(This copy is an AI-assisted translation of the original transcript in Chinese)

E03 Bonus Episode | Chatting with Alice About Wealth, Growth, and Investing

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My friend Alice listened to the first episode and wanted to chat with me about a few topics she cares about regarding wealth, growth, and investing.

Her perspective is very helpful and made our niche podcast a bit livelier. Enjoy~

Timeline

00:33 Alice's self-introduction

01:19 Elon Musk's view on wealth: Is it far removed from us?

06:59 If growth doesn't necessarily bring value, how is this reflected in the valuation process?

27:35 How should a company boss decide whether to invest in growth?

34:16 What is the thinking framework of value investing? What mindset should one have when facing a specific opportunity?

Introduction: A Reunion of Old Friends and Resonance in Value Investing

Patrick: Hello everyone, I'm Patrick, welcome back to *Slow is fast*. Today it won't just be me talking alone; I've invited my friend Alice to record this episode together. Alice is an early listener of this podcast and gave me a lot of feedback after listening, so I wanted to bring her on for a chat. Alice, please introduce yourself first.

Alice: Hello everyone, hi Patrick, I'm Alice, very happy to be on the podcast. I previously worked in the financial industry for about ten years, mainly in private equity and investment management. Simply put, I have passion, interest, and also confusion regarding investing. Patrick and I are old friends, but because we were both very busy, we didn't actually communicate much. We recently met up, chatted about work and investing, and were pleasantly surprised to discover that we are both firm believers in Buffett's value investing.

Patrick: Yes, so we are both people interested in investing. Welcome Alice, let's start chatting.

Alice: Great, I actually prepared a few questions, so I'll go ahead and ask.

Patrick: Sounds good, no problem.

Topic 1: Cognition of Money and Early Financial Education

Alice: OK, the first one is regarding the cognition of money; I actually strongly agree with your viewpoint. Wealth is not money to be consumed; it represents purchasing power. A person's wealth is the proportion of their purchasing power relative to society's total purchasing power. This reminds me of what Elon Musk said: "Money is just a database for resource allocation." Meaning, spiritually, money is just a database for allocating resources. However, I found that when I share this view with friends, I get mocked. Because they say he can say that because he's a billionaire, because he's Elon Musk. I'd actually like to hear your thoughts on this viewpoint.

Patrick: Right, I think Musk's statement actually doesn't conflict with the idea that "money isn't a number, but your true purchasing power as a percentage of society's total purchasing power." What we need to understand is that money doesn't mean the bigger the number, the richer you are. You truly have to understand that ultimately this money must turn into consumption; you have to exercise the function of this money as purchasing power. So when he says money is a database, the number in front of everyone just indicates your proportion in the grand database, serving as proof of your ability to purchase resources. I think that's perfectly fine.

And is it because he's rich that he can say this? I don't think so. Unfortunately, it seems the rich in our society keep getting richer, while the poor seem to keep getting poorer. I think the main issue here is whether one has the ability to acquire assets. A rich person might have received education or learned lessons in society that made them realize the importance of assets. So after becoming rich, they continuously accumulate assets, whether it's buying real estate, stocks, or companies. And those assets can continuously accumulate wealth for them even while they sleep. But poor people, on the one hand, lack this awareness; on the other hand, they feel those are rich people's games that have nothing to do with them, so they just hold onto cash.

And regarding holding cash, we've discussed inflation before. Over time, as long as society's total wealth and GDP continuously grow, if your total cash remains unchanged, your proportion of the whole society will shrink. Therefore, the true purchasing power of your money is actually declining, making you increasingly poor. This is truly unfortunate.

But I feel that no matter who you are, receiving financial education is crucial. Actually, when we were young, we didn't receive good, systematic financial education. We didn't have a course—whether in elementary, middle school, or college—that truly taught you how to understand wealth, manage your wealth, and manage your finances. But financial intelligence is incredibly critical. We don't spend our lives constantly changing jobs just to be employees; ultimately, we want to acquire wealth and achieve so-called physical and mental freedom, right? So financial education is extremely critical.

Buffett achieved what he has today, I think, importantly because he practiced dealing with wealth very early on. He started buying his first stock in his early teens, and like us, he went through the process of staring at stock price charts and speculating. This is perhaps an unavoidable phase for every investor; you only get back up after falling down. But if this process starts early enough to help you get onto the main path of investing as early as possible, I think that is highly critical. So Buffett's ability to achieve today's success is related to starting early and stumbling early. Of course, it's also because his lifespan is long enough to let compounding fully exert its effect; time played a huge role here. Therefore, I personally believe financial education is very important, and I will definitely provide such financial education to my children as early as possible, allowing them to trial-and-error and stumble as early as possible.

Alice: I agree with you, establishing this financial mindset is particularly important. Actually, I think regarding the first question, the biggest takeaway is that ordinary people like us perhaps first need the courage to build the same cognitive framework as billionaires. Because we all want to "copy homework," but we currently cannot copy Buffett or Elon Musk's homework in terms of wealth scale or asset allocation. What we can do first now is only "copy homework" in cognition, building the same cognitive framework as them. Of course, this might face some peer pressure because others will say you think of yourself as a billionaire, but we really should look at problems from a billionaire's perspective.

Topic 2: Misconceptions About Growth and Valuation, and the Four-Quadrant Model

Patrick: Yes, I think you made a great point.

Alice: Okay, let's chat about the second question, which is about growth and valuation. Actually, in the traditional financial industry, regarding valuation, we generally use the Discounted Cash Flow (DCF) model. That is to say, an enterprise's value depends on its ability to generate cash flow in the future. But in your first podcast episode, I noticed you immediately targeted "growth," which somewhat challenges traditional authoritative thinking.

But I strongly agree with your view. Having worked in corporations and observed the development of many companies, I found that problems masked by blind growth can be fatal to an enterprise's long-term development. However, the market, including analysts, still only stares at its growth rate when giving valuations. It's like evaluating a child purely based on their test scores. Even if you know that while they constantly score high, problems have appeared elsewhere that could pose huge hidden risks for long-term development, the societal evaluation system—including parents, teachers, and the entire education system—still blindly praises them: "This child is great, no problems at all." If you think carefully, this is actually quite terrifying.

OK, here comes the question: for enterprises, these unseen problems are like those flaws or potential risks in a child that are hard to quantify with scores. How do you quantify them and apply them to your valuation model or valuation system? Or do you completely abandon this traditional valuation model, abandon the concept of discounting future free cash flows, and apply a discount based on your intuition? And if you apply a discount, where does this intuition come from?

Patrick: This is a great question. Indeed, "growth" is the main theme of our entire world right now. Every country talks about GDP growth, every company pursues continuous performance growth, and even, as you mentioned, children are pursuing growth in test scores. Growth is indeed the unavoidable dominant narrative of our time, right?

But from the perspective of value, as you mentioned, a company's true value depends on the discounting of its future cash flows. Growth is just one factor in this formula; it is not the entire formula, right? Besides cash flow growth, the formula also includes the discount rate, etc., so it's just one factor. However, I feel that currently, in the entire investment system, everyone seems to overly regard growth as the most core, most important factor. And this importance is sometimes treated without discrimination; people mistakenly believe all growth is the same, assuming that as long as the number is large enough, it must be better. This is definitely wrong.

Growth is usually good, of course, but regarding its actual contribution to value and determining how large the value is, there isn't an absolute, linear, deterministic relationship. So it's not a sufficient condition. It doesn't mean having growth is definitely good, and having no growth is definitely bad; it does not possess such a sufficient condition. It's like buying an electric car: you wouldn't decide how much to pay just by looking at its 0-100 km/h acceleration performance. You have to look at many other things: is it safe? Is it safe enough when driving fast? Is its intelligence and operating experience comfortable enough? etc. So growth is just one factor.

Logically speaking, if we look at growth, it must mean: if I put in one dollar today, I hope it will yield a return higher than interest in the future, for example, generating 1.1 dollars, right? If the return brought by this growth is lower than bank interest, it's meaningless; it must be higher than interest to truly create value. When we analyze an asset or a stock, we can analyze its historical data. Through its annual financial reports, we can look at its historical data to see whether the continuously invested capital has actually generated incremental profits and cash flow. At this point, we can analyze it clearly.

However, you can assume what the future growth rate will be in percentage terms, and plug it into this Discounted Cash Flow (DCF) model to calculate the company's value. But in reality, when Buffett and Munger make investment decisions, they don't strictly apply this DCF model. They don't actually precisely apply a growth rate to obtain a so-called exact value of the company. Because they'd rather be vaguely right than precisely wrong. It's very hard to be certain whether this company's growth rate next year will be 8% or 7.5%; who knows, right? So even though you have a seemingly very precise model with growth rate assumptions out to two decimal places, does the final value you arrive at really have reference value? Actually, most of the time it has no practical use. More often, it's a vague feeling to judge whether the company will develop well enough in the future, so they won't calculate it precisely.

But whether growth can create value is indeed strongly correlated with a company's business model. Why? In the real commercial world, if an enterprise wants to create value through growth, there are two core dimensions to consider: first, does this business require high capital investment to achieve growth? Second, after injecting the money, can it bring good profit and cash returns? If we map these two factors onto a four-quadrant grid, there are different types of enterprises:

1. High Investment, Low Return (Growth is a Nightmare)

For this type of enterprise to achieve growth, it requires extremely heavy capital investment, but the overall cash return rate for the company is actually very limited. The most typical examples are the textile industry or the airline industry. Take airline services as an example. Product differentiation on the demand side is extremely low. Passengers taking a flight simply want to get from point A to point B; other so-called differentiated aspects won't generate much of a premium. So it's hard to earn high profits, but on the supply side, it requires extremely heavy capital investment. The textile industry is similar, which is exactly the Berkshire Hathaway company Buffett invested in early on. When he first invested, he found the company was very passive, needing to constantly replace asset-heavy equipment like looms and textile machines. But because the differentiation of commodities is very low, they couldn't command a good price. Yet to survive, you had no choice but to invest in these assets. This feels a bit like the "concert effect": everyone is standing to watch a concert. If the people in the front stand on their tiptoes to see better, the people in the back must also stand on their tiptoes to avoid being blocked. The end result is that everyone is very tired, but no one sees any better than before. Once a competitor invests in more advanced machinery, you must follow suit to avoid falling behind. This forced heavy capital investment yields very low returns. For these types of companies, growth is actually harmful; it's a nightmare. Buffett also fell into a massive trap in the airline industry and lost a lot of money.

2. High Investment, High Return (The Most Perfect Asset)

This is the type of business investors love the most. High return is easy to understand. For example, Coca-Cola, which Buffett invested in: its profit margins are extremely high, generating massive amounts of cash for you continuously. But it has an even more powerful aspect: this kind of growth can be replicated globally. It can continuously invest in building bottling plants in different parts of the world to expand its distribution network, letting its products sell worldwide. It not only generates massive cash continuously, but you can also endlessly reinvest this cash, allowing its scale to grow larger and larger.

3. Low Investment, High Return (A Sweet Dilemma)

This type of asset seems to have an extremely high return rate, but you cannot continuously reinvest the money earned. A typical example is See's Candies, which Buffett invested in. This candy company is highly profitable, with gross margins over 90%, and an astonishing overall return on capital; it's an excellent business. But Buffett was also quite frustrated back then. He tried to take See's Candies out of California, but unfortunately, the brand's mindshare couldn't break out of California and couldn't support massive reinvestment capacity. It can continuously bring you cash flows at extremely high profit margins, but you cannot continuously inject money to scale it up. It belongs to sub-optimal assets.

4. Low Investment, Low Return (The General Norm)

In the real commercial world, the most numerous category of companies belongs to the low investment, low return category. These are the ordinary restaurants, small coffee shops, and common small businesses we see everywhere. Your return is actually very average, but similarly, you don't need to invest massive capital.

So we can see that because business models vary, different companies have entirely different abilities to generate cash and hunger for capital investment. Therefore, the importance of growth and the degree of value it can bring are completely different. We cannot generalize; we must analyze specific companies in conjunction with their business models.

In recent years, people have become extremely obsessed with and focused on growth. I think this is largely influenced by the boom in the internet industry. Early-stage internet companies often needed to "trade losses for growth," because this industry has a very strong "winner-takes-all" characteristic. Because its marginal cost is almost zero, its scale effects or even network effects are immensely powerful. For example, developing a piece of software and copying it to sell to 1 million people is the same effort, so its scale effect is very strong. Some even have higher-level network effects, like WeChat: once the product is built, 1 billion people can interact within it, which constitutes the ultimate type of moat. In the internet industry, the final winner is often just one or two, achieving winner-takes-all.

Moreover, this characteristic is not exclusive to high-tech industries; it has long existed in traditional industries. For example, Buffett invested heavily in newspapers early on, like the *Buffalo Evening News* and *The Washington Post*. The reason he loved investing in newspapers back then was because he acutely realized that within a small city, the newspaper industry had a "winner-takes-all" trait where "only one newspaper can survive." No consumer wants to subscribe to two newspapers simultaneously, and merchants placing ads only want to find the most popular local one. At the time, the *Buffalo Evening News* Buffett invested in was originally second locally. Through fierce price wars and trading anything for growth, it eventually eliminated the number one and achieved winner-takes-all.

So, if an industry possesses this winner-takes-all effect, there indeed will be situations where early profitability is sacrificed for growth. But the problem is that for ordinary investors, identifying the true winner early on is not that simple. Buying a stock is buying a company. We cannot generalize a company just because it belongs to a certain industry; ultimately, we must return to analyzing the specific company, seeing if its growth is truly beneficial to ultimate value creation.

Alice: I was listening very intently because I think your points are excellent. Responding to a few of your views: first, regarding corporate valuation and growth, we must establish being "vaguely right" rather than "precisely wrong." This reminds me of my time in business school when a professor once satirized the way we built valuation models. The professor said: "How do you make your model look more credible? You must remember to keep numbers to two decimal places. This way, everyone will feel the numbers you calculated are extremely precise and correct." This is actually a kind of "clear error." Although your underlying logic and assumptions might all be wrong, simply because you kept two decimal places, others often won't easily challenge your numbers. This is indeed ironic.

Also regarding growth, my feeling is that we are too easily stimulated by news and buzzwords nowadays. But what's crucial is that when a sum of money flows into and then out of an enterprise, you must ask yourself: where did this growth come from? What did it ultimately produce? Only then can you know if this growth is healthy and good. Finally, the newspaper industry example you gave was stunning. I never thought to compare the newspaper industry with today's internet companies, but after hearing you, I realize their underlying business logic actually shares so many similarities.

So we indeed need to break some inherent, conventional cognitions to rethink the business models and characteristics of businesses themselves, which can help us build better judgment. Right now, what is needed instead is an "unlearning" process—removing those incorrect, redundant things from our brains first.

Patrick: Exactly, because we are constantly stimulated by superficial things all day. It seems everyone is burning money for growth, so we feel growth is everything. But in reality, absolutely not all growth has meaning and value; ultimately, we must return to the very foundation of the business—the business model.

Alice: Agreed. Alright, the third question continues on the topic of growth. You actually slightly touched upon my question just now, which is about "how much value can one dollar of investment create." Because we often hear some corporate executives say: "When I invest one dollar today, I am actually building the company's moat, so I won't see a return on this dollar in the short term; but ten years from now, when our moat is built, the return it brings back will be multiplied many times." I'd like to ask how you view this issue? How should we weigh short-term versus long-term?

Topic 3: Capital Allocation Decisions and the "Profit First" Rule for SMEs

Patrick: Right, I think this perspective is also very good. The previous angle looked at growth from the investor's level, while this angle starts from the role of a company boss, small business owner, or CEO, looking at how to make capital investment decisions. If an employee came to me today and said: "Boss, I must invest X amount of money in a certain project, because this is for the future of our company." As a boss, apart from managing people, the most critical daily job is making capital investment decisions. So should we invest for the sake of growth? What is the most appropriate growth rate and scale for an enterprise?

First, this indeed has a lot to do with the industry attributes of the business. As analyzed just now, different industries have different business models. If you are unfortunately in a quagmire industry like airlines, facing intra-industry games, when the people in the front row stand up, the people in the back rows must also stand up, otherwise you see nothing. So often in these industries, much of your capital investment is purely to "maintain the current profitability level." It doesn't help you achieve true wealth appreciation, but you are forced to invest. Because, for example, if others buy Airbus A380s and you don't, your hardware experience isn't as good, so you are forced into continuous passive investment.

However, we must also say that every company can find its own methods. Even in an industry as difficult as aviation, there are still a few low-cost airlines that, through thoroughly revamping their business models, chose not to play the fleet upgrade game with the giants, opening a different lane, and thereby forging their own highly excellent business models.

If our investment is not for passive maintenance, but for active profit expansion, and, as you just said, this decision can truly deepen and consolidate the business's moat, then we should indeed invest boldly. But at this moment, the boss must make a highly rational judgment: is this investment truly deepening the moat?

We must remain highly cautious here, because in reality, many investments made by enterprises under the banner of building moats ultimately turn into blind diversification. For example, if I succeeded with this product today, should I horizontally expand to the next product tomorrow? Should Moutai really make Moutai beer, Moutai ice cream, and Moutai hotels? These decisions must be made very carefully. Because normally, blind diversification is not a good thing for the vast majority of companies. Sufficient focus is actually the secret to corporate success, and the hardest discipline to maintain in business. This is a massive topic; we can dedicate an episode to discussing it thoroughly later.

But for most of our listeners, you might be running a small business or doing your own side hustle, facing the dilemma of whether to invest precious funds in exchange for growth. For these SMEs (small and medium-sized enterprises), my personal advice is: Profit First, Net Profit First. Because for the vast majority of SMEs, simply operating the current enterprise efficiently enough to achieve good profitability is already a very difficult task, and there is often huge room for optimization here.

You can carefully examine your company's current net profit margin. For instance, if you are currently at 20%, and the industry leading level is 30%, you could even challenge yourself to reach 40%. In this process, you will find that you have many more urgent, more valuable things to do: such as streamlining unnecessary business lines, cutting pointless expenses, slimming down the team, or even actively advising bad, high-maintenance clients to leave, to maximize your net profit.

When your company has built a solid enough efficiency foundation at its current scale and the net profit is good enough, then achieving growth on this foundation will be very healthy and solid. But in reality, many situations are exactly the opposite: the company's operations are a mess, totally inefficient, earning very little money—perhaps the net profit margin is only a few percent or it's still losing money—yet it impatiently wants to solve problems by scaling up and expanding. This often just makes your footprint larger and larger, resulting in greater losses. So for SMEs, Profit First, Growth Second is a fantastic business philosophy. There are books specifically discussing this principle on the market; you can look for them, they are well written.

Alice: I understand. So "how much value one dollar can create" and "whether it is building a moat" highly depend on the industry the business is in, the size of the enterprise, and its development stage. Of course, this also extremely tests whether the founder possesses the foresight to accurately judge if an action is building a true moat. This is indeed a grand topic, which we will slowly explore next time.

Topic 4: The Dao and Tactics of Investing—The Five Basic Principles of Value Investing

Alice: OK great, let's move on to the last question, which is about a thinking framework, and beyond the framework, the temperament issue you discussed in your first podcast episode. Because personally, I feel that for any thought process, establishing a thinking framework first is the most important. I'd like to ask you: suppose I get an opportunity to visit a company on-site today, but I previously knew nothing about it. If I go today, what thinking framework should I carry to understand and see through the business of this unfamiliar company? And even, how should I decide whether to invest in it? I believe this might also apply to any new industry or new thing. I'm curious, how would you approach this, Patrick? Or imagine, if you were possessed by Buffett right now, how would he think about it? And also, OK, I know how I'm going to analyze it now, but what temperament should I bring to view this company and this investment opportunity?

Patrick: I think first and foremost, temperament is actually far more important than frameworks. Even though, of course, if I start investing today, I must first learn investment methods. These "tactics" are what everyone is eager to master quickly to show off their skills. But when it comes to investing, and running a company as well, the hardest part is still temperament.

This podcast is called *Slow is fast*, which actually originates from a classic short story. Jeff Bezos, the founder of Amazon, once called Buffett and asked him: "Your investment methods are so simple, yet you are the second richest person in the world. Why doesn't everyone just copy your homework?" Buffett replied: "Because nobody wants to get rich slowly."

So, his investment methods and frameworks are actually not complex. The difficulty lies in the fact that most people are unwilling, finding it too slow; they seem to think there is a faster shortcut. But in reality, it's often proven that shortcuts aren't shortcuts, but deep pits, right? So first, I think one must ask oneself: am I willing to get rich slowly like this? Am I willing to not invest in what I don't understand, right? Am I willing to maintain this rationality to do this? If you feel you can, then I think learning these so-called frameworks is meaningful.

Actually, cultivating this temperament requires continuous effort. It's not that some people are just born with it; it's also tempered slowly through experience over time. But generally speaking, temperamentally, some people are more suited for investing, while others are relatively less suited. But to achieve a good result, I think starting with temperament, with the "Dao," is actually more important. Because in too many cases, people invest even when they don't understand. “Understanding" is actually very difficult, but often people think they understand, or convince themselves they understand, and then bet heavily. Because when it comes down to it, the easiest person to fool is yourself.

So I really want to emphasize that temperament is far more important than the framework. Of course, value investing has a framework too. Basically summarized, there are five important principles:

1. Buying a stock is buying (partial ownership of) a company.
2. Correctly understand the market and the concept of "Mr. Market."
3. Correctly recognize your circle of competence; don't invest if you don't understand.
4. Focus on the margin of safety; the purchase price must be cheap enough.
5. Fish where the fish are.

Once you truly understand these five principles, you are actually already a value investor. We also have three criteria for judging a company: Right Business (good business model), Right People (good team and culture), and Right Price (good price). As long as these three aspects are good enough, it's a good enough company, and you can place heavy bets and invest. There are no other more profound secrets.

And of course, for things like business models, you must observe more, think more, and ask "why" several times for everything. Ask five "whys," ten "whys," until you reach the most fundamental level of the matter, rather than floating on the surface and echoing others' opinions. This is also critical. Ultimately, you will become a very good investor.

This is also something I will focus on expanding upon later in this podcast. For example, what each important principle generally means, what it means that buying a stock is buying a company, etc. I'll expand on these five principles, and then discuss how to distinguish what makes a good business model, good team culture, good price, etc. I believe these things can probably be explained completely within an hour or two. So the so-called "tactics" of value investing are just these one or two hours of content. But the vast remaining amount of time actually requires profound combat with your own temperament.

Alice: Thank you, Patrick, I think you explained it very well. Regarding your "don't invest if you don't understand," I think from an ordinary person's perspective, although they say the same words, it might be on two different levels. Your "don't invest if you don't understand" means you've applied your analytical framework and system, and you feel you can't see through this company—not because you want to negate it, but because you feel it might not align with your framework, so you choose not to touch it. But ordinary people often think: I truly understand absolutely nothing. If I really don't invest when I understand absolutely nothing, I might not be able to invest in any company my whole life. So I still need to learn the "tactics" and basic skills you mentioned. Of course, this sounds like it requires massive long-term accumulation to understand different industries and business models.

In other words, my biggest realization today is: first, we must learn to Unlearn. What is removed are the old, inherent, incorrect thinking frameworks and cognitions; take those things out completely first. Then next, we need to Learn (re-learn), sink down and learn the most fundamental techniques of industries and business models. Re-install these correct things into your brain, arming yourself as a value investor. Can I understand it this way?

Patrick: It's actually not as hard as imagined. Don't be scared by these mystical-sounding terms. "Business model" sounds like a grand term, but practically in daily life, it's just very plain, simple facts. Once our subsequent podcast episodes are out, everyone might understand immediately upon listening.

Alice: Simply put, could we say a business model is how it makes money, and whether it's making money smartly?

Patrick: Completely correct. Think about it, even if I just open a small restaurant, I will definitely know how this restaurant makes money—who my customers are, how much daily revenue I can generate, how much I spend on raw materials, how much I pay employees. This is fundamentally the logic of how a company makes money. So, living in different industries, you will definitely have your own unique circle of competence, and you will naturally have things you understand. Just don't touch what you don't understand; there will definitely be things you do understand. Then, discovering good companies within your circle of competence will lead you to your own good investment opportunities.

Alice: Great, thank you, Patrick.

Patrick: Alright, we'll wrap it up here for today. It was very pleasant, we'll chat more next time.

Alice: Thank you everyone, thank you, bye-bye!