The Australian Finance Podcast Episode Transcript

Episode: How Owen invests in small-cap ASX shares
Release Date: 03/06/2021
Speakers: Owen Raszkiewicz & Kate Campbell
Duration: 52:55

Please read this prior to using this transcript:

*Please note that there **may be human transcription errors** within this document, and we recommend referring back to the original episode for a true depiction of what was communicated in this conversation.*

*The information in this document is **general financial advice only**. That means, the advice does not take into account your objectives, financial situation or needs. Because of that, you should consider if the advice is appropriate to you and your needs, before acting on the information. In addition, you should obtain and read the product disclosure statement (PDS) before making a decision to acquire a financial product. If you don't know what your needs are, you should consult a trusted and licensed financial adviser who can provide you with personal financial product advice. Please read our Terms & Conditions and Financial Services Guide before using this document.*

Episode transcript:

Owen:
Thanks for tuning in to today's podcast. Please remember that all of the information in this podcast episode is limited to general information only. That means the information is not specific to you, your needs, goals or objectives, so you should seek the advice of a licenced and trusted financial professional before acting on the information. And before you acquire or apply for a financial product, please read the PDS or product disclosure statement, which should be available on the issuer's website. Lastly, please keep in mind that past performance is not indicative of future performance.

Owen:
Kate, thanks for joining me on this episode of the Australian Finance Podcast.

Kate:
No problems, Owen, it's good to be back today.

Owen:
Yes it is indeed. Recording remotely.

Kate:

Yes. I'm in, sadly, rainy Melbourne but you've got nice weather up in Sydney, so lucky you.

Owen:
Yes. Dear listeners cannot see this but I'm actually sitting on the edge of a bed in an Airbnb in Sydney with the curtains drawn behind me just to try and keep it nice and quiet, so apologies for any background noise. But hey, today, we're talking about two things, which are really exciting. One is space and the other thing is investing, in particular small cap companies, so small companies here in Australia. So you've got some questions for me and we're excited to talk about what we have in store today, so I'll throw it over to you.

Kate:
Yeah, we thought we'd talk a little bit more about small companies off the back of our whole shares month that you've had the pleasure of listening to us a lot talk about different investments, especially Disney over the last five episodes or so, so we thought maybe as a carry on from that, we would talk about the smaller companies on the Australian stock exchange and I know that's what excites a lot of investors and that's often what Owen covers on his other podcast, The Australian Investors Podcast. I think we're just talking about some of the basics because we haven't really discussed it before. What are the risks, because there are a lot more risks to be wary of, like investing in anything that's new, developmental, can be quite risky and with small caps there's a much higher risk than maybe some of the blue chip stocks that we've mentioned before, of going to zero.

Owen:
I'll hopefully debunk some of those myths for everyone today. We've got to be 100% honest here, one of the reasons that we're doing this episode is because we at Rask, as many of our listeners will know, we actually offer subscriptions, investment subscriptions where people can join and see all of our investment research. So you could join one of our services and learn about our favourite ETFs or you could join another one and learn about our favourite blue chip shares and this one in particular that we're talking about today is called our Rask Rockets Programme and hence, space and all the space analogies and phrases that we bring in today. Once a year, I'm just going to be straight up here, once a year we open a particular membership, we call it the Rask Rockets Programme, to people and to investors who want to start investing in small cap shares or for investors that have 20 or 30 years experience. We have investors on our books that join this service every year that have been investing for longer than I've been alive, and they join because they want to hear about all of these emerging companies, which are higher risk but they want our research on them.

Owen:
So this is what we're talking about today but instead of making it join now, buy into a service, what we're going to try and do is hopefully educate you on small cap investing and if you want to learn more, about our programme and what we have to offer then you can go and do that straight after this podcast.

Kate:

Awesome. I think small caps can be really fun and exciting, so it's a good episode to talk about today. I think we should just note that small caps can be really risky, so everything in this podcast is general in nature, so don't just go off and make a rash decision without doing your research, making sure you consider all the risks, which there can be quite a few. We can't always mention all of them today, so we might mention a company but we can't rattle off the hundred different risks associated with that new emerging technology. So make sure you do your research, listen to The Australian Investors Podcast, take our free courses on Rask education and speak to your financial advisor before acting as well. We've been doing this for quite a number of years now. Owen's got a whole team of analysts behind him and it's what helps keep everything else we do free. I hope you enjoy this episode as I ask Owen a few of the questions that I had about small cap investing and I presume that they're questions that other people might actually be thinking about too.

Owen:
Yeah, I think this is really good. You just mentioned something there Kate, just before we get into the small cap discussion, you mentioned that this is how, effectively, we keep the lights on. Our business, we have two missions and one of them is to help Australians take care of their finances, because we never had that kind of guidance growing up or at least I didn't have someone in my life who could give me sound, long term advice. If you don't have that in your life or if you know people that don't have it in their lives, that's why Kate and I started this podcast and that's why we do so many things and we have so many free courses. The other side of our business, the thing that pays for that is our subscriptions because we believe subscriptions are very transparent. You know what you're getting, you know how much you're paying, you know when you're paying it. So this is how we do it. It's exciting because this is what we love doing too. Without further ado, let's start talking about small companies.

Kate:
Awesome. So I thought the most important question to start with was, why do you personally choose to invest in smaller cap companies? There's so many options now we've talked about like exchange traded funds, there's robo-advisors, managed funds, property. There's so many investment options and small cap companies are arguably harder to do the work to invest in. So what makes you think that there's an opportunity there and why do you put your focus into that area?

Owen:
I guess we're trying to put our money to work in a place where we get the maximum potential return, potential meaning that we don't always get everything right, there is risk in investing as opposed to saving money so what we're going for is the assets or investments where we have potential for the greatest return, and there are many different kind of principles around science or whatever analogies you want to bring into this but basically, we're going to the point of least resistance with the maximum return potential. So down in the small cap end of the market, I say down there because what we're saying when we say small caps, we're talking about smaller companies. So if you look at a list of all companies in Australia, we're looking at the ones further down, so the ASX 200 has 200 companies, 200 largest in Australia. The ASX 300 has 300.

We're looking for companies when it comes to our Rask Rockets Programmes, we're looking for companies further down.

Kate:
With smaller market caps.

Owen:
Smaller market cap, hence the word small cap. It's hyphenated, but yeah. So when we talked about Disney in May, we were talking about one of the biggest companies in the world. When we talk about small companies, we could be talking about companies as they're valued on the stock market. They may be 1/100th, 1/1000th the size Disney is today. There's some real, key fundamental differences but to keep it as concise as possible, what I want to just get across to people is that, if you're investing in individual companies, you want to be able to invest in a way where you have a unique edge. So you understand that business more so than the next person.

Owen:
I don't know the exact numbers of Disney but I would imagine at any one time, anywhere in the world or all around the world, there would be at least 50 professional analysts researching Disney. They might be on Wall Street, they might be here in Australia, they might be in Europe. Everyone's looking at Disney stock and analysing it. What gets me really excited here in Australia is that you can go down, you can try and find one of these small companies and there might be no analysts that have ever taken a proper look at it. So then you as an individual investor, you could be the first person, the first good analyst looking at this company and trying to value it and trying to understand what widgets it sells, who is its customers, how much they make, and that's really exciting for someone like me. One final thing before I throw it back to you, Kate, well it's two things.

Owen:
One is that my business, Rask, the business that we're creating, altogether all of us, we have six employees, we have three contractors that permanently work for us and then some extras around the sides. We are a small business, right? But the companies that I'm looking at investing in on the stock market are not that small. So even though we say small cap, they can still have 100 employees. They can still have 200 employees and still be considered small. So these can be good businesses. Just because they're down the smaller end doesn't necessarily mean they're selling honey at the local craft market. They're actually legitimate businesses.

Owen:
One final thing is, and this is where people I think often go wrong, is they often buy small caps and they're all in, let's go all in on some resources companies from God knows where or some bio tech. The way we approach it is very different. We understand that there are risks but we still focus on quality companies but we take a whole of portfolio approach so that we don't just put all of our eggs in one company. We've got 10 or ideally 20 companies. We tell our members to allocate an equal amount to each of those 10 companies, which I'll get to in a minute because I know you've got a question on that.

Kate:
Yeah, and some of the awful stories that you hear about people losing a substantial amount of their wealth or maybe one of their parents' or siblings' is when they invest in one of these small caps, often because it was recommended to them on the internet or through a friend, and they just put all of their money into one company. I think that's really important and that sort of leads into my next question. Thinking about investing in small caps is part of your portfolio, you obviously don't want to put 100% of your portfolio into one company, regardless of whether it's a small cap but if you're maybe using the core and satellite approach like we've talked about before and maybe 20% of your portfolio is allocated to small caps or other things, how do you personally, and how would other investors assess how much to invest in small caps individually and as a collective part of their portfolio? Like working out what weightings to use in your portfolio.

Owen:
So it's obviously a bit different for me, Kate, because I'm the one who gets to analyse these companies every single day and I've been doing it for a long time, so it's different for me. I can say, by looking at this company, what do I consider to be the risk? Is it appropriate for my situation? Everyone's going to be different and that's the risk that we take by giving this research that someone thinks, hey, Owen just said this is a really good company to invest in, I've got $10,000, it's the only $10,000 I have, I'm going to put all my money into it. That would be a tragic idea. Even if we're right, all that that would prove to you is that next year when it comes around again, you just put all of your winnings, and I put air quotes, into that next company and you might be taking an even bigger risk again by throwing it all in again. So what we're trying to emphasise to people is, if you have $20,000 to invest, our programmes, our Rockets programmes, we call them programmes but they're just membership sites, we call them programmes and they're named Rockets because it's meant to be a bit of fun. I love space, everything to do with space. I'm a massive nerd, I've got a sweet telescope. Check it out on Instagram.

Owen:
The reason that we call it Rockets is because it is typically riskier. If you look at our results in the past, sometimes... We've got a public page where you can go and look and you can see the returns of our previous mission, which was called Apollo. What you'll find is if you look at the track record, some of the companies are down like 60% but then there's one that might be up like 1000% up or more and another one that might be up 300% and another one that's up 200% and another one that's down 40%. The point is here that if you were to just try to randomly pick one of these because you've subscribed to our service and you're like, "I'm just going to pick that one. It sounds good," but that's the one that goes backwards 60%, you're going to feel pretty silly and it's going to hurt when you've got all your money in that one. But if what you do is you follow what we say as general guidance, which is, if you are a member, don't over-complicate it. Just put the same amount of money into each individual one.

Owen:

So if you've got 20 grand and there's 10 picks, that's two grand in each. Even then, don't put it all in at once. Maybe put $1,000 in this month and $1,000 in two months once you're a bit more comfortable. This is a programme for more advanced investors. I'm being honest, Kate, we weren't sure if we wanted to run this podcast for The Australian Finance Podcast audience because we weren't sure how it would go down. So we're just being very plain here, very honest that it is higher risk but that's how we would think about it. Just to set expectations, we do make mistakes and a lot of our members that join us know that. Just like SpaceX had to fail so many times launching rockets into space before it got the one that went up, we're not going to get it right every time.

Owen:
When we did our survey last year of our Apollo members, what we found was that just using some crude numbers, that they would invest anywhere from, say, $3,000 to $5,000 into a company and so if you do the numbers, that's actually proven to be a very good decision for them but it could've gone the other way and some people probably put a lot more in, some people probably didn't buy every one in the first go. What we'd say is you've just got to weigh it up in your mind. This isn't a programme for absolute beginners. It's more one for someone that already has investing experience and that already has a portfolio, so they're not putting all of their money into small caps and they're realistic. Like I said, most of the people that join are analysts, fund managers, people that have been investing for a very long time. So anyway, I'm sorry, I should be excited, this is space, we're talking about space, it's called Rask Rockets Beyond but at the end of the day, we don't want people to join us if they're not prepared for the risks and they're not aware of those things. So if you're got an emergency fund, if you're not a beginner, check us out.

Kate:
Yeah, I think you definitely have to either have purchased a share or an ETF before you start getting involved in small caps and that's often where people go wrong because their very first touch point with investing is with a small cap or something very speculative and they can get burned and it can put them off for decades. Whenever we hear about that, it's really, really sad.

Owen:
That's the worst part of what we do, to be honest. If people come into our paid services and they buy a stock. We like to use the word company but I'm just using stock for this podcast, they buy a stock and it goes down 20%, they sell then they go and tell all of their friends and their children how risky investing is and never to do it again because it's like gambling, that's the worst outcome for us and we hate hearing that, right? But this is part of investing unfortunately.

Kate:
And I think there's enough hype out there that we don't want to be another hype service. Small caps can get a lot of hype and there's often very well paid media teams and PR teams behind small caps that, their whole job is to promote them on forums like HotCooper or Twitter and run events and all sorts of things to get the company known about.

Owen:
Yeah and that's true, right? I think you've got a question around that. Maybe, Kate, maybe I'll throw you a question before you throw it back at me, which is, what does it mean when people say they're pumping a stock? Because that's something that we hear a bit.

Kate:
I guess from my perspective it's when people are just out there on social media, they're telling their friends, this is the stock to buy, whether they're financially incentivized or not, or just incentivized because they've already invested money in, with small caps it's very easy for a one cent stock to go to two cents and suddenly, 100% gain. So I think that's what I would say pumping a stock is.

Owen:
Yeah, so this happens a lot, right? Your question is around the smaller... I sometimes think the small cap market is like the Wild West, there are some people in the Wild West era who made a shed load of money and then there are some people in the Wild West who had an absolutely horrendous time. For the average person, you would not want to go back to the Wild West era because it would've been a terrible existence. But for the people that owned the gold mines or knew where the gold was buried, you're doing really well and I think in some ways small cap investing can be like that. The difference is, in a modern era, everyone's going to tell you they've struck gold and they're going to sell you Levi jeans and shovels and spades and all the different things that go along with it because they think they can make money from you.

Owen:
The worst kinds, the people that get on some forums online, maybe I should say which forums but you might've mentioned one already, and they talk and talk and talk about how good this company is and then not only that, not only do you have private investors saying that on Facebook or these other platforms like Reddit, but then you go and you get your news from an outlet like, I'm going to say the Market Herald or one of these other websites where they're paid, they're incentivized to write good things because they're paid by the companies, and then you go and get expert advice, and I say that with air quotes, and it's from a brokerage firm that gets paid either directly or indirectly for doing business to raise capital and do capital raisings and then they put out broker research reports, PDFs, and they say really good things and they make light of the risks. This is why it's the Wild West in terms of some unscrupulous actor's like... I know really good financial advisors. I know personally many financial advisors that don't invest their clients money in small cap companies because they're worried about this type of thing happening. I guess for you, your question was around, How do you deal with that?

Kate:
Yeah, well I think if you're investing in a huge company like a bank or a telecom, or whatever it is, it takes a lot more than one person with a blog to move the market or change the value of the company but when it comes to a small cap, someone can write a report or someone can be promoting it online and get people very excited or very, I don't know, the opposite of that, and really move the market, which is kind of scary as an investor.

Owen:
Yeah, so imagine Elon Musk with Bitcoin is sometimes what small caps CEOs dream of having. They will say pretty much anything to get you to invest in their company and so, we're getting it from the CEOs right through to the investors on social media, right through to the brokerage firms, and so this is where you have to be really careful of incentives. I'm going to give you three steps to try and avoid these companies. If you at home are listening to this, hopefully not driving, don't take your hands off the wheel but you can write these three things down. These are the three steps that are absolutely fundamental to any type of investing, but especially for small caps. Number one is understand the incentives of management.

Owen:
If people go back and rewind to our previous episodes, you will know that one of our five key steps for investing is understanding the management team and so you want to be looking at, do they own shares in the company they run? Because that would mean, if they own a lot of shares, they want it to do well. Kate, you know this, the majority of my personal wealth, me personally, is in the company that we run. So for me, I'm not going to do anything that sabotages my own business. So if you find a CEO that acts in the same way for the long term, that's the type of person you want to invest with. Not with the person that doesn't own any shares in the company that they run because that's just kind of sketchy and they'll just be there for a pay packet and then, see you later next year when there's a better job.

Owen:
So understand management, stay sceptical. A lot of people when it comes to investing, I think Tash Invests said this on her show, that money is a point of anxiety and it's a point in their life, which most people don't really understand. It's the same in investing. A lot of people get into investing and they go for a small cap company because they think, high risk, high reward, I'll put a bit of money in that, I can afford to lose it, whatever. Then they go on social media and someone says something negative and instantly they're triggered.

Owen:
It's like a bull with the red blanket or red sheet. They just go crazy and they're like, "How can you say something so negative about my company?" But as an investor, you want to be negative, you want to understand the risks and you want to hear the people that have something critical to say because regardless of what you or they think, it doesn't matter. All that you need to know is what the actual company's doing. Understand incentives, stay sceptical, and the third piece, and I've got a few within this, it's like part A of part three.

Owen:
So this would be, just understand these things, the balance sheet. Just check to make sure it's got enough cash versus its debt. Number two, don't just take revenue, which is that thing that you see, like sales or revenue. Compare that to the cash flow of a company. So I'll give you a good example, right? Let's say we have a course on Rask and we charge $500 for it. We don't have a course that we charge $500 for but let's say we charge $500 for a course and you get a

year of access to that course, that's revenue for us. We can say that that's a year's worth of revenue but we can also say that we also get $500 of cash flow if you pay us instantly, right? Now that's not always the case, you don't always get the sale matching up with the cash flow. Sometimes companies can say, we've earned $500 of revenue, but they're not paid for 90 days or they're not paid for six months.

Kate:
Or it's in instalments.

Owen:
Or it's in instalments or its another weird thing. So in small cap land, companies will be like, hey, look at our revenue, wonderful, hooray. But then they've got no cash in the bank, like how does this match up? So you've got to compare the revenue, which they report to you, with the things that you see on the cash flow statement and then the final thing, and this is about staying sceptical, speak to actual customers, so tomorrow, I'm here in Sydney with Cathryn, one of our analysts, Raymond, Raymond doesn't know this by the way, but we're going to a store, a retail store up here to see how busy the store is, to determine if that company... We're going to try and hopefully speak to management and speak to the people on the floor working there, to determine if the company is indeed growing as fast as what management are telling us when they report to the ASX. These types of little things that you can do. You can use forums if you don't have access to a store network or whatever but actually going around management to actually double check what they're saying. That's called a channel check in investing. So these are the types of things that we do to stay away from the dodgy companies and the dodgy operators.

Kate:
Yeah and I know because it can be really difficult to find information and research when it comes to a small company, especially if no one's actually covering it, no analysts, no brokers. I know you mentioned going to the store and looking at some of the financials but what are some of the other ways that you can find more information about this company that might only have a five page website that's listed on the stock exchange?

Owen:
Yeah, so the about us page is normally a good resource. If you want to find out what we do at Rask, just go to our about us page. We do a horrendous job of explaining all the different things that we do, we know that, but if you go to the about us page, it kind of summarises the key things that we offer. Free courses, podcasts, news website, ETF research, whatever. It's got it all there. So that's typically a really good place to start and most companies at a pretty reasonable size these days, they have a video that's like an about us video like, "Rask Australia does free courses..." You get the whole idea. So we can use that, anyone... But if it's only like a five page, cruddy old website, which to be honest a lot of the times it is, you've obviously got to read the annual reports, which you can get in your brokerage account. You can typically get it on the company's website.

Owen:
You can go to the stores, which you mentioned. You can speak with customers by going on a forum. One of the things that we've done recently is we've joined Facebook groups of companies, these smaller companies. Because sometimes there are fan pages or there are pages for customer support and you can go on there and you can just see what people are asking. First of all, is there people there? Then you've got... I only discovered this today, on most Facebook pages, if there's, say, thousands of followers, you can actually go to their page and there's that community tab and then you can see the super fans, the people that are liking everything that this company does, and then you can look at them and say, "Looks like it's mostly middle aged men following this page," or, "It's mostly young women following this cosmetics brand," and you can piece together, who is this company selling to? Just by using things that are totally quirky. That whole Sherlock Holmes thing, which we talked about during shares month. I just want to talk about one last thing, if it was easy to do this, everyone would do it. Remember, we're looking for pieces of information that we can build up before someone else figures out that we've got that piece of information to try and understand what the business is doing.

Owen:
Peter Lynch who was a famous investor said, in his book, One Up on Wall Street, I think it was, he said, back in the day, women's leggings used to come in an egg that you could buy at the checkout and they come in a thing and they pop out, right? They're like leggings, old school leggings, stockings if you will. He had no idea that this was an actual thing that people bought but his wife did because she was going through the register and she was buying these things and he's like, what's this? Really interesting. You can do these things. If you saw that Afterpay was the sticker on the wall for every retailer in the country three years ago and you used that as a signal to learn about the company, then that probably would've served you pretty well.

Kate:
I think that's really interesting because I think during shares month we had a few stories, especially from Kev, of finding ideas not in the places you would expect and I think it's good to keep your eyes open and see what are emerging things in your own country and different ideas there. The next question I want to ask, which is more of... This is something I was wondering about. A lot of the small cap space, it takes a while for a company to become known in the investor community. Afterpay for many years, no one was really talking about the investment itself. It wasn't until the last few years that it really got hyped up and everyone suddenly knew Afterpay both from a consumer point of view and an investor point of view and what I was wondering, if no one else knows about a small cap company because you're the first one to discover it and research it, does it even matter if it's a good business? Because even if you invest in it, it could be a couple of years before people even start knowing about the company and investing in it as well. It could take a long time before the share price moves.

Owen:
Yeah, great question. This is like, how far do we want to unravel this question? What I'll say is that yes, for me, it does matter. If you're the type of person that could sell ice to Eskimos, you

could pretty much be a small cap investor, build up a following on social media and probably talk about it and try and get people to buy into the shares because they don't really understand what it does but it sounds cool. But if you're an actual investor, you've got to remember that you're investing... An investment in my eyes, and this is where a whole lot of the industry disagree with me, a short term investment in my mind is three years. That's short term. I want to buy businesses that I can hold for at least five years, typically.

Owen:
So what that means is that when I'm investing, Kate, I'm actually looking for companies that are very high quality. I mentioned before that some of these businesses, they could be really good businesses, serving a really good need for society or for their market or whatever. But they're still small, but that doesn't mean that they're not profitable. They could still be paying dividends. To put it in context, when I go into a café, I don't know if this is just me but now that I'm an investor and I've learned how to invest in companies, when I go down the street and get a coffee, I love the coffee and I focus on that, sure, but what I'm actually thinking about when I'm sitting there is, I wonder how much money they're making from coffee. How many customers have gone in this hour? Looks pretty busy. Who's running the business? That woman behind the counter, she looks like the owner, because she's really passionate.

Owen:
So I'm thinking about all these different things and I'm thinking, I wonder if she wants to sell part of her business to me, because I would love to buy even a small percentage. You think about these things, and the reason I bring this up is, it wouldn't matter if no one else sees that, as long as you buy a really good business, you're going to make money whether it's today or in five years. If you buy a good business and you're right about that, eventually everyone else will recognise it. It might be by the time that same business owner has 20 stores in her network rather than one but eventually it tends to happen. And sometimes you get it wrong. Sometimes you're sitting there twiddling your fingers and you're bought into this company and three years down the track, it still hasn't done anything. There's one more thing that I want to unravel here, which is that the difference between what I just described in a café example, like buying a small part of a café, and investing in shares, is that between you and the company and what it's actually producing, is this really unusual thing called emotion and it's what drives the stock prices in the short term.

Owen:
So imagine, Kate, for example, that I said Elon Musk is not the founder of Tesla. Everyone would be like, oh my God, he's not the founder of Tesla, it's not worth as much today, therefore I should sell, but it could be the same business. It could still be sat making the same amount of profit and all that's changed is your perception, the way you think about the investment and if enough people think about that in the stock market, even if it's Tesla or it's Apple, the biggest companies in the world, your emotion and the market's emotion can actually influence prices dramatically in the short term. I've found that over the very long term, you're better off focusing on good businesses than trying to predict what the market or this big herd of people is going to try and think about a company.

Owen:
A really good one would be lithium. People think that lithium's going to be some sort of life saving energy source but you would want to buy that before everyone thinks that, not when people think it because yes, it might still be the same thing underlying that but if you think it before everyone else, you're buying before you have to pay up for the emotion that's now all of a sudden with it. So choose the business first, focus on finding a really good businesses with good people, good products, a large market for it to grow into and then let everyone else catch up to it later on because that's a better recipe than the other way around.

Kate:
Yeah, because I sometimes see companies that are doing things like drug trials where they don't really have something on the market yet or they've got experimental technologies. I've seen this in the past with drone companies and all sorts of things in healthcare where the company's listed, they've got money, they're researching but there isn't actually a viable product or service yet. Sometimes I wonder, that can be really risky to wait for 5 to 10 years while this happens.

Owen:
Yeah, so there are two areas of the stock market, which I don't go into typically. They are bio technology and mining and exploration. Let me just backtrack a bit. If there are 2,000 companies on the stock exchange, if you take away the top 300, so we're not investing in bigger companies for the Rask Rockets Programme. The Rask Rockets Programme is only about small companies, so we have to exclude the top 300 pretty much by default. Let's say, round figure, there was 2,000 before, now we've taken out the top 300, now there's 1,700. I don't know the exact numbers off the top of my head but if we just took away the companies that were in resources and mining and we took away companies that were involved in bio technology and we took away the companies that weren't yet making any sales, so there are companies that exist don't make sales yet because they're waiting for a product to be announced or they're waiting for drug trials, if you take away all that stuff and you just focus on the companies that don't have that much debt, make some type of revenue, operate in an industry that we can understand like software, technology, retail, payments, industrials.

Owen:
There's a heap of different companies that we can kind of understand. You're actually only left with about 50 to 100 in Australia on the ASX that are kind of good and not really speculative, like not right out there. They're not mining lithium in Mali, for example. They're not right out there. If you exclude all then, you're down to about 50 to 100. From that list, then we look at the management team, we study the management team. We get down to, say, 30 to 50. From that 30 to 50, then we look at, is this company actually big enough for us to invest in it? So when we do our Rockets memberships, one of the things we have to be careful of is, because of our members...

Owen:

If we have, just hypothetically speaking, let's say we have 100 members join us on the mission. That means that if they invest $2,000, they're investing a pretty considerable sum of money as a group into these small companies, so we have to be mindful that the companies also meet what we call liquidity filters so that there are enough shares to go around. So we have to speculate at what people are going to want to invest. So that's another filter. By the time you do all that and then we do CEO interviews and then we do our industry research, we're down to like 10 to 20 companies on our final list that we've done interviews, or we'd like to do interviews with. We've done our reports on, we've done our valuations and then we pick of those 10 to 20, the final 10. Now the reason I'm saying all this is that's just an illustration of the process we go through to actually find good companies. It's not just like, pick one out of the stack and see how we go. But there are two things I want to say to all people listening to this that might be invested in bio technology before it's made a product and exploration companies on the ASX. These are very popular speculative investments.

Owen:
Now, as investors, what we have to do is we have to try and make an educated guess about the future. So the future's uncertain, we're trying to make a guess. We're trying to think about probabilities. Now I believe that if you are an investor in a bio technology company that hasn't passed clinical trials, there is no way that you can predict the outcome of that trial because if you could, then why are they doing trials? It's the same with exploration. If everyone knew where the gold was, why did they bother exploring? So as investors we're trying to avoid these massive uncertainty gaps in our knowledge and trying to stick to what we know. It might not be as exciting as trying to find lithium in some outback destination but it allows us to sleep and allows us to focus our attention on companies that have a reasonable chance of success.

Kate:
Absolutely and I know, I think for a lot of people listening, most companies listed on the market would probably fall outside their circle of competence-

Owen:
Good point.

Kate:
... especially in small cap companies, because they can be so... Just looking through the list of listed companies, you can't not believe some of the weird, things that exist in Australia listed on our market.

Owen:
You can find companies that aren't even Australian that are in Australia and they have some weird stuff going on. Companies from overseas that can't even be audited by Australian auditors because they're overseas. Just a weird kind of thing. We just tend to avoid all of those weird ones. They're like, too hard, move on. They're in that bucket.

Kate:

Yeah, if you are interested in researching small cap companies and you're thinking, hey, most of it seems like it falls outside my circle of competence, how would you go about approaching that or maybe what areas should you focus on expanding your circle of competence?

Owen:
Yeah, so start with what you know, which is your circle of competence. If you work in a retail store like Lovisa, great, Lovisa's a great store that sells little pieces of jewellery really cheap. You can bundle like five pieces together and you can get it for 15 or 20 bucks or whatever and Lovisa, if you go in the shopping centres, you will know that Lovisa tends to not have big stores. They tend to have tiny, tiny little stores and the reason why is because the things that they sell are tiny. They're small, they don't need a lot of space and Westfield and all the shopping centre providers give them that space for very, very cheap because they weren't going to use that space for anything else other than maybe a shelf anyway but Lovisa can fit in there so hey, we'll rent it to Lovisa. So that's an example of using something that you might know, like if you worked at Lovisa, I would encourage you to go and look at the share price of Lovisa now. Look at it over five years and you'll probably look back and you're like, damn, why didn't I see this coming?

Owen:
So that's using what you know to your advantage. The other things that you can do is not just necessarily your place of work but also your hobbies and interests. If you have an interest in, I don't know, skydiving, I'm sure there's a company on the ASX that would do skydiving. I know there was but I think it went out of business. Find the companies that do that and then try and learn about them. You already have the hobby. Or you might study whiskeys or you might study, whatever your hobby is, you can find companies that do that so don't necessarily have to be in your job or in your occupation, it might be in your partner's occupation. Like my partner, she's an occupational therapist and there's a company on the ASX that does occupational therapy. It's a pretty small company but you can find out about that. For me personally, Kate, as you know, study technologies undergrad, I kind of geek out a bit when there's a bit of software to be done or a bit of coding or whatever. I like that. I like companies that are from the industrial sector, which is basically this all in one sector, which just includes manufacturing, tyres, doors, widgets for your house, defusers, lamps, all that kind of stuff that gets made, that's an industrial company. So we look at that.

Owen:
You might be a geologist and you might say, "Owen, that thing you said about resources two seconds ago doesn't make sense to me because that's in my circle of competence." That's okay, that's cool too. Various studies show that the people who make the most money from the property market, carpenters and builders, when they're investing, because they understand the market. So it's about using all of that to your advantage. You can learn anything. I wasn't born understanding technology companies. I went to uni and I studied it in my own time. You, Kate, you're studying law at the moment. You weren't born with that, you had to learn about it but now you probably have a better framework and level of understanding to go and analyse legal companies because you know what's involved in the process. So those are just little things that

you can do and that's the fun part of investing. The fun part's not looking in your brokerage account to see what's going up and down, the fun part is actually learning about the companies and all the problems they're solving.

Kate:
Yeah and I think just talking to your friends and family, going to lots of different events, just learning and pushing yourself out of your existing comfort zone helps to expand that circle of competence and one idea I didn't think about with this, which I probably should've taken into account many years ago, where I was working about four years ago, we were building integrations with Xero for the accountants and all that and at the time, I was just like, yeah, Xero's listed, that's cool, but I wasn't really that interested in direct share investing. That could've been an indicator at the time. We're integrating with this, our clients' accountants love this software, why don't I look into it? It's not what the company I was working at does but it was one of the tools we used. So the clients of your company, what are they talking about? What do they need? Just looking outside the box, you can find a lot of insights if you just look a little bit further than the screen.

Owen:
If you worked in Coles, you might think that you don't know anything about an industry that has relevance, other than Coles or Woolworths but hey, if you look across the hallway and you say, that retailers got Afterpay on the window and then you look across over there, you say, hey everyone's paying with Afterpay over there too. This is a common theme here. Or this A2 Milk product, everyone's coming in and buying tins of this A2 milk product for their infants but I don't think they have 50 babies so I don't know what they're doing with 50 cans of infant formula. Maybe they're doing something else with it. These are examples. Another good one is Freedom Foods. They do gluten free foods. Maybe they're one of the leaders in gluten free foods and maybe coeliac is a real problem. All these different things. There's a shortage of bananas, does that mean banana prices go up?

Owen:
Probably. So who stands to benefit from that? You can constantly think in ways about opportunities and also threats to the companies that you own and I think that's what's exciting. That's what makes me an investor because those are the things that I want to do and whether they're small companies before anyone else has found them, they're kind of under the radar, that's even more exciting because then potentially we get to find these companies before everyone else sees them going through the cashier or sees them down the street. Like you said, Xero, many years ago, for what it's worth ago I bought Xero many years ago but then I sold it many years ago and then I watched it double and then I finally bought in again. But those are the types of things that you have to be aware of in the piece and you tilt the odds in your favour.

Kate:
And looking for the problems you see in society and finding the companies that are actually trying to solve that is also another good way to look at it, not looking for the company itself but who's solving the problem.

Owen:
Yeah, absolutely.

Kate:
I have just one more question to ask you because we probably should wrap up but one of the big things with small cap companies is that one bad report or a short report or something like that can suddenly tank the stock price because small cap companies, like any other company, have to disclose things like major contract wins, key information, to the market. That can be scary. How do you keep an eye out for what's on the horizon and react appropriately?

Owen:
Yeah, that's a brilliant question and the answer is, I guess it depends on different companies but when it comes to our members in particular, obviously there's a lot of work that goes into researching the companies before these things happen. I think Warren Buffett said, he's a better investor because he's a business person and better business person because he's an investor. One of the things that is really... We have some listeners of the podcast and some members write in and say, "I'd love to do your job," and I think the reason that they say that is because we get to research all of these different companies every day and that's true, we're very, very fortunate that that is our job, to learn, basically, about great companies and some pretty bad ones too, by the way.

Owen:
Over time, what you begin to recognise is patterns in the way people think, patterns in the way people respond to new products and marketing and services and so on and so forth, so what we do when we make a formal recommendation for our membership communities is we write it down. So we write down the opportunity, what we see in the market. We often have a CEO interview. We're pretty fortunate in being able to do that now. The CEOs tend to tell us what they want to tell us but they often reveal things without even revealing things like how they behave and what have you and that gives us a general sense of their attitude towards their business.

Owen:
So we write these things down in advance, and anyone can do this. We said this during shares month, write down what you're doing and then what happens next is really interesting, we put in the risks section of every one of our reports, there's always risks and that's investing. So we try and what we do is we invert the logic. So I've said this in the podcast before but instead of seeking brilliance, we're trying to avoid stupidity. So what are all the ways that we could go wrong? A very simple way to do this, what sucks? So I'm going to buy this company, what sucks about it? What could go wrong? If you just invert your thinking, you'll be like, this company's depending on that supplier, this is their key customer so we have to be careful about that relationship.

Owen:

This is the way they market their product, so if this happens, if Google changes their algorithm, we're probably going to have to be concerned about that. This is the key competitor and the competitor on their website says they have 10,000 customers. If they, in six months say they've got 15,000 then they could be growing quicker than our company, so we're going to keep an eye on that. So what we do is we set these reminders to check in on these risks every so often. It might be every three months we say, go and check this company's number of downloads in the App Store, and we find out what's going on there. Why has the rating gone down? Why has it gone up? Etc.

Owen:
Then when bad news inevitably arises, because we tend to hold companies for five years, we try to anyway, can't say that for sure but we try to, that's five years of these companies potentially making announcements. Every year they've got to release an annual report, every year they've got to release a six monthly report. Chances are most of them have to release quarterly reports under the reporting rules on the ASX. That's a lot of reports and chances are at least one of them is going to be a stinker. So we've got to prepare ourselves by reflecting back on the reasons that we own the stock, or own the company. What were some of the risks that we outlined at the time? Have they got better? Have they got worse? Did we misunderstand something? So then for our members' sake and for our sake, we kind of know in advance that if there is going to be something bad, then this is chances are what it is. If, by the way, the news that we get is really bad and it's not on our list of things that we identified in the beginning, we probably didn't do enough work for our members. We probably didn't spot that or think laterally enough.

Owen:
You know, so an example is, I think Afterpay's a great business, by now, pay later, wonderful, wonderful, wonderful. If you didn't think about regulation when you were doing your research, the chance that they would get regulated, then that's probably on you as an investor because that was pretty obvious that that was a risk and so you would at least be mindful of that. So we try and do that in advance, Kate, I'm sorry for the long-winded answer but we try and do that in advance before the bad news comes but it eventually does for any company and that can be often an opportunity to buy a good company when it's cheap.

Kate:
Awesome, so if anyone listening is interested in learning a bit more about Rask Rockets Beyond and what you're up to on your rocket ship, how can they find out?

Owen:
Yeah, we don't have a literal rocket ship. That would be amazing. We don't have that yet. So go to the link in the show notes. There'll be a link in the episode description for this. I do hope that you learned a lot but if you actually want to find out about the mission, every year, we name them something, so last year it was Apollo, which is obviously named after the missions that put someone on the moon, this year we're calling it Beyond because we're going beyond. Sounds kind of ominous but kind of intriguing at the same time. You can find out all of the information

there. Just to be 100% upfront, I don't want to waste your time with this. This is our most expensive membership and it is by far our most, I guess, premium service. Because we can't take in a lot of members, for all of the effort, like we spent months and months and months doing this, we have to charge a fee that's appropriate for that.

Owen:
I mean I'm going to be honest with you, which is not what a lot of finance people do, it is $2,000 for the first 12 months and so that's priced at that point where if you're an investor and you have an established portfolio, it's probably not that big of a deal but if you're new to investing, this probably isn't the one for you. So yes, it's great and we love hearing from people. The only two groups of people to get a discount on our memberships, this membership in particular, is our existing members of Rask Invest, you'll get a discount if you're a member, or if you're an Apollo member, i.e. from the first Rockets mission. You'll find plenty of details of what you get, but even if you're not sure, but it sounds kind of cool, just follow the link in the show notes and register your interest. The reality is, we can't take everyone on the registered interest page anyway. We just can't, but just register and then you'll get the details. I'll be coming out with a video in a couple of weeks. Actually no, by the time this goes live, Kate, we're recording this in advance, there will be a video that gets sent to everyone on the wait list in the next few days.

Owen:
So go and check that out, get on the mailing list, register your interest and if you don't want to be part of it, it doesn't matter, maybe next year. But for this year, it's going to be exciting, we're going beyond, we've identified some great companies. There's going to be a lot of reports, a lot of interviews with CEOs, lots of analysis. It's great and if you made it this far through the podcast, hooray, small cap investing isn't for everyone, so I guess that's kind of cool. Are you a small cap investor, Kate?

Kate:
I might have a couple, yeah.

Owen:
Is this in the Forest Fund?

Kate:
In the Forest Fund, yeah. I just wanted to mention that if you are interested in learning a lot more about small cap investing, you've got quite a few episodes. I was listening to one before with Andrew Page from Strawman and Mark Tobin from Micro-

Owen:
Microcaps, yeah, good guys. Good investors. Microcaps. Coffee Microcaps is the name of it. So they do interviews. Mark does interviews with small cap companies, which is great, and Andrew obviously at Strawman.com, which is a place where you can go and you can share your thoughts on companies and see what others have to say too. So both great platforms. Yeah, there's plenty of resources like that. Then we have the valuation course on Rask. So maybe

you're not up for Rockets this year, you can go an learn for free on our website and learn about how we value companies.

Kate:
So I'll include all of those resources as well as the information on Rask Rockets Beyond in the show notes so you can check that out and learn a little bit more.

Owen:
Yeah. It's great fun. It's a bit of a space theme. One final piece of trivia that in the observable sky, there are over a billion stars that we can see and so if you think about that when you look up at night, there are over one billion stars and we have one that supports our entire solar system. It gives you a sense of the humility you need to go through life because it tells you there are a lot of planets, there are a lot of solar systems, don't spend your time wasting it, worrying about what you're going to wear today or how you're going to feel when you get up in the morning. Just go about your life, have fun, take it all in and enjoy it while you've got it because we're only a small little speck of dust in this huge universe. That's a little bit of space trivia. Over 1,000 stars in the observable universe. I'll leave you, Kate, with that one and everyone else.

Kate:
Well thank you very much Owen and I hope everyone learned a little bit more about small caps today.

Owen:
And space, thanks for listening and thanks for joining me, Kate.

Kate:
Thanks for tuning in to this episode of the Australian Finance Podcast where our mission is to improve the financial futures of all Australians. If you'd like to learn more, create a free account at Rask.com.au/account to download free episode workbooks, bonus resources and take our amazing, free, personal finance courses.

Owen:
You can also join our online community by following the link in the description. If you enjoyed the show, what we'd love is for you to leave us a snappy review on iTunes and you can follow us on Twitter and Instagram @raskaustralia, Kate and I are also on both of those channels. Finally, if you have any feedback, suggestions for episodes or guests to come on the show, or you just have a question for us, shoot us an email at podcast@rask.com.au.