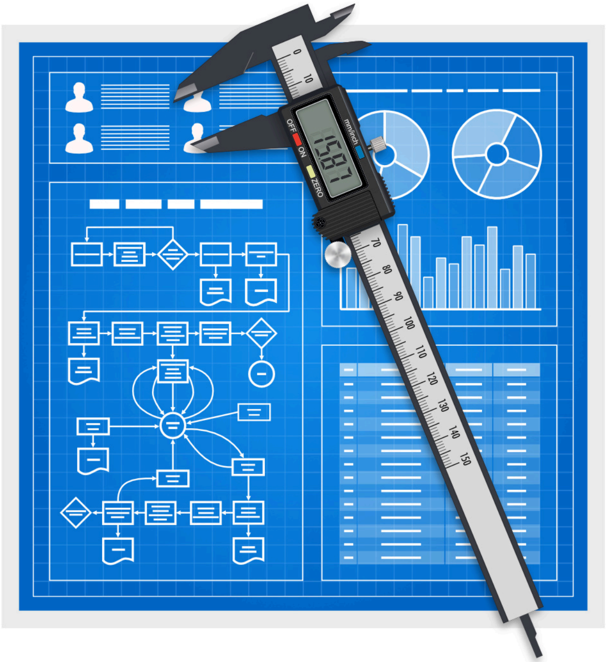
POLYMATH INVESTING



How industry experts can leverage their knowledge in public markets

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Polymath Investing

How industry experts can leverage their knowledge in public markets.

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https://florian-morata.com

To my role models: Benjamin Franklin, Charlie Munger and Warren Buffett

To Katja, my inspiration, my anchor, and my love. This book is for you.

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Introduction

This is a short book to explain how you could use your industry expertise to make more money with the stock market than investing in index or picking stocks intuitively.

About the author

I'll start with a brief description of who I am so that you can understand my background.

I'm Florian Morata, an engineer, entrepreneur, and investor. Before entering the public markets, I spent 15 years building and operating two businesses in software engineering and sales training before selling them.

I am currently the Chief Investment Officer of Morata Capital, an EU-regulated alternative investment fund manager, and a researcher at the Strategic Intelligence Institute, author of Geopolitics Simplified.

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What is it about?

It's about investing in high-quality companies when the market is overly pessimistic about them.

These opportunities are rare. They appear when the market overreacts to a problem, such as a product issue, disappointing quarterly results, a scandal, a fear of court litigation or new regulation, or a cyclical downturn. The key question is whether the problem will affect long-term economics or not. Answering that requires deep knowledge of the business, what customers truly think, the competitive landscape, and the broader industry ecosystem.

It is Warren Buffett's investment philosophy applied to complex industries where deep expertise matters. Essentially, you make money because you understand the company better than most market participants. There is no magic.

The goal is not performance at any risk. The goal is to buy companies with a bright future at a reasonable price, do so with discipline and clarity, and compound capital steadily enough to sleep well at night.

This book is meant to help you understand the process, not to tell you what stocks to buy. Companies mentioned are examples, not recommendations.

Who is this for?

Contrary to the vast majority of finance books, this book is exclusively for industry experts: entrepreneurs, business owners, engineers, doctors, lawyers, insurers, consultants, and other specialists who understand how companies in their field succeed or fail. Beyond the company's product expertise, they have a deep understanding of the company's customer context, goals, constraints, alternatives, and buying criteria.

To be more specific, this strategy tends to work better in some industries than others:

Business software (e.g., Microsoft, Constellation Software, Adobe), Semiconductor tools (e.g., ASML, Synopsys, Cadence Design Systems), Industrial technologies (e.g., Roper Technologies, Graco, Ametek), Aerospace & defense (e.g., TransDigm, Safran, Teledyne), Healthcare tools (e.g., Danaher, Intuitive Surgical, Stryker), Financial infrastructure (e.g., Mastercard, S&P Global, Moody's), Insurance (e.g., Progressive, Marsh & McLennan, Arthur J. Gallagher).

When the business model is quite simple, like Coca-Cola, industry expertise provides limited edge.

In addition to this expertise, they also need a particular temperament:

1. Patience. A long time horizon, of at least five years,

represents the second part of the advantage. Most fund managers are forced to focus on quarters because their investors are impatient. As a result, the market values companies mostly based on their short-term performance. Even index funds are affected because they passively follow the market. A patient investor can focus on long-term value. This mismatch occasionally creates bargains when short-term disappointment obscures long-term value.

2. Humility. A clear recognition of one's intellectual and emotional limits is critical here.

- Intellectually, you can deeply understand only a few industries, not all of them. Stay within your area of expertise. Industry specialists often see risks and opportunities long before they appear in financial statements. That is the edge this method tries to exploit. Outside your field, that edge usually disappears.

- Emotionally, markets provoke greed, fear, envy, and regret. They distort judgment and push people toward bad decisions. This approach therefore requires patience, discipline, and emotional steadiness. You must be able to wait for rare opportunities, hold through volatility, and keep your mood and intuition under control through a sound process: write your thesis, use a checklist, limit unnecessary market noise, and review holdings on a schedule, not in reaction to headlines. Few people possess the required emotional predispositions.

3. Independence of judgment. Pain makes people act faster than gain. Professional investors are often judged more harshly for underperforming than rewarded for outperforming, which gives them a strong incentive to avoid being wrong alone. In that environment, it is safer for fund managers to own the same companies as everyone else than to be contrarian and risk standing apart. Individual investors can exploit that constraint, but only if they have the knowledge and temperament to think independently. If you are uncomfortable holding what the consensus considers bad, this is not for you.

4. Tolerance for volatility. You must also be prepared for significant volatility. Volatility is uncomfortable, but it is not the same as risk. For a knowledgeable investor, price swings can create opportunity rather than danger. The key question is not whether the stock moved, but whether the business changed. Many large institutions, such as pension funds, banks, and insurers, cannot tolerate volatility because they need liquidity, not because volatility prevents good returns.

5. Tolerance for concentration. There are only a limited number of true opportunities, so we do not have the luxury of diversifying across many companies. In our context, having a portfolio of 10 stocks is reasonable since you may only find four or five opportunities ev-

ery couple of years, and they tend to come in clusters rather than one by one. However, concentration has three conditions: you understand the business deeply, the downside is limited, and the discount to value is meaningful. Most investors should diversify widely because they lack the knowledge to concentrate safely. But for a disciplined specialist, the risk can be manageable.

If you do not recognize yourself in these traits, a quality investing fund run with similar principles, or a low-cost broad index fund, may suit you better. However, this is not a solicitation to invest in my fund, as we are not the only fund doing that. I am simply describing my process.

Why Polymath?

It's called Polymath because it requires working not only with depth (industry expertise) but also with breadth, across economics, sales, marketing, and regulation, all the way to psychology, culture, and geopolitics.

As you know, no company operates in isolation. Customers, competitors, suppliers, employees, regulators, and society at large all shape outcomes. This strategy requires you to put yourself in the shoes of each of these groups. Be the customer: understand their daily life, goals, constraints, and buying criteria. Analyze the main competitors and suppliers one by one, as if you were planning to invest in them. Explore the company from the employees' perspective. Understand what the regulator looks for and how it is influenced by the general public and local culture. Develop a geopolitical lens, and anticipate how the company's major operating centers could be affected by world leaders, especially in troubled times. Check whether the company deals fairly with each group; if it misleads or abuses any of them, it will eventually pay for it in the long term.

As a result, you need to think in terms of whole ecosystems, not individual companies. That's dealing with many different groups of people whose perspective you'll need to understand. That is the intellectual breadth you'll need on top of the depth of industry expertise.

The Top 5 failures

In investing, survival comes first. If you suffer permanent losses, compounding stops.

That is why risk should be assessed before upside potential. A great investment is not the one with the largest potential upside; it is the one where you know for sure that it can hardly lose much value while still having quite large potential upside, even if not the highest.

"Heads I win, Tails I don't lose much," as Mohnish Pabrai would say.

After studying investment failures, five causes appear repeatedly:

1. Misunderstanding the business. The investor misunderstood the true drivers of demand, competition, or risk.

2. Weak protection against competition. Customers had easy substitutes, rivals improved faster, or the company's advantage proved weaker than it looked.

3. Excessive debt. The business could not withstand a downturn and lost flexibility when conditions worsened.

4. Poor management. Management was dishonest, short-term oriented, incompetent, or misallocated capital.

5. Overpaying. Even a good business can be a bad investment if bought at too high a price.

These are the downsides we want to avoid before investing.

How to Evaluate a Business

We look for high-quality businesses at reasonable prices.

In a nutshell, it means:

1. They have forced demand. They are hard to replace for a vital and recurring product. Think about Visa and Mastercard.

2. They have a durable competitive advantage. Customers can't easily switch to competition. Think about Microsoft Windows, as it's not easy to switch to a Mac for users requiring specific business software.

3. They have a long runway. They can continue to grow for the coming decade. Think about McDonald's when it started conquering the US with more restaurants and new burgers.

4. They can manage their debt during hard times. They have limited risk of going bankrupt during economic crises. Think about Apple with little debt and a colossal war chest.

5. They are managed by honest and competent leaders with long-term incentives and good capital allocation skills. Think about Warren Buffett managing Berkshire Hathaway, not CEOs bending the truth as it suits them, focusing on short-term profits at the expense of tomorrow, or making bad investing decisions.

6. Last but not least they are sold for much less than their long-term value. That only happens when the market underestimates them due to short-term issues that appear more problematic than they really are. Think about Amazon and Microsoft around 2005, in the aftermath of the dot com bubble collapse, or Moody's that lost half its value in 2022.

Since we often buy these companies during troubled times, they always have something slightly broken somewhere which explains why the market discounts them. The criteria we are going to evaluate are not a binary yes or no checklist nor a numeric formula to compute. They are simply guidelines intended to help us understand each aspect and form an accurate picture of the situation in order to assess whether the long-term economics are damaged or not. It requires judgment.

Basically, we buy cars at a discount because they cannot start. Our job is to distinguish a simple battery problem from a much more costly engine failure so that we buy only those that are easy to fix. This requires specialized expertise.

Pre-filter

Because this method relies on deep understanding, the first step is elimination. Most listed companies should be rejected quickly.

First, the company must be in your field. If you do not understand the industry deeply, pass.

Second, the industry genuinely interests you. You will need to study it for years, not days.

Third, the business operates mainly in countries you understand. Prefer cultures, political, and regulatory systems you can judge with reasonable confidence.

Sticky Customers

It's easier to grow a business when people are forced to pay you.

The ideal business is hard to replace for something vital and recurring.

In plain English, the buyer absolutely needs a solution. He cannot wait or assemble an in-house solution, and the company is by far the least painful option for him because alternative solutions do not fit his needs well.

Ideally, you want to be the customer yourself so you will know without a doubt that the power balance strongly favors the company over its customers. However, if you cannot be the customer (for example, defense companies), you will have to clarify the following points:

1. What does the company sell?

This is the obvious starting point for being able to analyze a company. List the main products and services.

For example, Microsoft mostly sells cloud (Azure), Office, and Windows.

It is not a quality factor in itself but a requirement to be able to evaluate the factors that matter.

2. Where profits come from?

Revenue can mislead. What matters most is where profits come from. Identify the true economic engine of the business.

Microsoft makes most of its profits from its cloud services. Amazon makes most of its revenue from retail, but most of its profits from its cloud too. In these examples, you should pay more attention to their cloud customers than to Windows users or Amazon's shoppers.

This question helps focus on the right customer segments. Microsoft also sells to gamers, but they represent only a small share of its profits, so their opinion is not as important as the ones from its cloud buyers.

3. Who are the key customers?

Identify them, understand their jobs, incentives, constraints, and buying criteria. Different customers buy for different reasons.

In the case of Microsoft cloud, customers are mostly IT leaders from older enterprises like Walmart and BMW, while Amazon cloud customers are more engineers from cloud-native companies like Netflix and Airbnb. Microsoft's buyers are compliance sensitive, often due to regulatory pressure or industry ecosystems. On the other hand, Amazon cloud customers are more sensitive to performance and flexibility, especially in the context of software startups.

4. What do they think of the products?

Learn how customers view the product: what they value, what frustrates them, and how that compares with alternatives. Reviews, trade publications, user forums, expert commentary, and industry contacts can all help. Ideally, you want the product to be popular, beloved, and high quality. A hated product is often an invitation for competition.

Microsoft cloud is popular, loved, and seen as high quality by executives, but less so by engineers. It's just the least painful option to modernize aging large corporation's IT having legacy in-house Windows business applications. On the other hand, for companies like Apple, having a popular, beloved, and high quality product for a particular customer segment is central to their success.

What key customer segments think of the product is not a factor in itself; it is only a step to understand the deep reasons customers buy. Sometimes a hated product that is bought again and again suggests that there are deeper stronger influences forcing the sale, like compliance requirements or lack of better alternatives.

5. What are the customer's alternatives?

For each key customer group, identify the realistic alternatives: direct competitors, in-house solutions, doing nothing, or lower-end substitutes. This clarifies pricing power and switching risk. Ideally, you want a unique product where all other options are much more painful than buying the product.

For Microsoft, the alternative is continuing to use their in-house solution, or switching to cloud with Microsoft, Amazon, or Google. In-house gives more control but is slow and expensive, while Amazon and Google require much deeper changes for companies having a long history with Windows in-house.

This is a very important question that needs to be investigated deeply because it is a fundamental requirement for long term growth.

6. Why do they buy?

Go beyond features. What job is the customer hiring the product to do, and why is this company chosen over alternatives? Don't guess, read reviews.

Cloud buyers need to modernize their companies faster and cheaper than doing it in-house. Then, IT leaders of large companies tend to favor Microsoft because they want compatibility, safety, and compliance, while engineers of cloud-native companies favor Amazon because they want performance and flexibility.

It is the most important question, and you can only answer it accurately and precisely enough after answering the previous questions. When you deeply understand the customer context, its goals, constraints, and alternatives, the real reasons why they buy become much clearer.

7. Is the product mission-critical, recurring, and long term?

The ideal business provides something important, difficult to replace, and embedded in the customer's workflow. Necessity and stickiness matter. Think about infrastructure, cloud, payment, network, utilities, healthcare, etc.

Recurring revenue is valuable because repeat sales are usually cheaper, more predictable, and more resilient than one-off transactions.

Long term means that the customers continue to buy for many years, ideally indefinitely. Think about SAP, central software piloting the company, often very costly, long, and risky to replace. SAP customers often stay for decades.

The combination of mission-critical, recurring, and long term allows the company to compound over the years by keeping the existing customers captive.

The cloud can only be replaced at a higher cost and with large delays for large companies. Microsoft is foundational for its customers. The cloud is by nature a recurring revenue.

Durable Competitive Advantage

1. What protects this company against competition?

A good business is not enough. You want a business whose advantage is hard to copy. The most common forms of protection are:

a. Switching costs. It's hard to replace the product with an alternative (risk, time, cost). Examples: Microsoft, SAP, Salesforce, etc.

b. Network effects. The product is more valuable the more users there are. Examples: Facebook, Amazon marketplace, Mastercard, Google, etc.

c. Brand. Customers are loyal for many years despite higher costs. Examples: Coca-Cola, McDonald's, LVMH, Ferrari, etc.

d. Scale. The company is so large and efficient that smaller rivals cannot match its costs or breadth of offering. Examples: Walmart, Amazon logistics, FedEx, etc.

e. Regulations. The product is so regulated that creating a new competitor is very hard. Examples: Moody's, Lockheed Martin, Waste Management, Duke Energy, etc.

f. Technology. The company has unique and highly valuable technologies that rivals cannot match. Examples: NVIDIA, ASML, TSMC, Synopsis, Cadence, Applied Materials, Lam Research, Thermo Fisher Scientific, etc.

Most businesses are less protected than they look. That is why it is so important to put yourself in the customer's shoes: only then can you see what truly keeps them from switching, especially during difficult times. The protection is sometimes not the product itself but something around it like distribution, qualification, procurement habits, integration with existing systems or simple organizational inertia.

2. Is it durable?

The most factual evidence of a durable advantage is pricing power: raising prices above peers and inflation even during hard times and without losing customers or damaging returns.

Unfortunately this is not enough as it mostly involves looking at past results and the company could be a weakening giant. Therefore look also towards the future and ask what could break that advantage. Regulation, technological change, customer behavior, mismanagement or a better alternative? How long can this business remain impaired before customer behavior changes permanently? These become key monitoring points.

That's why thinking about industries and putting yourself in the shoes of each actor, including customers and competitors, is so vital.

Here are some examples of companies with durable advantages in various domains. Software: Microsoft, Intuit. Finance: Visa, Mastercard, S&P Global, Moody's, MSCI. Brands: Hermès, LVMH, Ferrari, Apple.

Durable Growth

Having forced buyers and a durable competitive advantage is a strong start. But if the company can't grow, it's less appealing because a significant part of value creation comes from growth.

Therefore, we look for companies having many opportunities to reinvest at high returns. Often, they cannot reinvest, or at lower returns, which means not compounding but plateauing.

The ideal runway is a very large and growing market, with a small but growing market share, on top of a strong potential for adjacent product creation, as well as international expansion.

Think like McDonald's starting with a single restaurant and only one burger on the menu, expanding into the large and growing fast food market, with a lot of potential for new burgers and countries to expand in. Also keep in mind that now that there are McDonald's all around the globe it is harder to expand. Most runways eventually slow down, even those of the best businesses.

To decompose the ideal runway, let's explore these questions:

1. How large will be the total market in 10 years?

Take the existing market and evaluate if it will grow or shrink in the coming decade, and by how much approximately. This is not an exact science, so better to be approximately correct than precisely wrong. Think in ranges: pessimistic, baseline, and optimistic.

To get a sense of the destination, look at what would limit the market from continuing to grow.

Having a large growing market is an important factor of long-term success.

2. What's the current company market share and how much can it capture in the coming decade?

Same logic, but on the market share of the company. How could competition limit this company from stealing its share? How strong and durable are their competitive advantages? That's where immersing yourself in the shoes of the key customer segments is critical.

If competition is too strong and the company too weak, it will be hard to grow.

3. Can the growth happen with minimal capital?

If you don't need to double the assets to double revenue, that's clearly positive. On the contrary, it's not a deal breaker to be capital intensive, but capital requirements usually slow growth.

If the growth can be self-financed, that's a major advantage.

4. What is the potential for adjacent product creation?

And are they going to be as profitable as the core engine?

It's not a deal-breaker if the company cannot produce complementary products, but it helps a lot to sell more to existing customers, which are usually easier, faster, and cheaper to convince since trust is already established.

5. What is the potential for international expansion?

And will they be as profitable in different contexts, economies, and cultures?

Again, a product that is international by nature (ex: Microsoft Azure Cloud) has more potential than a product for tax preparation in a specific country (ex: Intuit). It's not a deal breaker, but it helps.

6. Is there a flywheel?

Ideally we look for a self-reinforcing business model as the company grows. For example, when being bigger means lower cost to produce or higher value for the customer. Ideally, customer acquisition costs become more affordable over time.

The absence of a strong flywheel is also not a deal breaker, but a strong flywheel can significantly accelerate growth, and therefore the investment returns.

7. Is it a non-cyclical industry?

A cyclical industry means that the company's revenue and profits are influenced by macroeconomic cycles, like being profitable when the economy is booming, and then way less during recessions. It complicates growth because it makes it much more difficult for managers to decide when and how much to invest, putting them at greater risk of losing their competitive advantage if they make a mistake. It's still possible to grow, but it requires a lot more prudence in calculating normalized earnings to decide when it's the right time to buy and at which price, based on cycle history, to ideally buy the company when they struggle. That's why being in a non-cyclical industry, growing every year, is usually more interesting for such strategy.

Survivable

Having deep industry expertise is critical to understand where the market is going, but some problems can only be uncovered by looking at the financial statements. This list contains only the most critical elements to check, with debt being by far the most important item.

1. Is the debt manageable in crisis?

When you invest for the next decades, you'll eventually have to weather a crisis or two. If the company can't survive them, you lose everything invested in them. So the goal is not only to have enough low debt, but to have significantly more assets that can be sold quickly and at a good price during a crisis.

For example, goodwill is an asset that can't be sold. Brands, patents, and other intangibles may be difficult or impossible to sell depending on context. This is often a challenge for tech and consumer products companies. Even tangibles can be hard to sell without significant discount during a crisis, and the general idea is that the more specialized they are, the harder they sell. Generic residential real estate can potentially be liquidated with limited losses, but custom design industrial machinery may only be worth their metal weight in some contexts, a very small fraction of their official book value.

Companies with a strong competitive advantage often have low debt, but some businesses with a reasonable amount of debt can also be excellent too, when debt is used conservatively to magnify the returns.

We will evaluate the debt in two steps: first, the short-term debt (less than 12 months), and then the long-term debt.

To evaluate short term debt sustainability, first measure the total debt against crisis time assets value. The crisis time assets value is a fraction of assets:

Current assets:

- Cash and government bonds: 100%

- Other short term investments: 75%

- Accounts receivable: 75%

- Other current assets: 25%

- Inventory: 50%

Non-current assets:

- Long term marketable securities: 60%

- Private equity: 20%

- Property, Plant & Equipments: 25%

- Other assets (intangibles, goodwill, leases, deferred tax): 0%

Do these crisis time assets cover short term liabilities?

Go to websites like roic.ai to get the data you need for free.

For example, Microsoft, crisis time assets are roughly half of total assets, and even this half cover twice the short term liabilities.

Then evaluate long term debt sustainability. Does the earnings cover the long term debt within two years? Microsoft covers it in a single year.

This is just a "back of the envelope" quick estimate to gauge survivability. It's not a hard rule, but it helps you realize that some companies are much stronger than others to survive their debts in the next crisis, and it's completely independent from how customers feel about the product. You can only read that in the balance sheet.

2. Are ROIC and ROE over 15% for several years?

High and persistent returns on capital are evidence of business quality, especially when they are achieved without excessive leverage. Do not obsess over one year. Look for consistency across time. A temporary collapse is ok if there is a long history of high profitability.

For example, Microsoft is often between 15 and 35 for ROIC and 15-45 for ROE.

Sometimes it is okay to not have high ROIC and ROE if the company is currently reinvesting most of its profit in a profitable way, assuming these are not mandatory investments just to keep up with competition. However, it is trickier to evaluate, so sticking to companies with proven profitability is usually safer.

3. Are gross margin over 80% and operating margin over 30%

This is not a strong rule, just general guidance for the kind of companies well suited for this strategy. Also, look at the average of the good years, not a single year. High margins, especially if sustained over time, suggest an underlying durable competitive advantage. High margins also allows to cushion difficult times.

4. Are earnings real and share count under control?

Selling something on paper is good, getting paid for it is better. Otherwise you can "sell" things to customers who actually pay late, partially or not at all. Therefore you want to check that Free Cash Flow is close or above the Net Income over many years, and have a clear reason why when they diverge.

In the case of Microsoft, they are historically very close, but between 2020 and 2025 FCF lagged more and more behind, mostly because of massive capital expenditures in their cloud infrastructure. It's not ideal, but their cloud being a major profit driver, it makes sense.

A great business can also spoil its investors from profit if it emits too many shares. Check if share count is staying stable or diminishing. Sometimes increasing the share count to finance major investments can be acceptable, but only if the investments are wise.

With Microsoft, the share count is decreasing over time, which is good.

Aligned Managers

The CEO of a company will develop the culture of the company, and everything will be influenced by his vision, from the processes to products.

1. The CEO tells the truth

Honesty comes first. If management cannot be trusted, the rest of the analysis becomes unreliable. Did he ever lie or mislead investors? On the contrary, did he promptly disclose bad news and acknowledge mistakes? Was he prudent in his vision, and did he achieve his stated timelines?

For Microsoft, Satya Nadella doesn't have significant negative records on this topic, contrary to Elon Musk. Nadella is however a bit optimistic in his vision.

2. The CEO thinks long term

Look for managers who talk and act like owners: investing for the next five to ten years, not managing to the next quarter, with compensation aligned with that same timescale.

A bad manager tries to make this year's numbers look good, even if it hurts the business later, cutting important spending like R&D, product quality or marketing, chasing flashy deals, and talking more about the stock price or quarterly targets than about customers, products, and the company's future. That's not what we can read from Satya Nadella's actions or communication with investors, like during earnings calls.

3. The CEO is particularly competent

Sales and profits grow year after year under a competent CEO. He speaks clearly and takes responsibility for mistakes. A not so competent one will evade the topic, have excuses, complicated explanations and blame someone or something else.

Satya Nadella is clearly competent by that definition.

4. The CEO uses money wisely

Capital allocation is one of management's most important jobs. Cash can be reinvested in the business, used to acquire other businesses, distributed via dividends, or used for share buybacks. The test is simple: has management created more long-term value per share with that cash, after tax, than shareholders could likely have created elsewhere?

Unfortunately, when the CEO bonus is tied to next year stock price, he may doing what boosts it at the expense of future profits, by reinvesting in poor businesses that look great in appearance, buying back when the current stock price is overpriced, or distributing dividends when he has better options internally (which is tax inefficient).

Microsoft has been an excellent capital allocator overall, primarily because it has retained huge amounts of cash and reinvested them into businesses with strong moats and high returns, most notably cloud, enterprise software, developer tools, and increasingly AI-enabled productivity. That said, the evaluation is not static. The next few years matter a lot because Microsoft is now deploying enormous capital into AI infrastructure. The central question is whether those investments will earn incremental returns comparable to the returns generated by earlier cloud investments. If they do, Microsoft remains a top-tier allocator. If not, then recent capital allocation may prove less impressive than the past decade suggests.

Reasonable Price

A great business is not automatically a great investment. Price matters. If you overpay, you ruin the investment.

To get an idea of whether the price is reasonable, first assess normalized earnings, which are what you expect the company to earn under normal circumstances. Sometimes you need to exclude extraordinary items. Sometimes you may add back parts of the investments you believe will pay off.

For example, with Microsoft, from the 2025 earnings of $100 billion, you might deduct AI-related income because you noted that most enterprise customers representing 60% of revenue are still mostly experimenting with it, having a low renewal rate and little conviction about the benefits. In that case, let's use pre-AI earnings of $70 billion.

Then divide the current stock price by earnings per share to get the normalized price-to-earnings ratio. In Microsoft's case, that would be: $420 / ($70 billion / 7.5 billion) = 45.

As a practical rule, I rarely want to pay more than about 20x normalized earnings for an excellent business, around 15x for a good one, and around 10x for an average one. For even the best businesses, paying above 30x normalized earnings usually leaves too little margin of safety and makes attractive long-term returns unlikely.

In Microsoft's case, at $420 per share, the company is too expensive relative to $70 billion in normalized earnings. That is very common for widely known, high-quality companies. In that case, you do not invest at that price; you wait for a better opportunity.

A word of caution, however:

First, even if the reference P/E ratios I gave (20–15–10) already take into account a margin of safety, when uncertainty is high, you should demand an even larger margin of safety in the form of a lower P/E ratio and a smaller position size.

Second, you should only use normalized earnings to calculate your P/E ratio. Do not use the P/E ratio shown on financial websites because non-normalized earnings can significantly distort the results. For example, a company that is going to collapse next year can still have substantial earnings today, making the P/E ratio look lower than it should. Conversely, a high-quality company making good investments can appear to have a very high non-normalized P/E ratio because current earnings are reduced by those investments. So always normalize earnings yourself.

No website will ever give you this number because normalization requires judgment and deep expertise in the specific company to understand what should be added back to earnings and what should be excluded. Unfortunately, you cannot use a screener for "low P/E" or "52-week low stock price" to validate this point. Screeners can be used to generate ideas for companies to analyze but not to determine whether a low P/E ratio or low stock price represents a reasonable price. Most stocks are cheap for a good reason; only a small percentage are cheaper than they should be because the market is overly pessimistic about them. Mispricing is rare. Markets are mostly efficient.

How to Invest

Where to Find Opportunities

The best opportunities usually appear when a strong business faces a temporary problem that the market mistakes for a permanent one.

Good idea sources include what other investors who have a similar strategy recently invested in (ex: dataroma.com), industry publications, trade media, earnings calls, specialized newsletters, and watchlists of high-quality businesses.

Stock screens can help find companies at their 52-week lowest price, but most cheap stocks are cheap for good reason. Treat screens as a starting point, not a conclusion.

Use Lists

A simple watchlist system helps keep research organized.

Blue: newly discovered businesses to investigate.

Red: rejected businesses (quality, complexity, lack of expertise). Add a note explaining why you rejected each, so you can revisit them in a couple of years.

Yellow: high-quality businesses that are too expensive at the moment. Update the list every quarter as price, earnings and situation evolve.

Green: high-quality businesses trading at attractive prices.

The Operating Process

1. Collect opportunities (e.g., every quarter)

2. Keep only companies in your domain of expertise that you are curious about and that operate in countries you know deeply

3. List the main products sold and where profits come from

4. Find who the key customer segments are

5. Read their product reviews

6. Understand their context

7. List their alternatives to determine how hard it is to replace the company

8. Determine if the product is vital and recurring

9. Understand why they buy, through their goals and constraints

10. Clarify what protects this company against competition

11. Check for pricing power

12. Evaluate the total market today and in 10 years

13. Evaluate the market share today and in 10 years

14. Evaluate how much capital is needed to grow

15. Evaluate the potential for new products and geographies

16. Evaluate the presence of a flywheel and cyclicality

17. Evaluate if a sale of assets during crisis can largely cover all debt

18. Check ROIC and ROE (ideally over 15% for several years)

19. Check gross and operating margin (Ideally over 80% and 30%)

20. Check if most earnings convert into Free Cash Flows

21. Check if share counts are stable or decreasing

22. Find if the CEO has ever lied or misled anyone in the past

23. Read transcripts and CEO interviews to assess long-term thinking

24. Look for sales and profit growth consistency under this CEO

25. Evaluate each year if the reinvestment of profits was optimal

26. Check if the current price is significantly below long-term value with a margin of safety

Monitor Weak Points

Before buying, identify the few conditions that must remain true for the thesis to work. Those become your monitoring points. When these conditions are permanently lost, sell the position regardless of the current market price.

This makes investing calmer and more rational. You know what to watch, what would change your mind, and what would force a sale.

Cash

Cash is not just idle capital. It is also optionality. It allows you to act when markets panic and prices disconnect from value.

The right cash level depends on opportunity set, mandate, and temperament. When little is attractive, holding cash can be rational. When exceptional bargains appear, cash should be deployed decisively.