

“Far and away the best prize that life has to offer is the chance to work hard at work worth doing.” - Theodore Roosevelt

- January marks 6 years in operation for Farnam Street Investments. It's been an outstanding experience so far! It can be paradoxically both daunting and comforting to engage in your life's passion every day. Knowing it's the first few miles of a marathon is a little intimidating, especially when you're not quite certain where the course will take you. At the same time, we've known from Day 1 that the bricks we're laying in these early years are the foundation of something special, and we have a lifetime to build it right. We want to enjoy the journey and not just rush for the destination.
- Thank you to everyone for your support along the way. We're blessed with a truly incredible client base. Here are some pictures from FSI's Annual Bash in October. It was such a privilege to throw on the aprons and serve everyone up a fun time. It felt more like a family reunion than any stuffy "business lunch." Thank you for coming and making it special.

<https://goo.gl/photos/avz41Hmv8uGxjGBk8>

Market Update

“What The Fed did, and I was part of it, was front-loaded an enormous market rally in order to create a wealth effect...and an uncomfortable digestive period is likely now... The Fed is a giant weapon that has no ammunition left...It was The Fed, The Fed, The Fed... in my opinion they got lazy...and it is time to go back to fundamental analysis ...and not just expect the tide to lift all boats... and as [The Fed] tide recedes we are going to see who is wearing a bathing suit and who is not.”

- Former Dallas Fed President Richard Fisher, January 2016

- 2015 was an interesting year in the markets, though it's possible you didn't notice. The median stock in the Russell 3k, which comprises 98% of U.S. equities, ended the year down over 20% from its 52-week high. That means at least half of the stocks in the US had losses greater than 20%-- the definition of a bear market. So how come there wasn't more media attention and why did the index basically stay flat for the year?
- A handful of large stocks (in particular Facebook, Amazon, Netflix, and Google) effectively carried the index and kept it from sliding with the majority of stocks. Remember that the indexes are "market-cap weighted," meaning the bigger the company, the more the impact on the index. When just a few performers do all of the heavy lifting, this is called bad "market breadth." Poor breadth has historically lead to the index crashing not far behind as the stallions run out of steam and catch down with the rest.

- › The 4 stocks (FANG) saw their market prices grow 60% during the year while their earnings only grew 13%. This implies very high expectations for the companies' future prospects. A "P/E" multiple is one measure of how high expectations are. One way to look at it is how many years it would take for the business to earn the amount you just paid for it, if it brought in a steady state of last year's earnings every year going forward. Here are the trailing twelve month P/E's for 2015's 4 big movers:

Facebook (107x), Amazon (950x!), Netflix (307x), Google (32x)

- › It will take an investor almost 1000 years for Amazon to "break even" if it continues with its current earnings rate. We're patient, but that's a little much for even us. People are willing to pay that many multiples because they believe the earnings are going to grow. You really need a rosy future for earnings to grow that much and allow for a good investment return. Any hiccups along the way and expectations (and your investment) come crashing down. We operate on the other end of the spectrum. We'd rather buy a company at 5x earnings or less if we can. Then even a mediocre future can create good investment results. A lack of 5x P/E companies available in the market left us no choice but to be in safe cash.
- › Based on the start of 2016 so far, it looks like our patience may be well rewarded. As of this writing on January 13th, Facebook is down -8.8%, Amazon -13.9%, Netflix -6.8%, and Google -7.5% in just 2016. We are perfectly situated to take advantage of opportunities that are emerging every day the markets tick down. If things get really bad, expect a call from us requesting you send more money, because that will be the time to invest and really get rich. You're always welcome to preempt our call as well.

Yarak, Profit First, and Automation

"A fat wallet is the enemy of superior investment results." – Warren Buffett

- › *Yarak* is a falconry term of likely Persian descent that describes when the bird is in a state of hunger (but not to the point of weakened), super alert, and laser-focused on the hunt. When in this state, the bird has incredible clarity, energy, and singularity of purpose towards its most important objective: hunting to feed itself. The bird is the purest expression of its genetic hunting potential when in *yarak*.
- › If you're a successful small business person, which includes many of our clients, how can you harness the *yarak* phenomenon and put your business in a state of hyper-focus and readiness to hunt? There's a simple trick to do just that. Most businesses hustle to create revenue, pay out their various expenses, and with any luck, there's a little profit leftover for the owner. Here's what we learned in business school for about \$120k in combined tuition: *Revenue - Expenses = Profits*. It makes sense. But it is exactly backwards if you want to succeed. The process you should follow is:

Revenue - Profits = Expenses

- Don't wait to see if there's anything leftover. By carving out the profits before anything else, you create a constraint on the resources available to go toward your expenses. This constraint unlocks your creative juices to meet clients' needs, streamline operations, and only allocate to the expenses which truly generate value for your customers. There's no room left for fluff and bloat. Difficult decisions on how you should run your business become obvious.
- People will often make big, lasting life changes when they're confronted with an existential scare like a heart attack. A key ingredient of yarak success is to manufacture a "fake heart attack" for your business. To do this, you need to shunt your profits out of the business and into an account that is difficult to access and generally ignored. This will put the money "out-of-sight and out-of-mind," and when you look at your company's shrunken operating bank account, it will create a yarak-like sense of urgency that would otherwise be clouded by a large cash balance. No longer fat, dumb and happy, maybe you make that extra sales call or hold off on that unnecessary expense. Everyone wants to run a tight ship, but the best way to harness your entrepreneurial verve is to tie your own hands. It will turn all of your business SHOULD'S into business MUST'S.
- For a more detailed explanation of this concept, we suggest Mike Michalowicz's book [Profit First](#). If you're a business owner and want a free copy, send us an email and we'll get one out to you.

"There's no sauce in the world like hunger." - Miguel de Cervantes, author of Don Quixote (1547-1616)

- As luck would have it, these same principles apply to you and your family's personal finances. You should really consider yourself as a small business unit with revenue (wages), expenses (living), and profits (savings and investments). Here's how it looks for an individual:

Wages - Automated Savings = Living Expenses

- This has often been referred to by numerous personal finances experts as "[pay yourself first](#)." Many of you already do this with automatic contributions to your 401k. It's a great step toward a healthy retirement and should definitely be maximized. But it's not enough. The problem is money in retirement accounts isn't available to you until you're almost 60 years old. If you wanted to retire before then, you have nothing to live on. You could be incredibly wealthy in your retirement accounts, but still forced to work until your 60. That's why it's so important to save additional money. And the least psychologically taxing way to saving is to do it in an automated fashion.
- If you wait around to see if there's anything left to save, there never will be. Some emergency will always come up and absorb your savings. Here's what you do instead: every time you get paid, an automated amount also flows out of your checking account into your Profit First account. You'll hardly miss it and will quickly adjust to your new "income" level. You're free to spend the remaining amount guilt free because you're still being a responsible saver.

Start small, but commit to continually increasing the amount. After a while, it will become a game to see how much you can transfer out every month, and you'll be amazed at how the money piles up. If you do the saving right, the investment returns are just the cherry on top.

- By having a set amount of expenses to live on, you'll force yourself to get creative with your expenses. This often doesn't mean a decrease in the quality of life, just the opposite. You're forced to ask yourself if each expense is actually bringing that much joy to your life. You won't have that conversation with yourself unless there's a sense of urgency from being in yarak. It's too easy to ignore while all of your wealth bleeds out quietly like sand through your fingers. We've all asked ourselves, "Where does the money go?"
- Automated savings and profit are the surest path to financial felicity. If you want help in setting up your Profit First account and having us apply a Buffett-inspired approach, we can set up business or personal accounts and manage them for this express purpose. We've done it for our own businesses and personal finances for years, and can attest it is the easiest method to achieve financial independence. It's a 100% certainty your future self with thank us (and you) some day! Even if you don't want us to manage it, do yourself a favor and unlock the automated savings miracle.

FSI's New Financial Platform

- We're launching an exciting new initiative that we're calling "the G.Y.M." (Grow Your Money). This new platform will help us collaborate tightly with clients on their financial game plans. We can even show you graphically the dramatic impact from setting up a Profit First account. A Gym membership will be provided free of charge for all FSI clients. More information can be found here: <https://goo.gl/2TngKG>

As always, we're thankful to have such great partners in this wealth creation journey.

Jake & Lonnie

Performance since Jan 2008*

FSI (after all fees)	+57.8%
S&P 500 (w/ dividends)	+65.8%

* Based on auditable track record of our flagship fund The 5505 Fund formerly named RCM Partners Fund.

It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities discussed. Fund results may differ significantly from separately managed accounts. Individual SMA results may differ due to timing of purchases, account size, and portfolio strategies.