Why Stock Investing Should Beat Other Types of Investing

Description

In the book *Brandes on Value: The Independent Investor*, Charles Brandes states that stock investing should beat other types of investing over the long term, because behind each stock that does well is a business that continues to create value.

Some people like real estate investing better because it can create tremendous wealth. However, investors likely need to take on a lot of leverage with mortgages. If prices rise, investors can get excellent returns. However, if prices fall, investors can get in deep water because of the huge leverage.

Brandes says, “Values are based on whatever revenue streams can be generated, and those cash flows are a direct result of overall business health. For example, the cost of owning a single-family home is covered by money earned through a business. Consequently, businesses have to be more profitable than real estate (as an investment), or else rent couldn’t be paid or houses purchased.”

It’s not that businesses aren’t leveraged either, but if the money borrowed is used to invest in projects that generate cash flows (potentially forever), value (that leads to wealth) is created.

Businesses should produce higher returns

Stocks play a role in bonds, too.

“Interest on corporate bonds is paid by the cash flow of businesses, and interest on government bonds is paid by taxes on the wealth of businesses and individuals. Real estate rents are paid by business cash flows. Art, commodities, and precious metals are all purchased with wealth produced by businesses. So, it followed that businesses, over the long term, should produce higher returns than all other asset classes,” Brandes writes.

Investors should choose which business to own carefully

Investors should keep the following in mind:

1. Not all businesses are worth being owned

2. Investors shouldn't pay any price even for the best of companies

What do I mean by that?

When building a stock portfolio for the long term, it's important to start with a foundation of quality businesses that generally do well no matter what kind of economy we're experiencing. For example, utilities are essential businesses. No matter what's happening, we need to use electricity and that's where utilities such as **Brookfield Renewable Energy Partners LP** (TSX:BEP.UN)(NYSE:BEP) come in.

Brookfield Renewable generates consistent cash flows to pay its distribution. Currently, its quarterly distribution is US44.5 cents, totaling an annual payout of US$1.78 per share or a yield of 5.9% at $37.6 per share based on a foreign exchange of US$1 to CAD$1.25.

A business can be great, but its stock can be horrible. A business can continue to become more profitable, but its stock can go nowhere (or worse, it can fall) because sometimes the market bids up the price of a business, making it overvalued.

During the Internet bubble, **Microsoft Corporation** (NASDAQ:MSFT) traded as high as 75 times its earnings! Even when the company's earnings per share grew 10.4% per year on average after that, it took eight years for the company's earnings to catch up to its price. So, investors who bought during the bubble experienced horrible returns during that period.

Conclusion

One of the best ways to build wealth is to become a part owner of quality businesses, such as Brookfield Renewable and Microsoft. However, even for businesses of the highest quality, investors should never overpay for them. For example, the financial crisis was a great opportunity to buy quality companies at substantial discounts. Nevertheless, in any market there are companies on sale if you look hard enough.

CATEGORY

1. Dividend Stocks
2. Investing
3. Tech Stocks

TICKERS GLOBAL

1. NASDAQ:MSFT (Microsoft Corporation)
2. NYSE:BEP (Brookfield Renewable Partners L.P.)
3. TSX:BEP.UN (Brookfield Renewable Partners L.P.)

Category

1. Dividend Stocks
2. Investing
3. Tech Stocks

Date
2025/07/03

Date Created
2016/03/29
Author
kayng