



Why I don't invest in stocks, bonds and mutual funds?



Real estate is the most powerful way to accumulate wealth. More people have become millionaires through real estate than any other means. We know how to find the property, create a plan for improving the cashflow, negotiate the deal, and manage the asset. Your passive investment provides you with the opportunity to earn an income without the nine to five. We create a unique business strategy that fits your financial and investment goals. Get the financial freedom you need to do more of what you love. **We are Red Pill Kapital, with a K.**

So, why not just invest passively in stocks? The reality is that the average stock market return over the last 15 years was 7.04 percent, and if you look at it over the last 30 years, it's about 9 percent, and that's based upon the highs and the lows and the average investment. Unfortunately, no one can perfectly time a market, so you're ending up most of the time with an average return. If you invested \$100,000 in 2004, it would be worth \$277,000 in 2018, and that sounds pretty good.



Let's do the math

Let's look at

Volatility

Brokerage
fees

Taxes

Inflation

Lack
of leverage

The volatility of the stock market from year to year, month to month, day to day, minute to minute, affects the purchase and sale price, and you're unable to actually time a market. The average return of \$100,000 invested in 2004 would be worth \$225,000, based upon an average annual return. It really results in a **5.6 percent** annualized compounded return—and remember, compounding is the critical element in building your wealth.

If you extract out the **brokerage fees** with an average expense ratio for an actively managed mutual fund, it's between 0.5 and 1 percent, and some funds can exceed 2.5 percent. So, let's just say that you take out 1 percent fee each year. Instead of being worth \$225,000, your \$100,000 investment in 15 years is worth only \$193,000. That's only a **4.5 percent return**, and that might be acceptable,

With **taxes**, if you're filing jointly and you're making more than \$77,000, your long-term capital gains rate is 15 percent. So if you sell your entire portfolio and extract out your money, no matter what you do, at the end of the day, your average annual return is going to go down by 15 percent, so your average return decreases from **4.5 percent to 4 percent**, compounded.

Let's talk about **inflation**. The Federal Reserve has an annual inflation target of 2 percent, and interestingly, actual inflation rate has actually been less—1.6 percent over the last 10 years. If you compound that out over 15 years, an inflation rate of 1.6 percent reduces your after-tax return from **4 percent down to 2.5 percent**.

The thing is that in the stock market, you can't really gain **leverage**. Banks won't lend you money to go make a stock market investment, because they're not in the market of gambling, and when you invest in the stock market, you're gambling. You're speculating. The odds are not in your favor.

So what does this mean?

All of this means that if you invested \$100,000 in 2004, your actual return after you pay your brokerage fees, your taxes, and have your purchasing power eroded, ends up with a 2.5 percent compounded return.

If you use the rule of 72, which is a way to determine the number of years it takes to double your actual cash, 72 divided by 2.5, it would take 28.8 years—nearly 30 years—to double your \$100,000. That's not a great return.

So what are the alternatives to generate a higher rate of return, but a lower average risk?

Because at the end of the day, there are certain things that you could certainly have a higher rate of return, but the average risk rate is so high, that it's untenable. It would be investing in cash-flowing apartment buildings, investing in cash-flowing commercial real estate, because that gives you a high degree of return with much less volatility—much less volatility than residential real estate, much less volatility than the stock market, much less volatility than cryptocurrency.

Cash flowing real estate is valued based upon capitalization rates and net operating income

So essentially, net operating income, which is, how much money do I have left after I pay all my expenses? Gross income minus expenses, equals net operating income, divided by the asset price, gives you the formula for cap rate, and each particular asset has a particular cap rate. If you work this formula backwards, you get net operating income divided by cap rate, which tells you asset price. As you increase your net operating income for that particular asset type, you know the cap rate, you get an asset price. Typical cap rates vary by asset type. They vary by class; they vary by demographics, but the cool part about it is that you can dramatically enhance the net operating income by either increasing the income or decreasing the cost. You can reposition an asset, and when you do that, you dramatically change the asset price.

$$\frac{\text{NOI}}{\text{Asset Price}} = \text{Cap Rate}$$

Reverse engineering this and increasing NOI by either reducing operating expenses or increases income, dramatically increases the Asset Price

$$\frac{\text{NOI}}{\text{Cap Rate}} = \text{Asset Price}$$

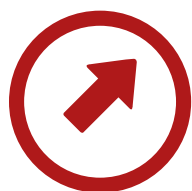
Typical Cap Rates vary by the asset type, class, and demographic. NOI can be significantly enhanced by asset management, usually by improving operating efficiency, sometimes by repositioning.



Lower risk

Real estate has much lower risks, especially multi-family real estate, which is what I specialize in. I do certainly do some commercial real estate—that's strip centers, office buildings, and things of that nature. My cap rates are higher, because there's little bit more volatility, and the cap rate in another presentation goes through what is a cap rate and what does it impute to volatility, but most of my investment is in multi-family. If you look back at the housing bubble of 2008, when it popped, the delinquency rate for Freddie Mac single family loans hit 4 percent, but in contrast, the delinquency rate for multi-family loans peaked at 0.4 percent. It's almost negligible, because the normal rate is about 0.2 to 0.3 percent, so it really didn't change much.

The reason why it's such a low risk is the underwriting. Your asset is based upon net operating income, and when we have a recession, people can't afford to live in a house, but they have to live somewhere, and typically, they'll migrate to apartments. The worse the economy does, the more likely it is that a B and C class apartment building will do better. This is an excellent hedge against recessions, and it's unlikely that during a recessionary period, your cash flow is going to be significantly diminished. That doesn't mean it won't happen, but in a class C or a class B, these people have nowhere else to live. They have to live somewhere.



Higher return

We get a much higher rate of return. On average, the stock market rate of return for 15 years was 7.04 percent, but as we went through, after we took out fees, inflation, taxes, you ended up at about 2.5 percent. In our average multi-family syndication, we routinely see average rates of return of 10 percent and above.

That's all in—so that would mean about a 6 to 7 percent annualized rate of return, and then as the tenants pay off our mortgage and we build equity, and we sell the thing in five, six, seven, or 10 years, we get the realized equity from the tenants paying our debts. So, we end up on an average rate, a little bit above 10 percent. The thing is, that this stuff is protected against inflation, and in fact, inflation is my friend in real estate, and it's tax-advantaged.



Cashflow and appreciation

The nice part about what I just said was it's not just the cash flow from a month to month operation. It's the appreciation that we get—because the real estate itself has increased in value. Unlike stocks and bonds, multi-family syndications generate cash flow for their investors from income generated by the property. You rarely will get significant dividend yield from stocks, bonds, or mutual funds.

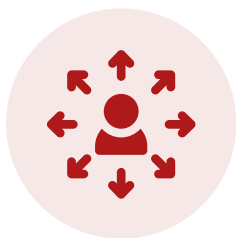
Now, the actual performance of the property is directly enhanced or worsened by the investment management group, so that's what you have to look at in its key form. The investment management group is what determines whether you're going to get asymmetrical returns against the market. You want to get the benefits of the real estate, and have dramatically better returns, and the cool part about it is the multi-family asset itself is appreciating value over time, and you're paying down the debt on the thing, and so you get the appreciation, as well as the debt pay down, which increases your equity position.



Tax advantaged

Real estate is tax-advantaged, and this is one of the few investments that's truly tax-advantaged, compared to stocks and bonds, and other business investments in precious metals. The IRS allows multi-family investors to write off 3.6 percent of the building value each year, and that's called depreciation. But that's a phantom expense—that's not real. It doesn't actually cost you anything, but it does reduce your taxable income. Now, with the changes in tax law, you can do accelerated depreciation, and you're able to carry forward your "loss" to future years, or you may even be able to carry back your loss to previous years. You might be able to reduce other taxes that you've owed in the past, or that you may owe in the future.

Bonus depreciation in the recent tax changes permit us to deduct the entire value of the investment from our taxable income in the first year sometimes, and this can produce a giant tax loss that we can carry forward. That doesn't mean you get to depreciate the entire building, but you may be able to depreciate it enough that it exceeds the amount of investment. You might be doing 30 percent or 40 percent of your total building depreciation, which might exceed your total investment. The cool part about this is if we sell the building for a big profit, we may not have to pay taxes on it at all, because we might be able to do a 1031 Exchange, and that further allows us to defer the taxes, perhaps even indefinitely. There's no other investment on the planet that offers this kind of incredible tax benefit—that I know of.



There's also the concept of **opportunity zones**. Opportunity zones are specific tax-advantaged harbors created by the federal government, and what I look for, because most people think of opportunities zones as being in the ghetto, but they're not. You can find opportunities zones right along college campuses that are highly gentrified, but the household income is low, because students don't have household income. But you know what? It's amazingly gentrified and it's not going to deteriorate. So I preferentially look for asymmetrical returns and opportunity zones that are unique—opportunity zones that look like they have low household income, so they satisfy the opportunity zone requirements, but yet, are stable and growing, and gentrified.

Tariffs and labor shortages are your friend

With these tax issues that we see and the labor shortages that we're finding, these are your friends, because the thing is, if there's a labor shortage and you already own the building, and this labor already occurred 15 years ago, the current buildings are going to be way more expensive. The higher the current tariffs go—the higher the price of steel, the higher the price of copper—the more expensive new construction is. The more expensive new construction is, the less competition you're going to have. So as new development costs are much greater than existing because of material costs and labor shortage, you're actually in a significant advantage, and your rent ratio does extremely cool things when you don't have to pay for those huge expenses.

As I said, you're inflation protected, and I'll kind of go through this. **Multi-family investments are a fantastic hedge against inflation.** I'm going to do a diagram here, which will kind of show you what this means. The cool part about it is that as your income goes up and your expenses go up, so does the value of the property, because you're actively managing this investment, and here's an example.

Purchase Price	\$ 1,000,000					
Down payment (20%)	\$ 200,000					
Inflation Rate 2%	2%					
	Purchase	Year 1	Year 2	Year 3	Year 4	Year 5
Inflation Rate	2%	2%	2%	2%	2%	2%
Income	\$ 30,000	\$ 30,600	\$ 31,212	\$ 31,836	\$ 32,473	\$ 33,122
Expense	\$ 24,167	\$ 24,650	\$ 25,143	\$ 25,646	\$ 26,159	\$ 26,682
NOI/mos.	\$ 5,833	\$ 5,950	\$ 6,069	\$ 6,190	\$ 6,314	\$ 6,440
NOI/y	\$ 70,000	\$ 71,400	\$ 72,828	\$ 74,285	\$ 75,770	\$ 77,286
Cap rate	7%	7%	7%	7%	7%	7%
Value imputed	\$ 999,999	\$ 1,019,999	\$ 1,040,399	\$ 1,061,207	\$ 1,082,432	\$ 1,104,080
Return on equity		26%	26%	27%	28%	29%

You have a purchase price of \$1 million. You put \$200,000 as a down payment, and you have an average inflation rate—let's just set it at 2 percent. Your income was \$30,000 the first year, and it goes up, just from the inflation--\$30,000, \$30,600, \$31,000, \$31,800. It just goes up 2 percent. Your expenses mirror, and they go up. Your net operating income slightly is greater than your expenses, and the net operating income is significant, because as you look at your NOI against your cap rate, and you look at your imputed value of \$5,833 NOI per month, which equates to \$70,000 net operating income per year, divided by the cap rate of 7 percent, gives you the imputed value going in of \$1 million. By the fifth year, just on inflation alone, your net operating income per year goes to \$77,000. The cap rate's 7 percent, but just by the inflation, your value imputed has now gone up to \$1.1 million, and your return on equity, the investment that you did, the \$200,000 down payment, has gotten to 29 percent. This is the concept of leverage of inflation—because you only had to put up the \$200,000, and your tenants are paying your bills, and the tenants are protecting you from the inflation.

Leverage:

stock investments



vs.

real estate investments

If you look at leverage—stock market investment versus real estate investment—you typically buy stocks only with the cash that you have. With real estate that is cash flowing, the bank is going to be willing to give you a five to one ratio. They're going to lend you 80 percent, and so, a 2 percent change in net operating income translates to a 10 percent change in leveraged value. The cool part about leverage is not just the leverage of money; there's also the leverage of market intelligence. You can have a huge impact on real estate because you can understand the local dynamics of real estate, and you can have specific advanced knowledge of changing market conditions. If you did the same thing in the stock market, you'd go to jail, because that would be a SEC violation. Specific advanced knowledge in real estate is just considered good business, but in the stock market, it's fraud.

So, how can you invest if most of your money is locked up in retirement accounts?

Well, look at the retirement accounts from your past employers. That money's just sitting there. Now, do a quick gut check. Think about this—how many years total has that money been sitting there? Look at how long it's been there, and look at how many dollars you earned. Take the total dollars in the account, minus the total invested dollars, and those invested dollars include any matching or direct money that you put in, and that gives you dollars earned. Take dollars earned, divided by years, and you're going to get your yield rate. This is you actually doing your own math, and you're going to find out that you've probably earned 4.5 to 6 percent, at maximum. That's before you've removed inflation, and that's before you've taken out taxes that you're going to have to pay at the other end eventually.

$$\text{dollars earned} = (\text{total \$ account} - \text{total \$ invested})$$

$$\text{yield (\%r)} = \frac{\text{dollars earned}}{\text{years}}$$

So then why do I maintain a current employer-sponsored plan, but dissolve all of my old plans?

It's the matching, because the reality is, I've already been matched in my old plans by my old employers. They're not going to match me continuously, so I might as well do something with the money that they gave me. I create a self-directed IRA with all of my old plans, and bundle it all together so I have one place to invest from. I'm not withdrawing the money; I'm reallocating the money and I'm putting it to a higher and better yield, a higher and better purpose. I'm improving my velocity of capital, and I have my current retirement plan with my current employer because they match. It doubles my money, but once I'm done with that match, then I'm going to take it, and I'm going to move it into my higher velocity of capital account—my self-directed IRA.

A diagram consisting of three light red circles arranged horizontally. The first circle on the left contains the text 'Self Directed IRA'. The middle circle contains the text 'You are not withdrawing, you are reallocating to a higher yield'. The third circle on the right contains the text 'Velocity of Capital'.

Self Directed
IRA

You are not
withdrawing, you
are reallocating to
a higher yield

Velocity of
Capital