PAUL'S COMPREHENSIVE LIST OF INVESTMENT LEARNINGS

When I began my journey of investing, I didn't know the different paths I would go on and insights I would gather along the way. Investing is a topic I am passionate about and have come to appreciate all the lessons (some expensive) I have learned. I would like to share with you my list of learnings. If you haven't already read my six-part series on investing, I would encourage you to start there.

This list is by no means exhaustive – but do use it as a guide as you follow your own investment journey; and a template to build on and add your own learnings:

Diversification is Critical

The reality is, no matter how smart you are, you cannot always pick winners; there's always more risk than we can see. Diversification therefore is a smart way to protect your investments.

Invest In What You Know and Understand

Only invest in something that you fully understand the ins and outs and how the money is made. Avoid Black Box investments even though the sponsor has a good track record. There can be no unclarity in investing – you need to see and understand everything. No matter how attractive the opportunity seems, regardless of the sponsor's track record, that is not enough to base your decision on. Don't pursue any investments where you do not completely understand how the money is made.

Risk Management

When making an initial investment, believe it represents a unique opportunity. If it does not pan out and declines, resist the opportunity to "leverage down".

Rely on your own instincts more than the opinion and recommendation of the promoter, even if you trust and have confidence in the promoter.

Understand the Risk-Reward Ratio

When considering an investment, you need to understand the risk to truly understand how attractive the reward is. We often get interested in an investment that shows a very attractive return; however, with higher returns comes higher risks. I find it important to compare the return to the amount of risk. One of the best investments I ever made only generated an 8% return, however, it had very little to almost no risk. In my opinion, it was better than a typical investment that might generate a 20% return. Thus, remember it's not all about maximizing return.

Past Success Does Not Ensure Future Success

Prior success of the sponsor in similar ventures should definitely be taken into consideration; however, it does not automatically guarantee future success.

Stress Test

Before committing to an investment do a stress test. Stress tests identify and highlight the areas where your investment could potentially go wrong such as a longer hold period, higher exit cap rate, increased operating expenses etc. Request that some of the assumptions be changed/stressed and see how much of an impact it has on the overall return.

Character Assessment

Invest with people that you think have high integrity, good character, and solid values on how they're managing their life and their investments. Character assessment has proven to be very valuable for us.

Asset Return Report

It’s important to track and stay on top of your investments, but it takes a little bit of work. Even if you have one investment, set up your systems right. As you make new investments log in the information, and then track it over time. Review your investments at least twice a year.

Economic Cycles

Economic cycles change over time - take inflation and interest rates as an example. Make certain each new investment evaluation considers if critical variables may have altered and should be included with the new investment.

Don’t Be Impressed by Who Else is Investing

Don’t let your decision to invest be swayed based on who else is investing. Be sure to do your own due diligence before investing in a deal.

Make Sure the Sponsor of the Deal Has Skin in the Game, and Not Just Fees

It’s important to determine if the sponsor of the investment has put real money into the deal. Sweat equity is not enough.

Don’t Sign Personally on Any Debt

Don’t personally sign for any loan where you don’t have complete control over the investment.

Public Investments

Bond funds have been evaluated and recommended as the optimal fixed income investment based on historic performance against respective benchmarks.

Private Investments

Mergers and acquisitions require a lot of work, time and manpower in order to be executed efficiently and successfully. Make sure senior management is deep enough to carry out the business plan.

Waterfall and Preferred Return

Depending on how attractive the investment is and its risk-reward ratio, they will both have an impact on the waterfall distribution and preferred return.

Have A Strategy to Manage Problems

Plan before going into an investment how to best mitigate and manage any problems that may arise.

Sight Inspection

If investing over a certain dollar amount, personally plan to visit the business offices, meet the team, audit what they're doing and see the investment firsthand.

My 5% Rule

Do not to invest more than 5% of your portfolio in any one asset. There is no guarantee it is going to go the way you think. Stay diversified.

Use Benchmarks

Benchmarks are very valuable. Come up with a benchmark for an investment so you can compare how one investment is doing relative to the market of other investments in that asset class.

Choose the Best Managers

Do your due diligence to pick the best experts to manage your investments. They must have demonstrated success in the past and collectively possess all the skills to successfully manage a diversified portfolio Once selected, let them decide the asset allocation, the investments to invest in, and do not micromanage them. Hold them accountable for the job they do. Look at your managers performance quarterly and compare them to other managers and benchmarks when available.

Investing in Funds

Investing in Funds offers some benefits such as diversification. You can invest in larger transactions than if you were doing it yourself. But funds have drawbacks as well.

Tax

Don't let the income tax benefits drive the deal. Sometimes you can pay too much attention to the tax component of the investment. The investment should always stand on its own. The tax benefit should be a complement, but sometimes deals are so advantageous from a tax standpoint, not enough emphasis is put on the economics of the transaction.

Walk Before You Run

When perusing a new investment – especially with a new sponsor or in a new asset class that you have not developed expertise in yet; it's better to walk before you run. In other words, invest a smaller amount in your first or second investment and learn from the experience before you increase the amount you're investing. Always prove things out as you go.

Income Tax and Real Estate Investing

Real estate is generally complicated from a tax standpoint and advantageous because you get depreciation that's built in and shelters a good portion of your income stream and shelters the tax. So, pay attention to the tax component. Don't let it drive it, but know it, and don't just look at an attractive return. Our preference with real estate deals is to invest in individual deals that can be underwritten as opposed to funds which represent an open investment for the sponsor to determine what pool of options will be invested.

Unlike many other investments, real estate investments typically come with a built-in tax shelter provided by the ability to depreciate the asset. Even though the asset rarely goes down in value, depreciation is allowed by IRS which often will shelter the income generated by the investments thus deferring the tax down to the road to the time the investment is sold. In addition, the income that is deferred is taxed at the lower capital gains rates than the higher ordinary income rates. Also, it is not uncommon to find a real estate investment where the depreciation not only shelters income from the investment but is large enough to shelter other income as well."

Liquidity and Cash Flow

Be sure to understand how liquid the investment is. If it's not self-explanatory take the time and find out from the sponsor. It's also important to be clear on the cashflow before making an investment.

Private Investments

Private equity and venture capital investments we effectively addressed by investing in funds, which allows for diversification, access to successful managers, and minimize time spent monitoring investments. Individual private equity deals must be pursued with sufficient due diligence to confirm the risk of making the investment.

Black Swan

In the investment world, a black swan is something that doesn’t happen very often. It usually comes in from left field and there’s no way to accurately predict it. Examples include national disasters, pandemics, war, terrorism. A black swan is something you cannot underwrite, and it causes a market drop that you would not anticipate. Investing with this mindset will help keep you diversified.

Investing with Family and Friends

I don't recommend investments to friends. If you bring an investment to friends and it does well, everything is just okay. If the investment doesn’t go well, it can potentially damage the friendship. Recognize when you invest with friends, you're not only risking your money, but you’re also risking the friendship.

Competency

As you continue to grow your investment portfolio, aim to grow your expertise and competency in an asset class or industry as it will improve your ability to identify and negotiate better on investments.

It’s my sincere hope that this list adds great value to you and helps you grow as an investor!