

October 2011 Partner Letter

Third Quarter Performance

"It's a crazy speculator's market in which one day it's the Apocalypse and the next day it's Nirvana and we switch back and forth like a light switch. It makes no sense to me."

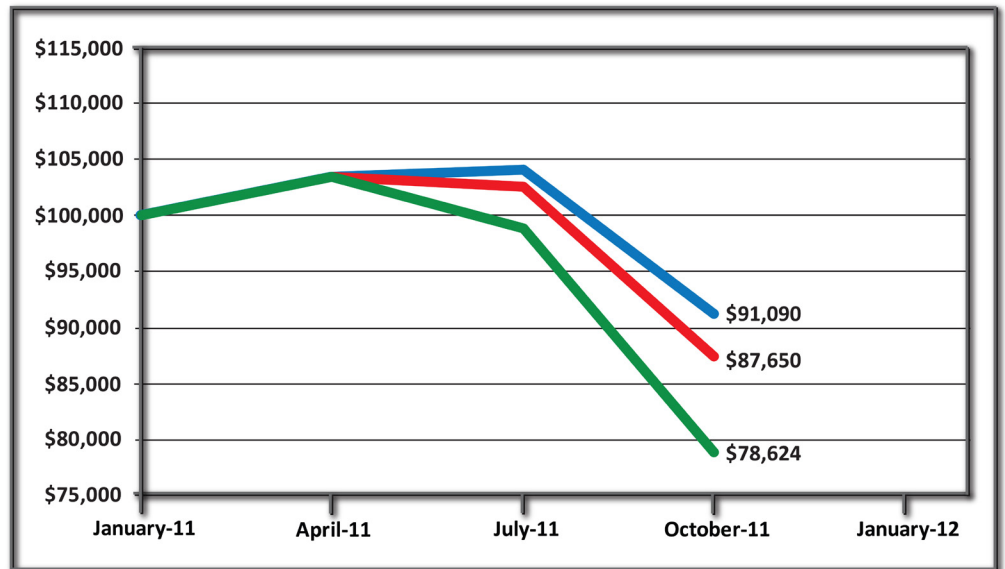
- John Bogle

(9/7/11)

"We should spend our time trying to find value among the knowable-- industries, companies, and securities-- rather than base our decisions on what we expect from the less-knowable macro world of economies and broad market performance."

- Howard Marks

Results of a \$100,000 Investment



One thing to notice in the relative performance of the the fund vs. both the S&P500 and the Dow Jones Industrial Average is the size of the underlying companies in each "vehicle." The DJIA (blue line) is the 30 largest U.S. companies, the S&P500 (red line) is the 500 largest and FSI (green line) is 25 companies that nearly no one has heard of (this is by design: when stocks are under-followed, price vs. intrinsic value is more likely to deviate). We believe that the wild volatility swings have spooked many investors into familiar names, hence the recent scoreboard shows Win: DJIA, Place: S&P500, and Show: FSI.

"Charlie and I have always preferred a lumpy 15% to a smooth 12% return."

- Warren E. Buffett

Part of owning small cap stocks means generally accepting higher highs and lower lows. FSI will continue to have similar performance characteristics as we're most concerned with returns over a long time-horizon and believe smaller companies give us the best chance at return maximization. Looking through the rearview mirror, it is easy to imagine that scared investors would abandon small companies and flock toward the large, why own small caps? We feel this is a classic case of *hindsight bias*. We don't consider ourselves enlightened enough to make those kind of predictions about investor reactions; we'll stick to our knitting of buying good businesses when they're selling for cheap and keeping our eyes on the long-term prize.

"When proper temperament joins with proper intellectual framework, then you get rational behavior."

- Warren E. Buffett

Our temperament and intellectual framework manifest themselves in our riding out short-term volatility and concentrating on the long-run results of buying great small businesses when they are selling for unreasonable prices. We believe this continues to be the most beneficial course for our partners, despite the painful times of under-performance we must face on occasion. We encourage partners to keep the faith as *small caps tend to bounce back strong* after previous lagging. We believe we're well positioned to benefit, whenever that eventually happens.

New Tools and Investments

"I am ashamed at the number of things around my house and shops that are done by animals-- human beings, I mean-- and ought to be done by a motor without any sense of fatigue or pain. Hereafter a motor must do all the chores."
- Thomas Edison

One of the ancillary benefits of teaching is that we come in contact with numerous highly-capable students possessing skills that we assuredly lack. We were fortunate enough that one such student, Ramy Hindiyeh, wanted to help us with automating some of our search processes. Ramy wrote a computer program that gathers and compiles all of the data we would want to see on a given company; we merely feed it tickers and greedily await the results (talk about giving a couple of kids the keys to the candystore!). This was previously a manual process for us and carried with it a chance for data-entry error. We're afforded an instant snapshot of what's available and how any stock compares to our current holdings-- i.e. instantaneous opportunity cost. There are firms that provide similar services to Ramy's tool, but licenses typically run \$20-30k per year, well above our modest research budget. Much like Buffett combing through the Moody's Manual starting with the letter "A" before he'd ever heard of Berkshire Hathaway, we're able to search the globe ever more effectively for great businesses selling for unreasonable prices. Thanks Rami for giving us the gift of time!

Speaking of search, our quest for value has recently lead us to the Land of the Rising Sun. In fact, we've invested ~20% of the fund into a basket of very attractive Japanese opportunities. We're eager to see what fruit they will bear and will more than likely add until we reach our self-imposed maximum of 25% of the fund; we're that enthusiastic. See [our article on seekingalpha](#) for a detail account of our rationale.

Annual Meeting in April

It's no secret that we're unabashed Buffett copycats. In that vein, just as Berkshire hosts a "small get-together" with 35,000 of Warren's closest friends, FSI will have an annual meeting in April of 2012. Once we get the exact date confirmed, we'll send out a formal notice. We hope you'll be able to attend.

Investing in the Fund

The next opening to invest in the pooled fund will be January 1st. For new partners, please allow at least 2-3 weeks to complete the paperwork and for funds to clear. For adding money to an existing account, please allow at least a week for everything to process.

For the separately managed accounts, there are no quarterly windows to worry about. We're ready to help when you are. We encourage you to call or send us an email, we'll take it from there to ensure the process is easy, painless, and turnkey for you. Whether it's an orphaned IRA from an old job or you're leaving your job and need to do something intelligent with your 401k, we're here to help.

Thank you for your continued trust, referrals and support. If you have any questions, please don't hesitate to call or email. We're never too busy to help you or people you care about.

Warm regards,



Jacob L. Taylor, Managing Partner

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FARNAM STREET Investments

101 Parkshore Dr., Suite 100 Folsom, CA 95630

Cell: 916.775.3741 ■ Office: 916.932.2046 ■ Fax: 916.932.2001

www.farnamstreetinvestments.com