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E04 How to Pick Good Stocks? Can I Buy This One?

February 26, 2025

Finally starting to pick stocks, any secret recipes?

Can I buy this one? What if I can't sleep after buying it?

What do you mean by "understand"? What is the "good" you speak of?

First case study: Is Moutai really a good company?

It's not easy to do. Yes, money isn't easy to make, just take it slowly.

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Introduction: From Outward Seeking to Inward Restraint

Hello everyone, I'm Patrick, welcome back to *Slow is fast*. In the last episode, we discussed how buying a stock means buying a company. Today, we will dive deeper into how to find good stocks and good companies.

Of course, this kind of knowledge or information should be everywhere. There are people teaching you how to pick ten-bagger stocks over three years, various tycoons or key opinion leaders analyzing their portfolios, and all kinds of financial professionals teaching you how to pick blue-chip and dark-horse stocks, etc. There are also slightly more practical ones teaching you to buy a book to first learn about financial statements, analyze what a Price-to-Earnings (PE) ratio is, what valuation is, and so on. In my view, these are all outward-seeking endeavors, a bit like wanting to find a martial arts secret manual, learning it, and hoping to quickly master peerless skills.

However, in the value investing system, the most important thing is actually inward-seeking, which is to look at yourself. This brings us to the third principle of value investing, which is: Everyone has their own circle of competence; don't invest if you don't understand.

It sounds very simple and straightforward; each of us surely has things we understand. The point here is that you must clearly understand the circle of your competence: what its radius is, and how much you truly understand within that circle. Things outside the circle are things you don't understand and shouldn't invest in.

What is True "Understanding" in Investing?

But a very crucial point here is understanding what "understanding" means in investing. It actually doesn't mean you need to know everything about the company, like exactly how the product is made, the various details of the product, or whether there are hidden mysteries in its financial statements. These are not what is meant by "understanding" in investing.

Understanding in investing means whether you can see clearly how much money the company can make ten or even twenty years from now, and whether you can make a good judgment on that. This is the most important thing for investing, which means you must understand the company's so-called business model. A business model refers to how a company makes money.

Value investing emphasizes the circle of competence, and it doesn't care how big it is. Everyone's circle of competence will certainly vary in size; does your smaller circle of competence mean you can't make more money? No. Investing doesn't care how big your circle of competence is, but rather whether you clearly know where the boundaries of your circle are.

The biggest taboo is pretending to understand when you don't, lacking self-awareness. There's also the mindset of constantly trying to expand one's circle of competence, always feeling that knowing more makes it easier to make money and increases the win rate. Neither of these is the most critical; the most critical thing is knowing clearly where your circle's boundaries lie. Draw a circle; how wide is its diameter, and how much scope can it cover? Once clearly known, do not invest in what you don't understand.

This is easy to say, but not actually that easy to do. For example, as we mentioned before, investing is not just investing in trends, right? We are currently experiencing a revolution, whether it's new energy, AI, autonomous driving, or even quantum computing trends. Some people might have stronger professional skills and understand more; others might feel these things are completely incomprehensible, but this isn't crucial. Regarding these so-called trends, is it true that as long as I understand them, I have a chance at investment success? As mentioned before, buying stocks does not equal buying trends.

We might easily be able to judge who the losers will be in a trend, but it's almost impossible to judge who the winners will be. Using a previous example: with the invention of the automobile, we could easily judge that the biggest loser would be the horse, and the horse-breeding industry would likely slowly disappear, right, eventually leaving only pet horses or racehorses. But trying to judge who the ultimate winner of the automobile revolution would be is almost impossible, and this applies equally to current trends. So, don't invest if you don't understand; can you truly be certain, for example, how much money this AI company can make ten years from now?

Industry Identity Does Not Equal Business Insight

And regarding "don't invest if you don't understand," sometimes even in your own industry, you might not understand it that well; I myself have made this mistake. I used to work in the internet industry. You feel like since you are in the internet industry, right, you work at an internet company, and you deal with these things all day, shouldn't you understand internet companies very well?

But in fact, the so-called "understanding" isn't about knowing how internet companies differ from traditional companies. Their work habits, how they build products, how they drive growth, and even their talent management methods are all very different. These details do not equip you to judge whether this internet company will still be able to make a lot of money ten years from now, or how much it can make. Only by truly grasping the essence of how the entire industry makes money can you make a sound judgment, and this includes the current AI industry as well.

Of course, AI is the opportunity of our era and the most popular trend right now. Actually, among those supposedly working in the AI industry today, very few truly understand the definition of "understanding" in investing. Very few possess that kind of comprehension capability.

We can easily judge who might be the losers due to AI's development. It's obvious now; for instance, if you used to write marketing copy, or considering AI's extremely strong programming capabilities now, you can imagine that if you are a junior programmer, you might also be a loser. But to judge who the winners of AI will be, who the winner will be in ten years, is an almost impossible task.

I remember a year ago we still thought China's AI was led by Baidu at least, or one of the "AI Little Dragons." But today, the sudden emergence of DeepSeek makes me feel that might not be the case. Can you judge what will happen in ten years? I even think Sam Altman himself might not be able to judge the future of OpenAI. Currently, every AI company has its own definition of AGI (Artificial General Intelligence), right? A year or two ago, everyone's judgment was that AGI might arrive in ten or fifteen years. But in recent months, it seems it might arrive in just two years. We are still in the very early stages of the AI revolution.

On the issue of AGI, when our understanding of how human intelligence biologically emerges is very limited, for us to claim that we will definitely build artificial intelligence rivaling human intelligence within a certain number of years... I think, of course you can make this judgment to show your ambitions, but rationally speaking, you can actually ask yourself: are you guessing, or do you truly have this ability? No one has a crystal ball, yet everyone can make some judgments about the future; who can't, right? But I think admitting that you don't know is actually a much harder thing to do.

Rationality is the Only Antidote

Recently, Buffett released Berkshire's 2024 shareholder letter, and many articles have been analyzing and commenting on it. One article noted that in this year's annual letter to shareholders, Buffett made no mention of topics like artificial intelligence, Nvidia, Bitcoin, or chips. Of course, I think mainstream media and the public are definitely curious: you are the Oracle of Omaha, and everyone really wants to know how you judge these latest trends. But actually, Buffett stated long ago that he doesn't understand them.

Many people think Buffett is being modest, but in reality, he is just being rational. Because from an investor's perspective, truly understanding is very difficult. Truly understanding a company means you can bet heavily when the price is right. That means you could invest all your investable assets, your entire net worth, into this company you understand, provided the price is right. Therefore, value investing does not emphasize so-called diversification.

If you have five ideas, and you truly understand all of them, why wouldn't you invest in the best one? Of course, assuming you understand them all, there is no need to invest in the second-best idea. So if you think you understand AI, you might need to ask yourself if you are willing to put your entire net worth into this company, whether it's Nvidia, or OpenAI if it goes public in the future.

Furthermore, if it's a company you truly understand, you can ignore market volatility. If it's a company you don't understand, or a stock you bought by copying a big shot's homework, there's a huge problem: it's very hard for you to hold onto such a stock. Because the market is constantly fluctuating, and sometimes the volatility is quite terrifying, with sudden swings of 20% to 30%. If you don't understand it, just a few major swings will shake you out, and in most cases, you will exit with a loss.

Because you don't understand, you lack an anchor point; you don't know the approximate range of the stock's true value, so you can only drift with the tide. If you don't understand the company, when the stock drops 20%, you might panic, doubt if you copied the wrong homework, quickly sell, and leave with a loss. Or if it suddenly rises 20%, you might think that's enough, quickly take profits and exit, and then it continues to multiply several times over, right? So with companies you don't understand, it's very hard to make money. It's also very hard for you to ignore Mr. Market knocking on your door every day, quoting you very exaggerated prices; you have no way to ignore the market's volatility. So this "understanding" is actually not a low requirement; it's not the colloquial sense of "I know this company pretty well, I've used its products, I know its profit growth level," that is not understanding.

The first introspection metric: If you have your eye on a stock and you need to ask others, "Can I invest in this?", it means you don't understand it. If you frequently can't sleep at night after buying a stock, it means you don't understand it.

Your circle of competence might just be that big. Through your introspection and judgment of your own capabilities, your circle of competence can help you filter out the vast majority of companies. You don't even need to look at 90% of the stocks on the market because they have nothing to do with you. Therefore, the most important first filter in value investing is your own circle of competence, not other things.

How to Discover Your Own Circle of Competence

Some people might say, based on your definition of "understanding," it seems I don't understand any company; what should I do? You can say you don't understand many companies, but to say you don't understand a single one is unlikely. You live in a commercial world, and there will certainly be some companies you can comprehend.

Everyone has their own methods to find a company within their circle of competence.

For example, Buffett's early approach was probably flipping through so-called listed company manuals. A thick book of thousands of pages listing all public companies, their financial data, and basic information. Buffett flipped through it page by page, multiple times, and found some of the companies he invested in early on. Of course, we don't need to do that now; we have software, right? You can do various screenings and analyses on them, but for ordinary people, this might not be a feasible method either; ordinary people won't sit in stock trading software screening stocks all day.

Another method is actually to pay attention to the businesses or companies around you. Often, if we aren't actively thinking about investing, when we walk past a store or hear stories about certain companies, we just listen selectively and leave it at that. So often what you need is to keep a string tuned in your brain.

This tuned string means: when I see this company, when I hear stories about it, or receive information related to it, I reverse the question and ask myself, is this company worth investing in?

Because everyone has rich work or life experience, you can always think about who you interact with the most, whose products you use often, whose services you subscribe to or pay for frequently, or notice which stores around you have long lines and good business. If you remind yourself to understand how the company's business model works, you might already have entered the process of screening stocks based on your own circle of competence.

We don't need to look at companies we will never understand, nor do we need to follow the herd and force ourselves to try to understand them. Often, you might only need to focus on the simplest businesses to find good investment targets. Moreover, aside from public companies, you can absolutely focus on private companies; no one says investing is only for public companies. If you see a good business next door, and the required principal isn't high, you can negotiate for that business, and then you own that asset and shares in that company. So as for how to screen, everyone has their own methods, but you must keep that tuned string in your head to pay more attention to the business models of different businesses. Start with the simplest businesses; you can definitely understand them if you observe them closely.

The "Three Goods" Framework for Judging a Good Business

Moving on to how to filter out good companies. In value investing, the definition of a good company actually consists of three things: a good business model, a good team and culture, and a good price. This is what Buffett calls "Right business, right people, and right price." What exactly constitutes a good company? It's actually those companies that live a long time and ultimately have a very high value (which translates to a high market capitalization if public)—the companies that are built to last.

Among these three criteria, the first two—a good business model and a good team and culture—act as a filter. This means that if a company's business model is bad, or if you judge its team and culture to be bad, you can directly filter it out; there's no need to even look at it. Only after it passes the first two criteria do you move to the third criterion, using a good price to measure whether you should buy the stock.

The Core Foundation: A Good Business Model and a Defensive Moat

The first criterion is a good business model, and this is arguably the most important one. As discussed earlier, a business model refers to how a company makes money—how it makes money now, and whether it can still make money, and how much, ten years from now. Of course, many factors influence a company's business model. For example, what kind of industry it is in, the industry's prospects, the competitive environment of the entire industry, and down to the execution capabilities of the company itself.

Because a company's value is the sum of all its future free cash flows discounted to today, for a company, its ability to generate cash flow (i.e., its ability to make money) is paramount. Earning ability cannot solely be judged by history because its value is the sum of all future discounted cash flows. So the important thing is to judge whether its future earning ability is sustainable. Therefore, understanding a company's business model plays a decisive role in an investment judgment of a company.

The hardest and most important influencing factor here is actually competition. Because we are in a market economy, if a company has been very profitable in the past, it will naturally attract countless competitors. Business is profit-driven; as long as there is an opportunity, with people making money and such high gross margins, it will attract countless imitators and disruptors. Therefore, to judge whether this company can still make a lot of money ten or even twenty years from now, it is crucial to judge the competitive landscape and its changes.

Here you might have heard of the so-called corporate moat. The concept of a moat, to put it plainly, means whether you have any defensive advantages in the face of competition. A good business model must be one with a relatively deep moat. A good company must have high walls and a deep moat, ideally with sharks or something inside. Inside the castle is the owner, who will spend money every year to fortify his moat, allowing himself to withstand competitive attacks from the outside.

So what kind of enterprise possesses a deep moat? There are many different situations here, but generally speaking, companies that are not easily affected by change will have a deeper moat. We live in an era of technological explosion, with constant new technologies and new startups emerging, hoping to disrupt these older, seemingly powerful companies and hoping to be the ones at the top of the market cap rankings in the future. If an industry or a company's business is very easily affected by change, its moat might not be that solid. So you can see that those so-called new tech companies must constantly guard against whether new technologies will have a disruptive effect on their current business models.

Conversely, some traditional, seemingly unsexy industries are not easily affected by change. For example, as Buffett often says, regardless of what high tech people use in the future, they will still chew gum, they will still drink Coke; these are companies not easily affected by change. So a good business model has no direct correlation with whether the company's business model is very sexy or whether the industry it's in is high-tech.

On the contrary, some very boring businesses have very deep moats. For example, you can search for a US listed company called Waste Management. The name of this company dictates that it won't be a very interesting company. What does it do? It's a waste disposal company that collects the trash from your home. You can take a look at how many times this company's stock price has multiplied in recent years. Does Waste Management have a moat? You can casually ask around or use DeepSeek to quickly get a preliminary understanding.

Recently I also looked at a private company that was very interesting. It helps the government's Transport Department paint lines on ground roads—painting white lines, yellow lines. The contracts it signs with the government are very long-term, and the business is very stable. It's hard to imagine that such seemingly ordinary, non-high-tech companies could have quite good business models.

Another extremely crucial factor determining a company's moat is product differentiation. As mentioned earlier, companies like airlines and textile firms have terrible business models precisely because their products lack differentiation; they are all commodities and can only compete on price and cost. In contrast, highly differentiated companies usually possess pricing power, meaning they can continuously raise the prices of their products. Because its product is not easily substitutable and competitors cannot adequately satisfy its users' needs, it can continuously raise prices. Therefore, product differentiation is a critical factor determining the business model of an industry or company. For any company, what it needs to do is constantly strengthen its differentiation and satisfy differentiated needs. Only by satisfying these differentiated needs can it earn the portion of money it deserves.

Besides this, of course there are many other so-called moats, such as scale economies, network effects, etc. Does a company have a strong moat? You can ask yourself a question: If you had enough money and could hire the best managers and the best team, would you be confident you could defeat this company?

For example, Moutai has a market cap of 1 trillion. Suppose I give you 1 trillion; are you confident you can take it down? You can ask this question. If you feel you are smart enough and have enough money, yet still have no way to take it down, it's highly likely this company possesses a very strong moat. So a good business model is one that, because it possesses a strong moat, can confidently deal with competition and continue to make a lot of money in the next ten years.

Case Study Analysis: Moutai's Commercial Essence and the Common Sense of Supply and Demand

Let's use Moutai as an example. Is Moutai's business model really good? There is a lot of analysis and doubt right now. For example, "Young people don't drink baijiu, Moutai is definitely doomed"; "Moutai has strong financial attributes, many hoard it hoping to sell at high prices, so once its financial attributes burst, Moutai's bubble will burst too"; and many people constantly analyze Moutai's retail price, bottle opening rate, etc. To analyze whether Moutai's business model is good, we actually need to clarify one point: looking ten years ahead, is it possible for Moutai to continue making money as it does now, or even make more money? In many discussions about Moutai, many people possess a lot of seemingly profound knowledge or information, but fail to do even the most basic supply and demand analysis.

Core Common Sense 1: Any company has a specific target audience it serves, and that audience is not everyone.

No company should say, "I make products, and I believe I am serving everyone in all of China or even the whole world." Every company has its target customer group. But I see many analyses saying, "I don't even drink Moutai, and I'm a young person, I really don't like drinking baijiu, so Moutai is definitely not going to work out." For a company, you might not be its target customer, but that doesn't matter; it doesn't affect its ability to make money. We must first determine Moutai's demand side—who are its customers? They are people who love drinking baijiu. So what affects Moutai's demand is not young people, but whether there will be fewer and fewer people who love drinking baijiu in the future. This is the question we should be asking. Moutai has never claimed its target audience is young people; if it did, that would obviously be an unwise move.

Moutai should only focus on those who love drinking baijiu. It needs to focus on how those people evaluate Moutai liquor and how to improve their experience across all aspects of drinking it. If it tries to serve everyone, it might veer off track. You need to clearly know who your target customer is and forget the rest. All you need to do is push your product and service to the ultimate limit, letting those who truly need you feel your product's value. If a startup or a business seems to want to serve and please everyone, it will end up producing very mediocre products and services.This common sense is actually not understood by many. When judging Moutai, people often only discuss their own experiences, without analyzing the overall experience of all the company's demand-side customers from the company's perspective.

Returning to the supply side, there is a very clear figure: Moutai's annual production is about 50,000 tons, while the annual production of all baijiu is about 5 million tons. So looking at it, Moutai accounts for only 1% of the total baijiu production. The question we need to ask is whether this 1% supply can satisfy the demands of its target customer group. This supply and demand determine its price. I don't drink baijiu either, but my own intuitive analysis tells me that this 1% supply should fall far short of demand. Of course, this is directly reflected by the current situation where Moutai is hard to get, and by its price. Then we need to make a judgment: will this supply and demand relationship remain the same in ten years? Will it still be hard to get?

You just need to know that Moutai cannot expand its supply indefinitely. There is a saying, "You cannot produce Moutai liquor outside of Maotai Town." The natural conditions and the microbial ecological environment dictate that Moutai cannot expand its production limitlessly. So as long as those who love baijiu still exist, and as long as Moutai's supply remains this limited, it will always be in a state where it's hard to get. You can ask anyone who loves baijiu: if they could buy a bottle of Feitian Moutai at the original price of 1499, would they be willing to buy it? This directly reflects the true consumers' attitude towards its product.

Additionally, Moutai has another very deep moat. For any brand or consumer product, the biggest difficulty is inventory management. If you release a new product and it does well, it sells out, right, and inventory can't keep up; if it does poorly, it becomes slow-moving stock, and constantly depreciates in the warehouse. But Moutai has a very strong characteristic: its inventory never spoils; instead, the longer it sits, the higher its value. This is a trait very hard for other consumer products to possess. Every bottle of Feitian Moutai is blended using base liquor (these aged liquors) and new liquor. Moutai's over ten thousand tons of base liquor might show a value of X on its financial statements, but its actual value should be rising year by year. And those fermentation pits used for brewing might have their value depreciated and amortized to zero on the financial statements, but you can imagine, since only Maotai Town can produce Moutai liquor, how massive the value of these pits truly is. So this characteristic of Moutai liquor is an immense competitive advantage.

To judge whether Moutai's business model is good, I think we must return to its fundamentals. People who love drinking consider drinking a way to pursue happiness and joy, and Moutai is the best baijiu; other liquors are baijiu, but only Moutai is Moutai, and Moutai serves those who truly love drinking. So we can imagine, ten years from now, can you judge whether Moutai will still be able to make money, or even make more money?

As for Moutai's so-called financial attributes, meaning Moutai first sells to its distributors, Moutai only earns the margin between the ex-factory price sold to distributors and its cost price. Once distributors get the Moutai, they will of course mark up the price, hoard inventory, speculate on it, etc. This is why we currently see Moutai selling for two or three thousand. Assume that in the future, Moutai can only be bought through direct sales (via its APP or flagship stores), with no distributors at all; do you think Moutai wouldn't sell out? Under such circumstances, Moutai still earns the same price, which is the difference between its retail price (ex-factory price) and its cost price. So whether Moutai's financial attributes will burst mainly affects whether distributors can make money. For the Moutai company itself, the impact is not significant. Of course, some people have claims like you have to buy other products to get an allocation of Feitian Moutai, so sales volume will be affected; I think people can judge these details for themselves. So in my own judgment, I think Moutai's business model is a very good one. If I had 1 trillion, there's no way I could recreate a baijiu that could defeat Moutai.

Organizational Culture and "Pursuits Beyond Profit"

Alright, that's enough analysis on business models; you can try using a similar approach to analyze a business you might be more familiar with. Actually, the Moutai business is also a very simple and direct one, and I believe many people can understand it. What's important is that you possess common sense and can form your own independent judgment against echoed opinions.

Now let's talk about what constitutes a good team and culture. Before talking about this, I want to make a point: a good business model is more important than a good team. Just like in horse racing, you can say the jockey is certainly important, right, but for the horse race, the most important thing is still whether the horse runs fast enough. The team is very important, but compared to the business model, it is not the most important. Some people might look at whether an enterprise has charismatic entrepreneurs, right? We have many charismatic entrepreneurs in the business world, but a charismatic entrepreneur is not a sufficient condition for a good company. There are many very good companies where you might not even know the name of the President or CEO. Buffett also has a saying: a good team is of course important, but the company I want to buy is one that even an idiot could manage well. Because one day your company will be managed by an idiot. This is, of course, somewhat of a half-joking statement, but what he means, I feel, is that the business model is the most important. A good business model ensures that even if the manager isn't exceptionally brilliant, he can ensure the company continues to make money, as long as he doesn't do incredibly stupid things.

Compared to the team, culture (a good culture) might be something more invisible and intangible, yet it is actually a very important thing; it is more important than the team. Culture is somewhat like the roots of a tree, growing by absorbing cultural nutrients. A good culture is revealed in the words and actions of everyone in the company, in why they are doing this thing.

There is a saying in the book *Built to Last*: Great companies have pursuits beyond profit.

The recently emerged DeepSeek, its original intention in doing this was to allow people in impoverished areas, ordinary people, to enjoy the inclusive benefits brought by artificial intelligence. Clearly, this is a company with pursuits beyond profit. If it only pursued profit, it would scheme to find ways to make the most money. This seems a little contradictory; we just said a good business model is a company that can continuously make money, make more money, but a good culture is a company with pursuits beyond profit. But this is actually not contradictory. Because as a commercial company, of course you must make money, right; there's a saying that not making money is immoral. But if your eyes are solely fixed on making money, your actions might become distorted; you might think about how to cut corners, how to squeeze employees, etc.

So truly successful companies, truly great companies, do not use making money to guide their establishment, development, and future planning; they are often guided by loftier goals—serving user needs well, placing consumers at the highest position, creating good products that can endure, etc. Ultimately, this business will give you a good return because you satisfied the needs of others and created sufficiently differentiated products. So making money is not your guide; rather, it will naturally follow as you make contributions to all of society.

And of course, good cultures vary widely; companies with pursuits beyond profit are also diverse. When investing, we use a good culture more as a filter. If this company's culture is bad, then I just filter it out directly. For example, if the company has instances of dishonesty, fraud, or something like that, these are excluded directly; also the "profit above all" mentality mentioned just now, instead of putting consumers first; there's also, for example, the culture of grandiose posturing found domestically, always wanting to do something huge and shocking, instead of steadily serving their consumers well and ensuring product quality, etc. I don't need to elaborate on this; based on your own moral standards and feelings, it's easy to judge whether a company's culture is good or not.

Returning to the Moutai example, is Moutai's culture good? Some people might say Moutai is a state-owned enterprise, very bureaucratic and slow, so its culture is very bad. Perhaps we shouldn't look at it that way. There is a book written by Wu Xiaobo called *The Biography of Moutai*, which mainly records the entire history of Moutai from its birth to modern times. It contains many stories, especially about the relentless pursuit of Moutai's quality by entrepreneurs of Ji Keliang's generation. You might not know, but Moutai once had a history of losses for over a decade, and during that decade, they still insisted on putting the quality of the liquor first. In that era, this was actually a very difficult thing to do. Because there were actually many other liquors that made slightly less-than-stellar liquor, right, and they were all making money. Moutai never abandoned its pursuit of product quality. Just this point alone is actually something many companies cannot achieve. They truly prioritize product quality and consumer experience of the product. You have to think, if you were at the helm of Moutai, if you truly prioritized profit above all, you could do many things; if you wanted to expand production, you could always create lots of low-end liquor. Regardless of which management team it is, at least for Moutai currently, putting product quality first is already very rare. So you can't say Moutai's culture is bad; instead, this is a very rare representative of a good culture.

Estimating Value at a Glance: Rationally Assessing Asset Prices

Finally, a good price. First point, there is no absolute good stock. You can't say a company has a good business model, a good team and culture, so I'm willing to buy this stock at any price. Any investment must be evaluated in conjunction with price. The so-called good price, to put it plainly, is wanting to use fifty cents or even less to buy something worth a dollar. Only then is it possible to achieve a good return. So there is an anchor point of value here; we must have a rough sense of how much this company is worth to see if buying at the current price will yield a good return.

However, in the practice of value investing, this valuation is not a highly precise operation. It's not about making numerous assumptions, building a model in an Excel spreadsheet, and calculating the company's price; it's more about a rough estimation. I get a sense of roughly how much money the company can make, and what my approximate return rate is. It's the concept of sizing up at a glance. Whether this person is fat or thin, I don't need to build a model to calculate, right; I can tell at a glance.

This brings us to the fourth important principle of value investing: prioritizing a margin of safety.

That is, if there is something worth a dollar, and you think it's worth a dollar, buying it for ninety cents is actually a bit dangerous. Because your judgment of the company's one-dollar value contains many assumptions, and there will be various surprises along the way. You can never predict earthquakes, COVID, etc. So when you buy a company, you must leave a sufficient margin of safety, trying to use fifty or sixty cents to buy something worth a dollar. This world is full of too much uncertainty; any assumptions and analyses have the potential to be wrong. So we must maintain enough margin of safety to guard against completely unpredictable risks.

Let's return to the example and see if Moutai's price is a good price. There are, of course, many valuation methods: PE ratio, DCF (Discounted Cash Flow), DDM, etc. But I think for ordinary people, we shouldn't overcomplicate simple issues. We still need to size things up at a glance; a rough estimate is fine.

Is Moutai's price good right now? We can look at it this way: buying a stock is buying a company. Buying one lot of Moutai with 100,000 RMB is no different from buying the entire company with 1 trillion. If you buy this company at a Price-to-Book (PB) ratio of 1, then the return corresponding to your purchase is the company's Return on Equity (ROE). We know a company has net assets, which is the shareholders' equity. The Return on Equity is calculated by dividing the company's earnings by its net assets. For example, if the company's net assets are 100 RMB, and the company earns 20 RMB every year, then its ROE is 20%. If you buy this company at the price of 100 RMB, then your corresponding ROE is 20%. This is very simple data.

Now let's look at Moutai's current price; it's at a PB ratio of about 9. If its net assets are 100, the current price is about 900. Then let's look at Moutai's ROE, which is around 35%. Moutai has basically no debt, so this ROE is an unleveraged ROE. Companies with leverage might need to be treated differently. So Moutai is very simple; it just has a 35% ROE.

If we now buy Moutai at a PB ratio of 9, our entry return rate is 35% divided by 9, which is about 4%. What does that mean? If you buy Moutai at the current price, as a shareholder, your first-year return rate will be around 4%. Of course, based on your judgment of Moutai's business model, you can estimate what its future growth rate will be; so that 4% might slowly grow—4.5%, 5%, 6%—and maybe after ten or twenty years, it should have exceeded 100%.

What you need to judge is whether this growth rate's first year, at around 4%, is a good return rate for you. This depends on each individual's opportunity cost. What return rate can you get with your current money? If your money is in the bank, your return rate is less than 1%, so this 4% return rate is clearly better than your bank return rate; it might be a quite good price. If you already achieve a 20% return on another asset, then this 4% return rate is not good for you; you should clearly place your money in that 20% opportunity if available, rather than the 4% opportunity. So whether a price is good varies from person to person, depending on everyone's opportunity cost, which is the return rate you can currently achieve.

For Moutai, an entry return rate of 4%, along with its potential future upward trend in returns, must be weighed by each individual. But I think this method is a very quick and simple way to determine the return rate and size things up; there is absolutely no need to make complex valuation model assumptions, etc. Therefore, judging a good price is actually something that appears (and is) not difficult for ordinary people. So from the above analysis, the criteria for judging a good company are: a good business model, a good team and culture, and a good price. Explained in just a few minutes. So the method sounds indeed very simple: find good companies that you understand and that meet these three criteria, buy them, and firmly hold them. If your judgment is correct, you will develop alongside the company; as the company makes more and more money in the future, you will too, ultimately making the money you deserve to make.

The Ultimate Game: Fighting Temptation and Trading Inertia

But in actual practice, this is not easy. Where is it not easy? It goes back to the mindset of investing.

Difficulty 1: Only Making Money Within Your Cognitive Boundaries

The first point is that it is always very difficult to only make money within the scope of your own cognitive abilities. Because you will see people around you, or someone on your WeChat Moments or Xiaohongshu, who bought a stock and posted their return rate, and you will ask yourself: "Am I wrong for delaying action?" You will be blinded by jealousy and buy stocks you don't understand. Or sometimes you will regret; I believe many people have sighed: "I felt company X was pretty good back then, but didn't buy it, and later it multiplied a dozen times, so I missed a good company." So you feel very regretful. This can only be called missing a money-making opportunity; it doesn't necessarily mean you missed a good company. Because a good company is one that meets the criteria I mentioned earlier. And a stock you missed that once went up tenfold might merely be a speculative opportunity; such opportunities are actually everywhere. There are too many examples in a casino where I lost 1,000 bucks, but someone else made tens of thousands, a 20-fold return, right; you can't envy these. So value investing's so-called circle of competence, the so-called "don't invest if you don't understand," is simply telling us that you only make money within your cognitive boundaries; you make the money you should make, and the money you shouldn't make has nothing to do with you, just block it out.

Difficulty 2: Enduring the Extreme Patience of Gaining Nothing

Then the second difficulty might be: I've been looking for several months and haven't found anything; do I just keep waiting here doing nothing? It is indeed very hard; it requires you to have immense patience to wait for a good opportunity to appear. When there are no good opportunities, you basically do nothing but wait. Buffett's job—even though he tap dances to work every day—is just looking at companies, reading, and eating hamburgers every day, nothing more, right? For them, having one good opportunity, one good company a year might already be a lot. So being able to wait for an opportunity that comes once every year or two, which is truly a company you understand, and waiting for a good price to buy and hold long-term, is a very difficult thing. Therefore, Buffett describes value investing somewhat like waiting for paint to dry or watching grass grow slowly; that's the feeling. So it won't be a very exciting, roller-coaster, thrilling experience. If you pursue excitement, your best destination is a casino.

Furthermore, the commercial society and information age we are in will constantly tempt you, urging you to trade quickly, or even frequently. Because these brokerages, these practitioners, these professionals—their business model is realized by extracting commissions through your constant trading; they have to do this. So the mainstream voice is "The opportunity is here, act quickly, or you will miss the golden opportunity," etc., etc. Stock commentary news on TV, on Xiaohongshu, in WeChat Moments, etc., various ads will tell you to act quickly; opportunity knocks but once. This is a completely different value proposition from value investing, which requires you to only invest in what you understand and act only when the price is right. But behind them are different behaviors triggered by their respective incentive mechanisms.

Difficulty 3: Crossing the Crisis to Hunt for Bargains When "Good Stuff Isn't Cheap"

The third difficulty is: good companies are generally quite expensive. Our market is of course not perfectly efficient, right; if it were efficient, there wouldn't be people like Buffett who can consistently beat the market. But long-term, or most of the time, the market is still relatively efficient. If there are good companies, they are usually recognized, and their prices won't be too cheap. So you are unlikely to see very cheap Moutai, Tencent, or Apple, right? But the market will always present opportunities. Because we know that when a crisis hits, 600-buck or 800-buck Moutai will appear, Tencent at two hundred-something will appear, and very cheap Apple will appear. So you can't use this as an excuse, or say that since it's expensive most of the time, I'll just buy it expensive. You might still need to wait, or you need to find where the fish are, avoid competition, and avoid overly efficient markets. If we have the chance, we can find another episode to discuss this thoroughly.

If good companies are generally expensive, can we buy companies that aren't very good according to the three criteria, but are cheap enough? In his early days, Buffett also transitioned from buying so-called "cigar butt" stocks—which are extremely cheap, very bad companies—to later buying good companies at a fair price. Cheap companies can also make money, and some make quite a lot. But if you want to sleep soundly with your investments and not be made extremely anxious by it, it's better to buy good companies. Because with cheap cigar-butt stocks, although they might make money, you might inevitably experience some thrilling scares. It's better to hold some good companies; these good companies will bring you long-term surprises, and you can sleep very soundly.

I feel for most people, if you truly cannot find—haven't yet found—a good company within your circle of competence, then invest in indices. If you are optimistic about China, invest in Chinese indices; if you are optimistic about the US, invest in US indices. When truly good stocks are discovered, you can switch to stocks. There is no need to buy a very poor company hoping to bet on its turnaround, only to fall into a value trap and lose everything.

Conclusion

So today we talked about how to pick a stock, and what kind of company stock is considered a good company and a good stock.

Overall, value investing is a way of thinking; its essence is that we shouldn't be influenced by others or the market. You must return to your own circle of competence and make independent decisions. Of course, when making decisions, you must have a certain margin of safety. What we need is to secure a relatively certain return in this uncertain investment game. Ultimately, what matters is whether you are truly investing or speculating.

A smart investor invests in value, not price. Speculative investing is like gambling, essentially betting on luck. So we'll stop chatting here today; there was quite a lot of content. If you have any questions or disagreeing viewpoints, you can leave a comment in the Xiaoyuzhou comment section. See you in the comments, bye-bye.