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Active management doesn't mean activity just for the sake of it. The goal is good long-term performance without taking unnecessary risk. Our time horizon is not fixed. We hold some stocks for long periods, and some stocks relatively briefly. The consistent focus, however, is to keep looking through the noise in an attempt to deliver value.

On average, the noise tends to come out in the wash over the course of two to five years in most instances, as fundamentals end up taking charge. We have, however, been holding Microsoft in the Credo Best Ideas Portfolio for even longer than this – essentially since inception of the portfolio more than seven-and-a-half years ago.

A star was born

Microsoft is a household name. At its peak in December 1999, the company was valued at more than 4% of the market capitalisation of the S&P 500. Since the early 1990s, Microsoft dominated the personal computers market, first with MS-DOS and then with Windows. The year 1990 saw the birth of Microsoft Office, which is still ubiquitous in the workplace. The '90s also saw a decade of legal clashes with the Federal Trade Commission. Large companies get a lot of attention, as regulators try to decide whether their power benefits or harms consumers.

Since the '90s, Bill Gates has moved on to focus on philanthropy. He stepped down as chief executive officer in January 2000.

Gates later also stepped down as chairman, in 2014. Peaking at $58.75 (around £45) a share in 1999, the stock fell as far as $15.15 (around £12) by February 2009.

A decade of pain can kill even the most persistent of supporters. Along with the legal battles, the rise of Google, Facebook, Amazon and Netflix also removed the idea that one company could completely dominate a digital future with no checks and balances.

Analysing the fundamentals of businesses is complex. The Microsoft story is a great example of three things that really matter – valuations, earnings growth and management.

Price is not value. But what you pay for something matters.

After launching Windows in the mid-'90s, earnings accelerated, and Microsoft became a market darling. From a price of around 22 times earnings in 1994, the peak in 1999 saw shareholders paying 60 times earnings, implying very high expectations, as far as future earnings growth was concerned.

Losing speed

Subsequently, earnings did grow impressively; just not as fast as had been justified by the overoptimistic valuation. As a result, the price earnings ratio dropped from 60 times in 1999, bottoming at approximately 9 times earnings in 2011. This de-rating more than offset the earnings growth over the period. It is noteworthy that after the share price peaked in 1999 near $59 (around £50), it would not reach those same levels until 2016 – 17 years later!

We do not advocate just buying something just because it is cheap. We don't blindly divide price by earnings (P/E) and pick the lowest number. Our focus is on calculating the intrinsic value, looking through the current noise and having a longer time horizon than most sell-side analysts.

Sell-side analysts make recommendations about buying and selling, but don't become owners themselves. This can limit the timeframe over which they are judged. We look towards the longer-term earnings growth potential. We look at whether the multiples investors are being asked to pay for the earnings are justified. We look at the dividend yield we can pocket while we wait.

Future self

When we bought Microsoft in 2011, we did so because the valuation looked extremely attractive relative to its long-term earnings potential. Bear in mind that, by then, Microsoft was no longer a market darling.

Until a few years ago, the market worried about Google's free Chrome operating system. They worried about competitors stealing market share from Microsoft. We felt that Microsoft Office and Windows had a strong, defendable moat. A network effect means cooperating is easier if people are using the same software. Corporates tend to know how to use Excel and Word and have everything saved in those formats. Shifting has a cost, and stickiness makes change a challenge. Only very price-sensitive consumers brave the change.

The rise of smartphones also had investors worried about declining personal computer sales. We felt that this shift would be temporary and sales would stabilise as smartphone penetration peaked.

These worries provided us with an opportunity, in the same way the optimism of the late '90s should have inspired caution.

Another factor, in addition to what you buy and what you pay for it, is who will be driving. The chief executive that had taken over from Gates had not done a great job: Steve Ballmer had, in our opinion, made some major missteps in missing the opportunity to buy Android, prioritising Windows, rather than cloud computing, and making poor acquisition decisions such as Nokia. He had, however, been in place for more than a decade and was nearing retirement age.

In 2014, Satya Nadella took the reins as CEO. The combination of an attractive valuation, strong growth and an excellent management team has meant that we have been able to hold Microsoft for an extended period. We have seen the share price go up more than threefold since we originally bought it in client portfolios, and we are happy to continue holding the position. •