Investments:

A Real Estate Investor's Thoughts on the Stock Market

"Sure, this company doesn't make any money today – but we hope it will make lots of money in the future. That's why it costs 20 times more than a company that's actually making profits today." An old friend of mine recently became a stockbroker, so we talk about the stock market a lot. The previous phrase is one that I often hear from him, and it doesn't make a lot of sense to me. As a real estate investor, I'm used to the property's value being tied to the profits (income) it generates. This is why an 8 unit property will almost always be worth more than a 4 unit of the same type, and in the same location. More income generally equals more value. This month, we'll take a look at the stock market and evaluate it from a real estate investor's point of view.

I Do Have Money in The Stock Market – But It is Not "Serious Money"

Before I dive into this month's topic, I think it's valuable to state my position on stocks. I do have some money in the stock market, but I wouldn't call it "serious money." What's serious money? That's money that you can't afford to lose. I prefer to put my "serious money" in real estate. Sure – it's possible to lose money in real estate, but my personal

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belief is that there is less risk – and the risk that's there is more manageable.

Why Would I Pay More Today for Something That Might Be Worth More in the Future?

To illustrate an example, I'll pick on Tesla Motors and General Motors. Tesla currently trades for $354.80 per share. With approximately 168 million shares outstanding, that gives Tesla a market capitalization, (or total value), or $59.39 Billion. General Motors trades for $37.62 per share. With about 1.5 Billion shares outstanding, this yields a market cap of $54.8 Billion.[1]

The most important numbers to investors, of course, are "how much do these companies earn?" Over the last four quarters, Tesla has brought in $10.06 Billion of revenue – which I think is surprisingly low for a company that sells cars starting at $70,000. (Their new "affordable" cars don't appear in these past results.) Tesla's net Income for the last 4 quarters was negative $765 million. (A loss.) Why then, is their stock so expensive? Stock investors are willing to pay more because they think the company might make more money in the future.

I'm not sure, however, that is such a realistic expectation. General Motors already has the sales figures that Tesla executives dream of someday realizing. Over the last four quarters, GM brought in a staggering $160 Billion of revenue. (That's a LOT of cars.) Their net income over the same period was $8.8 Billion.

Thinking with my real estate mind, if one buys a portion of $58 Billion Tesla,you'll get an equivalent portion of their income (zero.) Buying the same portion of $53.4 Billion GM, will earn the same portion of that $8.8 Billion of income. If those were two buildings, I know which one I'd buy. Why would stock investors think any differently? I don't know the answer to that question, but; evidently, they do.

How to Compare Prices of Different Stocks

While us real estate investors may be familiar with Cap Rates and Gross Rent Multiplier measures, we may not yet be experts at similar metrics for analyzing stocks. The "Stock Market CAP Rate or GRM' is called a Price/Earnings (PE) Ratio. The formula for PE Ratio = Price per share/ Earnings Per Share (EPS).[2]

When we apply this formula to the above stocks, (I'm just taking these numbers directly from Fidelity.com so that I don't run into rounding errors), we end up with no number for Tesla (we can't divide by zero), and a PE Ratio of 5.8 for GM. In an effort to make a comparison, let's say that Tesla earned 1 cent per share over the last year. (They actually lost $4.71 per share). If we take $354.80 and divide it by $0.01, we get a PE Ratio of 35,480.

This means that a GM buyer is paying 5.8 times earnings for the stock while a TSLA buyer pays 35,480 times that. Again; if those were apartment buildings; which one would you buy? If you expect Tesla to someday sell as many cars as General Motors, why would you expect them to be worth more than General Motors when they're worth the same amount today?

When Buying Stocks, Think Like a Real Estate Investor

I believe that thinking like a real estate investor (by buying income) is a good way to mitigate risk in the stock market. Following this plan can help investors avoid getting caught up in trends like the "dot com boom" of the 1990's by focusing their efforts on companies that make money. I do not own positions in any of the stocks mentioned in this article – please call my office at (877) 313-1868 if you have any questions.

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1 All quotes and financial information sourced from Fidelity.com, September 1, 2017.

2 Investopedia.com – accessed September 1, 2017.