Navigating the Current Market Conditions – David Phelps (Part 2): Ep #449

Full Episode Transcript

With Your Host

Dr. David Phelps

[Dentist Freedom Blueprint](#) with Dr. David Phelps

Navigating the Current Market Conditions – David Phelps (Part 2): Ep #449

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 all, this is David. I just want to give you a brief intro to this week's podcast. I began last week with a monologue podcast on what I see in the marketplace. I think this is a time when I really need to speak up and talk about the areas that I think are going to be of interest and probably something you should at least look at in your own life.

So, if you didn't catch last week's podcast, I would go back there and pick that one up. Or if you listen to this one today, then go back and pick it up then, but this is a continuation week number two of last week's podcast, *Navigating the Current Economic Turmoil.*

A lot of business owners I see do abdicate their financial future because they feel like they don't have time, don't have the sophistication, and they feel like they've got time. Well, as long as you're earning money in a business, typically, you can keep up with inflation. And so, it feels like, well, it's okay, it's okay.

But once you want to take your foot off the pedal, that's where the rubber meets the road. And I get a lot of doctors who reach out to me at Freedom Founders who have been hardworking for decades in their businesses, their practices, they've accumulated some decent amount of net worth in various investments. A lot of that could be in the stock market and their 401(k)s and cash balance plans, some actually have done real estate.

In fact, I had a couple today on the West Coast who over 30 years, do-it-yourselfers first both in their business and real estate, had built up over 30 years of just being disciplined, some solid equity in a number of real estate projects.

The problem is on the West Coast, that equity never really produces real cash flow. Well, it produces some cash flow, but based on the valuations, they're getting maybe a 2 to 3% return on their capital. Well, like I said, I could do better that in treasuries today. I mean, if that's all I can get, I'd sell out all my real estate and put it in treasuries.

Now, that's not going to cover the basis for inflation long-term. My point is, there's different ways to invest, different places to do it and do it without having to be boots on the ground and do it in your own area.

Investing in your own area may or may not be the right thing to do based on where you live. Where you live is where you live and you do business, but maybe not the best place to invest, particularly in alternative investments.

So, that's something I see often. I see the fact that people can be sitting on, again, a lot of equity, sometimes it's in their business itself, in their practices itself.

I was talking to a doctor, actually a dentist with three associates, has a practice that has been “valued” by a practice broker, some 12 to $14 million. Well, let's just be conservative and call it $10 million. And he's worried that he couldn't exit that practice and have enough to sustain his lifestyle. I said, “Well, why do you say that?” He said, “Well, I went to my financial advisor, and he said I needed to kind of bank on a 5% return on my capital.”

So, he said, “Based on that, my financial advisor said I need to have $15 million.” Well, he may be close, but after taxes, he's probably going to be down in that 8 to 10 million. So, he's only halfway there, and this doctor's been working hard, and he'd like to take some time off.

And when I told him, “You don't need any $15 million of net worth to do what you want to do,” his eyes just kind of lit up and his wife’s did too. And they said, “Well, how do you know David?” I said, “Well, don't take it on faith from me.” I mean, but I said, “I want to show you.”

And I said, “The social proof is not in just what I've done in my life. I'm a product of the product. I have done what I help others do. I have gone through my own life and exited or what I call escape the chair, the dental chair many years ago, but I had a need to do so because my daughter was sick.”

I was able to do that because I had built up with proximity to my own investments — yes, I had a lot of do-it-yourselfers in my early years when my time was not so valuable. But today, I'm able to invest very passively with our community. We have a full aspect of community due diligence and vetting. We are like a magnet for so many people who want and need private capital. We're able to pick and choose, we're able to curate.

Very few people on the outside, individually, have the opportunity that we have in our group to actually look at a wide range of operators and investments, and have the expertise to do the due diligence to mitigate our risk and put our ourselves in positions where we can invest our capital and do much better than the 5%.

Nothing wrong with 5% by the way, for liquid capital cash, nothing wrong with that. But you can't have the bulk of your money sitting there because inflation's going to run or is running right now, has been running 4 or 5%, and after taxes, you've got to be hitting at least 10% or more I believe, otherwise you're going to be depleting your capital base.

And I don't think anybody wants to try to time it, so they deplete their capital base by the same day that they pass away or die. It's usually just it doesn't work out that way. My game plan is to have assets that continue to produce excess capital more than I need to live on, and that wealth can be transferred the way I want to do it through trust to other people or to charities. I don't want it to deplete mine down to zero. That's just my plan.

Many financial advisors have a plan where you're supposed to be able to extract 2, 3, 4% of your principal every year over 25 years and have some decent returns. If that's a plan that you believe in and you're comfortable with, then go for it. But I think it's a risky plan, particularly by the fact that we are in a different market cycle, a major secular cycle.

Again, I'm talking about decades, I'm talking about four decades. As I said earlier in my monologue, we've had 40 years from 1980 of decreasing interest rates, which provided great tailwinds for any of us in any businesses, investments that we've done. Yes, you have to have some prudence, but we didn't have to be geniuses, things are going the other way, and it's going to take a lot more diligence.

Whoever your financial advisors are, as good as they may be or bend to you, do they have the experience? Do they have the knowledge of understanding how to go through these market cycles. Have they seen it before? Most have not. Most are not my age. Most are younger that means they haven't seen it. Maybe they've read about it in textbooks, but they have not actually lived through these large changing market cycles.

That's where you need to be if you're going to be your own best financial advocate and feel secure for you and your family that you're not leaving things undone should something happen to you. So, let's dig into some metrics, some data points that I look at. You can choose and decide how to interpret this yourself, but I'll give you my interpretation for your benefit.

Alright, weekly retail sales have been plummeting in the last number of weeks. I mean, plummeting, and I'm looking at the graph right now — I'm not showing you the graph, but I'm telling you the graph went from a high back during COVID when everybody had all kinds of money to spend, and it's dropping like a rock right now.

I mean like a rock, like heading back to where we were back in lockdown mode like in 2020. 2020 was down, that went back up again because all the money and it's back down again. That looks like a recession to me.

Industrial production, same as retail sales, it is now plummeting, heading back down towards where we were back in the 2008, great financial crisis. Leading economic indicators, there's a basket of what are called leading economic indicators. They have been negative, been down for last 15 months in a row.

15 months in a row, there's never been a time in the past when we've had that many months of successive leading economic indicators being down or negative where we haven't gotten into a relatively hard recession.

Next stats would be, I mentioned earlier, but credit card account balances are scaling web. Again, the parabolic or exponential shape of … it's not even a curve, it's like a straight lineup. I mean, it's exorbitant, and the cost of the interest to credit cards today, I think the average is like 21%. What's that going to do to your customer, your client, your patient, your tenant?

See, you may think you're fine right now, and maybe you are, but who are you relying on to continue to provide you income for your business activities or for your investments?

So, you have to consider the effect on other people, it's not just you. You may have money in the bank, good for you. You may have low debt, good for you. You may have a business you feel like has pretty solid margins, good for you.

But what's going to happen when things start rolling off and all the people you count on to supply you with income, either passive or active, what's going to happen to them? See this is what happens in a recession.

So, I'd say right now's a good time to remove all excesses; excesses you don't need in your businesses, excesses you don't need in your personal life, and any debt you can get rid of, that's particularly if it's not fixed rate. If it's adjustable rate, lines of credit, be very, very careful with those because rates are up on those and they can call those lines of credit. The banks can in a heartbeat, and they will.

Corporate bankruptcies are way up right now. This is again, a factor of the higher interest rates. The companies cannot roll their debt over anymore with the cheap interest rates of the recent past of the last decade or so.

SLOOS, what is SLOOS? The Senior Loan Officers Survey. Across the banking sector, across the nation, the senior loan officers report to the Fed and the Fed gives us a report on what they're seeing in terms of their ability or desire to extend credit, that is make loans to consumers and our businesses.

And right now, again, I'm looking at a graph and the tightening, again, it's precipitously stark, it's high, it means they're heightening … the last two months, they've really started to tighten across the board.

And again, what does that mean? Well, credit's everything to the economy. Credit is everything. People buy everything today on credit; houses and people take trips, and credit cards are used in just expansion of businesses, buying real estate, it's all dependent upon credit.

And when a credit is tightened, even with good credit scores and their interest rates are high, that's going to cause the economy to slow way down. Well, that's what the Federal Reserve wants to happen, I just don't think they're planning on happening to the extent that it's going to. This is just again, my opinion, but looking at data.

So, bank lending, tightening up and demand is falling off. That is a slowdown in the economy to where businesses will start laying off people.

You'll see that unemployment start to go up, which again, the Federal Reserve knows and it has to happen. I think it will.

Commercial real estate loans, again, right now, are really tightening up. And this is not good because a lot of real estate operators and syndicators and fund managers have been using what we call bridge loans; short-term debt to get into a project, only to be able to refinance it out to longer-term financing once the project is what we call stabilized. That's been the game for a number of years and it's worked very, very well because we had cheap interest rates, not the case now.

You can't have a 500% raise in interest rates and not affect the models that people have been using. And you're going to see more and more short selling bank repossessions. These syndicators are going to go out of business and the investors who put the equity in, it's going to go up in smoke. It's going to be tough. And that just causes a domino effect across the board. Well, everybody tightens up then, and like no projects will go to fruition.

Now, there comes a time when this becomes an opportunity and I'll get to that. But you have to be patient, you have to be patient. It's hard to be patient when everybody's been making money handover fist the last 14, 15 years. It's hard to say, “Well, why can't it continue?” Especially when the marketplace looks like it's continued on and everybody says in the media, “We've bought them out. There's no recession at all.”

Let's see, what else? We have the commercial and industrial loans, same as the consumer credit lending is tightening, same for small firms across the board. It's tightening up a lot. Well, here's a stat that you probably aren't aware of. The number of multi-family units under construction currently today, August, 2023, is greater than the number of multi-units that are currently for sale.

So, think about that. Think about we have all these new units that will be coming onto the market in the next year as we go into a recession. What is that going to do to valuations of these projects and also, to the rents? Well, I see both going down, not something people have been predicting because we've had this big rise of everything.

Valuations been going up over the last number of years, as have rents, it's been a great time. But you have to learn to know when to take your chips off the table, when to get out and when not to get back in, and then when to get back in again. And that's something you have to really have a finger on the pulse of what's going on on the street.

You read the stuff in the newspaper or … well, who reads the newspaper anymore? I still get one. But wherever you get your information online, it's generally being reported after the fact. I like to stay in touch with actual people who are boots on the ground operators because that's where I know what's happening here. That's the access points that most people don't have.

There's a CNN, what's called a fear and a greed index. So, fear on one side, greed on the other. And a year ago, that index was right in the middle. It was neutral. It was neutral a year ago. Today, it's far on the very high greed.

Extreme greed is where it's at today. Even though it's CNN and I laugh a little bit, that's actually a pretty reliable source of looking at the emotional mindset. It's very greedy. What does Warren Buffet say? He says, “Be fearful when people are greedy, be greedy when people are fearful.”

It's not time to be greedy folks. It's time to step back and be patient. All these people who are trying to still sell you on the standard model of syndications and equities in real estate — and I'll just speak about stocks. I just think if I were in stocks today, for the most part, I'd pull out and I'd just go to T-bill if I didn't know what to else to do and just wait it out a little bit.

Oh yes, you might miss another little high in the next few months. I'm not saying it couldn't go up, but I think you're going to see a big downturn. And the problem is that those of you who are … or business owners, which I think many of you are, you're not going to get the same kind of increase in your investments proportionate to what you can potentially lose in a downturn.

I'll say it again. You can't get the same proportion increase in the run rate up as opposed to the losses you can take and probably will take on the way down. So, it's better my experience that when you've had some highs to exit, even if you exit early because you stay on a high ground, and then you can take your time to go back into the equity markets and run back up again at the appropriate time, based on whatever sector you invest in.

Housing affordability. Well, again, this is where people say, well interest rates have gone up from under 3% to now, over 7%. So, that's a little bit more than a two times rate increase. But people are still buying houses. Well, there's dynamics in place that are a little bit unusual because a lot of people have those lower interest rates. They don't want to sell their houses and move if they don't have to.

So, you stay put because you've got that low interest rate, which is really almost like debt as an asset today. If you move, you got to take out another mortgage, you're going to be paying way more in payments interest rate than you are in a same size house, same location.

So, people aren't going to move unless they have to. But eventually, people will have to start moving. Well, things come up, things happen in life, and at the margin at the outside, whatever the transactions are, that's what starts to set the market.

So, as people have to sell, then you're going to find that they're going to start lowering their prices, their values, their sale price in their homes to attract people who can still afford them, especially in a recession with tighter bank credit underwriting.

See, all this plays in and people aren't accounting for that. They're thinking, we're just going back to normal. These hiring strikes, they don't matter. It's okay. It's all strong, it's all good.

Commercial real estate's going to take the biggest hit first, starting with office. And then I think we're going to flow into the other sectors, all the way down. Hospitality, tourism, that's going to take hits, and you'll get into sectors of multifamily, self-storage, mobile home parks. A lot of it will have to do certainly with the operators and what kind of debt financing, if any, they have on projects.

If they've got long-term stable debt at low interest rates, good operators, they'll do fine, but many people are not in that position. And if you're an investor in one of those, just keep your fingers crossed that your operator doesn't get caught. But many will. I'm just telling you, just be aware. So, housing affordability is a factor and I think it will start to show up in the next several quarters.

Lastly, just another indicator, we've seen car prices, new cars, used cars, went way up over the last couple years because of supply chain issues. There's again, not enough inventory. Well, they're starting to come back down now.

Again, we've reached the end of this plethora of money being in the marketplace where people had money handover fist, and even was offsetting the higher interest rates, now, I think we're starting to see the effects of the interest rates, and the reality that people don't have all the money in the world. In fact, they're having their credit cards and pay the higher interest rate is causing them a lot of difficulty in managing their monthly payments.

Again, this is going affect the entire economy. No matter what business sector you're in, what investments you're in, understand that it's all tied together, and there's very few places that are actually safe space other than, as I said earlier, short-term T-bills. If you have to sit there for a couple quarters, I don't think that's a bad thing.

I'm more liquid today than I have been probably in my whole life, mainly because I had to keep my money working when I was younger because that's how you grow an estate. But today, I'm more into terms of preservation of capital because I don't want to take the losses that I think a lot of people will take.

That's just, again, some of my admonitions to you. You take it for what it's worth to you, and realize that you may be in a different phase of your life where you could take more risk but I just would say don't take unmitigated risk no matter where you are in your career and age cycle.

I'll end with this, just a brief summary; what would I do today in general? Again, in general, I would exude a lot of patience. I'd be careful about doing any kind of big expansion of my own business. I'd say be careful. I'm not saying you shouldn't. You may be in a position where it makes sense for you.

Be careful about using debt today because again, you're going to have to pay that debt back. Don't use any short-term debt. Don't invest your money with anybody who's in some kind of project with short-term variable rate debt, big mistake.

Don't speculate, invest for the long haul. I know it's fun and it's exciting and there's FoMo, fear of missing out for people who have done things like taking a big rise in crypto a year ago, only to see it fall back down again, or jumping on Nvidia, tech bubbles, whatever it is, there's fear of missing out and everybody says, “Well, I got to jump on that too.”

Be careful right now, pull back. Don't just look at everything on social media and think that you need to do it too because I think that's the biggest mistake where we are in the market cycle. We are not in my strong opinionated position, going to go through the next few quarters without a significant correction in all the markets.

I think we're going to have a relatively hard-fought recession. But on the other side, I said there's going to be opportunities. It's never the last train out of the station, never the last train out. There's always going to be new opportunities, and the better ones are yet to come.

Maintain more liquidity right now. If you can pay off some debts or if you've got some capital that you're not going to just put back into some longer-term investment, keep a little bit of capital on the sidelines, put it in the T-bills where you've got access to it if you need it or when the new opportunities come about, that's when you can make hay.

I did that very thing coming out of the 2008 great financial crisis when we could buy assets. Primarily, for me, it was real estate, but we bought a ton of real estate coming out of that down cycle and we rode that back up, and more than doubled our money in a few short years. I think that's going to happen again. But you've got to be positioned for it, ready for it.

I would be looking more at investing in debt. So, T-bills, treasuries are debt. In real estate, I invest in debt. I make loans or make loans through other people. I think that's the safest place to be right now. I can get very strong, good interest rate returns more than T-bills. Certainly, there's a little bit more risk. But again, if you learn to underwrite, you have the right access points. It is not hard to do.

I'll look at equities that would be in the financial markets. Stocks — I don't do stocks, but that would be for you if you do financial stocks or equities in real estate. I'll do those later, they'll come back, there'll be opportunities there. I don't want to be involved in those right now. The ones I have, I will run with those because it's hard to exit. But as long as they're operated well and they're all set with fixed rate debt, they're going to be fine. They'll be fine.

They may take a loss on valuation, but as long as they're operating and producing the cash flow I want, that's all I care about. At the end; equity, your net worth accumulation, wherever you've got it, it all comes down to one thing — comes down to the predictable sustainable income that equity will produce.

Going back to the doctor couple that I talked about earlier that had a lot of equity in their real estate on the West Coast; a lot of equity producing very minimal returns, and not even sustainable and they're still managing a lot of it themselves, dealing with tenants and insurance, and all the stuff that they in the sixties, you go, “Well, why are you still doing that?”

It's only because they don't know. Not that they haven't been prudent, not they haven't been disciplined, they've done that, but they deserve the right to understand how to make that network work better for them, more sustainably, more predictably and with less of them doing it hands-on.

Hands-on is fine when you're young, that's where you put the hands on but later in life, it's about freedom, it's about choices, about optionality. You can't be free if you're still dug in to all aspects of your business, and your investments like in real estate, it's just not the way to exit.

You deserve to have that opportunity, but if you don't know what to do, that's what's going to keep you from making any moves and we open up that door for more and more people in the Freedom Founders community.

And I'd love if it's right for you, if this message is really hitting you where I hope it does, you're at least thinking about what I'm talking about, you at least study it — and if we're a right fit for you at some point in the future, love to talk to you.

If not, just stay prudent, stay patient, be diligent not only about your own business, but about the capital that you're putting into investment for your future. It's your future, it's your freedom. You've got to stay focused on it.

That's it for me today. Take care.

You've been listening to the Dentist Freedom Blueprint Podcast. If you're tired of trading time for dollars and you want to create more freedom in your life, I encourage you to visit my week blog, freedomfounders.com/blog. I post weekly hard-hitting videos about creating more freedom in your life. Check out my latest book on Amazon, *What's Your Next?: The Blueprint for Creating Your Freedom Lifestyle*, or visit freedomfounders.com to learn more about how we help high income earners create the freedom to buy back their time and create more impact.