The Ultimate Cheat Sheet for Success in the New America
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THE JAMES ALTUCHER REPORT

EVERYTHING YOU NEED TO KNOW ABOUT THE STOCK MARKET CRASH, INVESTING AND ANGEL INVESTING

First off, I have to tell you two stories.

One: On December 13, 2008, pretty much one of the worst weeks in market history, my publisher decided that should be the launch date of a book I wrote.

The book was called "The Forever Portfolio" and it was about the stocks I felt that people should buy and hold forever.

Nobody bought the book. That's not true. At last count, 299 people bought the book.

Nobody wanted to hear about buying stocks forever. People were selling stocks and not looking back.

I was scared also. I had started a new hedge fund in September 2009. But the hedge fund that funded me got too scared and decided at the end of October to stop the experiment.

I really thought all aspects of my career were over. Plus, I had recently sold a company for all stock and that stock had gone from $13 to $7 and I had just bought a home (against all of my later advice).

So what happened? The guys at Choose Yourself Media did an analysis the stocks in the Forever Portfolio have gone up 191% and the stocks in the Dow Jones Market Average have gone up 80%. In the past 5 years I have (luckily I have to admit) outperformed the market (and Warren Buffett) by 22%.

I don't say this to brag. I got lucky. I was so scared I couldn't sleep. I would go on the Erin Burnett Show on CNBC every Tuesday and during the half hour I was on the show the Dow would go down another 500 points. Every week. I thought I was going to throw up all the time.

Second story: Fidelity used to ask me to give talks to their clients four times a year. Sometimes more.

IN THIS ISSUE:

EVERYTHING YOU NEED TO KNOW ABOUT THE STOCK MARKET CRASH, INVESTING AND ANGEL INVESTING.

The A through Z of what you need to know about the recent market crash and what it really means for your portfolio.

WHY I STOPPED ANGEL INVESTING (AND WHY AVERAGE INVESTORS SHOULD NEVER START)

Author, entrepreneur and (re-formed) angel investor Tucker Max breaks down the pros, cons and real-world truths of investing in startup companies in today's market.

QUESTIONS?:

HAVE A QUESTION FOR JAMES?

Every day, James answers listener questions in his wildly popular "Ask Altucher" podcast, which he records with his wife Claudia.

You can access "Ask Altucher" directly here or download episodes from iTunes here.

That February (2010), I was going through a divorce, I was still scared, and I had just gotten fired from the company that bought my prior company. So I had no income and no prospects in sight.

About 500 people were in the audience. I'm sure some of the readers of this newsletter were there.

I outlined all the reasons the market was going to go up. First, in the back office, I told all the Fidelity professionals why I thought the market was going to go up. One woman literally started crying and said, "thank you. Even if you are dead wrong I need some hope." Fortunately I was not wrong.

OH! I have a third story.

I forget the exact day. It was a year or two later. Maybe 2011. July 5th or 6th. I was debating Nouriel Roubini. He said the market was going to go 20-50% down from that point.

I said it was going to go straight up.

Again, I got lucky. It went straight up.

This sounds like I'm bragging (I guess I am a little) but I do a lot of research. An enormous amount of research. It's my family's livelihood at stake because I make my living by investing. I don't make it off fees or scams or going on TV or books. I invest.

But I'm a bit lucky. Because a lot of people do research. What I'm going to do is summarize some of my research by going through my process from A to Z.

Since these are bullet points and we are limited to about a billion or so words here this list might not be totally comprehensive, but maybe we can figure out a way (perhaps on a podcast) that I can answer any additional questions you might have afterwards.

By the way, a top Director at the Swiss bank, Credit Suisse, wrote to Nouriel Roubini about a year after our debate and said: "Looks like James was right. When are you going to invite him to one of your famous parties."

Roubini was well-known for having blow-out parties. I didn't want to go anyway (I'm more of a cave-man) but I was curious what his response would be.

He did write back, to his credit, and said: "Next time there is a recession."

Well, we're all still waiting.

HERE YOU GO, THE A THROUGH Z OF WHAT YOU NEED TO KNOW ABOUT THE RECENT MARKET CRASH.

A. **Since 1955, if the market is down for six months, it's on average positive one year later.**

I don't like statistics like this because there are too few examples. Suffice to say, we've been here before, we'll be here again, and usually the market is higher a year later.

B. **The market is down, in part, because of fears that China's economy is falling.**

China has grown 10% per year for 30 years. Now it's growing about 5%.

A couple of points. That's GROWTH of 5%, even though it's slowing.

Also, much of their growth was funded by our bonds, which they have been consistently paying back BECAUSE of their growth. And a lot of their growth has come from building first-world products that our innovation has developed.

They are the second-largest economy in the world. But let's not forget: in 1989, Japan was the second-largest company in the world. That was the highest Japan ever was. Meanwhile, we keep growing. The U.S. has been the source of innovation for both Japan and China.

But what if China fails?

OK, so what? Here's what EVERYONE has failed to mention in the newspapers: China represents less than 1% of U.S. exports. China could go to zero (and, one again, they are growing), and we'd still have a growing economy in the U.S.

C. THE FED

I put it in caps so you say it out loud ominously. People are afraid the Federal Reserve will raise interest rates.

How come? The Federal Reserve interest rates are (very roughly) the interest rate they charge banks. The lower they are, the less banks pay on savings accounts.

So if the Fed raises rates, savings accounts rates go up and people would rather invest in a safe savings account than the high-risk stock market.

OH MAN!

The Fed Funds Rate is 0.25%. I have to put an exclamation point in there. 0.25%!

Do you think if they raise it to 0.5%, or even 1%, suddenly everyone is going to say, "Man, I better move all my money into a savings account now.

Of course not! In fact, the Fed only raises rates when the economy is going strong, employment is strong and inflation is starting to peak up (which is not happening).

So typically, for at least the first year after the Fed raises rates, often the Stock Market goes UP, not down. And in a case like this, where rates are so low, it will take a long time before the Fed has rates at 6% or 7% where it starts to compete with the average market returns.

I actually hope the Fed raises rates although I think that is not likely given that I am more worried about DEFLATION than inflation right now.

D. P/E ratios

Readers of this newsletter are at all different levels of financial literacy and that's fine. When I was building my first business I could care less what a P/E ratio was.

Basically, if a company is worth $100 but its owners only take $1 a year home in income, then the P/E ratio is said to be 100. That's very high and it's where almost all the Internet stocks were in 2000 when they collapsed.

That's also 1% of what the company is worth. That's where I'd rather look at savings accounts or bonds.

So a P/E ratio of 100 is bad (1% return) and a P/E ratio of 5 (20% return with Federal Interest rates at 0.25%) is too low. Usually the market is around 15-20, particularly with Federal Interest rates so low.

The stock market's P/E ratio on average is 19 right now, which is high but not excessive.

BUT, market indices are weighted in favor of the larger companies so we should really be focused on those.

The P/E ratio of:

- Apple is 12
- Exxon ...12
- Wal-Mart...13
- Berkshire Hathaway (Warren Buffett)...18

These are the companies that should tell you if the market is high or low.

How come? Because if the market is lower is Apple going to really trade low enough to give out a 20% dividend? That would be almost impossible. And there is no sign that the growth in these companies is slowing.

Which brings me to:

E. When the entire market goes down 10-15% does that really mean 8,000 companies should simultaneously lose 15% of their value? This is why I am always suspicious of media-driven market selloffs.

For instance, Disney, which is about to release the first Star Wars movies in a decade or so, just lost $32 BILLION in value in the past five days.

Really? Is it going to lose another $32 billion and then release Star Wars, which will be the biggest movie in box office history?

F. I know a lot of people are panicking but we have to have a little perspective.

The market has "crashed" and "reeled" according to the headlines at the Wall Street Journal, which I used to write for.

Guess what. It's down 3% in the past year. 3% is not a crash. That's what's called a normal market where stocks go up and down.

And it's UP about 18% in the past two years. That's about average. Maybe slightly above average.

This is neither good news nor bad news (which is the point). It's not even news. The market might go lower. But it has not been anything close to a crash and is only called that to scare you.

G. Warren Buffett likes markets like this (I wrote the book "Trade Like Warren Buffett"). Why?

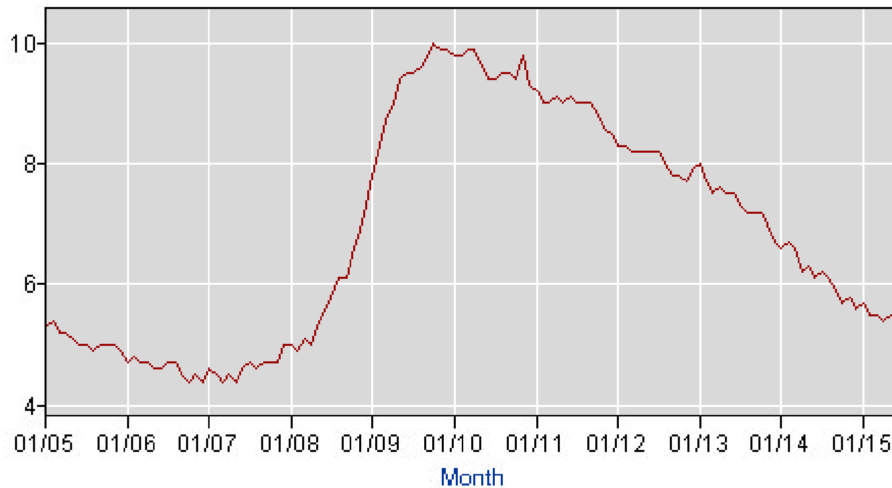
As he puts it: When you go to the grocery store you aren't hoping that hamburger prices are high. You are hoping they are low.

Unless, of course, capitalism is falling apart (which it didn't even do when it looked like it was in 2008).

When stocks are low, chances are they go up from here. Even in the worst part of the 2008-2009 crash, guess what happened – just a few years later the market was back to all-time highs.

H. Unemployment

When people are employed, they buy more, companies do better, and stocks go up.



Looks like people have jobs to go to.

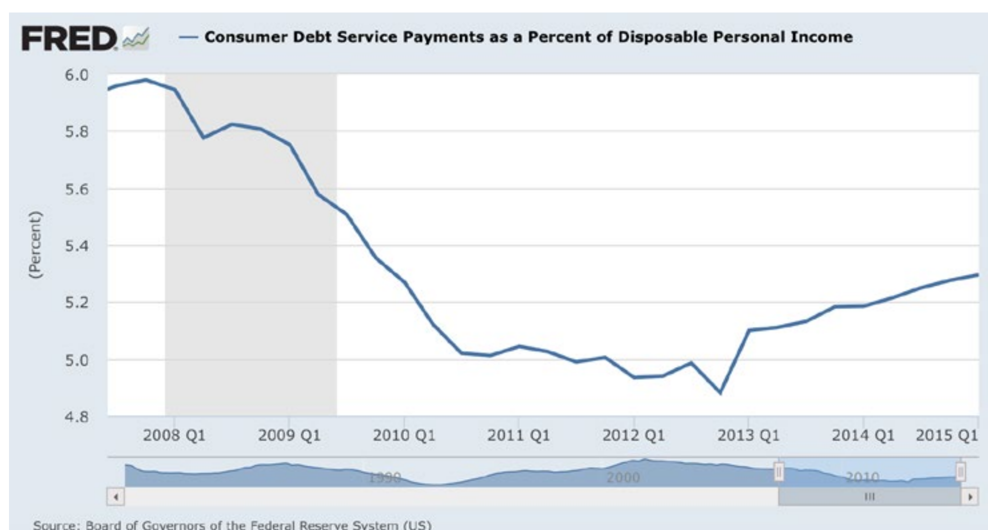
Now, you can argue, look at 2007. They had jobs to go to then and then we had the biggest crash since the Great Depression.

Which is why another number is important.

People can't buy things if they owe a lot of money.

I. Household Debt Obligations

This is the ratio of how much of people's income goes straight into paying debts. Here it is, straight from the Fed:



Guess what? More people are employed and we owe less money. Hey kids, buy those crappy clothes at Forever 21 in the mall!

J. Fear

Check out this quote by Howard Ruff, who regularly appears on CNBC and warns about all the doom and gloom about to happen.

This is from his book, "How to Prosper from the Coming Bad Years"

"*Much of the American wealth is an illusion which is being secretly gnawed away and much of it will be completely wiped out in the near future. . . . So what is the rest of your future? A grisly list of unpleasant events—exploding inflation, price controls, erosion of your savings (eventually to nothing), a collapse of private as well as government pension programs, and eventually an international monetary holocaust which will sweep all paper currencies down the drain and turn the world upside down."*

Sounds pretty scary! Heck, I'm scared reading it.

It was written in 1979. Right before a two-decade (even a three-and-a-half-decade, if you count recent all-time highs in the market and economy).

Why did he write this? Because he wanted to scare you.

Here's what he wrote a few years after that quote:

"I lost my subscribers at the rate of 25 percent a year, by far the lowest attrition rate in the industry, but the sure road to failure, given the inexorable math and the nature of time, while some of my tougher and more savvy competitors are still in business with varying degrees of success, and some of them are very rich now. My wealth became barely a shadow of what it once was. As the list of followers shrank, so did the sales of the other products and services I offered them that I was counting on, until in the year 2002, my list had shrunk to only about 3,000 faithful followers. And how about my glorious Mapleton mansion? I lost it to foreclosure..."

Fear will only get you so far.

K. OIL

Another thing people are afraid of now is that oil is so low.

There's a cliché: We need to learn history or we will repeat our mistakes.

Unfortunately, even knowing history, we tend to repeat mistakes.

Oil was a massive reason the stock market hit its third worst period in in the past century, in 1973-74 when the OPEC crisis hit.

It's because Oil was going UP and not down. And OPEC was holding us hostage so we had no idea how high oil was going to go. It was crushing the economy.

Oil at LOW prices is not necessarily a bad thing.

That said, the fears are going to be over. How do I know? Because I invest in oil wells. Meaning I know guys working on the rigs who tell me what happens.

I spoke to a guy who recently went out wildcatting on his own wells who used to be a very high executive at Exxon. He schooled me on Oil.

He said, "James, everyone gets their data from the EIA. The Energy Information Association. We're all supposed to report how many wells we have drilling. Well, we delay. Between four months and two years. And that's the data the media gets."

"The reality," he said, "is that oil wells are shutting left and right. They are all shutting down at these prices."

"So does that mean oil companies are a buy?"

"Maybe," he said, "but the U.S. also gets oil from elsewhere. Better to buy a company like Apache Resources which has huge investments in natural gas which is also a byproduct of all of these oil wells."

L. HOGS

I want to tell you a story about fear. In 2009, the World Health Organization issued a pandemic alert on Swine Flu. I don't want to discount the importance of this. Over 200,000 people died. This is a far cry from the 18 million who died in the 1918 flu pandemic, but every life is important.

That's not why I'm telling this story. I did a video the day of the alert. How come?

Because a stock with the symbol HOGS fell 20% in one day. They were (or are, who cares) China's biggest pork packager.

Guess what? (I say that a lot but only because the gap between news and reality gets funnier and funnier): You can't get swine flu by eating pork products.

There was no reason for this company to lose 20% of it value in ONE DAY. It went back up almost immediately.

I am not judging fear as good or bad. And, by the way, I am not recommending people go out and buy the market.

The lesson to be learned from all this is to:

A. Not panic
B. Begin to look for opportunities when people are behaving irrationally

The market is going to crash much worse than this at some point. If you have an arsenal of good stocks and opportunities that are well-researched then you won't even waste your time looking at stock prices day to day.

That's the beauty of good research. That's why I've started thinking about stocks again. Because opportunities like this are starting to happen.

Not short term HOGS-style trades (although those will always be there and I will try to keep people informed of them).

But long-term trades based on the ever-increasing American innovation, which can't be stopped.

Which brings me to:

M. TRENDS

In 2008 the main trend that was happening in the economy was that people were taking out massive mortgages to buy houses and banks were not ready to handle defaults. They had horrible balance sheets. More on that later because it wasn't as bad as people said.

But now the trends are so much more diverse and the opportunities are so much greater.

Robotics, Drones, 3D Printing, Synthetic Biology, etc are all growing at rates of 100-300% PER YEAR.

That might mean they are small now. But in four or five years you could be 3D printing your driverless car and using a typewriter to type out the DNA for a new prosthetic leg that lets you run 60 miles an hour like the Six Million Dollar Man.

There are a couple of high-flying stocks (e.g. stocks with the words "3D printing" in them) that I wouldn't touch. But there are 100s of companies that are the suppliers of the main flagships of these trends.

Again, I'm never in favor of buying the market. Not because I think there's massive crashes. I just don't really enjoy watching the ups and downs and having to research all of the idiotic issues in play.

But I love looking at the back doors of these innovative technologies and finding the right plays. They might not work out tomorrow, just like stocks like Amazon and Apple weren't straight up lines. But they will be huge as the opportunities become apparent.

Don't forget the important rule: If you start with a penny and double it every day, in four days you only have 8 pennies. But in 30 days you have $10.7 million.

This is what happens in explosive industries. The first industry that experienced this growth was technology when Moore's Law in the 60s predicted that chip power would double every year.

Well, he was right. And now everything is run by computers. Your smartphone is a billion times more powerful than the computers on Apollo 11, which went to the moon.

N. Housing

The culprit! The bane of 2008!

Housing fell apart in the last crisis. In fact, housing fell apart in 2006, a full two years before the market fell apart.

So what is happening to housing now, which is a major part of the U.S. economy?

Last month sales of existing homes reached the highest levels since 2009.

Sales of new homes were also up 10% year over year. And with household debt obligations at a low (see above), this industry is not in danger of default. Far from it.

O. The Banking System

Part of the problem in 2008-9 was that the banks technically collapsed. Only a change in the laws plus a massive bailout saved them.

But on several metrics, banks are at their healthiest levels ever:

- chargeoffs (debt that is written off)
- capital in the bank
  (cash on hand if there is ever a run on the banks, although this is a very rough definition)
- number of banks failing the stress tests put in place are at the lowest level since crisis

So banks aren't failing.

P. The Reason for the Crash of 2009

Right now we are feeling post-traumatic stress over 2009. I am, for instance. When the market goes down 10% I call my best friend and ask if the world is over. I can't help it. It's like a reflex.

But then I start thinking again.

A lot of bad things were happening in 2007-8. Don't forget that the housing boom ended in 2006, so this wasn't the real reason for the crash.

What happened that caused the crash?

This is hard to explain but it's important.

If I owe a bank $100, the bank puts $100 as an asset on its balance sheet. It plans on getting that $100 back from me. If I miss a payment, it still has it at $100.

This may or may not be the correct thing to do. Maybe they should mark it down a little.

But for 100 years they didn't.

Then in late 2007 (the peak of the market was November 2007) the Financial Accounting Standards Board changed the rules.

They basically said, "banks have to mark debt where the last price was."

Imagine if your house is worth $500,000. Your next-door neighbor dies and his kids are desperate to sell the house so they sell it for $300,000.

According to the new law in 2007, you would have to "mark" your house at $500,000.

Hedge funds were aware of this and began selling the debt, forcing banks that held similar debt to mark them down because of the new rule, even if there were no defaults (yet).

So banks were no longer meeting the minimal required standards and started to fail. One thing led to another and we didn't have a housing crisis (which was in 2006), we had a financial crisis (2008-9). Hedge funds made billions. Main Street went bankrupt.

Guess when they changed the rule back: Early March 2009. The day the market started going straight up again until it hit all-time highs.

I'm not saying this is the only reason for what happened. A lot of bad things were happening and, to be fair, banks were over-leveraged (which they aren't now).

But still, when you change the rules without taking into account what could happen, a crash could happen, which did happen until the situation was reversed.

Nothing like this is remotely happening now. A healthy capitalist system depends on healthy banks. Healthy banks eventually lend to companies doing innovation and that builds new industries and economies go up.

Again, it might not mean the market goes up or down. It just means, don't panic. Look for your spots. Some sectors will crash, some will go up.

We're going to experience a lot of ups and downs just like we just did. I don't say this to scare anyone. Just to get ready for it. I will tell you what I like to do. I don't always do it but I try.

Q. Don't Do Anything

I don't even look at the newspaper. I watch comedies. Lately I've been catching up on "The Jim Gaffigan Show." He's in his first season and it's very funny. I can't wait to see him live on December 12 at Madison Square Garden.

When markets go down 10%, some of my smaller stocks go down 30%. I don't think of it (well, I do a little. I get scared). But the reality is: If the story hasn't changed, the stock is just going along with market volatility.

R. Use 2-3% of Your Portfolio

When I buy a stock, I only use 2-3% of my portfolio. This gives me room to maneuver when the stock goes down and I can buy more. I've bought more shares of TROV for instance when it went down once.

I believe in the long-term stories of every stock recommended here. And that strategy has served me well and made me a lot of money in the past five years.

But it's hard not to panic. I basically research my way out of the panic. I admit it.

S. I Diversify by Hedge Fund

I admit I'm not the smartest guy on the block. The smartest guys have 100 PhDs working for them and people visiting factories in other countries and writing down the license plate numbers in parking lots and so on.

The hedge funds.

So what I do is keep track of their filings and their movements. Watch what stocks they buy, wait for the stocks to dip, and then it's as if the hedge fund is working for me. I get a better price, I get total nimbleness, and I get to pick the best of their picks.

Example: If Warren Buffett buys IBM at $120 and it goes to $100, well I'm fine taking Warren Buffett's free advice, buying it at a discount to where he buys it, and then riding it out since he's a long-term holder.

Interesting report: If you JUST piggyback Warren's picks (and not wait for a discount), even then you would've outperformed the stock market by about 10% per year.

T. I Don't Day Trade

A situation like HOGS is a very rare example. There are a few other rare examples like that but you have to really be watching for them.

When you day trade you turn the stock market into a zero-sum game. There are winners and losers.

You're on one side and I always imagine Vladimir Putin and the top hedge funds on the other side. They are going to win.

Often if a stock goes down people trigger panic. They call me and ask, "are you selling?" and I always ask, "did the story change?" and they say "no, but the stock is down."

Fine, if the story hasn't changed and nobody is breaking the law with insider trading (which does happen but you can tell often and avoid it) then I might even buy more.

U. The Role of Quant Hedge Funds in the Crash

A good friend of mine is the head of all wealth management at the largest Swiss bank.

I called him up. What's going on?

He said, "This is the result of default triggers that are being set off at every quant hedge fund. They were up a certain amount for the year, when it falls below a certain number, they sell everything so as to preserve their fees just in case this is a mega-crash."

So, much of the crash was created by automatic triggers worried there would be…a crash.

Hedge funds manage over a trillion dollars of money. When they are all piling over each other like little kids trying to escape. Bad things happen.

But once the rush is over they look around and say, "What did we just do?" And just as quickly they try to get back in.

Normal humans aren't worried about taking home $10,000,000 bonuses.

Well, I thought I had up to "Z" but the stock market as a whole is not that interesting. STOCKS are interesting to me.

It's worth noting that these stocks all started in depressions or recessions:

- IBM
- General Motors
- United Technologies
- Hewlett-Packard
- Intel
- Southwest Airlines
- FedEx
- Microsoft
- Symantec

So even in a recession, you can find opportunities that can create billions in value for early shareholders.

Which begs the question, should people consider angel investing?

Angel investing is when you invest in a private company that may eventually go public.

I've had some big successes in angel investing in the past few years but I don't recommend it.

I think we are entering into one of those rare periods where the cheapest but highest growth companies are going to be found in the public markets, particularly after the recent volatility.

But why would I say that even though I have made good money angel investing? I even advise a top angel investing Venture Capital fund.

I was talking to my friend, Tucker Max, who is a successful angel investor. He's up maybe 1,000% or more from angel investing. In fact, we've been in many of the same deals for years.

I asked him what his thoughts were and he graciously wrote them down. We've even spoken about some of his investments on my podcast.

Here's what he has to say about angel investing. This can almost be like a bible of angel investing.

WHY I STOPPED ANGEL INVESTING
(AND WHY AVERAGE INVESTORS SHOULD NEVER START)

BY TUCKER MAX

I started angel investing almost by accident, which sounds strange to say. Who "accidentally" invests tens of thousands of dollars into highly speculative ventures? Well, I did.

A friend introduced me to Clayton Christopher who was raising money for his new liquor company Deep Eddy. Their first product, a sweet tea vodka, was amazing and he was an experienced entrepreneur, so I went in.

Investing was an exciting, interesting process. Then the company took off, and I got to tell everyone I know that I invested in that new vodka that everyone in Austin was drinking. Winning is the ultimate intoxicant, and from there, I was hooked.

I started investing in companies left and right. I became a huge cheerleader for angel investing. I wrote about how great it was, I recommended everyone do it, and helped a bunch of people start.

I was wrong.

I have completely quit angel investing, and I'm telling you to never start.

Be clear: Angel investing as an activity is great. When the right people do it the right way, great companies are created and everyone wins. I'm NOT reversing my position on the activity itself, only on who should be doing it. Angel investing still works, and still makes money for people, but the deck is too stacked against everyday investors in the startup world to recommend it to everyone.

By the end of this piece, my hope is that you will understand four things:

1. Why I stopped actively angel investing
2. Why most people should never start angel investing
3. Who should be doing angel investing
4. What you should do instead
(and how to invest if you must angel invest)

MY ANGEL INVESTING BACKGROUND

Tucker Max (Photo: Randy Stewart/Flickr)

This will give you an idea of my angel experience. I've found that 80% of the writing about angel investing is total crap, written by inexperienced amateurs who have never done it. That's not me.

From 2010 to 2014, I put 1.2 million dollars (of my own money) into ~80 companies. Thirty-six were direct investments. You can see some of my direct investments on my Angellist page. The rest was invested through two larger funds where I am an LP (ATX Seed Fund and Evolve VC), and one smaller fund I advise.

I've done pretty well with my investments. Emphasizing that no return is truly real until the money is in the bank, I can say that as a minimum, a 5x return on my 1.2 million is guaranteed. And because the internal rate of return on the two funds I am in is very good as of right now, a 20x return (or more) is very much in play over the next 6-8 years.

I also gained notoriety from my angel investing. I was written up in New York Magazine as a leader in the trend of celebrity angel investing. I wrote about some of my investments, and a series of posts I wrote about crowdfunding, both of which got a lot of attention.

Because of these posts (and other things) I had hundreds of companies ask me to invest, I spoke at conferences about crowdfunding and angel investing, I was asked to write for magazines and sit for on-camera interviews for documentaries, and was even offered a role on a TV show about angel investing (that never ended up airing). I'm also a mentor at the best consumer products incubator in the nation, SKU.

This is not bragging. I am a small fish as far as angel investors go. I say this only to establish what very few who write about angel investing on the internet have: *I have actual experience and credentials investing real money into real companies.*

WHY I STOPPED ANGEL INVESTING

There are two reasons I personally stopped angel investing:

1. There's a dearth of good people to invest in
2. Angel investing is a poor use of my time

1. THERE ARE NOT ENOUGH GOOD PEOPLE

Lots of people talk about the start-up and tech world being in a bubble. This is just objectively not true. Yes, there is a ton of money chasing companies, and yes it is pushing prices up, but we aren't close to a bubble. There are many ways to see this, but the big one is obvious: it's never a bubble when everyone talks about it being a bubble.

There are also people who say the company ideas out there suck, and that start-ups aren't solving big problems. This is nonsense. In fact, from where I sit, most of the cutting edge work being done in America to make the world better is coming FROM start-ups. None of it is coming from the Gawker writers talking about tech's issues, that's for sure.

Combine these two things—lots of money chasing start-ups, and start-ups working on big ideas—and that should be really good news, right? After all, that is the ENTIRE point of investment: allocating resources to the highest possible use.

So if there is enough money and lots of good ideas, where is the problem?

It's the people.

What's so great about entrepreneurship is that you don't have to be from the "right" crowd to start a company—you can just do it, without anyone's permission. But when you have a lot of money chasing all these great ideas, and you combine it with the fact that entrepreneurship has gotten sexy in the last few years and become the "in" thing for a certain crowd, what you end up with is ***a huge number of people starting companies who have no business at all doing that.***

I don't mean this as a social judgment, or to cast aspersions. One hundred years ago we might call these people charlatans or snake oil salesmen. But that's not what's going on here. Most of them are very sincere, and their ideas are great. What I mean when I say "they have no business starting a company" is that ***they cannot actually execute effectively in a start-up environment.***

Ultimately that's the only measure that matters: can you do the job? Over the past 18 months, I've probably looked at around 400 companies in many different areas. I'd say that 75% were solid ideas, and I'd say that over 50% were in potentially huge markets. But I'd estimate that only about 20% of the people starting those companies have the ability to actually do the job.

These are not random companies from off the street. I'm talking about teams I'm seeing at Demo Days from major incubators, or outfits that have already raised big seed rounds, or start-ups that have gotten press. These are "validated" start-ups (at least validation as it is currently defined).

There is an anti-bubble in talented people—a black hole, and I'm not about to get sucked in past its event horizon.

And by "ability" I don't mean "they have the right resume." I mean far more basic things, like "they have no idea how to sell this product," or "they have no idea what business they are even in." Brad Feld captured it perfectly in this piece. I was having conversations like that one every day, the same as him, with inexperienced kids totally lost in all aspects of running a business.

I think this became a problem for two main reasons:

1. Bad education:

There is not a well-understood theory of going from a start-up to full company. There is a lot out there on how to come up with ideas and test them (e.g. The Lean Start-up), and the entire business school MBA edifice is great at teaching how to manage a company once it reaches scale with a market-validated product.

The problem is there's very little effective information about going *from tested idea to scalable company*—what to do and how to do it. In essence, our informal educational system teach 0 to 1 pretty well, and our formal education teaches 10 to 1000 very well, but there is almost nothing about 1 to 10 (which is VASTLY different than the other two).

NOTE: *First Round Capital is one of the few places I see creating amazing and informative content in this specific area of need.*

2. Young = stupid:

Most of the founders are young, and young people are inexperienced, which might be great for a lot of reasons (energy, enthusiasm, flexibility, no assumptions), but it almost automatically makes them stupid at entrepreneurship.

I was *exceptionally* stupid when I was young, so I speak from experience here, but without an experiential framework to fall back on, you have no way to understand and solve many of the hundreds of problems that come up when you start a company. The younger you are, the less experience you have, the harder this whole thing is.

This doesn't mean young people can't excel at entrepreneurship. Yes, of course some young people can and do build companies and become amazing CEO's. Please, do not point to Mark Zuckerberg and Evan Speigel as your rebuttal; they are by definition the exceptions that prove the rule. For every one of them, there are 50 founders who torpedo their previously hot company by making all the standard mistakes of youth. Ask any VC you know to tell you those war stories. They have way more of the bad than the good.

I have seen this play out firsthand in my own investments. I can think of two portfolio companies specifically, both of which have raised major rounds from big name VC funds, where I have to actively refrain from punching founders in their stubborn, arrogant faces.

Almost every decision they make is wrong, and the worst part is that I can see precisely how they reason themselves into the wrong decision, and I take pains to point out exactly where the reasoning is wrong, what will happen, and the right way to go.

Do they listen to me (or their other investors)? No. These two founders have done what Mark Zuckerberg said about Twitter, "They drove a clown car into a goldmine." They're young and arrogant and inexperienced, and their little bit of success went right to their heads, and so they think they know everything. I'm watching two amazing ideas that should grow into amazing companies get destroyed by the inexperience and arrogance of their young founders, and it drives me nuts.

Side Note: They are both young males, and young males are especially susceptible to this. I like investing in young female CEOs and older CEOs (either gender) MUCH more than younger males. In my experience, they listen to people, they don't assume they know everything, and they make smart decisions based on good principles, not ego-driven impulses.

Studies bear out the wisdom of this preference: both women do better and experienced people do better at starting companies than young men, and the best VC on earth agrees:

Which brings me back to my original point: **there is so much money chasing so many good ideas, but there are *very few founders who can effectively execute.***

So why does this matter? Why does this make me stop angel investing?

Because the next 2000 and 2008 are inevitable. And it won't be pretty.

When that tide comes back in, a lot of these companies are going to drown. Not because their ideas or businesses are bad, but because the founders have no idea how to run a company, and like Ben Horowitz says, you see who the real CEOs are in times of stress, not abundance.

There is an anti-bubble in talented people—a black hole, and I'm not about to get sucked in past its event horizon.

2. ANGEL INVESTING IS A POOR USE OF MY TIME

(relative to other things)

Even though angel investing looks like this casual, easy and fun activity, make no mistake about it, if you want to avoid losing your shirt, you spend a LOT of time on it: finding deals, vetting companies you're interested in, and then once you invest, working with them like hell to make them succeed.

Just one example: I invested in a custom dog toy company, PrideBites, and have probably spent at least 500 hours over two years learning about the dog toy space, the dog retail space, and the complexities of Chinese manufacturing and logistics (so I can better advise them). Not to mention, another 500+ hours I've spent with the team helping them through all the hundreds of issues that come up. [Yes, these are young guys, and yes they are inexperienced and stupid, but the difference is they listen, and they take direct instruction well, and they have rapidly gotten better, and their company is doing great because of how much they have personally grown and learned.]

That's almost a full time job—and it's only ONE company.

I did win at angel investing. Barely, and I did it with a ton of advantages you probably don't have. And even I'm getting out, because I know so much of my success was luck.

Could I do this with all of the companies I angel invest in—spend my time helping the founders develop? Yes. And if I really vetted my founders well, and really spent time with them, then wouldn't that solve my issue with investing in experienced founders?

Yes it would, that's a very good observation, you're right to call me out in it. In fact, that's what a good angel SHOULD be doing.

But that's also why I had to pull the plug on angel investing; to be truly good at it would take serious time, and that is not how I wanted to spend my time. This is one of the big principles of wealth building (and lifestyle design) that most people ignore:

You should spend the majority of your time on the highest valued use of your time, and delegate or outsource everything else.

You remember above where I said there are so many great ideas for companies, and so few people who can execute them? Well, I'm one of the people who can execute, who can take a company from 1 to 10 (at least for some ideas), so I had to decide which would be the better use of my time: **angel investing, or building one of these great ideas into a company?**

This was not an idle question for me. In fact, I was forced to make this decision quickly and under stress.

In 2014, a new business fell into my lap. Completely by accident, I figured out a way to turn book writing and publishing into a service, and one that was really effective for turning the knowledge and wisdom of professionals into a great book (in only 12 hours of their time). The company took off before we were ready—we did 200k in revenue in two months, without even marketing—and I found myself having to cancel meetings with the companies I'd invested in, work late into the night, and saw the time with my family suffer (time that I try to hold inviolate to business intrusions).

I had to make serious decisions about where I was going to spend my time, because I did not have enough for both worlds.

I did two things:

1. I calculated the expected value of each path, i.e., how much money was I likely to make.
2. I thought about which path was more important to me in non-financial terms.

I won't deeply explain expected value (Wikipedia explains well), but essentially it's a way to assign an actual dollar amount to various decisions, i.e., how much am I likely to make on each path? Some basic calculations showed that expected value of the start-up was higher (though not by much).

But that wasn't the deciding factor. I have decent money, more than enough to not have to make decisions based on money only. For me, the deciding factor was asking myself:

"Why am I doing this? What really matters to me?"

What's always mattered to me is working on something I enjoy that creates something new and positive for the world. Whether it was creating entertaining books or a new publishing service or a new way to write a book, the desire to turn nothing into something in a way that solves a real problem and creates real value has always motivated me.

That's not what you do as an angel investor. What you do is *help other people* turn nothing into something.

Both paths are valid, but the second one is not a huge motivation for me personally. I'm sure the day will come when I am tired and want to just use my wealth and wisdom to help the next generation build the tools of the future. But I'm still young, and I still have my most productive business years in front of me. If I'm not going to spend it working on the hard and interesting problems, then what I am doing? Investing my money for what? To get rich on the labor of others, while I complain that there isn't enough talent solving the hard problems? That would be seriously hypocritical.

Beyond that, I internalized some disturbing things about myself when I was angel investing.

(Photo: Disney, ABC Television Group/Flickr)

There's a reason that Shark Tank is the highest rated show on TV; people love the vicarious thrill of being able to sit in judgment of someone else asking you for something. It's like a modern version of medieval serfs petitioning their lord. That is compelling spectacle, but let me tell you, it is even more compelling when it's you they're begging from.

Few people are willing to admit this about angel investing, but it's clearly true, so I'll say it:

Perhaps the biggest thrill in angel investing is that people flatter you and beg you for your resources, and this makes you feel powerful and respected.

Anyone who says that isn't a draw of angel investing is lying. It drew me in (at least at the beginning). I would say that this is the motivation of the majority of the amateur angels I see out there too. They like how it makes them feel.

But the thing is, it's a cheap thrill. You aren't really doing the important work—***the entrepreneur is the one doing the important work, not the investor.***

It's a false feeling of importance, and though it can be intoxicating at first, I quickly realized how hollow and unfulfilling it really was. I wanted to actually do important work, not just feel good about someone else doing work.

It's a basic question we all have to ask ourselves—do you want to be in the arena, or are you OK on the sidelines?

Both are valid, but personally, I gotta be in the arena, competing, putting myself on the line. I can't just watch.

Once I understood this, the decision to stop angel investing was pretty clear. This is such an important lesson, and so few people understand it, so please understand this if you don't already:

The only thing you can't replace is time. Deciding how you spend it is the most important decision in your life.

WHY YOU SHOULD NOT START ANGEL INVESTING

Those are my personal reasons I stopped angel investing. They may or may not apply to you. But even if they don't, you should still NOT angel invest. Here's why:

1. The economics of angel investing work against all but a select few
2. The structure of angel investing works against all but a select few

1. THE ECONOMICS OF ANGEL INVESTING WORK AGAINST ALL BUT A SELECT FEW

If you do not understand that quote, then you should NEVER PUT ANY MONEY IN A START-UP, unless it's money you are fine setting on fire and throwing out of a window, because that's what you're doing.

Peter Thiel gives [a long explanation of power laws here](), but Sam Altman [explains it]() quickly:

> *"Everyone claims that they understand the power law in angel investing, but very few people practice it. I think this is because it's hard to conceptualize the difference between a 3x and a 300x (or 3000x) return.*
>
> *It's common* ***to make more money from your single best angel investment than all the rest put together.*** *The consequence of this is that* ***the real risk is missing out on that outstanding investment."***

He continues on to explain what this means:

> *"Don't try to get good deals on valuation and hope for these 20-30M exits because too many things go wrong… and if you look at people who have been really successful angel investors, they're the ones that take bets on founders and ideas that they believe can be huge, and cheerfully lose their money a lot of the time."*

This means two very specific things. The only way to be a truly successful angel investor is to:

1. Invest in a ton of start-ups, be cool with watching most fail, and,
2. Have enough money to do both initial investments, and serious follow on round funding (at least pro rata, because tripling down on that one company that makes your whole portfolio is how you make pretty much all of your money)

You may think you understand this, but you probably don't. Paul Graham [explains more]():

> *"In startups, the big winners are big to a degree that violates our expectations about variation. I don't know whether these expectations are innate or learned, but whatever the cause, we are just not prepared for the 1000x variation in outcomes that one finds in startup investing."*

Because YC understands this well, [they've structured their whole program]() to search for these companies, and explicitly pick companies based NOT on who is highly likely to be successful on a low level, but on who has a SHOT at being one of the mega winners. This means they are reducing their "win" rate so they can increase their "home run win" rate.

OK, fine, let's say you understand power laws really well, and you have a ton of money, so you are willing and able to put five figures into 100 companies to ensure you hit that one massive Uber-like home run.

Well congrats, that's ***just the table stakes to get in the game.*** You still have another major problem.

2. THE STRUCTURE OF ANGEL INVESTING WORKS AGAINST ALL BUT A SELECT FEW

The other problem is that there are, at BEST, only a few of these massive home run companies formed each year. You think you can predict, out of the thousands of start-ups launched each year, which ones will be the winners?

A lot of people think they can. Almost all are wrong.

But here's the most messed up part: ***even if you can reliably pick the winners with some degree of certainty, you're still probably going to lose.***

Why? **Because you probably can't get into the winners.**

This is because the best companies (at least in Silicon Valley) tend to get identified early, and as a result, they have a lot of people trying to put money into them. And to even be able to put money in, you have to have a way in, which means one thing:

It almost always takes the right social connections to get into very early stage companies.

Let me be super clear about this: **all the great deals I got into were because of my social network.** That's it. No other reason.

This is (basically) true for pretty much every other angel investor. You win because of your network.

This means that only a certain type of person can truly be successful angel investing. Here are some examples of the type of people who win consistently and win big at angel investing:

- Paige Craig
- Chris Sacca
- Elizabeth Kraus
- Kevin Colleran
- Shervin Pishevar
- Gary Vaynerchuk
- Scott & Cyan Bannister

What separates them from everyone else?

1. They have solid reputations built over a decade (or more) as great people who work hard for the companies they invest in,
2. They have deep and vibrant networks in relevant start-up fields, built by doing a ton of things for other people (or because they are former founders or employees of tech companies, or both),
3. They have the money to double and triple down on their picks, and wait a decade for them to pay out,
4. AND they have something key that I've left out: they have the social clout to not get run over by VC's and literally pushed out of an investment. Oh, sorry, even the big angels have to worry about that.

Do you have those things? *Because the people you are competing against do.*

Seriously, read this post just about what Chris Sacca does for his companies. Or read about all the things that Paige Craig did just to get in the first raise AirBnb ever did. Paige does this for dozens of companies, which is why Paige is such a sought after angel that the best companies go to him. [Full Disclosure: I know Paige well. He's helped me so many times I could write a love letter about him.]

You probably can't come close to doing what these people do as angels. If you can compete, well maybe you're right. But realize that thousands of other people have read the same things you have, and are taking classes on this now.

You are not alone, and you are way behind, and it's getting harder and harder to build the skills and networks necessary to compete, and more and more money is chasing fewer and fewer capable entrepreneurs.

In fact, if there's a bubble anywhere, I think it's in the number of angel investors.

I bet you saw the blog post the AirBnb CEO put up a few months ago, showing the seven rejection emails he got raising his first investment. I was forwarded this by a few people saying things like "I would have known this company was a hit, I should angel invest." Maybe so.

But here's what you aren't seeing: That email was only sent to a handful of people, all of whom were already established angels/VCs. It wasn't going wide. The best companies never do that. Unless you can establish yourself to be the type of person that Brian Chesky would think of to send that email to, you should probably not be angel investing.

That's why I'm telling you to not angel invest. With the exception of a very specific type of person who, like Liam Neeson in Taken, "has a very specific set of skills" and makes this their full-time focus and goes all in, *the entire structure and economics of angel investing works against you succeeding.*

IF YOU MUST ANGEL INVEST, HOW DO YOU DO IT RIGHT?

The best way to invest in start-ups is to be a Limited Partner in a VC fund that's run by someone who can do this. You pay a 2% fee and 20% of the take, and for that, you're buying all of those skills and connections. That's what I exclusively do now (and that's probably where the vast majority of my returns will come from, those funds I invested in).

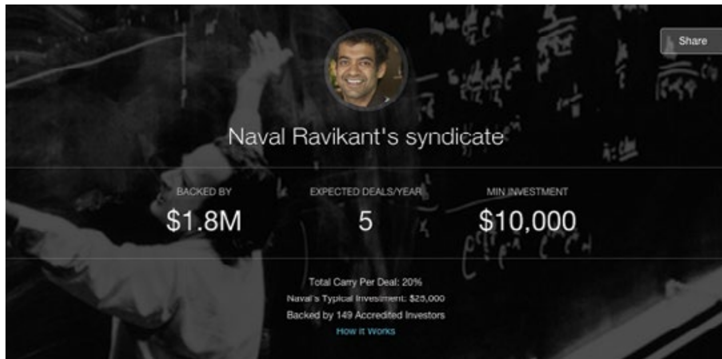
But that is really dangerous too. Why? Because most VC funds LOSE MONEY.

You need to know who to even invest with, and then hope you pick the right fund. And to do that, you have to have the connections to get into them because the best funds can pick their LPs...and you're now back to the same networking problem we just talked about.

Is there any other way to invest in start-ups, and avoid at least most of these issues?

Right now, I can only see one effective method for an average person to get reliable and (relatively) safe access to high-level angel deals:

Use Angellist Syndicates



These are the safest, most reputable way for a small-time, no connections investor to get into serious deals. Angellist is doing something pretty amazing here, and it doesn't get the press that it should. This has real potential to change the start-up investing world for the better.

Most of the angels I linked above have a syndicate, and there are more listed here (Tim Ferriss and Naval Ravikant are two other good syndicates to be in). No, I get nothing if you join their syndicate, and yes, I also have a syndicate and I didn't link it because I've never used it and I don't recommend you join it.

If you want to allocate some portion of your portfolio to angel investments, this is probably your best option. But I would read EXTENSIVELY about this before doing it. The risks are real.

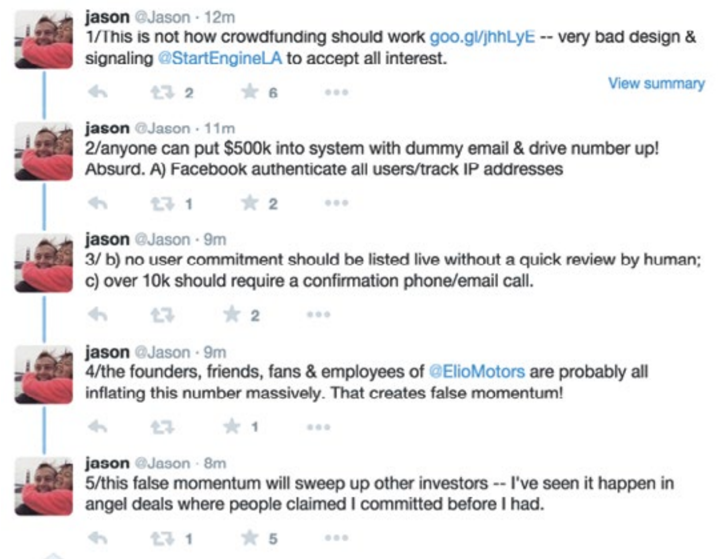
WHAT ABOUT EQUITY CROWDFUNDING?

I used to think equity crowdfunding would be amazing. I was a huge cheerleader. And I still think it will be... someday.

But right now, it's mostly a bad deal and ***I recommend that most people avoid equity crowdfunding.***

There are a lot of reasons why this is true; I could tell you the story about how I got screwed out of what should have been an amazing exit because of a platform that failed to negotiate an adequate liquidity preference.

But I think this tweet storm (and story) by Jason Calacanis might be the best summary of the reason equity crowdfunding is very problematic right now:



What he is describing is a basic pump & dump scheme, and you are going to see a huge number of people scamming and getting scammed through equity crowdfunding in the near future.

The sad reality is that people are ALREADY getting screwed left and right in equity crowdfunding, and they don't even realize it, and you don't hear about it because it's in NO ONE'S interest to tell you the truth.

Why?

Because everyone is making money—except the small investors using equity crowdfunding platforms.

Personally, I would avoid ALL equity crowdfunding for right now. Let other people take the risks, lose, get pissed, and eventually we will find equilibrium in the system.

Equity crowdfunding will be amazing and totally worth it someday, but not today.

CONCLUSION: DON'T ANGEL INVEST TO GENERATE WEALTH, BUILD COMPANIES INSTEAD

I'll say it again: I did win at angel investing. Barely, and I did it with a ton of advantages you probably don't have. And even I'm getting out, because I know so much of my success was luck.

If you must invest in start-ups, then use Angellist syndicates.

If you really think you want to be an angel, do it full time and 100%, otherwise you're setting yourself up to lose.

For most people, you're better off spending your time and money learning skills and building the company yourself (or even better, join a great company stage early and help them on their journey, it's safer and you can make a ton of money still).

The best opportunities out there for most people are in creating, not investing. Kevin Kelly said it best when he said we are only at the beginning of the incredible changes coming, and that most of the best ideas are still out there.

Find one and make it reality, like I am.

Tucker Max is the CEO of Book In A Box, and a #1 New York Times Best Selling Author.

I'D LIKE TO INTRODUCE YOU TO MY "MENTORS"

The power of words and ideas can transform your life. They are powerful. But you are more powerful. That's something people often forget. We think we are weak, powerless, stuck where we are. But it's not true.

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