From the Desk of Porter Stansberry

A Letter to My Son On His 16th Birthday

words of wisdom on life, happiness, and investing

Porter & Co.

Editor's note: **My son, Traveler, turned 16 this month. For his birthday I gave him $17,000 (the most allowed by law without triggering taxes) and this letter. There are not many secrets to a genuinely good life, but I think, in time, Traveler will realize that this letter was worth a lot more than the cash. Among the gems: being poor sucks and you do not want to go through life without teeth. You might also find the guide to successful investing helpful. It's my hope that you'll share this letter with any young person who might use it to help build a good and meaningful life.**

Dear Traveler –

Happy birthday, son.

You have brought me so much joy. Being your Dad is my favorite thing I've ever done in my life.

I am so grateful and proud that you are a fine person. You treat other people and their property with respect. You're kind and helpful – even to those who can't do anything for you. And you are honest to a fault. These traits will serve you well in life. I hope you keep them.

As you move forward in your life, I hope you will focus on:

#1. Finding a good wife. Who you decide to share your life with and have children with is the most important decision you'll ever make. Find someone who brings you joy and is willing to sacrifice for the good of your relationship. Look for someone with "an inner scorecard" – someone who thinks and decides for themselves what's best and that isn't worried about what the neighbors are doing... or saying. Find someone who, most of all, believes in you. Hang on to them, no matter what.

#2. Finding a career that fully engages your mind and challenges you. People will tell you that if you love what you do, you'll never "work" a day in your life. I disagree. What I've discovered is that when you're genuinely passionate about what you do, you'll work hard every day of your life. And, ironically, it's hard work that creates happiness.

#3. Being a leader in your family. You have two younger brothers. Whether they admit it or not, they will look up to you and respect you for the rest of your lives. Be a role model. Don't engage in vices with them. Don't be the person who gives them pot, or takes them to the strip club. Be the family member who reminds them to take care of themselves, to make good decisions. And show them the best way to live – in the healthy, honest, and disciplined ways that I see you living now. Especially when I am no longer around, look after your brothers, their wives, and their children. They will always be your family. And you will always be their older brother.

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The most important asset you have is your health.

You already know a lot about how to develop that asset. In short: don't let yourself become overweight. Don't drink to excess. Make sure you engage in at least some form of exercise every day for an hour. Learn to meditate and breathe to manage stress.

Recognize when you're engaging in activities that might threaten your health. Things like drinking and driving, engaging in risky sports or leisure activities, having unprotected sex, going through stressful periods of time with little sleep, etc. Try your best to minimize the times you do these things. Ask yourself: *is this really worth what it could cost me, physically?*

After you're 30 years old, make sure that you get a physical once a year. And, no matter what, go to the dentist religiously. *You do not want to go through life without teeth.*

Finally… in regards to your mental health… whatever the problem is… it will pass. Trust me. I have lived through lots of tough times. They all pass.

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The next more important asset you have… is assets!

Most people don't like to dwell on this obvious fact, but… being poor sucks.

I strongly recommend not being poor. Lots of folks defend being poor (and their own poor choices about their assets) by claiming that rich people are immoral or that there's something inherently wrong with being financially independent. Do not believe this ridiculous propaganda.

The free market is inherently ethical. The free market relies on free exchange to catalyze every single transaction. Everything starts with a free trade. When you buy something, no one loses. No one is the "victim." You've exchanged value for value. That's exactly why capitalism works so well, is so efficient, and is the best way to organize society: everyone is free to do as they please with their labor and with their capital.

Bill Bonner first explained this to me: *"Profit is the reward you receive, in the free market system, for increasing the economy's efficiency and capacity."*

If you're a bag boy at Graul's, you're increasing the efficiency of the food distribution system a tiny bit and the profit you make – your small hourly wage – is fair because of the small contribution you're making. But… in the free market… the more you increase the efficiency of the economy, the bigger the profits you can make!

So, if you take on big and important tasks – like curing a form of cancer, for example – you stand to make a big reward.

In my career I have helped wealthy investors do a better job of allocating capital. That's a bigger job than bagging groceries, but not as big of a job as curing a form of cancer. My rewards have been generous… but not ginormous.

Whatever efficiency you can create with your labor, you will only receive all of those benefits if you're working for yourself. If not, all of the people who organize the company – the managers, the salesmen, the secretaries, etc. – will have to extract a lot of that value from you.

If possible, find a way to work for yourself and build your own company.

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Besides your direct contribution to the economy, the other way you can (and I believe you should) generate wealth is through investing.

This is a passive way of creating wealth. Rather than exchanging your labor, you're lending out your capital. You're allowing others to employ your capital in their efforts to improve the economy. Both endeavors are moral: you're giving up your time when you work in your career and you're lending your capital when you invest. Depending on the contributions you make through your labor and by lending your capital, you deserve a profit.

To be a successful investor, you only have to master three factors.

Understanding these factors isn't hard. And all the complex jargon that exists in finance can be broken down into these three factors.

Given any amount of capital invested, your profit will be created by:

#1. Time

#2. The return on invested capital

#3. Your cost basis.

Time doesn't require any explanation. And it is, without a question, the most important factor.

A few years ago (2007) I told my newsletter subscribers to buy shares of Hershey. I explained that Hershey would become, without question, the best recommendation of my entire career. I knew this would happen eventually because of *time*.

Hershey is a uniquely long-lived company and it is destined to be around for at least another 100 years. I explained:

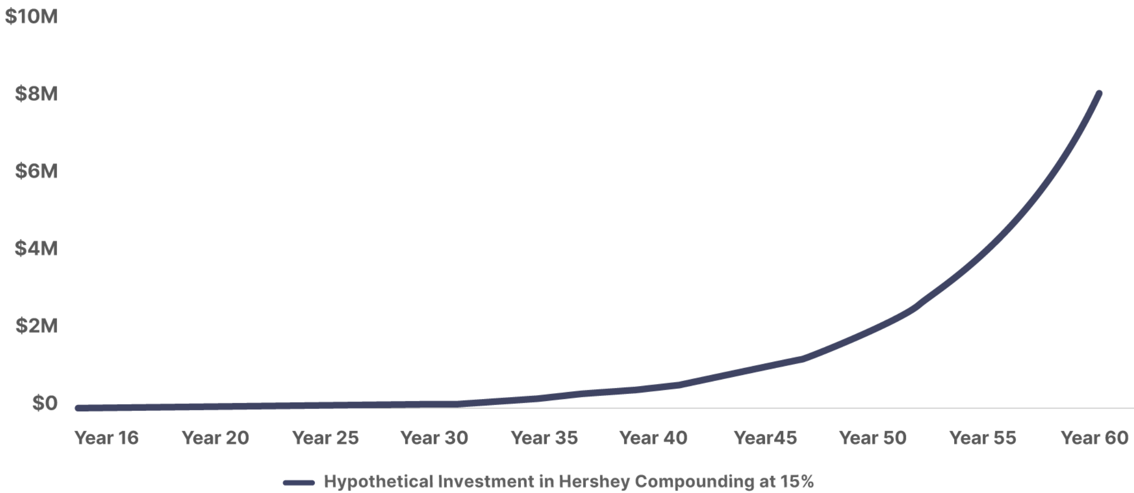
#1. The unique ownership structure of the Milton Hershey Trust means the company cannot be taken over by another firm. **It has an "infinite" timeline as a publicly-owned company, which is unique**.

#2. The product Hershey invented – chocolate – **is virtually timeless**. I cannot conceive of any time, no matter how far into the future, that people will not enjoy chocolate.

#3. The business has a very high return (~70%) on invested capital.

Imagine you'd turned 16 back in 2007 and you decided to buy Hershey shares with the birthday money ($17,000) I'd given you. Based on the price we paid at the time and the company's return on equity, I estimated the stock would compound your wealth at around 15% a year. (Happily, it's actually done a little better – it's been compounding at 16% a year.)

To maximize your returns, you set up a Roth IRA, which allows you to reinvest dividends tax free! Your $17,000 would have doubled by the time you turned 21! And by the time you turned 30, it would have surpassed $100,000 in value. It would become more than $1 million by the time you're 44. And $2 million by the time you're 48. At 51, it would be worth $3 million. By 53, it's worth $4 million. And so... on... hitting $10 million when you're 60.

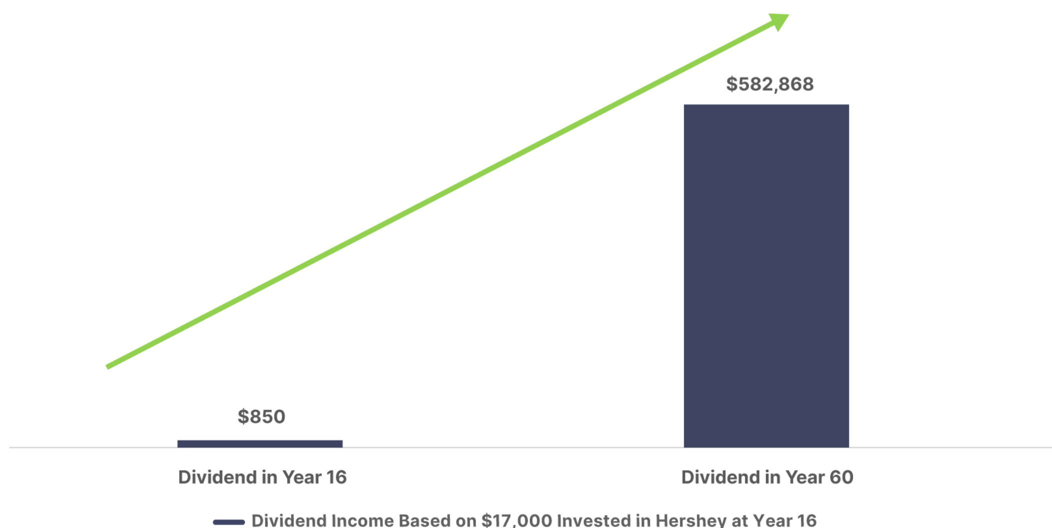


As long as Hershey keeps making great chocolate, earning a good profit on its capital, and paying dividends, you will get rich – assuming you're wise enough to avoid taxes and simply hold on to the position.

Traveler, if you're disciplined enough to take your birthday money every year and buy great businesses like Hershey when they are trading at attractive prices… there's no question that you will become a very, very wealthy man. All it takes is time, a small amount of knowledge, and patience.

Oh, here's the best part.

Assuming you'd bought Hershey with your $17,000 and held it until you're 60 years old, the annual dividend would have grown from $850 each year (in the first year) to $582,868.32 per year when you turn 60. At that age, you can stop re-investing the dividends and just use the income to pay for the things you need.



Source: Bloomberg

Traveler, I hope you'll use the capital I've given you to build a portfolio that can make your family completely financially independent. Doing so will allow you to spend all of what you earn from your labor.

This will give you an enormous advantage in life.

And it isn't even hard. But you have to start now, because time is the most important part. I know you understand time – you need about 40 years to produce substantial wealth investing modest sums in good businesses. And, since you have plenty of time, all you need to do now is find some very safe, high return-on-invested-capital businesses... that are trading at an attractive price.

What's "return on invested capital"?

That's the amount of money, after taxes, that a business can earn, measured against the amount of capital it holds in its business. This is also called "return on equity."

Say, for example, you want to invest in a movie theater. There's a myriad of ways that movie theaters generate revenues – selling tickets, food, drinks, sometimes parking, annual passes, etc. But at the end of the day, the movie theater makes some amount of money – after taxes. And that can be measured against the total amount of capital invested into the business. That rate of return tells you almost everything you need to know about the quality of the business for investors.

Let's say that the movie theater requires $1 million in capital to operate.

Where's all that capital? Well, that's the money that's invested in the down payment for the mortgage on the theater. That's the money that was spent on the improvements – like the popcorn machine. That's the money that has to be in the bank to cover payroll, etc.

So, against this capital, how much does the movie theater make – after taxes?

In the past, a good movie theater, like the AMC theater in Hunt Valley, could earn about 5% on its equity. So a movie theater with $1 million invested into it, should produce around $50k a year for its owners. That's not a great return. Reinvesting your capital at that rate would only turn your $17,000 into $145,471.55 by age 60! That's not a good retirement.

How can that be...? How can an investment in a chocolate company be so much better than an investment in a movie theater? How can it be $11 million different over 44 years?

Well, remember that capitalism is a moral system. The more your labor (or your capital) improves the efficiency of the economy, the bigger the profit you deserve.

Milton Hershey invented a way to keep fresh milk from spoiling – before refrigeration existed. It was a tremendously important invention for our economy

and his products and his brands have been delighting customers for more than 100 years. Obviously, the folks who own Hershey deserve a bigger reward, especially if, as Hershey has, it continues to grow its business and reaches more and more customers in more countries all around the world.

The power of Hershey's brand and the relationship it has with its customers all form what's known as a "moat" around its business that makes competing with Hershey virtually impossible. Add in the dominance it has in distribution, and Hershey's "moat" is one of the strongest in the world. Much like Coke in beverages. McDonald's in fast food. Or McCormick in spices and sauces.

Hershey is such a great business that it earns 70% a year on its equity!

That's incredible, isn't it?!

When you add together TIME + HIGH RETURNS ON INVESTED CAPITAL.... You get = WEALTH.

There's just one small problem: price.

Companies that can produce very high returns on invested capital almost always have expensive stock prices.

Most investors understand companies with great brands and big "moats" can provide unusually high returns over time. As a result, the share prices of these businesses are almost always higher, much higher, than the total capital in the business. (They're said to trade at a "multiple" of book value. Hershey, for example, currently trades at a share price that's 10 times more than the capital in the business.)

And... if you pay too much for the shares... you won't enjoy any exceptional rates of compounding. On the other hand, if you can buy at an exceptionally low price relative to the total capital in the business, you can turn an even lousy business into a great investment.

Take the movie theater. It isn't an exceptional business.

But... let's say that the owners, worn out by their very low return on invested capital... offered to sell to you at a discount. Even though there's $1 million invested in the business, they offered to sell it to you at half that amount – just $500,000. Even though the company still wouldn't be as great a business,

because you paid so much less than invested capital (you bought a discount to the so-called book value) it could become a good business for you. The return on your invested capital ($500k) would be pretty good – 10% annually. That would turn your $17,000 into $1.1 million by the time you're 60 years old and provide you with a $50,000 dividend each year in your retirement.

A lot of investors look for situations like this movie theater... when they can buy a relatively lousy business at a very cheap price. They call themselves "value" investors... and I don't recommend the strategy. Have you ever had much luck staying at a "value" hotel... or attending a "value" school...? Do you want to date a "value" girlfriend...?

What I recommend doing is exclusively buying the best businesses in the world.

Be patient. Only buy them when they're cheap enough. That's usually only during moments of panic. Thus, once you know the basics of investing, you'll discover the hardest part is mastering your emotions. Learn to ignore fear and temper your greed.

Today, Hershey trades for 10 times its book value! If you buy Hershey today, you'll pay more than 10 times more than the entire capital invested in the business on a per-share basis. As a result, you won't earn 70% a year on your invested capital. You'll earn about 7%. That's not good enough. As a good rule of thumb, you don't ever want to buy anything where your expected return on capital isn't at least 10% a year. And, ideally, 15% or more.

But, don't worry. Every now and then, even companies with the very best businesses in the world – like Hershey, Coke, and McDonald's – will trade at attractive prices... but not very often. Most of the time, you'll have to find businesses that offer these kinds of economics but are not well understood by other investors. Or, for one reason or another, are very out of favor.

Warren Buffett became the world's richest man because he figured out that property and casualty insurance companies (think car insurance firms, for example) can earn outstanding returns on invested capital. Why? Because they get most of their capital for free from their policyholders. You pay for insurance upfront. Claims on your policy, if any, only materialize over time. Thus in these companies, it's the customers that are supplying the capital.

With small amounts of invested capital, the returns on invested capital can be very high. But, since most investors don't understand these firms, it's not

uncommon to see them trading at big discounts relative to their high returns on capital. For example, one of my long-term favorite insurance companies, WR Berkley, earns 18% on its invested capital and currently trades at 2x book value. That would give us a 9% annual return on equity... which is very close to our threshold requirement. (Earlier this year it was trading cheaply enough to recommend to investors. I've included a copy of that report for you.)

Another example? Homebuilders that do not own land, like NVR, Hovnanian, and DreamFinders Homes. *These firms frequently trade at half of book value... and produce returns on equity of around 50% a year!* That's why I recommended Hovnanian – it is up 200% (in a year) and DreamFinders is up 100% in just a few months. Since 2007 when I recommended NVR, it is up about 1,100%.

How do these homebuilders produce such high returns on capital?

Because the homebuyers put up almost all the capital. The homebuyers purchase the lot and pay for the home, *before* it is built. These "capital efficient" homebuilders have found a way to use their customers' capital to grow their businesses.

So... when you're thinking about making a long-term, lifetime investment... do the following thought exercise:

#1. What role does this company play in the economy? Are its products and services in wide demand? Does this company "deserve" the profits it's earning? Does it provide things that people must have, or delight in?

#2. How much of a moat surrounds this company? Would it be easy to replicate this business or compete with it in its core markets?

#3. What's the return on invested capital? Is it high enough to justify the risks of owning the shares?

#4. What's the price of the business, on a per share basis? Is it trading at a multiple of its equity capital? If so, does that multiple effectively erase the company's returns? Can it produce a suitable return for new investors, at the current price?

Make one great investment a year for the next 20 years... and I have no doubt you'll become a billionaire, simply because of your passive investments.

I love you son –

Dad