SECTION ONE

FOUNDATIONS

CHAPTER 1

What Is Investing?

In 2010, I purchased shares of Domino's Pizza (DPZ). I remember paying $10 plus change per share, and I purchased $1000 worth. I really liked pizza, and I especially liked Domino's.

Why did I like Domino's? Well, for years as I was growing up, the company's product had this reputation of being extremely cheap and fairly low quality. If you ate Domino's Pizza in the early 2000s, then you know what I mean. It was bad. Like really bad. Essentially cardboard with cheese on it!

Well, in 2009, Domino's Pizza suffered some extremely bad press with a few viral videos showing employees doing terrible things to customers' food. If you search online, you can probably still find them somewhere. Suffice it to say they were "unappetizing." As a result of that negative publicity, many things changed at the company, including the CEO. In 2010, Patrick Doyle took over the company and began to reinvent it.

Doyle changed the entire company. He changed Domino's food quality, its marketing—the way it did everything. This became immediately evident in Domino's television commercials. I still watched football at that time, so I saw the commercials frequently. As I followed the shift in the company's advertising, I decided to try the "new Domino's" food. I was wary, but I'll be darned if it wasn't fantastic! It was a complete shift from their previous cardboard-tasting pizza.

DEFINITIONS

Above, I said, "Domino's Pizza (DPZ)…." The DPZ refers to the company's **stock ticker.** A ticker is the 1-to-5-character designation that you can use to look up a stock or a fund that trades in the markets.

So, I decided that this company was going places. I needed some of its stock. Being a fledgling investor and taking Peter Lynch's most excellent advice of "investing in what I knew" (as I was a connoisseur and frequent consumer of pizza at that time), I bought $1000 worth of DPZ stock: about 100 shares at $10 each.

That stock ended up going to over $500 a share at its peak and is worth about $350 at the time of this writing. I'll tell you at the end of the chapter what happened to my hundred DPZ shares. Did I make $50,000? Stay tuned.

But I tell you this story for a reason. What is investing? Why do you do it? What does it really mean to invest? You might think you know the answer to these questions, but it's important to be very self-reflective so that you have a foundation moving forward.

I didn't really know the answer to these questions when I bought that stock, but over the 13 years since, I've come to truly understand what and why I did what I did. And this knowledge—the what and the why—will help guide you as you move forward.

What Is a Share?

What is a share of a company? In a literal sense, it's a very, very small piece of ownership in the company. If you own a share of a company, then you are a part-owner. Some shares may have no rights associated with them, while others may include the right to vote in shareholder elections or to attend shareholder meetings. A shareholder's rights depend on the company and the share class.

Shares also come with one or two very important characteristics, which are the reason you're investing in the first place. They have the ability to appreciate in value, and many stocks entitle the holder to a payment reflecting a portion of the company's profit. That payment is called a **dividend** and is, in most cases but not all, distributed to the shareholder quarterly. It just shows up in your account without you having to do anything. Dividends are a key fundamental and will be vital in your investing strategy.

As we go through this book together, you'll learn more about how to value companies and determine which companies have a higher likelihood of capital appreciation. For right now, just keep in mind that these are the basic essentials of knowing what a share is.

So, your next question is probably, "Why do shares grow in value over time?" At least, it *should* be your next question. The answer, which is quite simple, is actually a reflection of the markets as a whole and not necessarily any one company in particular.

Shares grow in value over time—and the markets grow as a whole—based on only a single factor. People will swear up and down that there are tons and tons of reasons why things happen the way they do in the markets (and I'll touch on that in a few pages), but really, only one thing moves markets in the long run. Can you guess what it is?

FURTHER READING

Peter Lynch's amazing *One Up On Wall Street* is a book I highly recommend to any new investor. It presents different views than those I have in this book, but such views are important if you want to gain a good overall picture. Available on Amazon.

The goal of all companies is to make money. **The value of a share will increase, more or less, in proportion to the amount of money a particular company is expected to make.** The key word there is "expected." Keep in mind that *markets always trade off of future expectations*, frequently somewhere around six to 12 months in the future.

Now, of course, markets and shares of companies change value in the short run. That's because events that happen right now, today, can impact the expected future course of a company or the market as a whole. Someone once told me that, in the short term, markets behave like spoiled children. They tantrum from day to day as they struggle to digest news that may be impactful, but in the end, they move on only a single thing: **corporate earnings**.

Let's examine that for a moment. Why would markets tantrum in the short term if stakeholders could simply look at the larger picture for either the economy or a particular company and clearly see that it still has the same long-term prospects? This is a perplexing question that has its answer deep in the psychology of the human mind.

Human beings fear that which they cannot predict with certainty. That's the reason we worry about the future, the reason we look quickly to odd shapes in our peripheral vision, and the reason that many people choose to sell their stocks when anything uncertain happens.

A couple of terms you should know are **bull market** and **bear market**. The definition of a bull market is, technically, a rise of 20% in stock prices in a broad market index. More often, it means a space of time in which stock prices rise in general. For example, after the markets fell at the beginning of the COVID epidemic in March 2020 until the top in December 2021, we were in a bull market.

A bear market is the opposite: when the broad market index drops by 20% or more from its previous high. The period from January to October of 2022 was a bear market for U.S. stocks.

But let's move back to the larger picture of corporate earnings. When you purchase a share of a company, you are purchasing not just a piece of the company but a stake in the future growth of the company. You are saying that you believe this company will continue to grow its earnings—not "This is a great company at the moment" but instead, "Regardless of what this company currently is, it will be better and more profitable in the future."

It doesn't really matter what a company is at the moment. When I bought DPZ, it was an objectively terrible company, and that's why its shares were worth many, many multiples lower than where they would eventually go. Domino's had terrible cardboard pizza, abysmal marketing, and its product was really only suitable for drinking parties or perhaps as dog food. (Maybe that's too harsh, but I'm trying to make a point here.)

It didn't matter where that company was at the moment or where it had been. What mattered when I invested was where it was going. That's what I intrinsically understood as just a neophyte to the financial world. However, I wasn't really able to put my exact thoughts and ideas into those terms yet. I didn't understand how to fully read financial statements or earnings call transcripts. I didn't know what price-to-earnings ratios and enterprise-value-to-revenue were. I had no clue. I just understood that this company was going to go somewhere.

That is the essence of investing. You purchase those shares with the intention of seeing a specific company improve its earnings and thus its share value, regardless of what little things might happen in the meantime. As long as the essence of your original theory regarding the company's earnings remains intact, then you have no reason to ever exit the position.

As you're becoming an investor, this principle is one of the most important things you'll learn and one that I'll cover in-depth in a later chapter. How do you know when to hold and when to fold? It's a great question that I'll explain later, but for now, just remember one thing. **As long as your original reasons for purchasing the company are still viable, then you should hold the position.**

The Emotional Rollercoaster

When I purchased DPZ, I didn't understand that fact. I also didn't know what type of investor I was or what the goal should be for my portfolio. I didn't know nearly as much as I do today about the markets. I had no plan in place for my future, nor did I understand how to construct a portfolio.

What eventually happened was that I sold my DPZ shares at around $30 per share. I made a *triple bagger*—an investment that tripled in price. This would be a great win in most circumstances, but if I'd only understood the essence of investing and known what type of investor I really was, then I could have made much more money.

If I'd known that my original reasons for buying the company were still very sound, instead of getting blinded by tripling the profit, I'd have known that I could hold the shares for a significantly higher profit. In fact, those shares would be worth around $35,000 today, instead of the $3,000 I sold them for. Ouch.

But I didn't know what type of investor I was. I didn't understand that if I wanted to build a portfolio, I needed to hold stocks as long as it made sense to hold them. I didn't know anything other than "I've just made money, so let's get it out before the markets drop." That's something that many people feel and think. If you've been in the markets before, then you've probably felt it, too. Or perhaps you've thought, "I've already lost some money on this. It won't turn around, so I'm going to sell before I lose more," as you panic and sell out of a company.

IF YOU'VE FELT THESE FEELINGS IN THE MARKETS BEFORE

Do yourself a favor and write down very specifically what happened, how you felt, and why. It will become very important to remember this as you move forward.

Do either of those ring a bell?

If they do, then know that you aren't alone. Those are very common feelings! And they're frequently exploited by professionals who know what they're doing.