Winter 2025

Great businesses find ways of getting greater.
— Peter C. Keefe.

Every large and successful company began as a small one. Heineken, for instance, is a prime example. Today, the world's second-largest beer brewer began its business journey as a microbrewery with only a handful of employees. Identifying such an exceptional company early in its competitive life cycle is very hard, as well as an art.
My global search for small-cap companies with specific growth criteria yielded approximately 7,000 potential candidates, and with that, eliminating nearly 90% of all publicly listed companies. You can find the list **over here**.

The sheer number of potential candidates is overwhelming. Behind each one is a business adventure and a team of dedicated individuals working tirelessly to establish their dream to build an exceptional company. Just as every investor's journey is personal and unique, every business adventure is unique and worth studying.

When seeking investment opportunities in the small and microcap space, I prioritize companies with the following characteristics:

- **Financial Strength and Growth:** Look for businesses with little to no debt and rapid revenue growth—ideally doubling within a few years (e.g., from $20 million to $40 million). The company should already be profitable or have a clear and realistic path to profitability.
- **Competitive Moat:** Identify companies with a durable competitive advantage—a "moat"—that protects their market position. This could stem from strong branding, unique technology, cost leadership, customer loyalty, or regulatory barriers.
- **Aligned Leadership:** Favor companies led by an operator/owner with significant skin in the game, demonstrating their commitment to the business's success.
- **Attractive Valuation:** Ensure the stock is purchased at a compelling valuation, leaving room for potential upside.

Post-investment, closely monitor the company. In many cases, deeper insights into the business emerge only after becoming a shareholder. If your initial assessment proves incorrect or the company fails to meet expectations, be prepared to sell the stock promptly to minimize losses.

Ultimately, you'll want to narrow down this extensive list of 7,000 candidates to the very best 300 small-cap companies and monitor them closely. This is a daunting task without advanced AI tools, sophisticated screening techniques, and specialized expertise. It's such a joy to study these 300 business adventures!

The company's long-term competitive advantages are a crucial criterion for spotting possible multi-baggers, or compounders if you will. However, creating and sustaining a durable economic moat is frequently more difficult for small-cap and undoubtedly microcap firms. They might be less powerful in the market, have fewer resources, and be more vulnerable to disruption from bigger rivals and emerging technologies.

While Morningstar's moat ratings offer a useful initial assessment, they may not fully capture the nuances of smaller companies. To gain a truly comprehensive understanding of a small or microcap company's competitive advantages, it's crucial to conduct in-depth research. You can bring the vast number of 7,000 further down with sophisticated screeners, but even assessing the moats of a few hundred companies can be a daunting and time-consuming challenge.

But there is hope on the horizon. Let me show you how you can leverage AI tools for identifying moats. For instance, ChatGPT, Gemini, and Claude adapt their responses based on your specific interactions. Here's how it works:

- **Contextual Understanding:** These AI tools analyze the context of your conversations, including previous questions and responses. This allows it to understand your specific needs and interests.

- **Personalized Responses:** Based on this understanding, these AI tools tailor their responses to provide information or complete tasks that are relevant to your query.
- **Learning from Interactions:** Over time, these AI tools continue to learn from your interactions, improving their ability to provide accurate and helpful information.

I've found that the more you use these AI algorithms to discover economic moats, the more proficient they get at doing so. You could argue that everyone is creating their own specific AI environment with its own specific skills. My current AI environment identifies company moats instantly and actually assigns an initial moat rating to them. I find these results amazing and very accurate indeed.

As of today, AI-generated moat ratings are part of my due diligence process. These ratings are generated at an incredible rate, which greatly aids me in "turning over the rocks." In the attachment you will find the “AI moat rating” for one of Chris Mayer’s, author of the investment classic “100 Baggers,” latest investments, Computer Modelling Group (CMG.TO), which is currently not covered by Morningstar Equity Research, generated by AI in a few minutes.

If a mediocre or lower moat rating is assigned, it’s an immediate pass. And once I decide that the initial moat rating of the company is good enough and worth digging deeper, I will actually upload a few annual reports of the company to, for instance, ChatGPT for a more extensive assessment of the durable competitive advantages of the company.

Realizing a robust database of a few hundred potential multi-bagger stock candidates globally is hard work. Once established, this database becomes a valuable tool for identifying attractive investment opportunities, and by tracking valuations over time, one can capitalize on market inefficiencies to exploit valuation discrepancies in small and microcap companies.

As of December 6th, my research identified 111 undervalued small-cap companies with sustainable competitive advantages. Among these, 30 stand out as the strongest and attractively priced global small caps, representing roughly 0.05% of all listed companies worldwide.

Investment idea

The latest addition to the Intelligent Cloning Portfolio is Flow Capital Corp., a Canadian-based, publicly listed venture debt lender dedicated to supporting high-growth companies. Since its inception in 2018, the company has provided financing to businesses in the US, the UK, and Canada, helping them achieve accelerated growth without the dilutive impact of equity financing or the complexities of traditional bank loans. Flow Capital focuses on revenue-generating, VC-backed, and founder-owned companies seeking $3 to $7 million in capital to drive their continued expansion.

To date, the company has invested $156M+ in 66+ companies. Sectors they often focus on include technology, healthcare, and other high-growth industries, aligning with companies that have strong recurring revenue and growth potential. At a market valuation of $23.55 million, the company was trading at about 60% of its book value when I purchased the stock in November. Its total assets are $65.8 million.

A key part of Flow Capital’s value proposition is its investment structure, which aligns incentives with its portfolio companies' performance. This structure includes revenue-based royalties or revenue-linked loans, which allow Flow Capital to share in the success of these companies without needing an equity stake, making it particularly attractive to founders who wish to retain control. Flow Capital also secures additional upside potential through warrants, creating opportunities for higher returns if a portfolio company performs exceptionally well.

The firm's strategy focuses on strong terms that secure investment and repayment, enhancing shareholder alignment. Additionally, Flow Capital has strengthened its leadership team, with experienced executives like Vernon Lobo leading the company and board members who bring extensive industry expertise.

The top eight shareholders collectively own approximately 32% of Flow Capital. Notable individual insiders include Vernon Lobo, who owns 15.5% of the company; Michael Zych with 3.8%; Catherine McLeod-Seltzer at 2.1%; Alan Torrie holding 1.7%; and Alex Baluta with 1.7%. This type of insider ownership can signal confidence in the company's growth prospects, especially within the context of Flow Capital's alternative financing model aimed at providing non-dilutive capital to growing companies.

As a result of the strong portfolio returns and profitability, Flow Capital has seen its book value per share grow from $0.45 on December 31, 2019, to $1.23 as of March 31, 2024. This represents a compound annual growth rate of 27% over the four and a quarter years. Since March 2018, the company has been laser-focused on generating shareholder returns by growing book value per share, similar to the way Warren Buffett tracks his book value per share growth in Berkshire Hathaway.

	Flow's Book Value per Share	% Change
Dec 2019	$0.45	
Dec 2020	$0.56	23.4%
Dec 2021	$0.75	34.0%
Dec 2022	$1.22	62.7%
Dec 2023	$1.19	(2.3%)
March 2024	$1.23	2.9%
CAGR	**27%**	

Flow Capital announced recently its intention to commence a normal course issuer bid through the facilities of the TSX Venture Exchange to repurchase up to 10% of the company's "public float" (i.e., the common shares held by non-insiders).

The company believes that, from time to time, the market price of its common shares does not adequately reflect the company's underlying value and prospects. At such times, purchasing the company's common shares represents an appropriate use of its financial resources and is expected to enhance shareholder value.

A significant benefit of investing in these kinds of microcaps, like Flow Capital, is that large institutional investors, due to their size and constraints, may not have the capacity or interest to thoroughly analyze and invest in these smaller companies. This creates a unique niche where individual investors can uncover undervalued opportunities.

Have I gone mad?

When an investor with a solid belief in investing for the long run, like me, starts day trading 0DTE SPX options, should one question one's mental health? Anyhow.

Over the past three years, I've navigated the challenging world of options trading, using small amounts of capital—a crucial approach during this pioneering phase. In fact, if you start trading options, it's strongly advised to practice with a simulated account to get familiar with option dynamics without risking real money. It is indeed a high-risk, high-reward landscape, and while many professionals attempting the same path have failed, I've managed to gain solid footing.

What are 0DTE options? 0DTE (Zero Days to Expiration) trading refers to options trading strategies that involve buying or selling options contracts on the same day they expire. This practice has become increasingly popular in recent years.

The concept of 0DTE trading emerged as a result of several key developments in options markets:

- **Market Evolution:** Traditionally, options traders preferred to trade options with more time until expiration. However, as markets became more sophisticated and high-frequency trading more prevalent, traders began exploring same-day options strategies.

- **Rise of Retail Trading:** The democratization of trading through platforms like Robinhood and increased access to options trading made 0DTE strategies more accessible to individual investors.
- **Volatility Opportunities:** Traders discovered that same-day options could provide significant profit opportunities, especially around market-moving events like earnings reports or economic announcements.

The popularity of 0DTE trading significantly increased around 2020-2022, driven by increased market volatility during the COVID-19 pandemic, growth of retail trading communities, advanced trading platforms with low or zero commission fees, and increased options market liquidity.

While potentially lucrative, 0DTE trading is considered highly risky and requires rapid decision-making and close market monitoring. Regulatory bodies like the SEC have been monitoring the growth of 0DTE trading, concerned about its potential market impact and risks to individual investors.

As with any advanced trading strategy, 0DTE trading requires sophisticated knowledge of options markets, risk management, and quick analytical skills. It's typically recommended only for experienced traders who fully understand the potential risks and complexities involved. The learning curve is extremely steep. Most professional traders spend years developing these skills, often losing significant amounts of money in the learning process. It's not just about understanding theory, but developing an almost instinctual ability to process complex and often continuously changing market information instantaneously.

One of the phenomena you have to be aware of, both in investing and in options trading, is something known as the Dunning-Kruger effect. This is a cognitive bias in which people with limited knowledge or competence in a particular area overestimate their abilities. And especially if you start gaining experience with options trading, you must realize this can happen to you.

There are a number of reasons why the Dunning-Kruger effect occurs. One reason is that people are often motivated to believe that they are competent, even if they are not. This is because believing in one's own abilities can boost self-esteem and make people feel good about themselves. Another reason is that people may not have the skills or knowledge to accurately assess their own abilities. The Dunning-Kruger effect is, in fact, a complex mental phenomenon that is not fully understood. More research is needed to understand the underlying causes and consequences of this bias. Especially in short-term options trading, this phenomenon can be quite dangerous!

Probably the biggest mistake one can make as a novice is to start trading 0DTE SPX options unprepared as some kind of exciting and new adventure. You really have to develop or find an edge or insight the majority of traders do not have. Do not start managing real money without it. One of the reasons, I believe, why I was successful on this high-risk journey is that I applied the same learning technique that helped me to become a seasoned value investor, and that's the idea of cloning. You try to identify the very best traders out there and start copying their insights and ideas.

A key difference between learning value investing and short-term trading lies in community support. Value investing communities are generally open and helpful to newcomers, while the trading community is often the opposite. Traders tend to keep their best practices secret, fiercely guarding any discovered edge. This secrecy stems from the difficulty of finding an edge in short-term trading; once revealed, it's likely to be copied and quickly disappear.

While the intricacies of 0DTE trading, such as probabilistic modeling techniques, can be fascinating, they may not capture the attention of all readers. So I just skip the nitty-gritty, but it's worth noting that several notable entities and approaches exist within this specialized field.

For instance, quantitative trading firms like Citadel Securities, known for their extremely sophisticated options pricing and prediction models, or Jane Street, which has advanced proprietary models for options market making. And what about Two Sigma and Renaissance Technologies, which have legendary quantitative trading systems that likely include advanced 0DTE predictive capabilities?

But also some researchers at places like MIT's Sloan School and Chicago's Booth School have developed probabilistic models that demonstrate remarkable predictive power for short-term market movements. The work of Emanuel Derman (former Goldman Sachs quantitative researcher) laid the groundwork for many advanced derivatives pricing models.

Some prop trading firms have developed neural network and machine learning models that can predict SPX movement ranges with surprising accuracy. High-frequency trading firms like Virtu Financial have systems that can assess market microstructure and potential price ranges in milliseconds.

However, it's crucial to understand that these models are closely guarded trade secrets. Their exact methodologies are not publicly disclosed, and performance can vary dramatically. What works today might not work tomorrow due to market adaptation. The most sophisticated players in this field are constantly evolving their models, treating them like proprietary algorithms that provide temporary competitive advantages.

This year has been an invaluable year for learning and laying the groundwork for a short-term trading desk. I experimented with various approaches, including paper trades and small-scale capital deployments, while establishing best practices and accumulating significant short-term trading intelligence.

Some of the best practices in trading 0DTE SPX options can only be learned from real-world experience, which is precisely why it's crucial to develop these skills using a paper-based account or trading with minimal capital. And remember, never underestimate the Dunning-Kruger effect!
Let me share a personal experience. After practicing Iron Condors on paper, I began trading them, actually quite recently, with small amounts of money. For 15 trading days, everything went smoothly, and seeing how scalable this strategy could be, I became captivated by the vision of becoming a master Iron Condor trader.

On the 16th day, during what seemed like a calm pre-holiday session with low volatility, I established an Iron Condor position. Throughout most of the day, the trade performed well. However, this seemingly quiet and profitable day turned into a loss in the final 15 minutes when an unexpected sharp upwards move occurred.

Here's the crucial lesson: When trading Iron Condors, the most prudent approach is to systematically close the short positions 45 minutes before market close, regardless of market conditions. This strategy is essential because:

1. There's insufficient time to make adjustments if problems arise in the final minutes.
2. Short options face particularly dangerous gamma risk late in the day.
3. Market makers typically need to rebalance their positions near the close.
4. Unexpected news or large institutional orders can trigger sudden price movements.
5. The minimal potential premium decay isn't worth the substantial risk exposure.

These insights, among many others, can only be gained through hands-on experience. Consider it your real-world trading tuition. That's just how option markets work!

One notable achievement has been developing an edge through AI-fueled technology that signals important market dynamics during the day that might trigger trading activity. For example, it’s able to accurately predict the S&P 500's 90-minute trading range on low-volatility days. This capability allows me to forecast market direction multiple times throughout the day, proving especially useful for:

- Determining whether a trading day is suitable for a 0DTE SPX Iron Condor strategy.
- Identifying the optimal parameters for an Iron Condor trade.
- Proactively managing and, if necessary, adjusting the Iron Condor during the trading session.

Based on historical patterns and market behavior, my estimate of low-volatility days is between 35% and 40% of trading days. These are days with stable, range-bound movements, low implied volatility, and no significant catalysts driving directional momentum. But even on these low-volatility days, one must continuously monitor market internals to confirm range-bound behavior. This reduces the risk of being caught off guard by unexpected volatility.

Additionally, the platform for tracking unexpected range breakouts—which, as experience shows, are inevitable—has already been developed and is performing effectively. Early results are promising; my initial findings indicate that by accurately identifying and trading exclusively during these low volatility periods, being able to adjust if necessary in a timely manner, and closing the shorts 45 minutes before the end of the trading day, I have yet to record a losing trading day.

Here is, for example, a typical day-trading chart I use for monitoring the market internals. It shows the last few trading hours on Christmas Eve, when the markets closed at 1:00 P.M. ET., with a remarkable rally in the last 15 minutes of the day.

I am optimistic about the approach, but the consistency of it can only be judged on its long-term results. This technology is still in its early stages of implementation. Naturally, achieving statistically significant results will require at least a year of rigorous testing and validation. 2025 will be the perfect year to refine and fully evaluate its potential.

0DTE SPX trading is hard work. To ensure rigorous analysis and continuous improvement, I meticulously document each 0DTE SPX trading day in a 8-page report. This includes pre-market preparation, a detailed account of intraday activity, lessons learned and a comprehensive profit/loss evaluation.

That's a wrap! Value investing is often described as watching grass grow. Short-term trading is all about watching market internals flow.

So here we are

I trust you found this write-up insightful. It is indeed my ambition to build this consistently profitable trading desk and to invest these cash flows into the stock markets for the long haul. Hopefully I haven't painted too positive a picture of the chances of success. In any case, I absolutely take into account that it ultimately won't work out. We'll see.

As you've observed from previous write-ups, the earlier designed investment robots with their annually replaced constituents exhibited diverse performance across various markets. While the Indian robots achieved very impressive results, the Chinese robots performance was less than ideal. I remain committed to advancing this project, but the specific details of future robot constituents and performance will be treated as confidential information.

Thank you for reading my letter. Happy New Year!

Peter

Peter Coenen
Founder & CEO
The Value Firm®
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ATTACHMENT

Below is an evaluation of CMG's durable competitive advantages across key dimensions, rated on a scale from 1 (very weak) to 5 (very strong):

1. Brand and Reputation: 4

CMG has established a strong reputation as a leader in reservoir simulation software. It is widely recognized within the oil and gas industry for its expertise in thermal recovery and unconventional reservoir modeling, which are critical for optimizing production and reducing costs. CMG's software is trusted by major E&P companies and research institutions globally.

2. Regulatory/Contractual Barriers: 3

Operating in the software industry, CMG faces moderate regulatory barriers related to intellectual property (IP) protection, software licensing, and compliance with data security standards. While the technical complexity of reservoir simulation creates a natural barrier to entry, the regulatory environment in the software industry is less restrictive compared to sectors like healthcare or finance.

3. Technological Expertise: 5

CMG demonstrates a very strong competitive advantage in technological expertise, particularly in reservoir simulation, advanced computational modeling, and geoscience integration. Its continuous investment in R&D allows it to remain at the forefront of simulation technology, offering industry-leading solutions for complex reservoir conditions.

4. Economies of Scale: 3

As a niche player in the reservoir simulation market, CMG benefits from some economies of scale in software development and customer support, particularly as it licenses its products to multiple clients globally. However, compared to larger software companies that offer broader product portfolios and have global distribution networks, CMG's scale is limited.

5. Customer Loyalty: 4

CMG enjoys high customer loyalty from its existing client base, which includes major oil and gas companies and research institutions. The company's products are deeply embedded in clients' workflows, creating high switching costs due to the complexity and importance of reservoir simulation.

6. Industry Trends: 4

CMG is well-positioned to benefit from industry trends, including the increased focus on digital transformation in the oil and gas sector, demand for unconventional resource development, and the growing interest in carbon capture and storage (CCS). As energy companies prioritize cost optimization and emissions reduction, demand for advanced simulation tools is expected to grow.

Overall Rating: 3.8

Computer Modelling Group Ltd. demonstrates strong competitive advantages, particularly through its technological expertise, brand reputation, and customer loyalty in the reservoir simulation market. The company's focus on delivering industry-leading software solutions positions it well within the oil and gas industry, especially as E&P companies seek to optimize production and reduce costs.