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Brad Brain: What makes for a good investment

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Smart Money

Brad Brain: "I have fielded some questions from people looking for guidance in an ocean of investment choices. We have seen some sizable short-term gains lately, and that always gets people's attention. It can also lead to enthusiastic interest in what otherwise would probably be considered an unsuitable investment."
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I was looking back at some of the content that I have been sharing lately, and I noticed just how often I have been warning people of precarious situations; about investing based on flawed assumptions, about the dangers of reckless speculations, and about frauds and deceptions.

On a related theme, lately I have fielded some questions from people looking for guidance in an ocean of investment choices. We have seen some sizable short-term gains lately, and that always gets people's attention. It can also lead to enthusiastic interest in what otherwise would probably be considered an unsuitable investment.

Given all this, lets talk about what I think makes for a good investment. There are two parts to this: the first part is to identify what makes for a good business.

A good business sells things that people want and need. You may have the world's best 8-track tape manufacturer. But people don't want, and they certainly don't need, 8-track tapes anymore.

But even further, a good business doesn't just sell stuff that people merely want and need, but it provides things that are difficult to live without.

Imagine, for instance, not having banking services in your life. Financial institutions are where we obtain mortgages, where we borrow money to either get the things we want or to bail us out of a tight spot, where we can write cheques and pay bills online so we can settle up with people we owe, where we deposit our paycheques, and how we keep our money safe until we need it. You may be able to live without a financial institution in your life, but it would be difficult. Every adult reader of this column probably has at least one banking relationship.

A good business is difficult to replicate. Take, for instance, a railway. We use rail to transport people and things. But good luck starting a railway from scratch. Just laying the track across the width of a nation would be a massive task. Trying to replicate a railway could be done, but not easily.

A good business is difficult to compete with. Here's an example. Tell me the name of a soft drink. What is the first thing that pops into your mind? Chances are very good you said Coca-Cola. The impressive thing is you could go anywhere in the world and people will say Coca-Cola. It has worldwide brand domination.

Warren Buffett calls this an "economic moat" around a business that keeps competitors from gaining market share. The moat could be from exceptional service, from the quality of the product, from cost advantages, patents, or location. But some thing that makes a business hard to compete with.

Having found a good business as a potential candidate to invest in, its time to look at the second part, which is just as important. The second part is paying the right price. This is also the part that many people spend not enough time considering, to their eventual, inevitable regret.

The difference between a great busines and a great investment is the price you pay. Write that down, tattoo it on the back of your hand if you need to.

I get people asking me about what I think about some potential investment all the time. They are excited about an idea and the equate that to the potential for future investment growth, but probably 90% of the time they have not considered the price that the investment is trading at.

Folks, this is real simple. It comes down to this: If you pay to much for something, it's real hard to make money. Doesn't matter what it is. A stock, an apartment complex, Pokémon trading cards. Pay too much, and it's hard to make money.

The bottom line: A good business is difficult to live without, difficult to replicate, and difficult to compete against. But don't forget that the difference between a good business and a good investment is the price you pay.

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