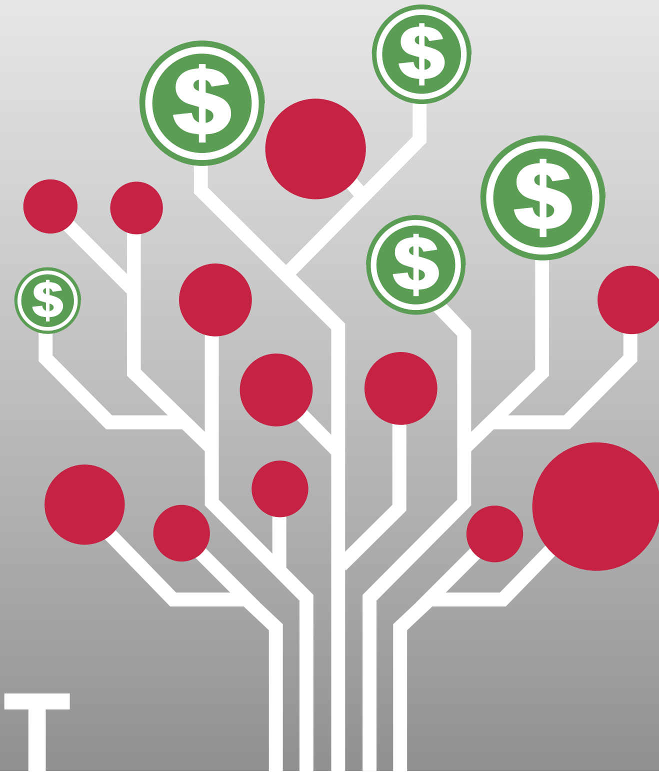


INVESTMENT STRATEGY

Most investors that I meet think they have a good investment strategy. Let me tell you that is almost never true! I've found over the years that this is another one of those ideas that people think they understand but really don't. "Strategy" itself is a word that is hard to define. Add "investment" in front of it and things get even more complicated. Investors are constantly confusing strategy with tactics or worse, investing without a strategy at all. These mistakes tend to be costly.

I find it helpful to think about the understanding of strategy by examining its use and meaning in the context of war. It helps, of course, that I've been obsessed with the history of warfare my entire life! Here "strategy" means something like the plan or policy designed to achieve victory over the enemy. It's the big idea—the "here's how we are going to win this war" idea. In the American Civil War, for example, the Union's Anaconda strategy (appropriately named!) was to completely blockade the South by land and sea and take control of the Mississippi river to starve the South of all the necessary resources they needed to effectively wage war. It all sounds so simple and obvious when laid out like this. That's one of the challenges with strategy. It's not always obviously actionable information or advice. This is where tactics come in. Tactics is all about the how. How are we going to execute this blockade? What kind of ships are we going to use? In what formations? How do we cover the ports?...It's about the actual execution of strategy.

I have come to believe that the key to investing is to find a strategy **that is consistent with your psychological disposition.**

When thinking about investment strategy, the questions you should ask are: do I have a plan or policy to invest my money to produce returns? If so, what is it? What's my big idea to make money with my investments? If you cannot quickly and clearly answer these questions, you don't have a strategy.

Most investors are essentially crowd-following momentum investors without even knowing it. They hear something in the news or notice a particular company getting a lot of attention for going up and up and up. Then they jump in with the crowd. Sometimes this works. Often it doesn't. In either case, this is not a good investment strategy, even when it works. This is how you get things like Dogecoin and GameStop. It's indistinguishable from gambling.

By the way, this momentum (gambling) strategy isn't just the purview of unsophisticated retail investors. Many so-called professional investors are doing the same thing and just calling it something else.

After experimenting with many different strategies myself, often unsuccessfully, I have come to believe that the key to investing is to find a strategy that is consistent with your psychological disposition. For instance, some people really enjoy the whole process of finding a "deal." You can see it in how they approach shopping for clothes or cars. They will scour the landscape and dive deep down rabbit holes all so that they can feel like they really found a deal. They will bargain and negotiate aggressively. For these individuals being a value investor makes a lot of sense. For others though, who don't have this psychological make-up, this desire to feel like they are winning when they make a purchase, value investing wouldn't make any sense at all.

I am attracted to real estate because it checks two important psychological boxes. First, I need something really tangible. For whatever reason, I feel better about my work when I can see it concretely and clearly in the external world. It's like I need some kind of proof or validation for what I'm doing all day. This is probably why writing is also so attractive to me. Secondly, I have this desire or need to feel like I'm actually doing something. It's almost like a guilt complex. In order to feel right, I just have to feel like I'm working hard. Real estate presents the perfect canvas for these two psychological needs.

This highlights, again, the supreme importance of self-knowledge. When it comes to investing, everything matters. It's not just about numbers, valuations, and charts. It's about self-understanding, emotional control, and self-mastery. The Ancient Greeks were on to something with their maxim of "know thyself." I discovered that there's something that doesn't feel quite right to me about the idea of making money by just picking the right stocks for example. So that's not my path and no judgment here. I don't think there's anything wrong with that kind of investing. It's just that, for me, that strategy doesn't make sense.

Ok. Once you've done this hard, introspective work on your strategy, the next step is to think clearly about its tactical implications. What exactly does it take to execute your strategy? Do you have the knowledge-base and skillset to be effective? Are you capable of developing a competitive advantage? If you cannot answer these questions and feel confident, it's time to go back to the drawing board. The tactical side of your strategy must be right for you as well. Don't become a trader if you don't love sitting in front of your screen all day looking at charts! Don't become a developer if you don't love architecture and design! You see the point.

In thinking about the tactics of investment selection, one of the questions I like to ask myself is this: What is the market willing to give me right now? I use this as a sort of reframing question. It's meant to remind me that investment is a two-way street. It's not just about chasing returns or looking for opportunities in the market. The market is constantly talking back, answering your questions, offering you opportunities and you have to remain open to these messages. Often the answer is: "not much." These are the moments when you have to be content to do nothing, no matter how hard that is! Sometimes the answer though is "a lot." These are the moments when you really need to be decisive.

Let's summarize our points here. First, make sure you actually have a strategy and aren't just gambling. Second, make sure your strategy makes sense for you and is consistent with your personality and psychology. And third, make sure you can credibly engage on the tactics of your strategy.

We will keep exploring the topic of investment strategy here but for now, let me leave you with some hard-earned wisdom from a decade in the trenches as a real estate investor. Of course, over these years, I made a lot of costly mistakes—don't trust any investor who won't admit to doing the same! And these mistakes were usually the result of either not having a strategy at all or seriously misunderstanding / messing-up on the tactics. With real estate, it's really easy to get hyper focused on the micro-dynamics of a given deal. You'll dive deep into the weeds and on paper have what looks like an incredible opportunity. However, without the bigger picture macro and strategic perspective, you'll miss out on some key dynamic that blows up the assumptions of your intricate deal-level model. You're left wondering what went wrong!?

When I first got into real estate investing, I was really attracted by this idea that you could produce superior returns by finding neighborhoods that were just about to change for the better (i.e. the gentrification strategy). This must have been a holdover from all my time spent thinking about the public markets. Over the years, I had evolved into a sort of Buffett-style value investor there and was always looking for the beaten-down companies that were about to transform and resurge.

So at first I was attracted to the "value" markets. Intellectually, I assumed that as long as certain factors were present (e.g. positive demographic trends, obvious signs of changing consumer preference, interesting new job or commercial centers emerging) these neighborhoods would obviously improve through time. But that's not really true. Maybe they will. Maybe the underlying premise of the investment is, in fact, true. But how long will it take? The success or failure of the strategy comes down to the time horizon. With real estate, changes tend to unfold much more slowly. Compared to other segments of the economy, it can feel like the pace of geologic time. Yeah, the tectonic plates are "moving" and mountains are eroding but it's a matter of inches per year. Ok, maybe things aren't that slow but that's the point. You can get stuck in a value strategy investment.

Now, neighborhoods do indeed change but only under a pretty unique confluence of circumstances and it can take as long as decades to play out. For the real estate investment entrepreneur this is often just too long. The strategy is binary in as sense. When it works (i.e. when you are able to invest in a market before it changes and hold on long enough to see that change come to fruition), it produces great returns. But when it doesn't work, you can get everything right at the micro level of the deal and still not make any money.

I have come to believe that the smarter strategy is to invest in already established markets, no matter what you believe about gentrification and transformation. This change in thinking is analogous to the change in mindset that Munger helped foster in Buffett's strategy—that it's better to look for good companies that are mispriced instead of just the most mispriced companies. What I have found is that properties in great neighborhoods are not only more consistent but also produce better overall returns.

Let's assume that you have two properties—one in the best neighborhood in town and the other in a gentrifying neighborhood. What ends up happening is that the property in the best neighborhood performs better in either scenario (whether the other neighborhood transforms or not). If the other neighborhood doesn't transform, it obviously performs better and when it does, rents and values in the already established neighborhoods go up even faster. I think this is a function of a network effect. If location is a big part of value (and it is), when a nearby neighborhood improves so too does the established neighborhood. It also becomes more valuable. And this makes sense. When a neighborhood transforms, there are more people and families with higher incomes around. The tax base improves as does the commercial potential of the community. There are just more resources and potential for economic activity and this benefits both neighborhoods.

Anyway. As I've learned more and more about this art I have come to believe that there are 3 super strategies in real estate:

1. Invest in assets that are not institutional yet but have a chance of becoming so.

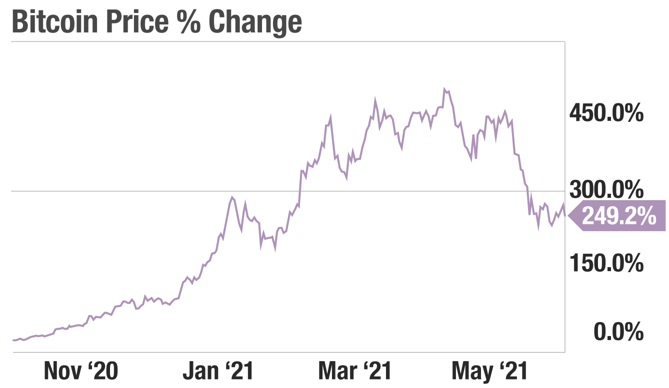
2. Invest in assets that are hard to finance now but will be easy in the future.

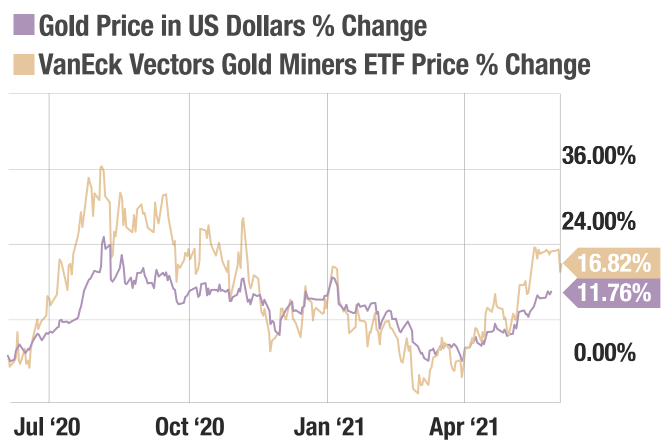
3. Invest in markets where people are going to migrate en masse and where supply is severely constrained by the regulatory environment.

As this edition is getting a bit long, I promise to revisit each of these in detail. Until then, good luck thinking about your strategy!

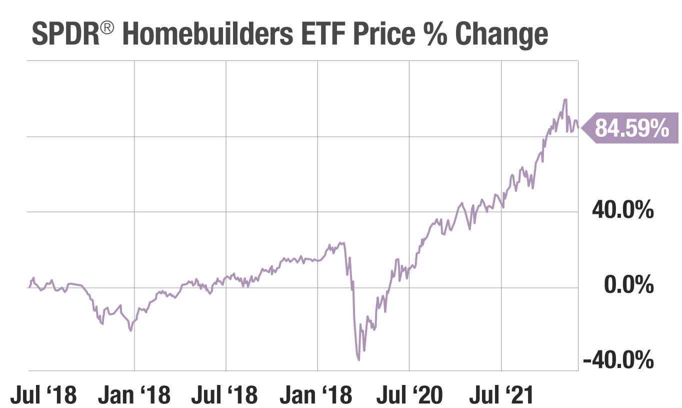
Recommendation Review

In October of 2020, at the inception of this project, I was very concerned about the election, the COVID crisis (we didn't know about the vaccine then!) and the general disconnect between lofty market valuations and a compromised economy. This led me to be bullish on investments like Bitcoin, gold, and gold miners, which, in my view at least, tend to do better as uncertainty rises. These investments have been a bit volatile but have done well. Interestingly, they have continued to perform even as uncertainty has seemingly declined. I think this reflects the reality that even though we have a lot of reasons to be optimistic about the future, the COVID crisis has introduced so much dynamism in our world that it's still hard to look out into the future with confidence. The threat of Inflation, something we have talked about a lot here recently, has made its way back into our collective consciousness and is already wreaking havoc on expectations and confidence. I expect these uncertainty investments to continue to do well and will be slowly adding to my exposure.

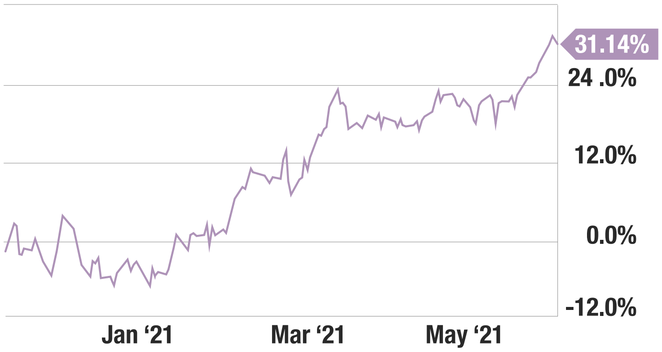




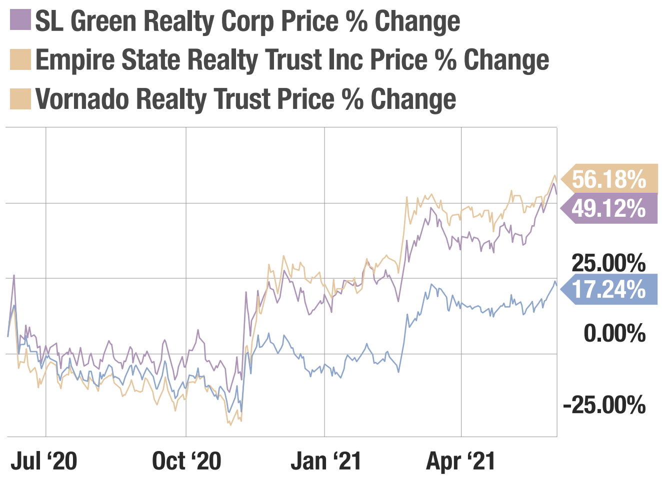
On the real estate front, I continue to be really bullish on for sale housing. I haven't seen market conditions like this since before the crash over a decade ago. COVID has absolutely unleashed something new in this space. The ferocity of the demand we're seeing suggests there's been a decisive shift in consumer preference, and, in our overly regulated development world, supply just cannot keep up. At Metros Capital, our investments



Equity Residential Price % Change



in fix and flip properties have done great. On our last deal we made over 50% in less than 6-months and we expect a similar return on our current project in San Diego. Who knows how long this will all last? It seems, though, there's some real strength and longevity behind this surging demand for housing. This is something I am staying very close to obviously and will be looking for more ways to invest here.



I've also been bullish on the comeback potential for urban multifamily. Based on what I was seeing with my own Metros multifamily holdings here in Los Angeles, I thought this "death of the city" narrative was way too overblown. In recent months, this has proven true and even the hardest hit places like SF and NYC are showing signs of recovery. Our investment in Equity Residential has done well and will probably continue to do so. I'm not adding to my position here but content to hold.

I wrote a few months ago now about the office market and while I'm still very bearish on it, I am content to sit on the sidelines on this idea. I don't see a good way to get exposure here. The publicly traded office REITs are well capitalized, and their numbers don't look that bad (yet). There's a ton of dry powder in real estate private equity, maybe as much as $400B, and the trouble in the office market that I see is likely to play out slowly over the course of the next few years as leases expire and are renegotiated rather than manifest quickly in acute cases of financial distress. I'll definitely be keeping an eye on this sector though.

Finally, as I've been thinking a lot about the exuberance we're seeing in the markets—and even contemplating how it might actually be rational given the unique circumstances present in our times—I opened myself to consider whether this seemingly crazy market behavior in the world of NFT's and virtual real estate made any sense. I have come the conclusion that it absolutely does, and it presents one of the best opportunities I have ever come across as an investor. I am spending most of my day digging into this space to try to find the best ways to invest. As of now, I am thinking that direct investments in Decentraland and Superworld look the most interesting and Ethereum itself might be the easiest way to gain exposure to this theme. Stay tuned here!