Debts & Properties

Risk and security

Lending money or becoming partners

Risk and security

I like the stock market but for me it's risk, it's uncertain, therefore I choose bonds because they are secure.

Who said that stocks are risky and bonds are secure?

Why do you ask? Everybody knows, it was always this way.

It's not just a mode of speaking ? We are reasoning together, this subject is so important that it necessitates some steps in a simple manner but with many details.

We divide the approximate total of investments into 3 sectors: real estate, bonds and stocks.

Regarding real estate there is land, agricultural and building properties, commercial, offices and residential property.

Then, is real estate secure or risky?

Absolutely secure.

What happens regarding bonds?

Obligation in affect can synthesize in the concept of debt.

There is debt of states. What's the main debt of states? It's government bonds. You lend money to the government and the government pays you interest.

Or there are corporate debts: corporate bonds are debts typical of companies.

Are bonds secure or risky?

They 're absolutely secure, it has always been this way.

Real estate and bonds are secure. On the other hand stocks?

As I said stocks are notoriously risky.

Well. Now we must understand what's behind stocks. What are stocks? They are parts of public companies.

Then when you buy stocks, you acquire a portion of public companies worldwide and throughout sectors. For example: food and beverage, commodities, energy, pharmacy, financial, industrial, services, technology, essentially all of the real economy. Behind stocks there is the real economy through various companies. Then everything that we call stocks is the worldwide economy quoted on various stock exchanges.

REAL ESTATE	BONDS	STOCKS
Secure	Secure	Risky
LAND - Agricultural property - Building property INDUSTRIAL COMMERCIAL OFFICES RESIDENTIAL PROPERTY	DEBT - Of governments - Of companies	COMPANIES of all sectors Food and beverage Commodities Energy Pharmacy Finance Real estate Industrial Services Technology **REAL ECONOMY!**

Emotion or reason? - 1

Split now investments into 3 big classes. If we think back, probably we will be adaquately intuitive with real estate, less with bonds and even less with stocks.

What do you mean when you define stocks as risky?

I fear that my investment could lose rather than grow.

You fear that in companies that are behind stocks something could go bad and perhaps in the end even fail.

Because this is true, food and beverage companies, commodities, energy, pharmacy, financial … could disappear . Essentially all of the real economy could disappear.

But if the real economy disappears, it means all processes of progress stop and then tell me what happens to building property?

Nothing.

If there aren't companies to build on it, this building property hasn't any value.

What's the purpose of industrial real estate if there aren't companies that buy or rent it for their productive activity?

The same as above, nothing.

And the same could happen for commercial and offices real estate. Only sparing residential property.

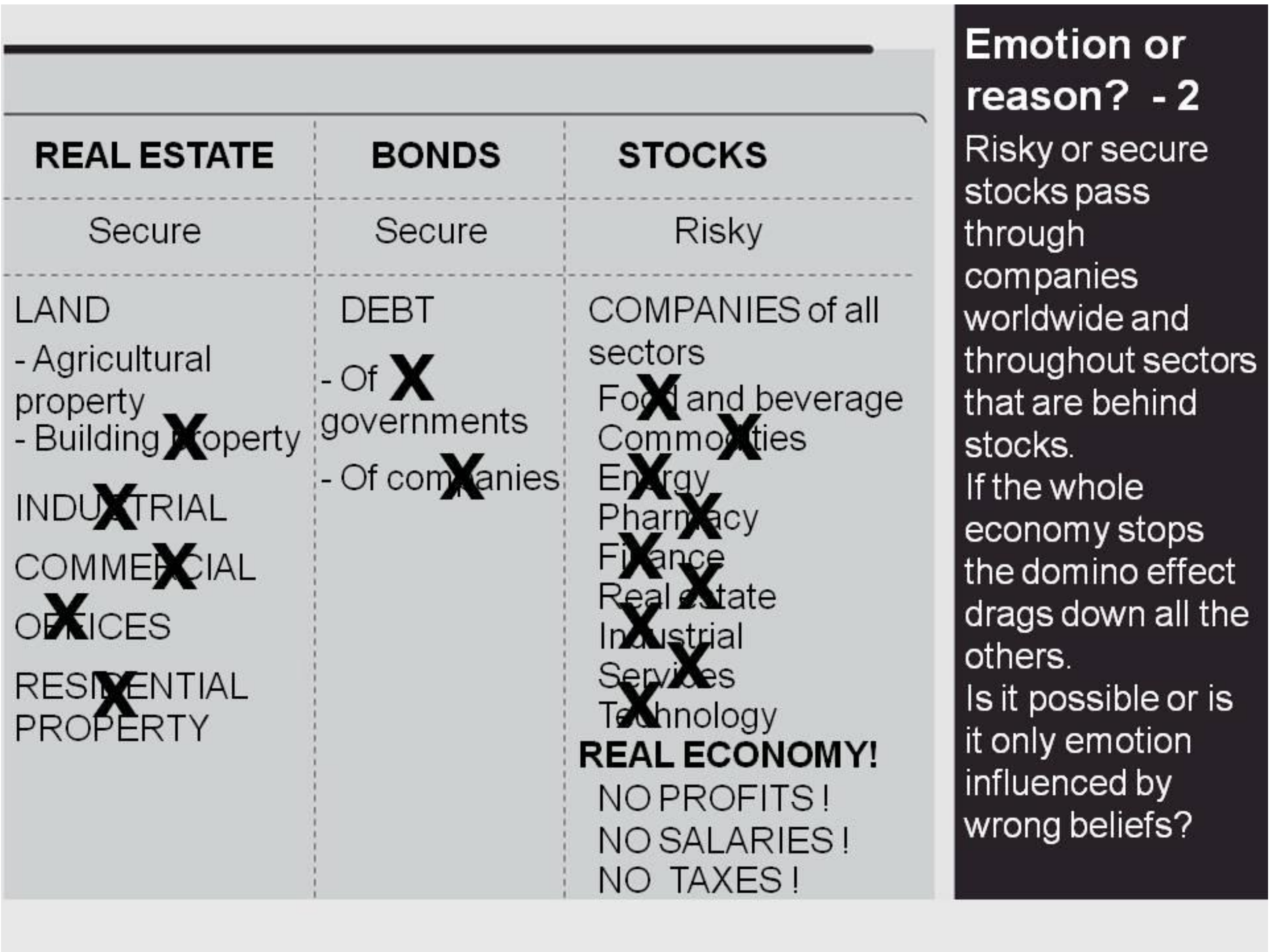
And if these companies disappear, how can they repay their company debt?

They can't pay, then company debts become uncertain.

Wait before you come to a conclusion. This hypothetical economy involution could affect the same real estate elements and the same bonds, and in addition block company employee salary. And if employees haven't salary, how can they pay residential property loans or rent?

Then even residential property loses value.

And who pays taxes coming from company profits, if there aren't any, and from salaries, if there aren't any?



It's a domino effect.

If government doesn't collect taxes how can it pay our public employee salaries and how can it repay debt?

Then even my secure bond ins't secure enough?

It spares only agricultural property where you can plant potatoes?

It's a scenario of fear.

Do you think that scenario is possible?

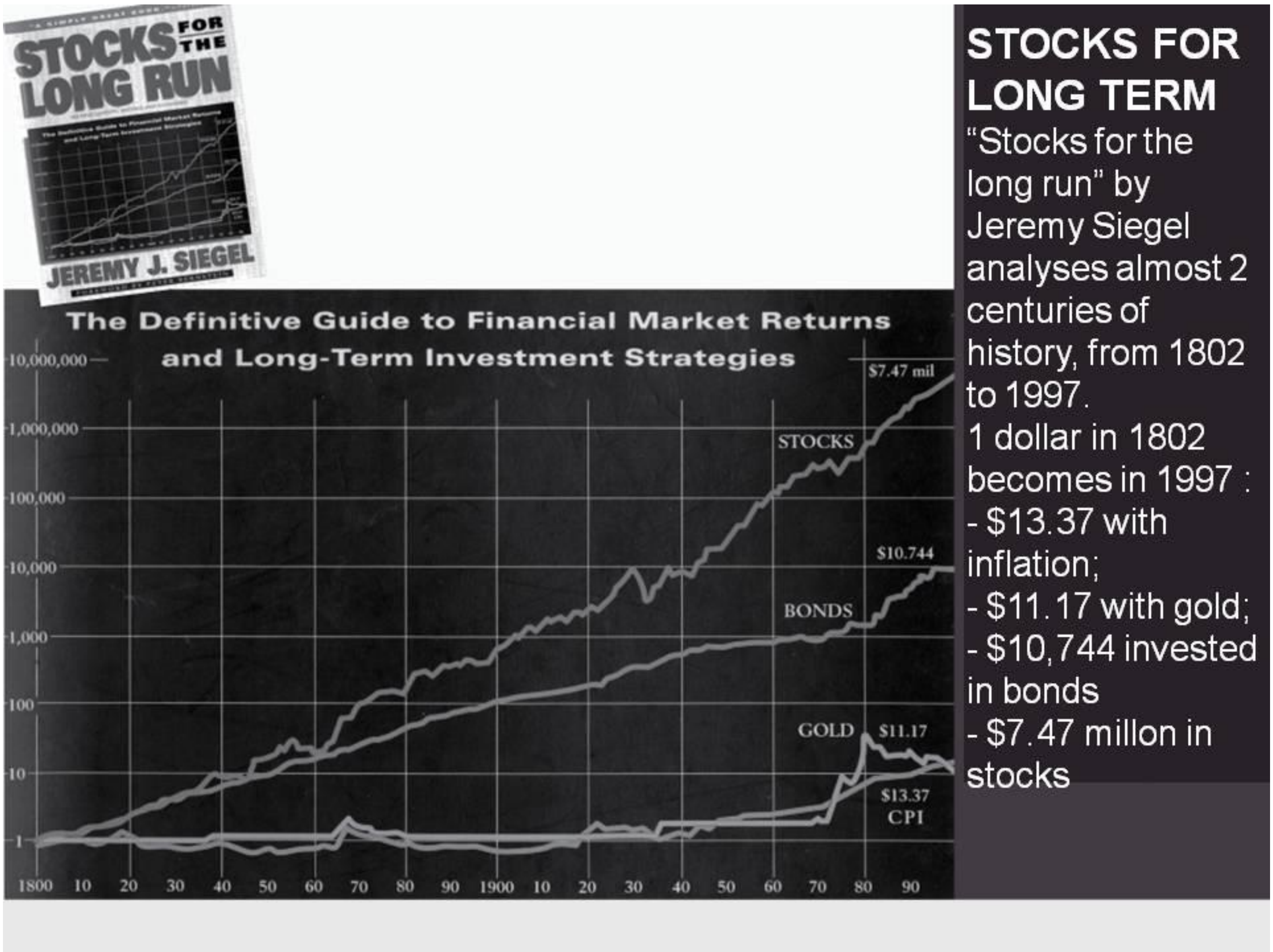
I don't know, I hope not

How is it possible that everything stops ? It's never been possible, it hasn't been stopped by wars either and so it's an absolutely emotional scenario.

Even in the case of a company failure, the problem is only that of the specific company, not of the global economy, because its business is taken up by the remaining companies: if your usual restaurant closes, from that moment you go to another.

With reason, we realize that the real economy and progress always go on.

Observe below the cover of *Stocks for the long run* by Jeremy J. Siegel, a classic book that reports an expansive two centuries of history.



It's evident that stock properties return much more than bonds. In 2 centuries, 1 dollar invested in stocks becomes 7.47 billion, against 10,744 of bond investment: 700 times more!

It's extraordinary.

No, it isn't extraordinary, it's normal and here's why; even "terrible" '29, recalled at every crisis, almost disappears into the graphic.

And then the real risk in the long term, not even waiting 2 centuries, is less earnings in the bonds sector. The only thing for you is that stocks, even diversified, are effectively risky in a short time. In very short periods it' s possible to have positive results but also negative results. For that reason stocks need extra long periods.

And then, aren't perhaps Argentina bonds government debts and Enron and Lehman Brothers company debts?

You have demolished my certainty.

Lending money or becoming partners

In the end, very complex “finance” is reduced to 2, simple elements: lending money or partnering

There are people who lend money to others with a cost, the famous interest. For different issuers, loans are called government bonds or corporate bonds, etc, but they are always debts.

Others instead investing in stocks become partners. Stocks are none other than parts of public companies; they are just properties. Then all that consists in choosing to invest in debts or properties, so lending money or becoming partners.

That is clear, reasoning a little

If you have a debt do you prefer to pay more or less?

Certainly less !

If you have a property, a company, from this company do you want to obtain more or less earnings?

Even here the obvious answer: more earnings!

Behind debts (bonds) and properties (stocks) there are people that use their experience and competencies in the interest of the company, so that often it’s a relevant economic power.

Yes, but what’s the connection between what I do and the interest of the company?

Their objective is to make the same choices that you make: behind stocks there are people who work to obtain more earnings and behind bonds there are people who work to pay less interest.

It’s for that then, in the long term, properties grow much higher than debts !

Then it isn’t extraordinary but it’s normal. It’s the confirmation of the objective: pay less debts and obtain more earnings.

However sometimes there are bonds with yields much higher than the norm

If, with the same duration, there are bonds with effective earnings much higher, it isn’t because the issuing was inattentive – as we said before, in fact, behind them there is experience and competence - , and those who invest aren’t more cunning than others. It’s because there is an elevated level of risk, as was clear with Argentina or subprime loan bonds: **higher yield = higher risk.**

If successful you have a good result but if unsuccessful you can lose all your capital.

If the yield is much higher than other bonds with similar duration it is already known that there is some risk.

*Argentina’s default was in 2001. In 2005 Argentina proposed a swap of approximately 30% with new bonds possessing nominal value.

The Lehman Brothers “crash” cost the default of stocks, when bond invested earnings received only a part of their compensation

It’s opportune to use correct terms for those who are perceiving:

- “Bonded debt” is neutral
- “Fixed revenue” gives an excessively positive idea
- “Debt market” instead is more intuitive for a commitment to be met.

If I invest in a company’s stocks but after the company goes bad or even fails?
Good question ! If you put all your eggs in one basket it’s possible nothing happens, but if something happens they are completely scrambled.
If instead you distribute the eggs into more baskets, if you diversify, you stay calmer.
To diversify means gaining results with less anxiety is possible.
Then it’s better to invest everything in diversified stocks?
Go slowly! Investing in diversified stocks for a long time could bring brilliant results as illustrated in the figure titled *“Stocks for the long run”,*
But if you invest for a short period, buying in the euphoria of 1999- beginning of 2000, and after selling from fear after September 11, you would have lost a significant loss . The market in fact in a short time is subject to strong and dangerous oscillations. So be calm, consider well what you do !

Speed is a bad counselor .