Global Value Investing in Our Era

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Thank you, Professor Jiang Guohua, Mr. Jing Chang, and all the teachers, colleagues, and students who made this course possible! This year, during Professor Jiang's visit to the U.S., we discussed how this course has had a meaningful impact in both academia and industry over the past ten years. The number of online course applicants this year exceeded 1,000, which is a testament to its success.

Ten years ago, when we decided to collaborate with Peking University to support the establishment of this course, it was inspired by my personal experience. Thirty-five years ago, when I first arrived in the U.S., Columbia University offered a similar course, which gave me the opportunity to meet value investing guru Warren Buffett. This encounter profoundly changed the trajectory of my life over the next three decades. So, we hoped to bring such opportunities and ideas to young Chinese students as well.

Today, many friends and students are participating both in person (in Seattle) and virtually from Beijing. Thank you for being here!

Without further ado, let me dive into the topics at hand. In my first talk in 2015, I discussed "*The Prospects of Value Investing in China*." Five years later, in 2019, the topic was "*The Theory and Practice of Value Investing*." Earlier this year, Professor Jiang visited Seattle to discuss ideas for the 10th anniversary and invited me to speak again. Today, I would like to discuss "*Global Value Investing in Our Era*."

Over the past five years, both China and the world have experienced many changes, causing significant confusion for investors. Value investing, no matter where it is practiced, must be closely tied to the era we live in. While value investing emphasizes bottom-up fundamental analysis, the companies we invest in exist in a specific era and are inevitably influenced by various macro factors. Thus, we cannot escape the times we live in. With that in mind, I would like to share some of my thoughts.

Today's talk will revolve around four key themes:

1. The primary predicaments of our current era.
2. Thoughts on the underlying causes and nature of these predicaments.

3. The middle-income trap, how countries can overcome it, and thoughts on the current state of international relations.
4. Returning to our main topic, how we as global value investors can respond to the challenges of the current era.

These four topics are vast, so we can't delve too deeply into them but will cover the key points of each. Please feel free to ask about any unaddressed areas during the Q&A session, and I will do my best to share some thoughts.

I. The Predicaments of the Current Era

What are the predicaments of our era? Let's discuss them from both domestic and international perspectives.

Domestic Perspective

Domestically, the challenges are tangible, particularly for young people, who feel the pressure of employment most acutely. According to data from the National Bureau of Statistics, the unemployment rate for youth aged 16 to 24 has reached approximately 20%. Behind the unemployment problem lies the issue of private enterprise confidence. Currently, China has about 700 to 800 million employed people, with 80-90% of jobs provided by non-state-owned enterprises and individuals, primarily private enterprises. State-owned enterprises and the government account for only about 10% of employment. Therefore, the unemployment issue mainly reflects the challenges faced by the private sector. In recent years, private entrepreneurs have faced a series of issues concerning property rights and even personal safety.

The unemployment issue also reflects a decline in consumer confidence. This is tied to the significant depreciation of wealth-based assets, particularly real estate. Real estate once accounted for about 70% of household wealth in China, still represents around 60% today, and remains as the primary source of family wealth. Consequently, sharp declines in real estate and capital market prices inevitably impact consumer confidence and expectations for the future.

Over the past few years, as economic challenges have emerged, policy responses have mainly focused on supply-side measures. However, the current problems are primarily on the demand side, leading to deflationary trends. In China, the term "involution" has gained popularity, reflecting intense competition in a deflationary environment. Under normal economic growth conditions, competition leads to upward, spiral-like growth rather than taking the extreme form of "involution." Additionally, in today's stricter regulatory and political environment, the bureaucratic system lacks effective positive incentives, leading to widespread "lying flat" (inaction) among government bureaucrats, which hampers policy transmission and implementation. These are some of the predicaments China faces domestically.

Over the past 40 years, China has developed to account for over 30% of the global manufacturing value-added. However, its domestic consumption represents only about half of this output, meaning that half of China's manufactured goods must be exported to other countries, with developed nations as the largest customers. Although Southeast Asia has become China's largest trading partner in recent years, much of this trade does not involve final consumption in Southeast Asia but rather re-export trade, with significant portions ultimately consumed in developed countries.

International Perspective

Internationally, China also faces a series of challenges, particularly in its relationships with developed nations in the U.S and Europe. Over the past five to six years, the most significant global variable has been the U.S.'s fundamental reassessment of its role in international affairs. Since World War II, the U.S. has served as a "stabilizing anchor," maintaining peace and stability in international trade, ensuring maritime security (Freedom of the Seas), and global capital flows. It established what is known as the "American Order," encompassing a series of systems, laws, and dispute resolution mechanisms, with the U.S. playing a core role in all aspects.

However, in recent years, Americans — from elites to the middle class to ordinary citizens — have increasingly questioned whether it is worth playing this role. The U.S. has borne about 80% of global military spending per some estimates and has served as the ultimate purchaser, currency provider, and final consumption market for the global economy, effectively stabilizing the global order. Yet, many Americans now believe that the U.S. has gained little in return. They view China's rise as having benefited from the "American Order" while posing fundamental or even adversarial challenges to it. Whether accurate or not, this perspective has led the U.S. to reassess its role and resource allocation in maintaining this global order. This shift has not only profoundly altered U.S.-China relations but also raised fundamental questions about the future of the global order: How will it evolve? Who will provide and maintain public goods in international trade, such as peace and freedom of maritime trade? In this context, what challenges will Chinese industries face, and what role will they play?

In Summary

Both domestically and internationally, a series of issues have emerged in recent years that can be referred to as the "predicaments of our era." These predicaments are not confined to specific times or places, nor are they short-term phenomena; instead, they reflect deep uncertainties about the future.

II. Reflections on These Predicaments: Appearances, Causes, and Essence

Next, I would like to discuss reflections on these predicaments.

These predicaments are not unique to China. Looking back at the past 500 years of world history, all countries entering the middle-income stage after industrial takeoff have gone through a transitional period. This is a universal challenge in the development process of any nation.

In my book, *Civilization, Modernization, Value Investing and China*, I divide the evolution of civilization into three stages: 1.0 (hunter-gatherer civilization), 2.0 (agricultural civilization), and 3.0 (modern science-technological civilization). The transitional phase between stages 2.0 and 3.0, which I call stage 2.5, is where China currently stands. Every country that has undergone industrialization, such as Germany, Japan, and some countries in South America and Asia, has faced similar challenges to those China experiences today. Some countries have successfully transitioned beyond this stage, while others are still trapped in the middle-income stage. Each country's path is unique. Moreover, humanity has yet to establish a 3.0 model for managing international relations in the 3.0 science-technological civilization era.

Causes of the Predicaments

The essence of modernization lies in the combination of market economy and modern science and technology, which results in perpetuating, compounding, and sustainable economic growth. Compound economic growth is a striking mathematical concept. For example, since the early days of reform and opening up, China's real economic output has multiplied by more than 45 times. Nominal growth figures are even more astonishing. However, while economic growth has compounded, social governance, human psychology, and political systems have not experienced similar compounding changes. This discrepancy arises because human nature has remained fundamentally unchanged since the emergence of *Homo sapiens* 200,000 years ago. In contrast, our economy has undergone three monumental leaps – from hunter-gatherer to agricultural civilization and then to modern science-technological civilization.

Thus, when the early industrial takeoff phase concludes, the gap between compound economic conditions and the slower evolution, or lack thereof, in societal, psychological, and political governance inevitably leads to significant challenges. These challenges are universal to all countries at this stage.

China's rapid economic transformation over the past three to four decades is not entirely unique. Historically, only the United Kingdom completed industrialization and modernization independently over a relatively long span. Other countries achieved industrialization through catching up, typically over three to four decades. For instance:

- Japan transitioned from the Meiji Restoration in 1868 to defeating industrialized Russia in 1905 in the Russo-Japanese War in just over 30 years.
- Germany's industrialization between its unification in 1871 and World War I also spanned roughly three to four decades.

- The U.S. transitioned from post-Civil War industrialization to becoming the world's largest economy in the 1890s within a similar timeframe.
- South American nations such as Brazil and Argentina experienced rapid growth post-World War II but fell into middle-income traps by the 1980s and 1990s.

Three to four decades of compound growth can drastically transform an economy, especially during its economic takeoff stage. However, this rapid transformation creates a significant mismatch with the realities of societal governance and poses major challenges across all aspects of society. Some societies can mobilize and succeed in crossing this stage, while others need a long time to adjust, some even took the wrong paths, as evidenced by the catastrophic outcomes of World War I and II. History shows that wars themselves do not solve such issues; instead, it is often the post-war reforms that bring resolution.

Examples of Paradigm Shifts

Let me provide a few examples of how conceptual paradigms evolve during this transitional stage.

1. **The Concept of Land**

In the 2.0 agricultural civilization era, land and population were the primary determinants of an economy's size. Together, they essentially defined the total output of an economy. However, agriculture imposed a ceiling to growth — known as the Malthusian trap — where population growth eventually outstrips land's ability to support it. Consequently, territorial expansion was the paramount pursuit of societies, ethnic groups, and nations. Many historical figures are remembered for either expanding territories or defending them against invasions.

In the 3.0 science-technological civilization era, sustainable and compound economic growth is driven not by land and population but by market size and the full circulation of productive factors. The failure to reconcile these old and new paradigms was a critical cause of World War I and II.

At the outbreak of World War I, all sides expected a quick resolution. However, once war for territorial expansion begins, deeply ingrained psychological attachments to land intensify the conflict, escalating it to a global war. Industrialized Europe descended into a war that claimed tens of millions of lives and led to the collapse of all participating empires, with none achieving their objectives. Had the outcomes been foreseen, no party would have initiated or joined the war, as even the victors paid an enormous price.

World War II, in essence, was a continuation of World War I, fueled by the same entrenched territorial impulses. However, the devastation caused by industrial warfare made the outcomes even more catastrophic, with global casualties exceeding 100 million. All participating empires and nations suffered heavily.

Ironically, post-war reforms in defeated nations like Germany and Japan helped them achieve the very goals they failed to secure through war. Germany, the main instigator of both World Wars, and Japan, the main instigator of the Pacific War, pursued territorial expansion as a means to secure so-called “survival space.” Their wartime mobilization was themed around the narratives of national survival and ethnic economic development. However, what they failed to accomplish through war was achieved in the post-war peace era. After WWII, both nations found opportunities for sustainable, compound economic growth.

After its victory in WWII, the United States became the first nation in history to unconditionally return all conquered territories to their original countries. Such an act was unprecedented in prior wars. In return, the United States established a global system based on its principles, encompassing international trade, goods exchange, and capital flow. All U.S allies joined this system, which enabled “borderless” economic grow for all these countries and the U.S. The underlying cause is that in the 3.0 science-technology civilization era, land is no longer the primary driver of economic growth. Instead, the scale of the market and the free flow of economic elements, such as technology, labor, and capital, becomes the critical driver.

However, the obsession with land still resides in our nature. In the current transitional 2.5 stage, this fixation on land and territory can be dangerous, capable of igniting nationalistic fervor at any time, as this mindset has been ingrained in human brain for tens of thousands of years.

2. The Dichotomy of Virtual vs. Real Economies

In recent years, many policies in China have sought to distinguish between the "real economy" and the "virtual economy," emphasizing support for the real economy while aiming to "redirect resources from virtual to real sectors." This distinction holds validity during the early industrialization phase when resources are redirected from agriculture to industry. However, as economies transition into stage 2.5 and beyond, especially in mature economies, this distinction becomes obsolete and even misleading.

Take video games as an example. Are they part of the real economy or the virtual economy? Many would classify them as virtual. Yet, on today’s battlefields, such as in the Russia-Ukraine conflict, a big influencing factor is not tanks, machine guns, or even non-intelligent missiles, but intelligent drones. These drones are mostly operated by skilled gamers. It is estimated that one to two million combat drones are active in this conflict, operated by individuals whose expertise originated in gaming. This demonstrates how intertwined the so-called "virtual" and "real" economies have become.

Another example is software: is it part of the real economy or the virtual economy? Software governs the global economy today, without which neither the Chinese nor the global economy could function.

Semiconductors is a sector that China has heavily invested in as part of its real economy. NVIDIA, one of the most renowned global semiconductor companies, is commonly seen as part of the real economy. Yet, since its founding in 1993, NVIDIA has not manufactured a single semiconductor wafer itself. All production has been outsourced to TSMC. NVIDIA is fundamentally a software company that designs the operational programs for semiconductors, giving it characteristics of the virtual economy. Before the advent of AI applications, NVIDIA's products were mainly used for gaming.

Germany is often cited as a model for preserving a strong real economy foundation. Yet today, NVIDIA's market value surpasses the combined market value of all publicly listed companies in Germany. It even surpasses the added market value of all publicly listed companies in Germany and Italy, as well as over 100 other countries. Despite potential bubbles in its valuation, NVIDIA is indispensable for the gaming, cloud computing, and AI industries. This blurs the line between virtual and real economies, making the distinction largely irrelevant.

3. The Role of Government

As economies transition, what role should governments play?

On a domestic level, during the agricultural era, centralized and decentralized governance each had their respective advantages. In a planned economy, the government functioned as a command center. With reforms, its role shifted to a guiding one. However, in a market economy, major economic decisions must be made independently by entrepreneurs with a stake in the outcomes, operating in competitive environments.

China's $18 trillion economy consists of over 100 million enterprises that are making billions or even tens of billions of dollars' worth of economic decisions daily. The sheer complexity and scale of these decisions are beyond the scope of any small group of individuals to plan or direct effectively.

On the international level, half of China's production is exported globally, with China being either the largest or 2nd largest trade partner for more than 120 countries. Together, these countries account for approximately 80% of the global economy excluding China, and the everyday life of billions of people in these countries are profoundly impacted by the billions of private decisions made in China. If the Chinese government continues its command or guidance mindset in thinking and dealing with issues, it will impact not only the 1.4 billion people in China but also the lives of billions outside of China.

Today, nearly every major global media features China on its front page. This reflects the far-reaching impact of Chinese government decisions on the world, affecting the livelihoods and interests of at least several billion people. In transitioning from an agricultural to a modern science-technological economy, governments worldwide have evolved from command-and-control roles to collaborative, consultative, supportive, and service-oriented roles. This transformation aligns with the scale and complexity of modern economic systems. China, too, must adapt its governance model to its unique role in global trade and its own economic realities. To trade with every country and export half of its production overseas, the Chinese government must consider the interests, perspectives, and economic realities of these global stakeholders.

These three examples underline that as an economy enters the middle-income stage, significant gaps will occur between the compound economic progress and the slower evolution of traditions, governance structures, and human nature. These gaps manifest across all aspects of the economy. Therefore, we need to repeatedly reassess and adjust those outdated ideas that hinder economic development.

III. The Middle-Income Trap, How Countries Can Overcome It, and Thoughts on the Current International Relations

Reflecting on the last 500 years of modernization, both China and other nations have amassed a wealth of experiences and lessons that provide valuable guidance for us. On this foundation, we approach our third topic: Can China overcome the middle-income trap and how should it handle today's international environment?

First, the perpetuating compound growth of a 3.0 economy is powered by the free exchange and circulation of all economic elements within it. Every instance of free trade and exchange generates a synergistic effect, 1+1>2, while knowledge exchange can even achieve a multiplier effect, 1+1>4. Thus, the more frequent and unrestricted the exchanges of goods, services, and ideas, the greater the incremental benefits. A truly modernized and sustainable 3.0 economy possesses this crucial trait – the complete and unobstructed circulation of all elements, without any bottlenecks.

What elements in China's economy have not yet achieved this level of full circulation and exchange? I will highlight two examples:

First, personal consumption in China accounts for only 40% of the economy, a proportion that has been declining in recent years. At the same time, the savings rate has risen from 40% to about 50%. Most of these savings remain within the banking system, which is predominantly controlled by state-owned banks. Can this system adequately circulate these savings back into the economy?

There are no successful cases in history, either domestically or internationally. For savings to truly benefit economic growth, a modernized capital market and an efficient financial system are necessary to promote the effective allocation and circulation of capital.

Reflecting on the history of economic development, the earliest financial system emerged in Venice, which was the longest-lasting republic in human history, spanning over a thousand years from the Medieval period to the Napoleonic era. From 1000 to 1500 AD, despite having a population of just tens of thousands, Venice almost monopolized the critical trade routes between Asia and Europe, becoming the largest trade empire of its time. What was the key to Venice's success? It invented several crucial parts of today's modern financial system – double-entry bookkeeping, later the joint-stock company, insurance systems, and banking systems that were related to modern trade.

At that time, Venice relied primarily on finance and trade. Its narrow territorial base lacked agriculture and industry, and other nations were still in the agricultural civilization era. Thus, Venice was unable to develop a true 3.0 modern science-technological civilization, but the financial systems and tools it invented were further developed and refined in a larger nation — the Netherlands. In 1581, the Netherlands declared independence and after a long 70-year war for independence, it rose to become the most significant maritime trade empire of the 17th century, conducting about a quarter of global trade through Dutch ships. With only a few million people, not much larger than Venice, the Netherlands developed the initial version of the modern financial system, including the invention of the public limited liability company. The Dutch East India Company was the world's first public company. The Netherlands also established a central bank and stock exchange, achieving a high level of securities market development, and even experienced the first speculative bubble in human history — Tulip Mania. These innovations led the Netherlands to far exceed other European nations in GDP per capita, and allowed it to maintain a position among the world's top ten wealthiest countries for the next four hundred years. Today, the Netherlands remains one of the world's largest trading nations, having maintained prosperity for over four centuries.

However, the Netherlands did not develop a standard 3.0 economy with industry, science and technology, and manufacturing — that milestone was achieved by Britain. How did Britain accomplish this? The most significant event in British history was the Glorious Revolution of 1688. This revolution achieved two milestones. First, in governance, Britain adopted a republican and constitutional monarchy system, ensuring that the monarch was no longer an autocrat but was constrained by various powers. The second achievement, perhaps more profound, was a "merger" that resulted in the financial and economic integration between the Netherlands and Britain. At the time, William III of the Netherlands who became co-monarch of England with his wife Mary II, was effectively the leader of both the Netherlands and Britain. He transplanted the entire Dutch financial system to Britain, a "merger" at the institutional level.

This merger brought a complete modern financial system to Britain. What is the ultimate product of a complete modern capital market and a financial system?

The capital market provides not just capital but a system based on credibility. Banks can provide capital but cannot create that type of system. What is a system of credibility? Entrepreneurs must have credibility as entrepreneurs, investors with credibility as investors, and the intermediaries linking savings and investment must have their own credibility, ultimately converging into a system that transforms the small amounts of money from ordinary savers who know nothing about business and investing into a significant capital base. The result of this capital base is the creation of effective productivity, supply, demand, and profits; a virtuous process with organic, perpetuating circulation. In this process, each intermediary is an independent and professional node, not directly linked to the final outcome but highly related through a system based on credibility. Thus, an ordinary small saver can also participate by owning a small part of a successful company. Many small savers, owning even just one share, can aggregate into a powerful capital base. Throughout the process, every intermediary plays its role, based on credibility, to pool these resources into the most deserving businesses and products and services.

This process establishes a complete system of credibility, which is linked to a structure of legal system, dispute resolution, best-in-class practices, and trust. Building such a system is incredibly difficult and requires continuous trial and error. After transplanting and establishing this system, Britain never lost a war in Europe again. Previously, Britain financed wars through the royal family, putting personal assets, income, and territory on the line and assuming unlimited liability. Now, it was replaced by a modern credit system. Through this system, Britain issued debt several times its GDP, attracting global investments without ever going bankrupt or defaulting. This was the first truly modern capital market system.

When scientific and technological innovations began to emerge, this modern system enabled Britain to rapidly establish the first modern 3.0 economy capable of organic, self-perpetuated, and sustained growth. This is the very definition of a modern state.

As we discussed earlier, personal consumption today accounts for only 40% of China's GDP, with nearly 50% going to savings, almost all controlled by the state-owned banking system, which is inefficient and incapable of establishing a system of credibility. The capital market system China has established is still in its infancy and has been shrinking in recent years. The existing system is far from a modern capital market system and lacks the capacity to convert substantial savings into potential consumption and investment to get the economy moving.

But China has a historical opportunity similar to Britain’s. What is this opportunity? Britain left China a gift — Hong Kong.

Hong Kong has all the elements of a modern capital market: a comprehensive institution with legal system, dispute resolution mechanisms, established intermediaries, and trust by the international community and investors. However, these advantages have not been fully utilized. If the relationship between the Netherlands and Britain was a merger of equals, then the relationship between China and Hong Kong is more like an acquisition, and the benefits of acquisitions are often not cherished enough — a significant difference. If Hong Kong's advantages can be fully utilized, it could serve as an important engine to reinvigorate China's capital market. Hong Kong and Mainland China's capital markets could operate separately, just like the early Shenzhen Special Economic Zone did by implementing different systems that ran parallel to one another, and ultimately triggering a wave of reforms around the country. The logic is the same. The Shanghai-Hong Kong Stock Connect is an important innovation, but it is just a start. If China can fully utilize the Hong Kong market system acquired through "acquisition", it is possible to establish a modern, credibility-based capital market system. The current state is still far from this goal, and the understanding and importance placed on it are still far from sufficient. Moreover, some of the practices in recent years have threatened the foundation of Hong Kong's existence as an independent financial market. If not corrected in time, the consequences could be immeasurable.

Therefore, China's economy is still far from its potential true growth prospect. At present, it can only rely on policy stimulus, but stimulus is not very sustainable. Stimulus is only effective when it leads to sustainable growth. Otherwise, China would have to rely on new stimulus every year.

China often talks about "modernization with Chinese characteristics," and this statement is correct because each country is unique. But the essence of Chinese-style modernization is still modernization, so it shares many commonalities with the countries that have already undergone modernization. China should promote modernization based on commonalities, while complementing its individuality, to achieve Chinese-style modernization.

Commonality was formed over the past few centuries based on lessons learned from failures and successful experiences, forming a consensus on what works and what doesn't. As Mr. Munger said, common sense is rare. People usually only learn common sense after paying a heavy price for violating common sense.

The modern market economy has been operating for four to five hundred years, and some of these consensuses no longer need to be discussed, doubted, or arbitrarily criticized and denied. These consensuses were first summarized by Adam Smith in *The Wealth of Nations* published in 1776. At that time, he observed that the market economy system had gradually matured from the Netherlands to Britain, having been in practice for one to two hundred years. He saw that although human nature is inherently selfish, the greatest aspect of the market economy is that through division of labor and free competition, it transforms the pursuit of individual self-interest into societal benefit. This is done by achieving the optimal allocation of social resources and

promoting continuous economic growth that benefit all social classes to help promote upward mobility between classes. The ideal of "everyone for me, and I for everyone," has actually been realized through the market economy. The market economy system, through the incentive mechanism of "everyone for me," has achieved the social benefit of "I for everyone."

This system is certainly not perfect, but among all the imperfect systems invented by humans, the market economy is undoubtedly the greatest system invention. This has been repeatedly proven by various successful and failed social experiments over the past few centuries. There is no need to criticize or deny these established consensuses, nor pay the price of violating common sense again.

Moreover, in the market economy, most resource allocation decisions need to be made by private individuals. As a prominent entrepreneur once said, let the soldiers on the frontlines who can hear the gunfire make the decisions, because it is difficult for the people in the rear who cannot hear the gunfire make the right decisions. Thus, the success of China's market economy has been achieved through the government continuously relinquishing power, continuously withdrawing, and transforming from a command role to a service role. Scientific breakthroughs and technological development are also the results of a highly marketized economy, not the cause. These are not only commonplace understandings about the market economy but also widely accepted consensuses.

Basic protections for personal and property safety are also essential for private enterprises to prosper. Entrepreneurs must feel secure about their personal safety to successfully run businesses. The resolution of legal disputes requires procedural justice. The difference between “rule by law” and “rule of law” largely lies in whether government power is checked by law and whether legal procedures are justly applied. When phenomena such as "arbitrary law enforcement," "selective law enforcement," and "cross-jurisdictional arrests" occur, do entrepreneurs have the right to defend their legitimate interests through the legal system? Will law-breaking officials be subject to appropriate legal penalties? Will officials who condone these illegal activities be punishable by law? Can ordinary people and entrepreneurs effectively protect their interests through legal procedures, rather than just through administrative intervention by higher authorities with more power? This is what we mean by procedural justice. These are fundamental needs in social development.

At the same time, a sound and complete capital market is crucial for the full circulation of economic elements. Today, China does not have a sound, complete capital market, resulting in personal consumption accounting for only 40% of GDP, while the savings rate is close to 50%. These figures show that resources have not been fully and effectively circulated. In fact, all countries have encountered the same problems after the initial industrial development and during the intermediate adjustment period; this is not a problem unique to China. Some countries have successfully passed this stage; some have experienced tragic consequences by instigating

devastating wars, but eventually got out of the predicament because of their failure in war; others are still struggling through this process. How does China power past this? China must maintain the commonalities of the market economy while also respecting its individuality endowed by Chinese traditions to achieve true Chinese-style modernization. Achieving this goal ultimately depends on trial and error and continuous correction. There is no fixed formula for achieving modernization that can be copied.

Reflecting on the beginning of the reform and opening up, Deng Xiaoping said that practice is the criterion for testing truth, and whether it works depends on the results. He also said to continuously explore, "crossing the river by feeling the stones," without any fixed rules. At this stage, many high-level policies are often not applicable and need to be continuously adjusted through practice. What is the key performance indicator (KPI) of practice? It is to achieve true modernization. True modernization means China can rely on its own organic, self-perpetuating forces to produce sustainable economic growth; organic, self-perpetuated, sustainable economic growth is the ultimate KPI.

The biggest driving force comes from the proportion of personal consumption in GDP. This is the most organic, self-perpetuated, sustainable economic growth driver; everything else serves it and is not sustainable. What is sustainable are people's continuous, increasing, and new desires. That is the most enduring, most innate, and always limitless growth driver in the market economy. Today, personal consumption in China accounts for only 40% of GDP, but up to 50% savings can be converted into fuel to power economic development, into new services, new products, and the birth of new enterprises. China has the best entrepreneurs, the best engineers, the largest unified demand and supply market, credible investors, and the ability to attract global professional institutions on the credit system supply chain. These advantages provide enormous potential to achieve organic and sustainable economic growth.

By contrast, personal consumption in India accounts for 60% of GDP, ensuring sustainable growth; in the United States, this proportion exceeds 70%, and its growth is also sustainable. Once China enters this stage, its growth will also become sustainable. But currently, it has not yet entered this phase. This is both China’s current challenge and an important opportunity.

To reignite economic growth from the current slump, China needs to find a starting point. But if it tries to grasp all aspects, it will be difficult to succeed; it is difficult to achieve "not only this but also that," so China must focus to have breakthroughs. Where should China focus to break through?

The economy is a chain of interconnected nodes, involving many elements – the spirit of entrepreneurs, consumer confidence, motivating incentives in the bureaucratic system, the trust of foreign capital, the improvement of U.S.-China relations, changes in the international trade environment, and the use of Hong Kong's capital market, protecting its independence and

restoring its momentum, and so on. All of these nodes on the chain are interconnected. So, the question is, which one is the chicken, and which one is the egg? Where does China start? The answer is simple, every node is both "chicken" and "egg," and all can "lay eggs." Any of these nodes can start a chain reaction because they all interact with each other. Stimulating any node can ignite the entire economic chain. But China's current problem is that all nodes are extinguished, and the entire chain is stagnant, which is a predicament it faces in the current time.

But since September 2024, China has seen a notable shift in policy. As long as China adheres to the principle that practice is the criterion for testing truth, continue to conduct trial and error and persist, it will eventually ignite a node in the economic chain. Once one node is ignited, then it will set off other nodes, because all the nodes on the chain are interconnected to form a whole, with each node being both cause and effect for the others, both "chicken" and "egg." So, there is no need to stick to one fixed direction. For a huge economy like China, as long as the environment is relatively relaxed, significant breakthroughs often happen by chance. For example, at the beginning of the reform and opening up, who could have predicted that a simple measure like dozens of farmers' blood pact to start implementing the household responsibility system would ignite China's 40 years of magnificent reforms? This measure solved China's food and clothing problems within a year, at least in some regions. Similarly, the reforms in the Shenzhen Special Economic Zone quickly sparked a nationwide wave of reforms, solving decades-old problems in a short time. Facts prove that significant changes do not need to be planned in advance, nor can they be, because China is simply too large.

China's potential is still great, and the problems it is currently encountering are not unique to China but common to all countries that have experienced industrial takeoff. These problems are largely due to society's deeply ingrained beliefs — beliefs formed during the agricultural civilization era, or even earlier — that have resulted in a huge divergence with the realities of tremendous, compounding economy growth. China needs to re-examine past concepts within the context of this divergence, and test which are right, and which are wrong. In practice, I believe Mr. Lee Kuan Yew's methodology is correct — resolutely replicate proven practices and avoid those that have proven unfeasible. This is a very simple yet profound principle of governance. In the end, China must still adhere to the principle that practice is the criterion for testing truth, using the results from trial and error to examine its ideas and methods. At the current stage of development, the most important practice is to promote China's organic, self-perpetuated, sustainable economic growth, and the key variable is the proportion of personal consumption in GDP. If this proportion can be raised from the current 40% to India's 60%, then China will have substantial development space and prospects in sustainable economic growth.

In this process, it is essential to reignite, activate, and connect the various elements on the economic chain. There are many nodes on this chain, including entrepreneurs, consumers, effective government officials, foreign capital, investors, professional institutions with credibility, as well as U.S.-China relations, China-Europe relations, China's relations with Southeast Asia,

China's relations with all other trading partners, etc. These nodes are all "chickens" and also "eggs," all are "egg-laying chickens," and any node ignited can reinvigorate the entire chain. But the current problem is that the whole chain is relatively static and has not yet started moving, including the special gift to China that we just talked about, Hong Kong, which is equivalent to the gift the Netherlands gave to Britain many years ago.

The system of credibility generated by the modern capital market is something a state-controlled banking system cannot provide, and it is not something banks can or should do. Banks cannot take on the role of making risk investments; if banks were to do risk investments, people would not feel secure putting their money in banks, and then banks would not exist. Public companies like NVIDIA are able to be born and grow because of modern capital markets, which aggregate small savings into capital through a system of intermediary institutions with credibility. This system also incorporates legal systems, best practices, dispute resolution mechanisms, historical practices, and long-accumulated trust. Currently, in China, only Hong Kong's capital market has all the elements of a modern financial market system. If the market's independence cannot be ensured, then it cannot operate effectively. The reason Shenzhen was successful back then was because of its independence as a special economic zone. To make good use of Hong Kong, at least in the capital market and legal areas, the promise of "fifty years of no change" must be honored. Credibility and trust in a system take a long time to build but can be broken quickly by only a few actions. Hong Kong's market and system need to be cherished and protected, but the premise is to understand its importance.

IV. How Should Global Value Investors Respond to the Challenges of the Times?

Why have I spent so much time on the previous topics? Because the biggest change since my last speech is that everyone's confusion and anxiety have visibly increased. It is extremely difficult to hold stocks steadfastly and truly practice long-term investing with such confusion and anxiety. This brings us to the fourth theme – as global value investors, how should we respond to the changes in today's international and domestic situations? How should we invest?

Firstly, our fundamental attitude as a value investor is that the macro environment exists objectively; we can only accept it, while the micro level is where we can make a difference. The world exists objectively and does not change due to our desires, imaginations, or subjective judgments. In investing, we must take the world as it is, not what we wish it to be or what we want it to be. It is what it is, take it. With this premise, we can make a difference at the micro level on specific companies.

The question is, under such confusion on the macro level, can we truly hold these companies firmly? Even after thorough research and analysis, can we remain confident in the companies?

Can we continue to hold them? After providing the macro background, this is precisely the core issue we need to address today.

To answer this question, we first need to define what true wealth means in the context of the world's long, large-scale evolution from an agricultural to a modern civilization. The fundamental goal of investing is to preserve and increase wealth, so we must first answer the question: What is wealth? Why do we invest and what should we invest in?

For example, in the agricultural era, wealth was land and population. But is land still considered wealth today? Looking at world history, especially in Europe, the feudal system lasted roughly several hundreds of years. Many countries' feudal systems disintegrated due to revolutions, with one exception — Britain. Over these centuries, Britain did not experience a major revolution, and many nobles retained their land and grand castles. In the past, these nobles were the wealthiest. Are they still the wealthiest today? The answer is no. Most nobles who only own land and castles are no longer wealthy; in fact, they have become relatively poor. Only a few nobles remain wealthy because they made other investments, not just relying on their original land and castles.

Why is this the case? Because maintaining land and castles requires a lot of manpower. A large castle typically needs dozens or even hundreds of people to maintain. However, over the past few centuries, the cost of labor has risen significantly, making it difficult for today's nobles to afford so many people. Similarly, land needs people to farm, but while the labor cost has increased significantly, the output from the land itself has increased relatively less. The value of rural properties has increased little, while maintenance costs are high. Thus, these land and castles that have not been converted for industrial or commercial uses have become liabilities rather than assets for the nobles. Today, British nobles who still maintain their land and castles mostly do so by opening their castles to the public for a fee. For example, they turn castles into parks and charge a five-pound entry fee per person. I believe many of you have traveled to Britain, visited such castles, or even rented castles for birthday parties, company events, weddings, etc. This is an example of the relative value change between land and labor.

Another example is cash. Of course, cash has value, but is cash wealth? Younger students probably do not remember, but older people should recall a term from the early days of reform and opening up, the "ten-thousand yuan households," and having ten thousand yuan was a remarkable achievement. "Ten-thousand yuan households" were considered the wealthiest at that time. However, suppose someone had deposited this ten thousand yuan in a bank back then, with interest included, would it still make them wealthy today? Obviously not. Today, many people earn more than this amount in a month. So, if you just save cash, then as time passes, it no longer represents wealth.

Thus, whether it is land, cash, or real estate (especially those requiring many people to maintain), none can become lasting wealth. Then, what is wealth in modern society? What is the function

of wealth? The essence of wealth is for consumption. The total size of an economy ultimately comes down to its total production or consumption. Thus, wealth is the proportion of your purchasing power within the entire economy. In the agricultural era, unit economic output barely grew, and there was a "ceiling" on the total economic size. Under such circumstances, an individual's share of purchasing power in the economy was relatively fixed, mainly achieved through land, population, and real estate, which constituted wealth.

When the economy enters a stage of sustained compound growth, the long-term trend is unidirectional growth, despite fluctuations in the short term. If your wealth is static, it will gradually diminish relative to the economic growth. The faster the economic growth, the faster your wealth shrinks. Over the past forty-plus years, China's nominal GDP has increased by more than 340 times, so the "ten-thousand yuan households" are no longer wealthy. Similarly, in the United States, being a millionaire was once a remarkable achievement, but a few days ago, Buffett mentioned in a letter that millionaires of the past are roughly equivalent to billionaires today. It shows that static wealth, carried in cash, cannot achieve sustainable, compound growth. When the economy enters an era of sustained compound growth, real wealth should be measured by your share of purchasing power in the entire economy. And your effective wealth is the proportion of your purchasing power in the economy where you mainly choose to consume.

Thus, the fundamental purpose of investing is to preserve and increase your purchasing power. The measure of wealth is your percentage share in the economy, not the absolute number. One person is wealthier than another because their share of purchasing power in the economy is larger. Having ten thousand yuan today no longer has the significance of a "ten-thousand yuan household" forty years ago, as the real purchasing power has changed exponentially since then. Real wealth is your share in the overall economy. As long as you maintain your share, you retain your wealth, even if the overall economic pie shrinks due to factors like war; if your share increases, your wealth grows. However, after entering modern civilization, the pie will grow in a wave-like, sustainable, compound manner, which is the most fundamental and defining feature of the modern economy.

Today, of the eight billion people worldwide, approximately 10% have entered a stage of organic, self-perpetuated, sustainable growth. About 50% are in a transitional state, including China. The remaining population is still in the early stages of transitioning from an agricultural economy to industrial takeoff. This centuries-long, continuous process is a paradigm shift in human civilization and no individual will can reverse it. Therefore, as a value investor, you must understand what value is, what real wealth to pursue, protect, and grow — that is your share of purchasing power in the economy. For global value investors like Himalaya Capital, as fiduciaries of other peoples' capital, our responsibility is to maintain and increase our share of purchasing power globally. Specifically, this means as a representative of investors, to find the most dynamic, creative companies in the world's most vibrant economies, and secure our purchasing power by owning their stocks.

Thus, as the entire economy grows, your wealth naturally increases. If your share increases, it means your growth exceeds the average. Even if the entire economy shrinks for various reasons, your wealth continues to grow as long as your share increases. With this understanding of wealth, you will better comprehend this statement: the macro is what we must accept; the micro is where we can and should make a difference. Maintaining this awareness allows you to calmly hold shares of the most creative and excellent companies without being shaken by macroeconomic fluctuations. Being able to sleep at night enables you to firmly hold your stakes, your purchasing power. This is why we first discussed the macroeconomic topics, but ultimately, we return to the core of investing.

Additionally, after the civilization paradigm shift, the global economy will continue to grow. That trend does not shift with the will of any country. Those countries stuck at the middle-income stage, if unable to cross it, will gradually see their economic share decrease. Take South America as an example, at the end of the 19th century, Brazil and Argentina were the most promising developing countries. However, they attempted several times and failed to successfully cross the "middle-income trap." After World War II, they had another opportunity but their growth stagnated again after the 1980s. Meanwhile, the global economy continued to grow. These two countries were once among the leading global economies but are now hard to find on that list. This is because, as they stagnated, other countries and the global economy continued to grow rapidly, causing their share in the global economy to continually slide. This is why China must maintain a sense of urgency.

As global investors, you need to invest in the most dynamic economies you believe in, but also pay attention to your actual needs so you can maintain your purchasing power where you consume. For global investors like Himalaya Capital, our goal is to select the most dynamic, creative, and competitive companies within the world's most vibrant economies, own their shares, and thus achieve the goal of maintaining and increasing wealth globally. However, for individual investors, you need to maintain your purchasing power in the economy where you are willing and need to consume, as that is your real wealth. For example, many Chinese investors' main purchasing needs are in China, and they may not need purchasing power in Europe or South America.

Can this goal be achieved under today's conditions? Let's revisit the origins of value investing. Value investing was born during a period of extreme macroeconomic turbulence and confusion. The concept of value investing was first comprehensively articulated by Ben Graham, Warren Buffett's teacher. When did Graham start to understand and practice value investing? He began investing in 1926, and like many investors, he experienced the "Roaring Twenties" in his first three years and engaged in many speculative investments. However, during the Great Depression from 1929 to 1932, his investment partnership lost up to 70% of its market value. After deep reflection, he truly began to practice value investing and successfully recovered the previous losses from

1932 to 1935. In 1936, he founded a new closed-end fund, which operated until 1956, achieving extraordinary returns over twenty years. During this time, he published *The Intelligent Investor* in 1949, where he fully explained the three most important concepts of value investing for the first time.

The founder of value investing, Ben Graham, discovered the methodology of value investing during a time of tremendous macroeconomic challenges. The challenges he faced during that era were much more difficult than what we face today. At that time, the U.S. unemployment rate reached 25%, and the economy shrank by about one-third to one-half, depending on different assessments. People felt hopeless, as if the world was coming to an end. By the time he broke even and started a new fund, the world had plunged into a global war initiated by the fascists, which ultimately led to the deaths of hundreds of millions, injuries to hundreds of millions more, and the utter destruction of most industrial systems in the world. In such an era, he generated outstanding investment performance.

Looking at our era today, compared to the thirty years when Graham pioneered and practiced value investing, which period would you choose to start your career? In such turbulent, confusing macro environments, value investing can particularly highlight its advantages and play its role. But you must understand what you need to protect and what your investment goals are.

Another important contributor to the theory and practice of value investing was economist John Maynard Keynes. Many are familiar with Keynes's macroeconomic theories and his contributions to the design of the post-war Bretton Woods system and global financial system, but few know that he was also an excellent value investor. From 1921 until his death in 1946, Keynes managed the most important endowment fund of King's College at Cambridge University, accumulating exceptional investment performance over 25 years. Keynes also had many speculative experiences early on, but through continuous lessons, he began to summarize the core concepts of value investing. Keynes's career trajectory highly overlapped with Graham's, both experiencing the "Roaring Twenties," the Great Depression, and World War II. However, unlike Graham, Keynes was in Britain during the war and at the forefront of the conflict, while Graham was in the U.S. and relatively removed from the direct impact of the war, making Keynes's achievements during this time even more remarkable.

Keynes and Graham shared many conceptual similarities, but Keynes emphasized more on the quality of the companies themselves. Buffett and Munger later coincided with him and further promoted this concept in their investment practices over more than sixty years from 1957 to today.

Another key figure was John Templeton, who played a significant role in value investing and spreading it to other countries. In 1939, during the war, when many U.S. stocks fell below one dollar, Templeton adhered to the principle that "cheap is the hard truth" by buying 100 shares of

every stock trading below one dollar on the U.S. stock market, investing a total of ten thousand dollars. Four years later, when he sold them, 100 out of 104 stocks had significantly increased in value. In 1954, he created the Templeton Fund and began to spread the concepts of value investing to many other countries. By 1992, after 38 years of navigating through various market changes, the fund had achieved returns of more than tenfold.

I founded Himalaya Capital in 1997. Before that, I bought my first stock in 1993, starting with cheap companies. In the process of investing in cheap companies, I gradually built my circle of competence, slowly transitioning from seeking cheap companies to seeking quality yet cheap companies. When the fund was established in 1997, I experienced the Asian Financial Crisis. Over the past few years, the Chinese market has experienced significant capital and asset price declines, with many people suffering from declines in real estate, stocks, and other securities prices. However, the scale of this downturn is still incomparable to the Asian Financial Crisis. During that time, the markets in major Asian countries fell by more than 70%, with the most severe dropping by more than 90%. Our fund also faced tremendous challenges and experienced considerable volatility, but the accumulative performance during those years happened to be a period of high returns for us, as the market was literally littered with gold.

I will share a funny story. At that time, I was in New York exchanging views with several fund managers, one of whom was a Korean American. We discussed our investments, and he mentioned his interest in South Korea. I said I was also interested. At that time, the South Korean stock market had fallen by 80-90% in dollar terms, because not only did the stock market decline, but the Korean won also depreciated by 40-50%. He mentioned that he was making a transaction: buying POSCO, as its P/E ratio was only two, while simultaneously short-selling Samsung Electronics, because its P/E ratio was as high as three. He described this transaction as fantastic, the best investment opportunity he could find. This may sound crazy today, but it vividly reflected the mainstream Wall Street thinking back then and what went on outside of value investing. By the way, this person later became infamous by almost causing Credit Suisse to go bankrupt due to fraud, and he was recently sentenced to eighteen years in prison by a U.S. court.

This is why true value investors can achieve good long-term returns in the market. No market is completely efficient because the market is not an abstract concept but composed of many individuals. Many may think the U.S. market is very efficient, but having been in this industry for 30 years and managing Himalaya Capital for 27 years, I have personally experienced the U.S. stock market fall by more than 50% several times. During the 2008-2009 financial crisis, the U.S. stock market fell more sharply than China's, and at the time, people feared the global financial system might completely collapse. When the COVID pandemic began, the U.S. stock market dropped by about 30%. In fact, such significant downturns occur almost every few years. During the 2001-2002 internet bubble burst, companies such as Amazon plummeted by 90%. The U.S. already has the world's most mature and efficient market, yet it still cannot avoid such substantial fluctuations.

So, based on my thirty-odd years of practice, the fundamental principles of value investing are definitely feasible. Other investors discovered and practiced the fundamental principles of value investing when faced with unprecedented macroeconomic challenges. Here, I summarize their most important contributions.

Ben Graham outlined three key principles. First, a stock is not just a tradable piece of paper; it is a legal proof of ownership in a company. As we discussed earlier, during sustainable economic growth, equity can protect your purchasing power, which is essential because the goal of investing is to protect and grow purchasing power. Second, the market is composed of individuals, and human nature tends to seek short-term profits, so people often treat stocks as chips for short-term trading, overlooking that they represent long-term ownership in a company. You can think of the market as "Mr. Market," a very neurotic person. His role is not to tell you a company's true intrinsic value but only to provide buying and selling prices. These prices are often far lower or higher than the value. For value investors, Mr. Market is here to serve, not to guide. Third, the future is difficult to predict, and cheap price is a hard truth. It is essential to have substantial margin of safety, because you may not fully understand a company or clearly predict its future. But if you buy at a sufficiently low price, leaving ample margin of safety, then you will be able to sleep soundly at night, and you will be more able to hold it for the long term.

For example, the Chinese stock market experienced a significant rise from 2005 to 2007, followed by a sharp decline for seven to eight consecutive years, entering a prolonged bear market. This rise and fall were highly related to the U.S. stock market and the 2008 Global Financial Crisis, but during that period, the Chinese economy performed relatively well, and many companies also showed good fundamentals. After seven to eight years of bear market, the market was arguably littered with gold, and many excellent companies' stock prices had fallen to levels that offered large margins of safety. Therefore, when everyone else is fearful, you can often find many opportunities. Whether or not you can seize these opportunities with substantial margins of safety largely determines whether you're able to truly create wealth.

Buffett and Munger, through sixty years of practice, further contributed to the concepts of value investing, offering another principle for value investing: long-term investment returns largely come from the value created by excellent companies through their long-term operating performance. Excellent companies can continuously increase their intrinsic value, which matches well with the essence of the modern economy, that is, a company's intrinsic value can compound indefinitely along with the economy's compounding growth. These exceptional companies have long-term capital returns that are higher than the industry average and their competitors. Therefore, investing in such companies can grow your wealth at a rate that also exceeds the market average. However, identifying and understanding these companies is not easy, so investors need to build their own circle of competence, clearly knowing what they understand, what they do not, and the boundaries of their circle of competence. Then they will only invest within the scope of their competence in those exceptional companies they understand and hold

them for the long term. The concept of circle of competence is an important contribution from Mr. Buffett and Mr. Munger. Indeed, Keynes had already practiced this principle in his era.

The fifth principle is Mr. Munger's contribution. I had a twenty-year friendship with Mr. Munger; he is both a friend and a partner to me, as well as my teacher and family. Mr. Munger and his family spend every summer on a small island in Minnesota called Star Island, vacationing and fishing, which is one of his favorite activities. My wife, kids, and I have joined him for many of the past twenty years. Minnesota has over ten thousand lakes, and Star Island sits in the middle of a large one. Interestingly, every time we went fishing, Mr. Munger would take us to different places. We would take a boat from Star Island to the shore, switch to a truck towing a fishing boat, then drive for an hour to another lake to fish, and each time the location was different. Later, I asked him, "Charlie, there's such a large lake next to Star Island. Why not just fish there?" He said, "You can try it." I did try once, only to find almost no fish in the lake, making it very difficult to catch any. However, the smaller lakes we went to always yielded good fishing.

I later discovered that Mr. Munger didn't know in advance which island we would be going to for fishing. Instead, a fishing guide led the way. His name is Donnie, and his family has operated a bait business called Leroy's for two generations, so he often searches for bait in different lakes year-round. Through looking for bait, he knows which lakes have fish, the different types, sizes, and seasonality of fish, and even the specific locations within each lake. That is his proprietary knowledge. Many people buy bait from him just to find out where the fish are. Mr. Munger always let Donnie lead the way, and we always caught many fish. I initially thought that all lakes had many fish, but my unsuccessful experience on the Star Island lake made me realize that indeed, not all lakes are the same.

Thus, Mr. Munger summarized the fifth principle: investing is like fishing; you must fish where the fish are. He says there are two rules to fishing: the first is to fish where the fish are, and the second rule is to never forget the first rule. This fifth point is also very important for investors. Minnesota has over ten thousand lakes, but we don't need to fish in the largest one. The same applies to individual and institutional investors. China's GDP is $18 trillion, with many industries and companies. Some perform poorly, but there are also many excellent companies, companies not fully understood by everyone, and that are completely mispriced. Investors don't need to understand every company, don't need to master all macroeconomic parameters, government macro policies, nor do they need to accurately predict the next ten years. The key is to find that "lake" where you can catch fish. So, Mr. Munger's advice to fish where the fish is to emphasize the importance of selection. I also noticed that every time we went fishing with Donnie, we were the only group on the lake all day, ensuring we would catch the most and biggest fish. Lack of competition is an important reason for mispricing.

Therefore, investors don't need to overly research the macro environment, don't need to understand all ten thousand lakes in Minnesota, nor do they need to thoroughly research the

Chinese economy or the world economy. They need to find which lakes have fish, where there is a lack of competition, where they have good knowledge and an advantage. This is where they can establish their circle of competence, just like Donnie. Donnie, through finding and cultivating bait, built a unique ability to locate little-known, fish-rich lakes. Once everyone knows where the fish are, it becomes hard to catch them; this is his unique circle of competence.

The sixth principle is what I'm sharing with you today, a conclusion based on the paradigm shift in civilization: the essence of wealth is the proportion of purchasing power in the economy, and the goal of value investing is to hold shares of the most dynamic companies in the most vibrant economies, thereby preserving and growing wealth. This principle is also the experience and contribution based on our practice at Himalaya Capital over the past thirty years.

I have been obsessively thinking and researching the phenomenon of modernization for over forty years. I have come to realize that what each country has experienced over the past few centuries is not a unique phenomenon but part of a broader paradigm shift in human civilization. This shift is not influenced by any country, individual, or small group. The global economy exhibits a unidirectional, wave-like growth, with short-term ups and downs, even cyclical fluctuations, but the long-term trend is unidirectional continuous growth. Even if the global economic pie shrinks at times, you can preserve your wealth by maintaining your proportion of purchasing power. Then, when the economy begins to grow again and the pie enlarges, you can preserve and continue to increase your wealth. This principle is my personal contribution. I hope to prove or disprove it through future practice.

Let me repeat these six basic principles of value investing:

1. A stock is not just a tradable piece of paper; it represents part ownership of a company.
2. Mr. Market is here to serve value investors, not guide.
3. Investments must have sufficient margin of safety.
4. Investors should have a clear circle of competence.
5. Fish where the fish are.
6. Wealth is the proportion of purchasing power in the economy. The goal of value investing is to hold shares of the most dynamic companies in the most vibrant economies to preserve and grow wealth.

My personal experience over the past thirty years also serves as an illustration of these principles. When I first arrived in America, I had nothing but debt. To reach where I am today and being able to share our experiences with everyone is indeed due to our practice of value investing. The philosophy of value investing can be applied in practice, and it can be successfully and sustainably implemented over the long-term. I hope to continue practicing value investing like Mr. Buffett and Mr. Munger for another thirty years. Today, thirty years later, I am still as passionate about this industry. It is a way to breathe in sync with the times and grow together with it, which makes it incredibly appealing.

Finally, let me share another little story. Everyone knows that Mr. Munger invested in very few stocks throughout his life, but he insisted on doing research. He once shared that he read *Barron's* for fifty years and found only one investment idea. Yet that single idea brought him returns of dozens, even over one hundred times. First, he earned nearly a tenfold return on that investment, and then he reinvested the proceeds into our fund, earning another tenfold-plus return. At 99 years old, Mr. Munger found another very interesting stock. It was a bit "politically incorrect" and grossly mispriced, so he made his only stock purchase in nearly ten years and lived to see the stock price double.

Today marks just over a year since Mr. Munger's passing. Last Thanksgiving, Charlie spent Thursday dining with his family and felt unwell during dessert, so he excused himself early to rest. The next morning, Friday, Mr. Munger was hospitalized. By Saturday, Charlie regained consciousness, said his final goodbyes to his family and passed away peacefully on Sunday. Until the last moment, his life remained calm and focused, dedicated to the work he loved most and he never stopped. Such a life is inspiring and uplifting for us all. Mr. Munger, through his life and over sixty years of investment success, taught us an important lesson: the macro environment is what we must accept, and the micro environment is where we can and should make a significant difference. Engaging in value investing allows us to breathe in sync with the times and grow alongside it. I firmly believe that those who are passionate about value investing, no matter their location or the challenges they face, can achieve meaningful results. I sincerely hope that everyone will continue to devote themselves to this wonderful endeavor.

Thank you!

Question & Answer:

***Question 1*: In the process of holding high-quality companies, if the market offers a clearly overvalued price, to what extent would you consider reducing your holdings? *Question 2*: Very few people can hold high-quality companies long-term and achieve sustained gains. Does this relate to luck and courage? How should young people make investment decisions amid uncertainty and insufficient information? When should they overturn their own understanding? Did you face such predicaments when you were young?**

Regarding selling, my considerations are as follows. First, if I realize I have made a mistake, I will sell immediately. Second, when there are better investment targets available that offer a superior risk-reward ratio and downside-upside ratio, I would opt to switch. Third, when the market exhibits bubble-like extreme overvaluation. However, valuation is often a concept of timing and largely depends on the company's long-term growth potential. A common human flaw is to amplify short-term factors and diminish or overlook long-term elements. Therefore, it's crucial to develop your own circle of competence; the deeper your research, the more thorough your understanding. Short-term overvaluation is less significant compared to long-term growth. But finding and understanding companies that can grow in the long term is extremely challenging. Such companies possess enduring competitive advantages over their competitors, vast growth potential, and excellent capital return rates. These companies are rare gems; hence we refer to them as the "holy grail." The best investments are often in these companies with long-term competitive strength and growth potential. Once you truly find and understand such a company, I generally advise against hastily selling it. Because if you sell it thinking it's overvalued, and later try to buy it back, you'll face the same issue that it's still overvalued, and you're back to waiting for it to be cheaper. During that waiting period, its growth could far exceed your original valuation estimates. If it's a truly superior company, this scenario is even more likely. If it's not a superior company, then it's a different issue.

Finding such companies in a lifetime of investing is not easy because they are inherently rare. A great company that you've thoroughly researched and also happens to be cheap is a very rare opportunity. In my 30 years of investing, I've only encountered such opportunities a few times. Equally important is being able to hold such a company long-term. No matter how long you hold it, you must continue learning about it.

Take Berkshire Hathaway as an example; we regard it as a fortress-like company, managed by some of the world's best investors, standing strong for over 60 years. Yet, its stock price has also dropped by more than 50% three or four times. Whether you can continue holding at such times largely depends on your deep understanding of the assets owned by the company. This depth of understanding is not easy, as Berkshire has many excellent assets and subsidiaries, and truly understanding them requires long-term research and knowledge accumulation.

Another example is BYD, which we've held for 22 years. During this time, its stock has dropped by more than 50% at least six times, once even by more than 80%. Each significant price drop tests the boundaries of your circle of competence. Do you really understand it? Do you truly know its value and how much value it has created? In one year, BYD might have increased its value, yet its stock fell by 70%. Only then is your circle of competence truly tested; touching its boundaries confirms its existence. During the time we've held it, BYD's sales grew from one billion yuan to nearly one trillion yuan, and it hasn't reached its limit; it continues to grow and create value. This is the intriguing part of investing.

Therefore, the length of time you hold a stock and the timing of when to sell largely depend on whether your circle of competence is real and whether you truly understand a company. Investing is not as simple as buying a stock and then resting easy. If it were that easy, everyone would be wealthy. Investing is not easy, but it is a fascinating and challenging job.

The fourth scenario occurs when, as fiduciaries to others' capital, we sometimes have to sell out of necessity. If we're fully invested and face redemption requests, since our fundamental principle is not to borrow, we may need to sell some holdings. We adhere to the principle of not borrowing because only by doing so can we withstand a drop of 50% in the entire investment portfolio. Significant stock declines are a normal part of investing. If you haven't been through such tests several times in your investing career, it's hard to clarify whether your circle of competence is real or not, whether you truly understand, are truly brave, or just reckless and lucky.

The stock market truly tests human nature. If you don't understand your investment targets, sooner or later, the market will defeat you. So, it's crucial to gain true understanding, continuously deepen and expand your circle of competence, and commit to lifelong learning. As I shared at the end of my talk, Mr. Munger bought a stock at 99 years old after having researched its industry for at least sixty or seventy years. Importantly, your knowledge can indeed compound. When you're young, you can start with the basics, such as buying the cheapest stocks. Because only if the price is low enough can you comfortably hold long-term, giving you ample time to understand the business and the company. Only then should you own those truly excellent companies. The premise for long-term holding is true understanding, not just for the sake of holding long-term. The core of value investing is understanding value. You pay a price to buy value, ideally a continuously growing value, at a price far below its intrinsic value. Build your circle of competence gradually. There's no need to rush.

<u>Question 3</u>**: How do you view the path to the 3.0 era for the United States? Apart from referencing the development of Hong Kong, can China also draw from some of the experiences of America's rise? Additionally, in the process of reform and rise, to what extent do high-level decisions determine the success of economic development?**

From a long-term perspective, what we see today is a paradigm shift of civilization. It is not swayed by any individual or any country's will, and it is determined by the laws of sustainable, compound economic growth in the modern science-technological civilization. If a country remains stagnant, it will fall behind, as other countries continue to grow. For example, in recent years, where China's economy has actually shrunk relative to the United States. Sometimes we also need to observe whether the nation is successful, whether people are still seriously trying to get things done. Today, China affects not just the domestic population of over a billion people but also about two and a half billion people worldwide. We are a community of shared destiny.

The emergence of the 3.0 economy in our era resulted from many coincidental factors, with the biggest coincidence being the establishment of the United States. The U.S. indeed has unique advantages, such as its vast geography, multiculturalism, the capacity to accommodate a large multi-ethnic population, and they continue to be true today. Therefore, the practices of the U.S. are not only the practices of the country itself but also the collective exploration of 3.0 civilization by various ethnic groups. These practices have broad implications for the world. Currently, about 10% of the global population has entered the 3.0 civilization, but international relations have not reached this stage. The iron law of modern economic development is that the largest market will eventually become the only market. Although there are many barriers, tariffs, and restrictions between markets, in reality, through third parties, the entire market will still connect and circulate; no one can do anything without anyone else, and temporary wars and conflicts will eventually end.

Today, humanity's organizational method is still based on governments and nation-states. Although economically, a common global market has formed, in terms of international relations, it remains a loosely organized system based on nation-states, without a formal international political organizational structure. The fundamental reason lies in the long-lasting gap between the rapid compound growth of the 3.0 economy and the slow or even stagnant evolution of human nature, organizational structure, psychology, culture and religious beliefs. Changes in international relations or national governance are very lengthy processes. If you study the modernization processes of other countries, you'll realize that many of the difficulties China faces today are not unsolvable. Looking back at China's modernization ups and downs since 1840 and comparing them to the challenges of the past few years, you'll find that current difficulties are only minor in the historical context and not worth overly worrying about. As investors, the key is to find that lake with fish where few people are fishing. You don't need to clarify everything, nor do you need to compete with the crowds on the largest lake. This is the beauty of value investing.

***Question 4*: How do we understand what a "cheap" company is? Do we look at the P/E ratio? The P/E of a company varies and is related to the growth rate; how should we interpret?**

"Cheap" is a multidimensional concept, related to relative value. In Benjamin Graham's era, he focused on tangible asset value, looking only at assets that could be quickly liquidated like cash

equivalents, tradable securities, readily recoverable accounts receivable, and even real estate. During the Great Depression in the 1930s, many such stocks were available. In 1993-1994, when I began investing, there were also very cheap stocks in the U.S. market. My first "ten-bagger" had a market value of $300 million and a book value of $500 million, $400 million of which were shares in a publicly listed company, TCI, which later became the largest cable TV company in the U.S. At that time, I did not look at P/E ratios, nor did I understand the remaining $100 million in assets. Later, I discovered that this $100 million in assets were very valuable, consisting of licenses for satellite communications and wireless networks that are fundamental to America's earliest wireless communication systems. I did not understand this initially and stumbled upon it by accident. After buying the stock, I resolved to study cable TV companies deeply, only then realizing the true value of the wireless network licenses. Thus, buying cheap can sometimes bring unexpected gains, but you must research deeply after buying. The more you understand, the more value you can gain.

Using P/E as a metric to measure a company's value requires a deep understanding of the quality of its earnings. For instance, are the earnings cyclical? If the P/E is low, is it because it is at the peak of the cycle, because the earnings include many one-time or cyclical elements, or because the earnings are genuinely long-term, stable, and sustainable? Only after clarifying the quality of the earnings can you assess the company's long-term growth prospects. Each company's value is somewhat unique, and you must understand exactly what you are investing in.

***Question 5*: What are the characteristics of excellent entrepreneurs? Is there a commonality?**

This question is very interesting. Over 30 years, I've met many successful entrepreneurs. If you have enough experience, you'll realize that these successful individuals, in the early days, were just like you, starting from nothing. When I met Jeff Bezos, he was, like me, a founder of a startup, and we hit it off immediately. He invited me to speak at Amazon when the company had just over a hundred people and had just rented its first warehouse. Every generation has its own success stories, and every era brings forth new talents.

There are many similarities and differences among outstanding entrepreneurs of each generation; they cannot be uniformly categorized. If there is a common trait, it might be their persistent optimism. Everything in the world is either bottle half full or half empty — no bottle is completely full or empty. Successful entrepreneurs choose to see the full half. Because founding a business always involves endless difficulties and challenges. If you focus on the half-empty part, always dwelling on negativity, how can you find partners? Rational analysis is necessary, but entrepreneurs must choose to believe in the power of belief. The future is not easy to predict, and often, you have to choose to believe. Belief is particularly useful in the shift to a 3.0 civilization because a rising tide lifts all boats — the economy itself is growing, rewarding those who choose to believe. So never admitting defeat is the first step to success. All successful people possess traits of never giving up, maintaining optimism, and believing in the future.

The advantage of the market economy is that it doesn't predetermine who can succeed; it doesn't care who succeeds. Elon Musk might have a hard time succeeding in China. Whether Jack Ma could still succeed today is also unknown. A highly inclusive society allows everyone to use their talents to the fullest because success in the market economy is determined by competitive results, not predetermined fate. No one knows which type of person is especially suited for success, and standards for success differ over time. Thus, freedom is crucial, providing flexibility is crucial, and different people ultimately have opportunities in the market economy. This is why the market economy ultimately transforms from "everyone for me " to "I for everyone," starting from serving self-interest to achieving great public good. It circulates all economic elements — no amount of talent is ever enough in a market economy. Continuous learning and self-enrichment are essential; even successful entrepreneurs must keep learning, or they can only succeed temporarily. Maintaining optimism, never giving up, continuous learning, trustworthiness, and integrity are all important. But beyond that, it really is about creating an inclusive environment where everyone can give their best and talents can be recruited without sticking to rigid standards.

***Question 6*: What is the meaning of investing? While individual investors' understanding and circle of competence can improve, leading to investment returns, what other value is there?**

Finally, I'll answer this somewhat philosophical question: are investors parasites, or do they benefit society? Especially since value investing emphasizes buying cheap, and each purchase implies someone else is selling. Does that mean your investment gain is sourced from another person's loss? The answer is no, value investors are definitely not parasites. As I mentioned, modern capital markets are a necessary prerequisite and cornerstone of modern economics. The existence of capital markets is the most important guarantee that all economic elements can circulate effectively. For capital markets to be efficient, they must allocate money to the most productive companies that can provide the products and services the market needs most. Suppose an ordinary person earns a thousand dollars a month and saves five hundred, intending to invest in the best companies. This requires a long chain, and each node in the chain is crucial, indispensable, building up to the capital markets, the public stock markets, whose most important function is that they can price companies correctly over the long term. Correct pricing means that the ultimate price roughly corresponds with value.

We say that capital markets are not always efficient, meaning sometimes they are ineffective in the short term. In the long run, market prices will fluctuate with value, with value as their anchor — only then is the market effective. Moving prices from short-term inefficiency to long-term efficiency is crucially dependent on fundamental investors, value investors. Value investing enables the market's price discovery function and is the most important node connecting the most valuable companies with non-professional individual savers. Each component of the capital market is important, including lawyers, brokers, analysts, managers, etc. Do not lightly assume that anyone working in finance on any node has original sin. These professionals and institutions

provide credibility. Of course, there are parasites in this industry. Only those truly deserving of fiduciary responsibility can generate credibility, and only when every node on the chain has credible intermediaries can the overall financial market have credibility. Free competition, survival of the fittest, along with legal regulation and long-term practice, can produce a truly efficient, credible financial market.

I generally don't talk about holdings, but since everyone knows about our investment in BYD, let's use it as an example. We've owned it for 22 years, during which its stock price fell by 50% at least six times, once by more than 80%. If there weren't value investors like us, BYD might have faced a capital chain break during some crises. For example, many high-growth companies experienced capital breaks this year. If we hadn't introduced a reputable investor like Berkshire in 2008, BYD's success would have faced more challenges. It's not that BYD wouldn't have succeeded as it has today, but it would have faced more challenges. This is a frank statement, a very clear example. Without value investors, the capital market loses its price discovery function, becomes ineffective, and can no longer turn savings into effective societal resources. Thus, excellent value investors, who earn what they deserve, are indispensable partners to outstanding enterprises.

This is why, when I first heard Warren Buffett speak, I decided to enter this industry; he answered the very question you asked. Personally, I've always been more interested in ethics and social justice than in making money, especially when I was younger. My earliest perception of Wall Street, like the cunning parasites portrayed in the Chinese play *Sunrise* with their secretive machinations and collusion, disgusted me. But Buffett made me realize that the essence of value investing is win-win. Investors are indeed an important part of a company's growth. I've also made some venture investments in my early career, helping more than a dozen companies successfully establish and grow as an angel investor. For VCs and PEs, the role of investors is even more apparent. A truly reputable, creditworthy public market investor plays a similarly important role in endorsing companies long-term. Moreover, the existence of public companies is crucial for converting savings into effective social resources, which are essential for these companies to grow. This is the most important node for our modern economy to enter self-sustaining, sustainable long-term growth. So, everyone on the chain plays an extremely important role.

These are common sense, yet rare. Your question is important, and grasping the knowledge to answer this question takes time. This is why we offer this course, why we discuss these topics, and why Mr. Chang, Professor Jiang, teaching assistants, and volunteers dedicate so much time to education. The goal is to turn common sense into consensus, so society won't demonize those working in the financial industry or impose original sin on the industry. Without such consensus, a country can be trapped in the middle-income stage, unable to form a positive cycle. An increase from 40% to 50% in personal savings rates effectively means a 10% reduction in GDP. A decrease in GDP lowers expectations for the future, further reducing consumption, causing companies to lay off workers. When the economy starts to contract, it keeps contracting more; when it expands, it keeps expanding more. So, bailouts and stimulus are necessary. But problems on the consumer

end can't be resolved by increasing supply. We need to increase real, sustainable demand. These are the basics of modern economics and are scarce common sense. The most important goal of education is to truly turn this common sense into consensus, allowing the economy to continue to develop on this foundation. But this scarcity is also natural; we've evolved over tens of thousands of years from an agricultural civilization, and most people's view of wealth is static. We think anyone who makes money is unrighteous. The static view of wealth is rooted from the 2.0 era. I named hunter-gatherer civilization, agricultural civilization, and science-technological civilization as 1.0, 2.0, 3.0, to distinctly differentiate them, because our concepts often linger in the previous civilization state and we have a hard time comprehending compound economic growth and compound wealth growth. The examples of British nobility and the ten-thousand-households can help you understand this point. Many of our outdated concepts need to change.

Today we also use this question to end our lecture, that true value investors have a fiduciary gene, have made important contributions to enterprises and the capital market, and are an indispensable part of modern economic development. I hope every practitioner in this field truly lives up to this responsibility. Thank you!