Quality Café: How to View your Stocks as Inventory within your Portfolio Warehouse *6-17-2025*

At Kaizen Wealth Strategies, I hesitate to say the word "portfolio." I believe the modern trappings of the financial media have imparted on their audiences a sense of personification which I believe leads to dangerous behavioral biases in our everyday investment decisions. You might be talking to a friend about Nvidia and make a casual comment, "hey did you see it crashed 20% the other day?" And the friend might get defensive, or even angry, "yeah, but it always comes back. Jensen knows exactly what he's doing." And right there is where the mistakes happen. Making an investment decision not based on rigorous, thorough, continuous analysis, but using heuristics that were created inside one's own mind, rather than the balance sheet and income statements of these great companies.

It's not that I don't like Nvidia – it's that the rules I use in my investing on behalf of clients does not allow any specific investment to become sacred. I view my stocks as pieces of inventory within a warehouse. I want to keep the inventory stocked up, but I want the companies in the warehouse that will ultimately bring the most value (i.e. sell the most) – the companies selling the most I want to put on the shelves again. The underperforming companies need to be de-commissioned and ultimately sent down to the minor leagues, because they weren't yet ready for primetime. And guess what, that company could be Nvidia, because Nvidia ultimately is run by humans, and humans make mistakes. They could underestimate fierce competition from AMD, or not fully understand the business implications of a segment in China, or lose an important supplier. But it is only through the harsh lens of viewing these companies as perilous investment decisions that need to be re-underwritten by a discerning set of eyes each and every day, that potentially fatal mistakes can be avoided.

Folks talk a lot about the distinction between "value companies" and "growth companies." As the fiction goes, value companies might be regular dividend-payers with low price-to-earnings multiples with expectations for their future business that are so low, that there's no way they can disappoint. Conversely, growthy companies face high expectations, but have high revenue and earnings growth rates to back-up the high price-to-earnings multiples they sport. I don't see a huge distinction between these two buckets of companies, because no matter what price you buy something for, there is going to be some expectation of growth. I find it more useful to figure out first whether a company is worth owning, and then worrying about how to mentally categorize it later. The only way I know to start doing this is to begin to standardize every company by its own growth rate. The way I think about it is the following: in the "old school" way of investing, value investors only wanted companies like Chevron that were "cheap," or had a low price-to-earnings ratio. In this same universe, the growth investors only wanted companies like Nvidia with earnings coming out the Wazoo. Who is right, and who is wrong? How do we compare one to another? The "old school" way of figuring this out was to punt the issue. Different strokes for different folks. The only problem with this line of thinking is that these two companies CAN be compared, by removing their company-specific growth rates as a variable. In other words, the way the smart-money evaluates relative value investments is to admit that company A vs company B have different growth rates. Company A, which is a value company, grows at 5%. Company B, which is a growth company, grows at 20%. The value company trades at a 10x P/E, which seems cheap. But the growth company trades at 20x P/E, which seems expensive. But let's utilize the PEG ratio (i.e., scale the P/E ratio by each company's specific growth rate, in order to compare "cheapness" apples to apples.) Doing so would lead to the insight that the PEG ratio of the value company is 2, and the PEG ratio of the growth company is 1. In PEG-land, ratios of 1x or lower, are outstanding (and cheap), and as the PEG increases, companies get more expensive. So in my view, company A may be "cheap" on a relative basis, if other value companies trade at average PEG ratios that are much higher than 2, but on a relative value basis, the growth company actually offers a much more dependable forward-looking value for investors who are wishing to cast-aside shallow, surface-level distinctions between value and growth. I hope it is clear, now, why the term "cheap" in the context of a traditional P-E-chasing value manager is not only a misnomer, it is a dangerous miscalculation that could be akin to a Battleship Captain thinking they were firing on the enemy, but instead was firing straight up into the air, onto his own ship.

My argument is simply that eschewing such meaningless distinctions is required-reading, if your aim is to get to the more powerful, underlying drivers of stocks, which is quality. Having the ability to standardize comparisons of different stocks, for value-seeking managers, in this day and age – is the necessary but not sufficient condition to gaining meaningfully positive performance for clients.

Finally, I'll leave you with a story about an interaction I had with a client. The client is a Medical Doctor, his financial advisor is his close family member. The two had picked stocks together, over time. He had made a lot of money in a particular stock. So much money that it had grown into a very large position within his IRA. It had grown to be $1 million, or roughly a quarter of his investable assets. I was tasked with giving an honest opinion on the stock – which I gave quite plainly. It was a fine company, but no company is worth betting a quarter of your entire portfolio on. Even the CEO of the company remains diversified by selling shares of his stock continuously in order to diversify away his risk. Knowingly holding that high of a percentage of one's portfolio in one stock is not only dangerous, but it showed the kind of "love and personification of stocks," that has become so widespread in this day and age. This client is a highly trained Medical Doctor, and a highly-regarded professional in his field. And yet, even he, an evidence-based professional who relies on the best science to do his own job, was viewing the decision to sell his largest stock as if he were deciding disown his favorite child. Not to mention, this exposure was in an IRA, so no tax consequences! Ultimately, the Doctor held the exposure as it went up 20%, and then all the way through an even more significant downturn. Even the "best stocks" will succumb to slowing growth, and the gravity of underperforming metrics. Warren Buffett aggressively sold his position in this stock around the same time I was advising this client to sell it. In sum – it pays to view your stocks as inventory. Emotional attachment will cause you to view your investments not through the unbiased lens of reasoning, but with the type of unconditional love that should only be given to family members or other loved ones (and such thinking will eventually hurt your portfolio.)