What have I learned from Warren Buffett?

Sunday, May 11, 2025

Dear Family and Friends,

Warren Buffett has announced he will retire as Chief Executive of Berkshire Hathaway at the end of the year. The veteran investor told his company's annual meeting that he would hand over the reins to Vice Chairman Greg Abel. "I think the time has arrived where Greg should become the chief executive of the company at year end," said Warren Buffett, 94. In this document, I've shared what I have learned from Buffett over the past two decades.

First and foremost, we cannot look around for people to agree with us. We cannot rely on others to even understand what we are talking about. We have to think for ourselves. The ability to detach from the crowd is a quality we truly need.

Successful investing is 99% temperament and 1% intelligence. The most important quality for an investor is temperament, not intellect. We need a temperament that neither takes great pleasure in being with the crowd nor in going against it. One should always seek opportunity away from where the crowd is heading.

As Munger once said, "To us, investing is the equivalent of going out and betting against the pari-mutuel system. We look for a horse with one chance in two of winning, which pays you three to one. You're looking for a mispriced gamble. That's what investing is. And you have to know enough to know whether the gamble is mispriced. That's value investing."

Although value investing has evolved since its early days, its core principle remains: buy companies capable of generating returns above their cost of capital at discounted valuations, particularly when the market has over-extrapolated short-term trends. Investing is fundamentally about understanding what is priced into the market today and anticipating how those expectations might change in the future.

As an investor, I focus exclusively on truly understanding what I am looking to buy. When I buy a stock, I become part owner of a living organism. A business is a team of people, with leadership, values, energy, and personality. In this process, I try to understand what makes it tick beyond the numbers: the underlying business, its industry landscape, strategy, and competitive moats.

I also examine the strength and trajectory of a company's main value drivers, sales growth, operating margin, and capital intensity. Using a reverse cash flow model (starting with the current share price), I assess what level of performance (value drivers and free cash flow) the company must deliver to justify its current price. I then use our information edge and knowledge of the company's value drivers to form our own expectations.

Are our long-term performance expectations higher or lower than what the market has priced in? If higher, the stock may be worth owning. As Warren Buffett famously said, "We do not have to be smarter than the rest, we just have to be more disciplined than the rest."

But if your views on investing and valuation were shaped by reading Ben Graham and nurtured by listening to Warren Buffett, it’s worth remembering the context in which their advice was given. Put simply, the doctrine that when investing in a stock, you should focus on management and moats while ignoring governments or macroeconomic indicators may have worked for U.S. investors in the 1980s, but it won’t hold up in other parts of the world, or even in the post-pandemic United States.

Stock-picking to gain an edge is increasingly difficult, given the broader availability of valuation data. After more than two decades of disruption, it's clear the center of gravity has shifted, for both economies and markets. Much of the value now comes from companies vastly different from those that dominated the 20th century.

While it's often noted that today’s largest companies derive their value from intangible assets, the more important difference is that these tech firms are less capital intensive and more agile. Their flexibility, allowing them to seize opportunities quickly and scale down rapidly when threatened, limits downside risk and boosts upside potential.

Value investors now face one of the most challenging environments in history. The shift in economic power toward globalized, technology-driven companies with massive user platforms has rendered many old-school value investing principles obsolete. Today’s value investors must leave their traditional comfort zone, typically mature companies with physical asset bases, to find value.

One of the core issues with traditional value investing is its aversion to uncertainty. The belief that businesses with too much uncertainty cannot be valued has led many investors to focus almost exclusively on mature companies, steering them away from tech. Unfortunately, many value investors are natural pessimists, convinced that betting on the future or paying for growth is a weakness. Ironically, this mirrors the investor's lament that a tech company cannot be valued.

The debate about valuing tech is nuanced, but one critical issue is how much growth is worth, and what we’re paying for it. As Bill Gross wrote two years ago, “Stocks may decline based on disappointing earnings growth, not higher interest rates.” Some argue growth is speculative and worth little, if anything.

At the other extreme are those who argue that growth is priceless and should be paid for without restraint. While both sides agree that valuing growth is inherently uncertain (because forecasts will often be wrong in hindsight), I believe we should not pay a premium for growth itself, but for quality growth. And quality is defined as the excess return generated above the cost of capital.

Picking stocks with excess return on invested capital (ROIC), while avoiding those without earnings, has been a simple but effective strategy for outperforming the market. Fortunately, our equity portfolio consists of value creators and price setters, with defined investment objectives, risk limits, regular rebalancing, tactical shifts when risk premiums change, and an open approach to the global investment universe in search of top-quality, cash-generating companies.

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Within our selected countries and sectors, we only own companies that can: (i) invest capital at returns well above their cost of capital (value creation), and (ii) raise prices without hurting demand (price setting). Returns on capital must be high, consistent, and unleveraged, supported by durable competitive advantages like switching costs or network effects, which prevent returns from being eroded by competition.

Pricing power, always an asset for businesses that possess it, may be an especially critical advantage in the year ahead. Inflation has resurfaced in many global economies, with signs it could persist. Rising costs can squeeze a company's margins and reduce investor returns.

Only companies with clear, sustainable pricing power can defend their margins by passing those costs to customers. According to Buffett, the key to investing lies not in predicting how much an industry will grow or impact society, but in assessing a company's competitive advantage, and, above all, the durability of that advantage.

For long-term investors, this means evaluating a company's prospects for sustainable value creation. Generating excess returns in the stock market is tough. But a rigorous analysis of competitive advantage, measuring the "moat", can help identify businesses capable of sustaining high ROIC. The purpose of measuring the moat is to establish a grounded view of both the magnitude and the longevity of that return potential. While industry and management matter, research shows that strategy is the primary driver of long-term value creation.

Take NVIDIA as an example. Its real moat isn't just the processor, despite its innovation, but the software abstraction layer (CUDA) and its vast, expanding developer community. NVIDIA introduced CUDA over a decade ago, and has continued to invest in both product and programming language, leading to its breakout success in recent years. I highly recommend reading our NVIDIA Valuation Presentation FY2017 to Present, a comprehensive, 200+ slide deck that delves into our thinking, investment philosophy, and conviction:
https://www.linkedin.com/pulse/nvidia-valuation-presentation-rafael-nicolas-fermin-cota

Sincerely,

Rafael Nicolas Fermin Cota (Nico)
Chairman, EuclidTech

References:

[1] Instagram Posts: As I watched managers and companies struggle with the after shocks of the economic shut down created by COVID-19, I wrote a series of posts on what I was learning, unlearning and relearning about investing: https://www.instagram.com/rafael_nicolas/. As the late, great economist John Maynard Keynes always said, "When the facts change, I change my mind." When we time markets, we are making a judgment on the equity risk premium (https://rpubs.com/rafael_nicolas/sp500_monthly_valuation), and reallocating our money accordingly.

[2] Global Capital Structure Database: For the past fifteen years I have been teaching students how to collect company level data and performing bottom-up analysis of leading economic industry companies. The idea here is to use the stock market conditions as signals for what is about to happen in the economy. Stocks usually lead fundamentals by about 6 to 12 months, thus it has a remarkably prescient message about future economic activity. And to help students avoid sprinting into an era where numbers are easier to produce than ever, I have also been sharing the optimal capital structure database for 50,000+ publicly traded companies across sectors and regions(https://github.com/rnfermincota/academic/tree/main/research/traditional_assets/database). Starting with how the market is pricing risk (both country and equity risk premiums), and then moving on to the cost of equity at each debt ratio, and then estimated the interest coverage ratio, synthetic rating, and cost of debt, taking care to ensure that if the interest expenses exceed the operating income, tax benefits would be lost. These hurdle rates also represent benchmarks that businesses have to beat to create value. When we invest capital in risky businesses, we need to not just make money, but make enough to cover what we could have earned on investments of equivalent. This also helps explain why the parallel-processing capabilities of Nvidia GPUs are so powerful to exploit industry trends and capitalize on company-specific opportunities ahead of the broader market.