Now, many of them could have been chronically ill, at the end of life, but still, you don't know when that day comes.

For a lot of other people, tragedy hits in other ways and they had no clue that their last day was coming.

So, what's my point? We don't have forever. We have so much time with our kids while we have them at home, until they become young adults and then they go on and become independent.

It's a different stage of life. We don't necessarily lose them, but we lose the earlier ages at which we thought, “Well, we'll get to that when we can.”

Alright, let's get back to the main point. The assets. The assets that will provide you the financial independence, which will give you the time freedom to do life the way you really want to do it, and not wait till you get to that mystical someday of quote “retirement.”

What are those based on? And the marketplace today, we've had, again, this bull run market coming out of the 2008 great financial recession. I was able, and really in a position to take advantage of that because of where I was.

I was out of my dental practice. I had created a network in a certain real estate market in north Texas where I've planted my roots over the last 40 years. I had private capital lenders, so I didn't have to rely on banks.

Because realize when there's a recession and there's a credit crunch, a contraction, a liquidity crisis, which is what I believe we're entering right now, the banks don't lend.

So, people get mixed up. They think, “Well, I'll start buying assets when they go on sale.” And what's the tip of the way people buy? Well, they leverage. And I'm not against leverage. I'm just saying you better learn a different way to leverage.

Like I had to do when I was coming out of college and starting my real estate portfolio at the same time I was entering dental school. I had to learn how to leverage without using banks. I had no credit. I had no credit at all.

So, everything I acquired from real estate standpoint, I had to do with creative financing. I leveraged like crazy. My average interest rate back in the ‘80s and ‘90s when I was building this portfolio, primarily based on single family rentals, was 8.5%. That was my average interest rate.

I still cash flowed every property after all expenses and after the debt service. I had to cashflow every property.

What I did is I purposely, intentionally what I call today, snowballed down the loans that I had. I acquired as many properties as I could. They all cash flowed. I did a lot of the management myself because I had the time.

And then I took the extra money out of my dental practice where I traded time for dollars. And instead of putting it into a 401(k) where that money would be locked up until I was 59 and a half, I paid down those loans relatively quickly.

And within 15 years, I had about 35 single family rental properties, of which the vast majority were free and clear. And that's what allowed me to break away, break the chains from my dental practice when I wanted to spend the time with my daughter.

I bought back my time freedom, is my point. Now, I was in my mid-40s when that happened. That's usually not when people can break away from their labor or active income production.

But because I had started early, the compound effect of time and investing in capital assets that historically have always produced a certain level of productive sustainable income, even throughout recessionary down cycles and would say hedged against inflation, that's what produced my freedom.

Now again, you have to look at where we are in not only the market cycle, which is that six to eight year typically, or this last long cycle, say where we are in that cycle, and then there's a bigger, what I call a secular cycle.

This last one has been about 40 years going from about 1980 to 2020. So, we're in the middle of a market cycle change where I believe we're rolling over, to use the term that's often used in economic circles.

We're rolling over from cheap money, low cost of capital where assets of all kinds have been bolstered in a stimulative marketplace where the Federal Reserve has kept interest rates low and injected additional liquidity into the economy, starting back in the 2008 great financial recession and then quadrupled that coming into the COVID pandemic.

So, if you owned or held or controlled any kind of real tangible assets or financial products for that matter, everything went up.

Now, the problem with thinking that that's the way it always works is what we call recency bias. I recently did a podcast on that. I won't go back into recency bias other than to say that you cannot look back in any kind of recent history.

And that can be a relative term. That could be a year back, could be three years back, could be a decade back, could be 40 years back. Depends on how you want to look at history.

But you can't look at any kind of recency bias or what's happened in the past with any predictive promise of what it may look in the future. And that's what I see too many well-meaning people do.

People who have built their stakes, made great inroads, been very productive and profitable, let's say in the real estate marketplace in the last decade, dozen years, half a dozen years, last two or three years for that matter, are just saying, “Hey, don't worry about the higher interest rates. Don't worry about the sluggishness of the economy.”

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"All you got to do is just invest. Whether you're investing in funds, or syndications, or single family rental properties, just invest. Don't worry about it. Just invest because long term real estate always goes up."

Well, that's not true. In fact, in the 2008 great financial recession, interest rates were going down when the Fed was trying to right the markets, interest rates were going down and instead of real estate going up, real estate was going down.

So, interest rates going down, real estate going down. It's not a congruent cause and effect. There's always lag periods, and that's what people don't understand.

So, it's not about timing the markets, it's understanding the big waves of the market. It's understanding how to look at these big waves and where to position.

There's another training that I do often called the capital stack. I'm not going to go into that today, it's a whole nother level. But understanding the capital stack as an investor is very, very critical piece of how you can be on the forefront of investing and being your best advocate.

So, investing in the capital stack, most people invest in the equity side of the capital stack. That means ownership. Traditionally, that's where money is made, whether it's in business or in other tangible assets like real estate.

Having some ownership or share of ownership in the equity portion of the capital stack is where the tax benefits come from. It's where the ability to leverage comes from. It's where the inflation or appreciation or value add comes from.

This is traditionally where people go, and I'm not saying it's wrong. I'm just saying that when you go through some major shifts in market and secular cycles, that's a time to be much more cautionary.

I'm not saying not to do anything. I'm not saying to stand still. I'm certainly not saying to put your head in the sand, but it's time to maybe reposition where you are on a capital stack.

And the other flip side of the capital stack from the equity side would be the debt side. Now, the debt side, and I'm not speaking from debt as a liability. Like when you borrow money to buy a home or a car, or a business, or practice.

I'm talking about debt as an asset where you, or your entity, or your qualified retirement account becomes the lender just like a bank. That's the debt part of the capital stack from a creditor standpoint.

Now, that's a very safe place to be when you're going through a market cycle and you're just not sure where the whole correction or market cycle shift, you're not quite sure where it's going to land.

We hear the Fed talking about, “Well, what kind of landing are we're going to have coming out of this recession?” And the Fed talked about a soft landing and then other people saying, “Well, it's going to be a hard landing.” And other people say it's going to be a complete bust.

Well, it's going to probably be something in between. I think with the longer upcycle we've had and the more artificial pumping up of the economy with the Federal Reserve and the Congress, both from a monetary and fiscal standpoint, juicing the economy with more debt …

Again, that steals from the future. You have to pay that back sometime. Even the United States of America with the dollar as a reserve currency is going to have to pay the piper at some point. How long they can kick the can down the road? Nobody knows for sure, but at some point.

So, you can't keep playing that game forever and hedging your bet by moving sometimes from the equity side of the capital stack to the debt side of the capital stack can be a smart move.

Well, just for instance, short term treasury bills today, whether it's 4 weeks, or 90 days, or 6 months today, relatively on the short term end of the stick, are paying 5% plus. We haven't seen that in over like 15 years. So, that's being on the debt side.

When you own treasuries, you own debt that's being backed by the US government. Pretty darn safe debt, and you're getting paid over 5% to have what we consider a risk off or a relatively almost 0% chance of risk at all.

Why would you take a greater risk right now, in equities that might, and again, the whole point is they might pay maybe 8, or 9, or 10%? Might pay. But the risk is they might not pay at all or might pay much less because again, where are we in the market cycle.

I'm not saying again, that you should shy away from equities. It depends upon where you are in your position of your life.

If you've got a lot of runway where you anticipate you'll be quote "working, trading your time for dollars, being productive in your business for some number of years," you've got more opportunity to take what I call a little bit more risk.

If you're on the more of the ender cycle where you're closing out, getting close to the end of what you want to consider your very high active income producing portion of your life, you probably don't want to take as much risk. And maybe you want to be a little bit more shy on the equity side for now, for now.

On the other side of a correction, a downturn, that's when the opportunities to buy back into equities can be a great opportunity.

And that's again, what I was able to do coming out of the 2008 great financial recession when I, along with my private capital lender cohorts (I don't use banks but I still leverage and I use leverage, either debt or equity leverage through private capital lenders) we could buy with all cash because the banks were lending.

So, when you have access to cash, doesn't have to be your cash, you have access to other people's cash and know how to put together joint ventures, then you can ride that new wave up again once you know and realize that just by doing the math, that the acquisitions you're making somewhere in the down cycle make a lot of sense.

There's no perfect timing here, but you have to have some experience to understand where you are in the cycle, to understand if this is the time to pull the trigger. Otherwise, you take what I call higher ground on the capital stack.

Again, that's going to differ for where you are in your life, what your goals are, how much you need to replace, active income with immediate income, cashflow today, how much capital you have in qualified retirement accounts that may be locked up for some years until your 59 and a half or older, when you can actually take it out without paying a penalty.

There's a lot of considerations and there's no right answer for anybody. That's the key. I'm not giving you advice here personally because I don't know your personal situation.

But until you are able to look at the variables and understand the variables and become your own financial advocate, you are just rolling the dice. Do you realize that? You're rolling the dice and you have no game plan.

I've seen too many plans made by well-meaning financial advisors, financial planners, who are still playing what I call the accumulation game with their clients because that's what they know.

The accumulation game is what you do on Wall Street where you put your money in stocks or bonds. You have the 60/40 portfolio. It's been standard for many years. It's a model that I think is old and is as old as the hills and doesn't make any sense at all today.

But these are standard models that financial world has used for years because it's safe, it's safe for them.

As long as they follow the quote “rules of Wall Street,” then even if the market tanks and you lose a lot of your capital, which happens again, through every major market cycle (six to eight years, this last one being a longer one, but I think we're going to see a very strong correction) they don't get in trouble because again, it's just part of the game.

If you don't want to go through that, which I don't anticipate that any of you listening wants to, you're going to have to do some work. There's no freebies, there's no, this is the right shiny object you go to, that's going to be the end all that's going to save you. There's no such thing.

You have got to put yourself in a place. What you do? You do the work like I did for 20 plus years on my own behalf, creating my own network, my own ability to acquire and create these plan B assets in real estate through a network, through other people.

You can do it that way if you're younger, that's a great way to get started. If you're a bit older and you don't have that kind of time, you don't want to waste the time, then you need to collapse time, full time by finding a group or a network that will help you do that and speed that up.

That's really what we do in Freedom Founders. But you may not be ready for Freedom Founders. It may not be something that's right for you. That's okay. I just want to give you a message to think about because there's no time like today to start figuring out your game plan for tomorrow.

This economy that we've got today, that is basically held up on stilts, in my opinion, ready to collapse at the first sign of the tide rushing back in or a hurricane storm of any size. It's going to blow it over. Where are you sitting with any kind of safety or hedge positions with your wealth?

It's a travesty to see people who have worked really hard all their life, done the right thing, been relatively disciplined in their life and have put money away wherever they were told to put it.

Only to see that when they're getting toward the end of what should have been a good long career and see 25, 35, 40, 50% of that washed away, literally or figuratively, I should say by the economic downturn because they had no idea.

And their financial advisor can only do what they can do. If they're all tied to the financial markets, that's where you get beat up.

That's not saying that the tangible asset marketplace business or real estate is not also, susceptible to the cycles. But you have so much more control because you've got proximity to those investments.

Proximity, meaning either you're in that business or you are managing that real estate or very close to it like I did for many years. I had other managers helping me manage what I had, so I'm close to it.

Does that take time? Does that take energy? Absolutely. Was it worth it? Well, I'll tell you, I was able to escape the chair almost 20 years ago and have enjoyed the second half of my life tremendously.

And the main thing is I was able to have time to focus on my daughter without feeling guilty because when I was with the practice and my daughter was sick, so much of her early life, I was torn.

I had this responsibility of a dental practice where patients and staff were depending upon me to be able to show up and carry my load, my weight. Because that's what you do when you own a business and you're the producer or primary producer. You got to be there and there's nothing wrong with that.

But when are you going to have even an essence of some time freedom where you don't feel guilty, where you can't take the time off, even if you're not ready to quote “retire.” And I don't like to use that word, but just for context here, I'll use it.

You're not ready to retire, but can you just give yourself permission to take some time off along the way instead of feeling like you have to grind it all the time because you're trying to reach for some number out there, some accumulation number, some millions of dollars that makes no sense at all because you just think that's what you have to have. And that's the fallacy in the traditional financial model.

I hope this has some meaning for you today. I hope that you'll take some level of action on what I'm talking about because this is a time to do it. I don't care where you are in your life cycle.

You may be younger in your career or practice, and that gives you time. But you've also, got a lot of headwinds coming your way, so you've got to be on top of this. There's not going to be a lot of leeway like we've had on the last 40 years with low cost of capital.

If you're mid-career, then you're in a really inflection point where you've got to really make sure that you don't take a unnecessary big hit right now.

And certainly, if you're towards the end and wanting to escape, meaning sell the business, the practice, you've got to know where you're going to put that capital. Because if you're no longer there working it, working your equity in your business, now, you are at the whims and the mercy of the market.

And if you have never studied that before, you may be in store for a lot of frustration, maybe even desperation. Don't let that be you.

Remember, it's your freedom. You've got to stay focused on it. See you next time.

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