When Investing, it is First About: Your Income, Compounding & Owning Businesses for Earnings, Only After About Stocks

99.8% of financial content is about stock prices going up or down. Stock prices are entertaining and many think that investing in stocks is buying something to see it go up in price.

The truth is actually far from such a mindset and I will explain 3 concepts that are more important that stock prices going up or down. We will discuss: **YOUR INCOME, COMPOUNDING & INVESTING AS BUSINESS OWNERSHIP FOR EARNINGS**.

To explain the above, which falls under portfolio strategy, I'll go through my Model Portfolio that I started in May of 2018 with 10,000 and where I add 1,000 per month. My goal is to reach 1 million in value over 20 years and to do that I need to compound at a rate of 12%.

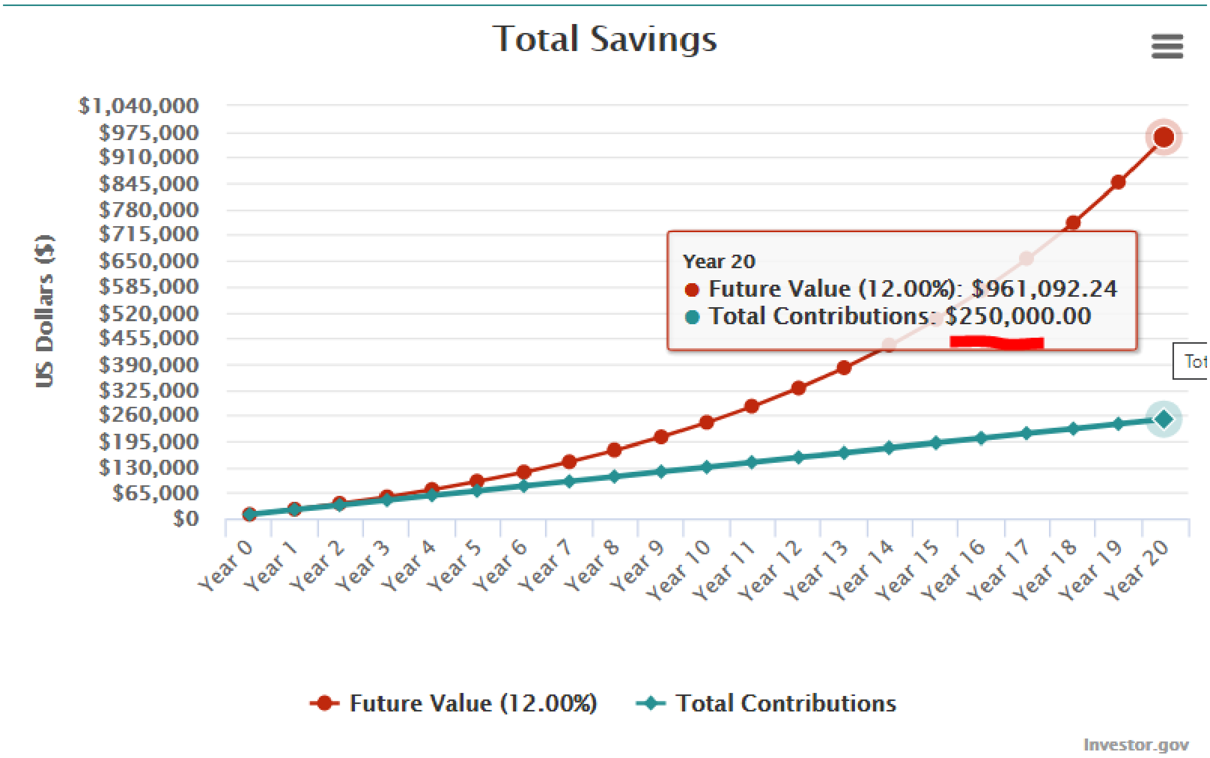
[Model Portfolio After 3 Years Discussion Video]

Let's discuss the concepts.

1) YOUR INCOME IS FIRST

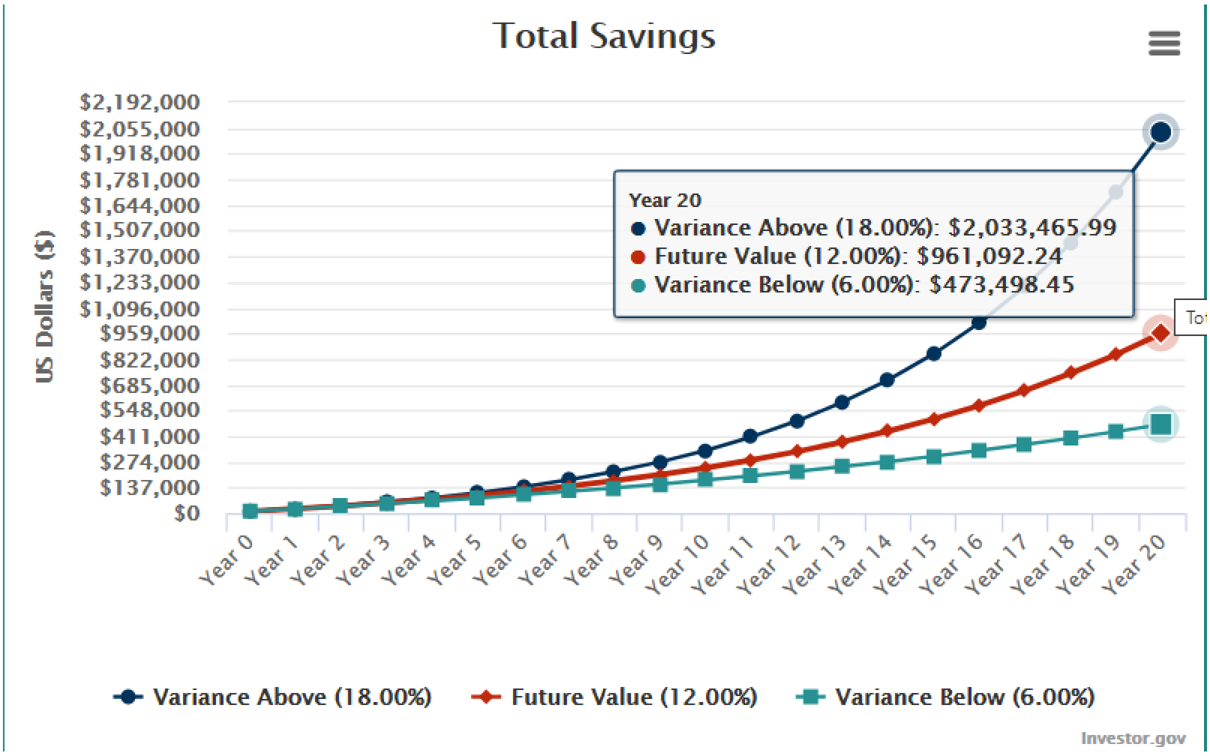
Usually overlooked or taken for granted when it comes to stocks is one's income. However, income and monthly available funds to deploy into investments is the fist key for wealth accumulation.

Weight accumulation fundamentals is actually the main reason why I launched my Model Portfolio alongside launching my [Research Platform] back in May of 2018. Having an investing mindset where you add funds to is perhaps the most powerful tool you can have when investing, everything else is secondary. If I can create a habit of investing each month, they I have already done more than is expected from my job.



Investing $1k per month over 20 years with 12% return per year – Source: investor.gov

As shown in the figure above, over 20 years, my contributions to the Model Portfolio will be 250,000. This is the core of a portfolio investing strategy. Later if I do terribly, I'll still have likely half a million, if I do great, I'll maybe end up with a few millions.



$10k start and $1k monthly over 20 years with 6%, 12% and 18% per year.

The problem is that most people talk about stocks, stock prices, and forget about income or about finding ways to get extra income, to add to one's wealth, which leads to less investing over time and less wealth accumulation.

When you have your income and investing strategy figured out, the next step is compounding.

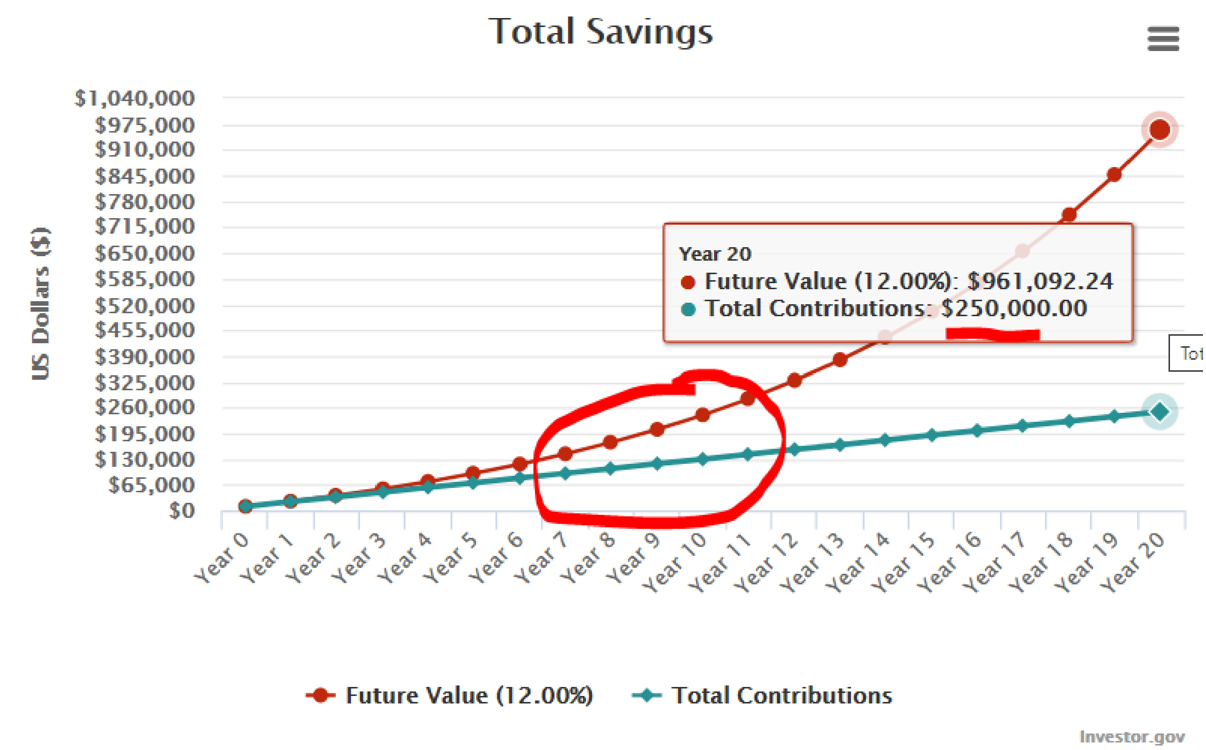
2) COMPOUNDING – KICKS IN AFTER YEAR 10

The 'miracle of compounding' or as Einstein called compound interest:

"Mankind's greatest invention" adding:

"He who understands it, earns it. He who doesn't, pays it." Albert Einstein

Compounding happens when the interest you earned in the beginning starts earning more interest and creates compounding over time.



However, it takes time for that first interest to accumulate and to make a significant difference. As we can see above, only after years 8 or 9, you really start to see the value of the portfolio detach itself from the contribution line. As more time passes, there is more interest, more return on that same interest, and the magic of compounding fully expresses itself.

If you are focused on short term stock price movements, you are not focused on compounding which is detrimental to your long-term wealth accumulation. On how to compound at 12% per year, you need to focus on earnings.

3) BUSINESS EARNINGS – BUSINESS OWNERSHIP

Now, those that are focused on stock prices might wonder why my goal is 12% when 12% can be made in a week with a good stock. Well, what you don't hear anybody talk about is that the stock supposed to go up 10% next week sometimes falls 50%, which is something that completely obliterates the stock price focus investing strategy.

What I am focused on and what really matters when it comes to investing is the business and its earnings over time. My return goal is 12% because I am confident that I can find good business that can give a long-term business compounding return of 12% and above.

"Over the long-term, investment returns are perfectly correlated to business fundamentals". Warren Buffett

If stock XYZ has a price of $100 and represents a business with earnings of $7 per share while growing those earnings at an average yearly growth rate of 5%, over the long-term investors can expect returns around 12% (8% from earnings and 5% from growth).

Over the short-term, anything can happen, individual stock prices usually go up 50% from their bottom tick to their top tick in a year and down 30% from their top tick to their bottom tick. But, on the long-term, investment returns tend to be perfectly correlated to business earnings.

To show this correlation, let's take a stable and steady growth business like Google (Google Stock Analysis). In 2006, Google's net income was around $2 billion, today in 2021 is around $40 billion.

Google's net income over time – Source: Macrotrends

If we look at the stock price since, it has too been 20x, with some differences depending on whether you pick a short-term period where the market was exuberant or pessimistic about Google.

Stock market returns are correlated to earnings – Google example

Because of the above correlation and because nobody can predict stock prices, my focus is on the business, understanding the business in order to buy parts of the business (stocks) when I like owning that business, its earnings, for what I have to pay for it.

When you have an ownership perspective, where you are happy owning what you just bought, not matter what happens in the stock market, you are a real investor and if stocks crash, you are happy to allocate more of your income or dividends to the business.

If stocks go up, you see whether there is something you like owning more but the key is that you derive your returns from the earnings. If here and there the market prices a business too exuberantly, you might sell and further increase your returns, but when you focus on the business and its earnings, you are not confused by the noise surrounding stock prices.

The key here is that you know to what are your investment returns correlated and you know what to do when investing. To check how I apply the above, enjoy my video on my Model Portfolio, its performance over the first 3 years.

SVEN CARLIN MODEL PORTFOLIO