Canada’s Youngest Retiree on “Idiot-Proof Stocks” and Buffett’s Valuation Wisdom

Description

Derek Foster is an inspiration for many Canadian investors. By using time-tested principles from great investors like Warren Buffett, Foster managed to accumulate enough cash to retire and live off his dividend income by the age of 34. Today, Foster is the author of several bestselling books, including *Stop Working, Here’s How You Can!*, *Money for Nothing*, and *Your Stocks for Free*, and *The Idiot Millionaire*. You can learn more about him here.

How did he pull this off? This week I got the chance to speak with Foster to discuss his investment philosophy and the state of the market today. Below is the transcript of our conversation; it has been lightly edited for clarity.

Robert Baillieul: You’re known as Canada’s Youngest Retiree after you left the rat race at the age of 34. How did you do it?

Derek Foster: Basically I started investing when I was, oh jeez, I think I started investing when I was 18 or 19. I can’t remember the exact time but it was quite early. I was learning and I think I read *The Wealthy Barber* and I started buying mutual funds and that kind of thing.

Pretty quickly I switched over to investing in dividend-paying companies and what I realized rather quickly was [that] you invest in great companies and the dividends keep coming — in good times and bad. Eventually I figured, “Hey, if I could generate a passive income stream to live on I wouldn’t have to work anymore.”

So the traditional model where you have to build a value of let’s say X and then you withdraw say 4% per year — the common metric these days — didn’t appeal to me because the markets go up and down whereas the dividends are much more stable or steady or whatever. So that’s the approach I use.

Baillieul: So you started investing in college. How long did that take you to build up that portfolio?

Foster: Oh, it took a long time. I started in university — I was studying business at the time and I had a part-time job and I live in Ottawa and I went to school in Ottawa so my costs were lower because I lived at home. But I did have a part-time job. So I sent a benchmark of at least $200 per month.

But I'm an avid saver so any bonus money I'd also throw in there. For example, you know when I got my tax return at the end of the year I invested a substantial portion of that or when GST credits came out — that kind of thing. Or the job I worked, at Christmastime actually paid me more money, so I would contribute even more.

It took about 15 years to build up a portfolio to where I didn't have to work anymore.

Baillieul: In your book *The Idiot Millionaire* you talk about buying idiot-proof stocks. So what's an idiot-proof stock and where do I find them?

Foster: I think the first thing is that I don't think I'm that smart of a guy and I don't think you have to be that smart to invest wisely. So when I talk about "idiot-proof stocks" I talk about something where the future is fairly certain.

For example, 10 years ago you figure something like a **BlackBerry** was a sure-fire thing because they dominated the smartphone market. They were the hot company and now they're not. The future of these competitive industries is changing and another competitor can come and steal their business quite easily. So that is not idiot-proof.

An example of a stock I own that I would consider idiot-proof would be something like **Tim Horton's** (TSX: THI, NYSE: THI), where you basically have one on every street corner. People drink coffee and coffee is actually kind of an addictive product. So people form habits and they tend to drink it every day. People have a habit of drinking two cups of coffee every day and the line at Timmies is always quite long. When people acquire a taste for putting something in your mouth you develop a certain taste for it and your tastes don't change very quickly. So I could come and open up Derek's Donut Shop and no one is going to go there because they're already used to Timmies.

So that's a company I would consider idiot-proof. Coffee is not a complex product. You boil some beans and add some water and there you go. The profit margins are high and they basically just print money. So that would be an example of my idiot-proof company.

Baillieul: So no sexy stocks like Apple or Google?

Foster: A lot of smart investors have made money in those stocks and good for them. I'm not smart enough to understand those. Apple is hot right now. Apple was hot actually in the early 80s. They were one of the first companies to enter the PC market. They were really hot in the early 80s. **Microsoft** sort of stole it away from them. Apple was just chugging along and they had a small market share to dedicated users and that was about it. It's only been in the last decade or so that they've really come on again.

It's a bit like going to a crapshoot or going to the casino. Some people do it and they make money and good for them. That's just not what I do. And I'm not saying you can't do it. I can't do it because I'm not smart enough to know what Apple is going to look like 10 years from now. So I tend to avoid those kinds of companies.

Baillieul: Avoiding bad businesses is important. But buying a good business is no good if you overpay for it. How do you determine the price you're willing to pay for a stock?

Foster: I think going back to Warren Buffett's idea — I'm a big Warren Buffett follower — where he said, "It's more important to buy a good company at a fair price than to buy a fair company at a good price." So I think it's more important to get a really good quality company. So 90% of my efforts are looking at the qualitative parts of the company.

But as far as valuation goes, again, it's hard to pinpoint an exact valuation on these companies. Two people could come up with models and come up with slightly different approaches. I tend to look at Value Line because it's a simple one-page snapshot and it became clear where the company has historically been trading at versus today. And you're trying to buy at the low end of the range. It depends on what the market is offering you.

A few years ago there was a ton of stuff that was super cheap — but now not so much. You don't want to overpay. I don't see tons of screaming buys in the market today. I just try to pay a reasonable price.

Baillieul: It sounds like it took you a long time to learn the art of investing. If you could go back in time and talk to yourself as a younger man, what's the one lesson you would tell him?

Foster: Don't try to strike it rich. I don't remember all of them offhand but there've been times when I bought a stock that has a bright future. I think one of the first stocks I bought was a junior gold producer way back in time in my late teens or very early 20s and I lost all my money.

So the focus on quality seems really key. I don't encourage people to overpay. But had you bought **Procter & Gamble** 20 years ago and you overpaid by 30%, you're still pretty happy today. Maybe not as happy as you would've been if you bought it at a reasonable price, but I think the lesson I learned was always stick to quality and there's really so few companies that are of the highest quality. But that would be the most important thing I think.

Coming up next
As we approach the five-year anniversary of the collapse of Lehman Brothers, I ask Derek what he learned from the financial crisis.

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Disclosure: Robert Baillieul has no positions in any of the stocks mentioned in this article.

David Gardner owns shares of Apple and Google. Tom Gardner owns shares of Google. The Motley Fool owns shares of Apple, Google, and Microsoft.

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