Jake Taylor Joins Us to Discuss Value Investing and the Importance of Journaling

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Dave

0:00

All right, folks, welcome to Investing for Beginners podcast today we have a very special guest with us joining us all the way from California very early in the morning. We have Jake Taylor is the CEO of Farnam Street Investments. He is also one of the co-hosts of one of my favorite podcast Value After Hours with Tobias Carlisle and Bill Brewster.

And Jake also wrote one of my favorite books, the Rebel Allocator. Jake, thank you very much for joining us today. We really appreciate it. And I guess could you kind of give a brief synopsis like how did you get into investing what started you down this path?

Jake

0:30

Sure. Pleasure being here. Thanks, gents for having me on my background was I got an undergrad degree in economics, and I graduated in 2003. If you remember, back then there actually were not that many jobs available for people with no experience, which was me. And so I happened to very fortunately get this an operator and training program at the California ISO and I, they taught me basically in a year, an electrical engineering degree and how to run the power grid.

So I went through that program got a job running the power grid, and actually did that for 12 years. But while I was in working for the power grid, I not sure exactly what I wanted to do when I grew up, even at that point, even though I had that that was a pretty good career, I went back to get my MBA in a working professional program at UC Davis. And so it's like nights and weekends. And the first year that I was there at Davis, I happen to win this lottery to go back to Omaha and have lunch with Warren Buffett. And one of those, you know, like one of the classes come and visit him. And of course, it was amazing as you would expect, I mean, he's so good.

And when I started digging in more about Buffett, I learned that, wait, he's just trying to find a deal on things, he just wants to pay less than what something is worth, I felt like I'd been doing that my whole life, you know, buying something on Craigslist, and then sell it on eBay in an arbitrage and, you know, always looking to find a deal never paying retail. And when you take that concept and apply it to the purchase and ownership of publicly traded companies, you know, little slices of a business, they call it value investing, and it made perfect sense to me. And so I realized that that was what my calling was. And so I started working towards, you know, starting Farnam street investments, actually with my boss at the time at the energy place, my mentor, he was also really into Buffett and so we started a fund together. And but I did both for more than five years running both the company and working as a kind of a as a power system operator.

So eventually, I was able to make the transition to full time, like my passion. And since then I've just been trying to tinker around with projects that I think are interesting and kind of like keep me moving forward and making progress. And that you know, included writing a book and you know, writing quarterly letters and doing podcasts and lots of other projects.

Dave

2:36

Yeah, that's awesome. So you have definitely gone a path that I would think that most people probably have not followed. So yeah, how did you feel about going from energy to investing was that a hard transition. And once you kind of stepped away from that, you know,

Jake

2:50

it is a little difficult in that you don't know what you don't know, if you're just an outsider, you know, if I had come up, you know, and I'd worked at Goldman Sachs or something, and then like, I would have a much better lay of the land probably.

But then I also on the flip side would have probably learned a lot of things that were maybe led me into some blind alleys as well and made you think like everyone else thinks so, too, actually, I think it's in the end of the day, it's actually an advantage to be have that outsider kind of mindset, as long as you kind of avoid some of those real obvious big mistakes that are kind of easy to make if you are an outsider. So

Dave

3:21

I guess let's talk about those. What are some of the big obvious mistakes that people could make?

Jake

3:26

Well, I mean, if you're trying to be an HR professional, I'm almost thinking more in the compliance realm, like you come in, and you're just like, you don't know that you're not allowed to say that, or you're not allowed to, you know, like, things that you would have learned kind of on day one at Goldman, or even actually, a big part is getting clients is hard if you didn't come from that sort of pedigree. You know, if you're coming in from an outsider, and if you didn't grow up in a, you know, kind of a silver spoon environment, which I did not, it can be hard to stand up a business that is, you know, that is functional and has enough assets to really like make a living from it. So yeah, I mean, there's definitely, like I said, there's pluses and minuses.

Dave

4:03

Yeah, for sure. So how long have you been running Farnam street now?

Jake

4:07

Our first fund launched in 2008. Okay, a little while. Yeah, yeah. January, January of 2018. I'm not even October. So yeah, well, we took the first you know, that year on the chin, like pretty much performed with the market down 37% out of the gates, but yeah, I mean, if what the mindset was that we're going to be doing this for a long time, you know, it's unfortunate, but you just keep one foot in front of the other.

We had some good years right after that, as you would probably expect, you know, value had a pretty good run there and especially, you know, 2009 1011 ish, so, it was okay, but it definitely, definitely not an auspicious start.

Dave

4:47

Yeah, for sure. So I guess kind of thinking about that. You've kind of you've gone through some different kinds of ups and lows and cycles, if you will of the market. So has that affected kind of how you think about your investment strategy or deal with the way that you look for companies and track those kinds of things.

Jake

5:03

Yeah, I would say that, like, I think everyone, every investor is imprinted based on whatever market environment they sort of cut their teeth on. And so if you happen to be, you know, come of age, in a very bullish time period, you're probably a little bit more turned tuned and turned up towards, you know, right tail outcomes and, you know, big investment results that you're looking for, if you came up, you know, in the Great Depression, you probably are wired for the downside and thinking about and I don't know, if it's DNA related, or if it's actually sort of like survivorship bias that like, if you've made it through that period, then you know, like the period kind of like winnowing down, you know, who survives, and then therefore, that's the population that's left after that time period, whatever the mechanism is, I think that whatever you kind of cut your teeth in, you tend to carry that with you through your entire investment journey.

And so I am very much kind of a downside protection minded guy, and I think about what's the worst case scenario, and I try to optimize for that. And, you know, that mindset can serve you well, at different time periods, but it can hamstring you as well, like, you know, 2015 to 2020, I would say, was a very difficult time for someone who was thinking about the downside, because the downsides did not really materialize that much. And a lot of the upsides that came about that would might have been a little bit longer shots than you would have expected, they came true, and you're gonna look like an idiot, if you are worried about the downside, and there's nothing but you know, upsides cashing in. So

Andrew

6:32

guilty. So, too, is that mean? Banks are kind of out of the equation here, because there was a lot of ugliness with the banking sector during that 2008 2009 period,

Jake

6:45

I actually owned a fair number of the banks in 2011 12, that 13 through that time period, and it was everything is always in relation to price. So there's ugly, but if the price is that much more attractive, like it's that beat up, then I can maybe get comfortable with it. There's no assessment of risk, where price is not a huge component of that. So the banks, I thought got unduly cheap, then we actually did okay, and those did pretty well.

But there were at the time, if you remember, it was like, the asset side of this is such a question mark, and the liabilities are very real, always right? Where are the holes in the balance sheet where this thing could explode? And if you can get comfortable with that, then you know, how much are you paying for it. And at the time, you know, it was well south of 50 cents on the dollar for a lot of them.

And we figured out that the assets were, even if there were some impairments, it wasn't going to be half of the bank's balance sheet was garbage. And it actually, if anything, the underwriting got really strong around that time period, because there had been so many problems before, especially on like, residential real estate. So ironically, it was actually a great time for them to because they had actually tightened up so much from and like basil rules were also, you know, pushing them into a lot more conservative positioning. So anyway, like it was, it actually wasn't that hard of a trigger to pull it that time based on the price.

Andrew

7:59

So I noticed you keep coming back to price, how does your holding period strategy factor into price? Do you ascribe more to the idea of buy until it's fairly priced? And then get out? Or are you kind of on the other? More like Buffett side of letting them run?

Jake

8:17

Yeah, so I mean, I think the right way to think about it is that over shorter periods of time, changes in multiple, or the sentiment of that company are going to drive results a lot more. And over long periods of time, the difference in multiple fades and the return on the business, the return on equity or assets or however you want to measure invested capital is what will dominate how things work out for you as an investor. So you when I first started out, I was a lot more short term focused in that I was looking for a multiple rewrite of things that were super cheap, whether it was, you know, really low price to book or even net nets, if I could find them. But what kind of happened is that that those super cheap things really dried up around that time period. And so you just couldn't fill up an entire portfolio of them. So now what do you do? So you have to start worrying a little bit more about business quality, you're trying not to reach too much and overpay for things.

But when you can't find these, like no brainer, you know, things trading for less than cash on the balance sheet, you have to find some new tools to get to work. And so that was part of my own, you know, a forcing mechanism to become a better investor like I needed that. Otherwise, I would have just probably hid out in net nets. And so now I tend to be more of a value buyer and a little bit of a growth holder if it converges into that. And I tried to look through a little bit deeper into, you know, a few years from my ownership, what might the business look like? And how cheap is it relative today to what it could look like in a few years and trying to be real conservative with my assumptions.

But you know, I wouldn't want to sell just because it ran up, you know, a little bit more than I was comfortable with before when there was still plenty of kind of IRR baked into where it was where the puck was going.

Andrew

9:56

Basically IRR for beginners who aren't I'm familiar with the term internal rate of return basically the upside potential that the business can continue to grow.

Jake

10:06

And really like my assessment of what the company is worth, and how close are we to that assessment, ideally, actually, like, I would love to find situations where the multiple doesn't change at all. I buy it at a 10 times earnings. And I hold it for a decade, and I earn a 15% return on equity that the company is generating internally. And I'll just ride that same multiple all the way through. But Mr. Market can kind of force your hand sometimes by, you know, if the price was to go up, and I went from a 10 times multiple, two, let's say at 20. Well, now all of a sudden, like my prospective return that I could expect starts to come down, and therefore I'm starting to look for places to trade up potentially.

But again, it always is this balance of factors of what do I know this company very well, versus the new thing that I'm buying? Maybe I don't know it as well, that's, that can be a very dangerous place. And then what is the kind of risk reward and how certain am I as the business results that I'm hanging my hat on. And in a world now where there's a lot more disruption from technology like it starts to get, it's kind of difficult to really, and I think you really saw this with COVID, where, you know, 2020 was an insane year for, you know, like the economy, just stopping who would have thought airlines with literally zero revenue, like who was underwriting that in their analysis, and then back to 2021, where you had just things like rocketing and like all over the place, work from home, completely changing how we do everything. And just a huge round trip in a lot of these companies that have kind of come back down to their trend lines, where they were in from 2019, like normalizing any business today is incredibly difficult based on the last few years of numbers, like it's a really hard task right now, like probably harder than any point I think I've seen in my career.

Dave

11:46

That's a great insight. And I guess one of the things that I guess I'm curious about when you're talking about some of the price issues, and some of the things that how do you think about projecting some of those things forward?

Is that something that you study the past and kind of project that forward? Or is it based on your experience by reading through all these companies and kind of understanding the businesses in where you think they're gonna go? How certain do you feel, you know, when you make a bet on a company that this is going to come to pass,

Jake

12:14

usually not very certain. I mean, ideally, you the right way to do this is to think in base rates. And so a base rate is, if we looked at an entire population of businesses like this, and the closer that we can get describing this particular business that we're trying to project, if we can find a lot of companies that look like that business, the more that we can kind of hang our hat on the base rate, if we're just using very general terms, you know, it starts to decrease the chances that the base rate that we're using actually applies to this individual business. So the base rate can be for a lot of things, whether it's, you know, how much are the revenues of this company going to grow over the next few years.

And so if we looked at, you know, companies that are like this, and the base rate said that, you know, companies this size in this industry, with this particular niche that they're operating in, have historically grown at 10%, let's say, that would be my base operating assumption. And now I have to have some kind of special insight into how the world works, to want to deviate off of what that base rate is telling me. And so that's the ideal way to do it. Now, the execution of that is like where the art is, in this, that's scientifically the right way to think about it. But to actually do it well requires, you know, the more experience that you have, I think really helps a lot in this. And this is where Buffett, you know, is still so good as a 90, you know, what is he now he's 92, he has been reading newspapers, looking at companies looking at the financials for you know, more than 50 years.

And he's been building these base rates in his head this entire time. And so he's got a very good idea about a lot of companies, even once he doesn't own what they are likely to do over the next five to 10 years. And so when something dislocates, the price, you know, gets away from what he thinks is a pretty obvious where this is going, he's ready to act like that. That's how he's able to make decisions in less than a day. Because he has a very good idea of what the base rates he can kind of expect. And as long as he stays within his circle of competence, which basically means like, either I know the base rate or I know something special about the world that allows me to know why the base rate is not right in this particular situation, then I know that, like that's how I could get comfortable with being able to make that kind of decision so quickly. That's awesome.

Dave

14:26

You're just confirming to me that Buffett has a computer in his head and he's like a Michael Jordan as far as intellect goes. So for those of us mere mortals, how do we learn about base rates? Like where's a good resource to learn more about those?

Jake

14:40

Yeah, Michael Mobizen, who is one of the best authors and writers and researchers in our field has a couple different papers on base rates that are very handy to have. So if you just Google Mobis, and I think it's m au BOUSSINP Will there'll be these white papers on base rates that they have should give you some of the base rates for some industries, that's kind of helpful.

Andrew

15:03

Do you have any favorites that you've leaned on in the past that you would be willing to share? Whether it's revenue or any other category?

Jake

15:12

Well, we could talk about mistakes that I've made and using base rates, if that's probably more instructive. I did a little post mortem on Google in earlier this year. And what I was trying to do was figure out like, I've been to Google headquarters, I have a lot of friends that work at Google, I recognize that Google was a special business a decade ago, why did I not own it over at any point during that, you know, 12 years? Why would I pass on it? And what was I doing? And how do I not make that same mistake again.

And so what it came down to was actually, you know, Google was a very big company in 2015. And typically, historically, the base rate would tell you that large companies don't grow as fast, because they've already saturated their markets, they're already giant, maybe they've already got a lot of the low hanging fruit in what they're able to do for a customer. Well, that is true. However, I was using a base rate for kind of more industrial minded companies, which is what we had at the time, like, I didn't have the words research that came out after actually from Mobizen, about how certain companies in the digital space are able to really defy the base rates of existing historical, big companies and keep growing at these incredible rates, even though they're large. And so you know, I had been using the wrong base rate, and when I would use that to kind of project revenue out and then you know, assume some kind of a profit margin and give some kind of, you know, multiple for that profit, I kept coming up with like, it seems like Google's fully priced this whole time, and yet, it just keeps going up and up and up. And every time I would run kind of an assessment, I'd be like, it seems like it's already fully priced, like the growths already baked into this, I don't see how I can win from here. But then, you know, if you use the newer base rate that's more applicable for this particular type of animal, then, if I had been using that, I would have seen like, oh, wait, there's actually a lot of cheap growth still here, if it follows that base rate.

And that would be how I would win. And maybe even margins are improving in some of these businesses as they get bigger. And now you also have, in fairness, a lot of multiple expansion on that, which I would have probably not, that's not what I typically tend to underwrite. Like, I don't want to really win most of the time, because everyone gets crazy excited about my businesses, like I want to win because the business is doing well and serve them as well. Now, sometimes they do get excited about it. And that's usually when I get tempted to sell a good business, which is actually a very frustrating position to be in.

But so that was where base rates led me astray at one point. And, you know, that's hopefully I learned from that, and that I, you know, just keep working on finding the base, the next good bass, right, and the one that's most applicable to what it is that I'm studying,

Dave

17:45

Why do you think Buffett and Munger missed on Google? Because I know they've admitted that they missed on it, do you think it was kind of the same idea?

Jake

17:52

I really have no idea because they actually, they're more guilty than I am? I would say, because they Well, I mean, in the meetings, they've talked about how they recognized well, one, they knew that newspapers, a one town, one newspaper situation is one of the best businesses of all time of the 20th century, they absolutely printed money. I mean, they made all the money that they ever wanted to make, basically. And because they had both sides captured, they had, you know, the more readership that they had, the more valuable it was to advertisers. And the more advertisers they had the more pricing that they could charge for it. So they were in a fantastic situation.

And Google is basically like the one town of the world internet newspaper with classifieds and search. I mean, it's, it's just an incredible business. And even to compound their error even more for Buffett and Munger, they had been paying a ton of money as GEICO owners to Google and seeing how well it was doing for them. So like they had an inside, you know, like front row seat to see how Google was working for ads and driving eyeballs for Geico. And they recognized it and yet, somehow, they still never pulled the trigger on it.

So you know, it makes me feel a little bit better that I was so stupid to not buy it, but I don't know what their excuses. I say that jokingly, because it's your best to ever have done it. But of course, of course,

Dave

19:13

it does help one sleep better at night, knowing that even the greatest can make, you know, can miss and make mistakes, you know, from time to time that this game is not easy,

Jake

19:20

and still get incredible results. That's the other nice thing about this is that you do not have to bat, you know, 900 or 1000 in this game to still do just fine.

Dave

19:30

Why do you think there's this perception that you have to be perfect to do well in the markets?

Jake

19:34

I don't know. Like a lot of it. I mean, the other thing I think that's that goes missing a lot in that conversation is that it's really more about slugging percentage than batting average. So you can have a great individual pick, but if you don't put hardly any money behind it, I mean, it's almost as if you didn't even swing the bat, whereas you can also you know, have a marginal idea that does not that great but maybe not that bad, but if you put a lot of money behind it, the opportunity cost of that idea can absolutely eat you alive of the things that you didn't invest in, because you were you had your money tied up in this, you know, dog for lack of a better term for a long time. So the position sizing is actually a completely different conversation than the stock picking. And it's probably just as important.

Dave

20:17

Well, maybe we could chat about a little bit.

Andrew

20:18

Do you have opinions on? Maybe somebody like you who does it professionally versus somebody who's kind of a DIY average investor? Do you think there's thoughts on either side of that spectrum? I guess?

Jake

20:32

Yeah. I mean, I would say I mean, it's the same for everybody. I would say like Daniel Kahneman would tell you that overconfidence is the number one killer of behavioral biases. And so how do you combat overconfidence, cut your position sizes down from what you think your gut is telling you, and spread your bets around a little bit more. I know that that's not a very Munger in kind of approach, like Munger would tell you put your, you know, the most money in your best idea.

And if it's better than all your other ideas, like why water it down with your 10th best idea? Well, I think the world's a little bit more random than that, for most of us, unless you are truly waiting for if you're following mongers approach, which, I don't know if you guys know this, but like in running daily journals portfolio, he sat in treasury bills from like 2005 to 2009. And did nothing. And you know, of course, there's no shot clock for him, because he's, you know, he's Munger, and he's running with this company, and he's totally in charge of it. But if you're a professional money manager, who's supposed to be picking stocks, and you had all your clients in treasuries for years, you're gonna get fired. I mean, there's just no two ways about that. But then in 2009, comes along, and he just loads up on a couple different things like Bank of America. And so he like just bet big when he had very overwhelmingly obvious smart things to do.

And then he went back to, you know, doing whatever designing dorm rooms and catamarans. And whatever else he's doing, reading books, but so that's one style, I just like you have to be, I think it's important to recognize, like, matching your own personality with the style that you're trying to implement. And so if you are that kind of person that can, can be doing other things and ignore markets for years on end, then you can probably can do that.

But for most people, I think you probably want to stay more fully invested most of the time and validate your position sizing out a little bit more because it's the world is a little more untamed than it seems there's there be dragons more often than you realize. So it's better to spread your bets a little bit more. And, you know, some diversification I think, is called for I love those examples.

Andrew

22:33

You know, when you talk about Munger in 2005, he had been an investor for like four or five decades, I don't know probably longer than that. So he kind of knows what he's doing versus somebody who's maybe trying to approach the market for the first couple of years thinking they can, after a couple of years of experience time, the market, it's a bit of goes back to that overconfidence idea,

Jake

22:56

I think you have to recognize also that chances are because of just the way that information flows, when you hear about and you get excited about investing as a new investor, chances are you are being sucked into something near the top. That's just how otherwise you wouldn't have been hearing about it. Right? If it's down, if everyone hates it, you're not hearing about it in any kind of news flow. And this actually applies to me as a value investor, like I got into value investing in 2000, let's say six, seven time period. Well guess what value investing had been doing for the last like six years. absolutely crushing everyone, right? So I was a momentum value investor in a way, like I got sucked into the top of a value sort of run. And naturally because you hear about it, and like, oh, this just makes a lot of sense. Like, of course, this is the right way to do it.

And it's working. Like of course, like I'm a genius, like I should be doing this. This is easy. This is very easy, right. And I think that applies to all investment styles, you get sucked in near the top, most likely, like, statistically, chances are, if you hear about it, and you're new to the game, you're getting in near the top. And you'd just have to recognize that and go slowly and try to find yourself and find your sweet spot where your personality matches with the investment and recognize that chances are actually it's not going to be whatever's happening right now is how you're going to actually do well and just be ready for that.

Dave

24:15

That's a very good point. That's a great insight. Think about the more people that have started investing in 2020. You know, for the last two years, the roller coaster that they've been on, I can't even imagine.

Jake

24:24

Yeah, and I mean, it would be very sad if this experience disabuse them from ever wanting to be owners of businesses via the stock market. I mean, that is a huge loss for them as a vehicle if they decide that, you know, the game is rigged or stocks are for suckers, or it's only a gambling instrument. That can be true. And Munger even talks about this. He'll say that sometimes stocks are priced like businesses and based on cash flow, and sometimes they're priced like Rembrandt's and it's more about just what are someone willing to pay for it?

So recognizing, you know, are you in an investment kind of market are you In a Rembrandt market, and, you know, we've been in a Rembrandt market for a couple of years there, you know, call the end of 2020. Well, let's start at 2009 really to say, you know, the pandemic, and then again, like even more, you know, kind of ecstatic Rembrandt market for 2021. It kind of feels like maybe we're at the end of that now. And we're a little going back more towards profits over promises. But we'll see, no one really knows the answers to those heads. You know, where's the market going? Questions?

Dave

25:32

No, none of us do.

Andrew

25:34

Yeah, it's, I mean, like you said, it's been a very interesting environment, since Oh, nine, obviously, nobody has a crystal ball. But how much hope do you have for some sort of reversion to the mean of like, how the market used to be, there's a lot of ideas going out there values, just taking a new form. And I think there's some other ideas that maybe it will revert, and we're starting to see that now. Do you have any thoughts on either of those things? Obviously, knowing nobody knows,

Jake

26:03

you know, I think you have to, there's lots of different ways to skin the cat. And yeah, so you have to, like I said, Do what is matches your personality. And I think that there's definitely like business value, the creation of business value is morphs over time as it should, right. Like, you know, 150 years ago, half of us were farmers. And that, you know, we were subsistence, you know, hand to mouth, basically. And now, you know, we've specialized enough and gotten enough output from, you know, every industry to where we can find our little niche where we can provide even more value.

And, you know, that is going to change over time, and it should otherwise we're not making progress as a species. So naturally, the owner of these businesses also has to think about how things are changing and recognize where things are going. With all of that said, I do think that, you know, reversion to the mean, is still an incredibly powerful force in the universe. And I would say that it's not, I don't think it's dead. I think buying cheap things, however you define cheap, you know, is, will work over time, I think that markets mean revert as well. And I think we will spend some time below the mean, at some point, you know, that will be when real investors are kind of tested. And it'll Ben Graham has the saying that, like bear markets are when stocks returned to their rightful owners. And so, you know, I think there'll be that time period again, and a cleansing. And that's what you need to generate good returns, like you need, you actually need pain, and you need a reset of a wash out of the exuberance, you actually did it to be on the other side of it with negativity.

And, you know, people, the death of equities was a famous article that was written in 1981, I think it was in Forbes, and it was, it pretty much marked the bottom of a 17 year bull market run.

So those are the kinds of things that you have to have at the bottom to have a truly epic kind of Bull Run and the Bull Run doesn't come from a, I don't think from a period like today, where you have a very high multiple of earnings being paid for most businesses, you have profit margins through the roof, compared to like, 1981 profit margins were down at like 2%. And now they're like 14, basically every like metric that you would look at, to say, Okay, can we like go in the other direction from here, like, we're kind of pegged out at the upper end already of where most of these datasets have lived for, you know, in some cases, 1000s of years, if you look at like interest rates. So anyway, long story short, there's still always interesting things to work on and learn about, and there are pockets that will always be available and like, smart things to do. So don't I'm not saying like, don't get out there and work, I'm just saying, you know, be a little more conservative and expect that, you know, it might be some tough times from here, actually, and that you actually should be looking forward to that, because that's when the real investors will reassert themselves.

And that's when, like the real, you'll start actually making, like the real money that you deserve to make and not sort of like to the moon as an investment thesis, you know, I just, I don't that was never really sustainable.

Dave

28:57

Yeah, totally. So you are obviously somebody that's spent a lot of time studying this, and you spend a lot of time looking at the companies that you end up buying. And so I'm wondering what kind of what kind of vehicle do you use to kind of keep track of your, your investment thesis, like, how do you track you know, hey, I'm gonna buy a company A and five years from now, how do you look back and see, why did I buy this? And is that still in play now?

Jake

29:22

Yeah. So I had this very problem for a long time. And I also knew that there were all kinds of little data points, like what I would call like dark data that were going without being captured, that I knew were important on the input side of the process, that were driving results. And it kind of drove me nuts that like I wasn't capturing these things.

So for instance, just even like a very basic example, you know, let's say I'm going through and looking at a bunch of different businesses, and maybe I spend five or 10 minutes on one and just kind of look through the financials real quick, and I just decided, not for me, okay, well, passing on that idea is that obvious thing we all do it, but why did I pass on it. And as a base of all of the times that I said, and I'm not that into it for this reason, maybe it was too much leverage or it's too expensive or the business like returns on equity aren't good enough for me or whatever the reason code was that I kind of used internally. How does it go on to perform from there? So what really what is the cost of my filtration system on the front end? And I wasn't keeping track of that. And so how would I know if my filtering is getting better or not, unless I'm measuring these things.

So little, and like a million other little things like that, that I felt like were going unmeasured, that I wanted to know about myself for my own process, and to get better. And really, at the end of the day, it's about closing feedback loops, because that's what's required to start learning and actually build intuition about things, you have to have feedback loops closed. So it was driving me nuts, so much. And I was like, looking around for some solutions. And I couldn't really find anything that was in what I was looking for. And so I basically decided to start building something myself. And I've teamed up with a couple of just amazing co founders that are a joy to work with. And we've hired employees. And so we've been building this software now for almost a couple of years.

And hopefully, maybe within the next maybe by the end of the year, we'll launch an actual public launch, and the name of it is called journalistic. And the idea behind that is that it's a journaling on the front end. So that's kind of your interface with, you know, getting your thoughts out into this. And then analytics on the back end to help you understand yourself better understand your decision making, which is where the key thing really drives is, how do we improve your decision making. And so closing those feedback loops through analytics and reports on the back end, that hopefully help you understand yourself better, that make you improve at a faster rate,

Andrew

31:40

to kind of like, illustrate, hey, by the way, here's where you missed these base rates, like three times, and listen to some one time thing, kind of,

Jake

31:49

yeah, I mean, the idea is really like, you know, if you do this diligently, one you learn about yourself, but to like, don't make the same mistake twice. If you're doing a good job of sort of postmodern being, you know, like when things went wrong, you know, that's how Munger would say, like, rub your nose in in your mistakes.

And so, a lot, this makes it a lot easier to recognize, like, oh, okay, here's where I'm making the same sort of mistake over and over again, and I actually have a behavioral bias here that's hitting me, I need to be aware of that and get nudged a little bit away from that, so that I don't keep doing it over and over again.

Andrew

32:19

Yeah, I like how it that's kind of focused on the opportunity cost side, which kind of fits in with what you were talking about with Google, I think it could be one of those hidden blind spots that you don't even realize you're doing it because it's just part of your everyday filter. And that, you know, there's so many different ways you could screw up, why not take some time to figure out if your systems like, out of date or needs some adjustment?

Jake

32:44

I'm glad you brought up blind spots, because that's 100% the right way to think about it. In fact, somebody who I know has done a lot of studying about human behavior. And you know, why do we do what we do says that like that, actually, all mistakes come from blind spots. Because otherwise, if it wasn't a blind spot, you would know and you wouldn't do it.

Right. And so like, he's he basically says, like, you can almost you know, all these, if you go through like poor Charlie's Almanac, where he goes through, like, I think the 25 behavioral biases that affect human psychology, this person would say like, you don't need 25 Of those, you just need the one and it's blind spots. And so revealing those blind spots is a big part of what we're after with this software is to just help you see, where are you making the mistakes.

Dave

33:25

That's awesome. I wish I would have had that 30 years ago.

Jake

33:29

Same here, that's, that's exactly why I was like, shoot, we got to get building this, I guess, because I'm not going to get better at the rate that I want to start closing these feedback loops. But even like we have some other kinds of cool stuff that's lined up there. So imagine that you're just sort of journaling about a particular idea.

And you're just dumping your thoughts in there, we're actually building an API like where it will do a natural language processing of your word choices, and assign a sentiment score to that journal entry. And then overlay that on the price of what you're, you know, as you're journaling about that idea, we can see how your sentiment has changed over time and show it to you so that you can get a sense of what I think most people are going to discover is that price is driving your sentiment in a major way, like how you feel about the company, how you interpret that next piece of data that comes in from a 10 Q wherever is colored by what price has been doing recently, which is not the right way to be thinking about it.

Like you should be recognizing the fundamental numbers, regardless of what price has been doing. And it's just incredibly difficult to do like we're all guilty of it. And conversely, you know, if the price has been going down, you're like, God, I hate this company sucks. Like I'm filtering every new piece of data that comes in with that sort of lens and what are hopefully our feedback that we're going to give you through your sentiment analysis will let you step out away from that a little bit and take those glasses off and be able to look at the real data, the real experience without being jaded by whatever the recent kind of scent of the recent price has been driving your sentiment. A

Andrew

34:58

Oh, that would be so cool to you. Who's and see people use? Yeah. Anybody I think about when you're in it like right now we're in 2022. So a lot of the way we think about the market today and whatever opportunities are in the market can be influenced by what we hear from CNBC, how we talk to our colleagues about the market all of these things, you know, I haven't been doing this forever.

But it's funny to me to hear the bemoaning of people talking about 2020. And how, you know, it should have been so obvious that I should have bought this stock or that stock like, No, you don't remember the conversations that everybody was having, that had so much to do not even with the stock market, but where the world was going. And we already two years later have forgotten so much of

Jake

35:39

that. I mean, our memories are so fallible, it's unbelievable. And that's another big part of wanting to just write things down is that when you can go back and see what you're actually thinking, it's it'll blow your mind, I mean, you will literally not recognize what was written there. But you know, it was you. It's crazy.

And that I think the being able to see that about yourself and see how much it changes you I think is just such an advantage if you start doing it, especially if you're younger, and a beginner, it's almost table stakes at this point, like if you want to get better, you really have to keep capturing these things. And the problem is, is that if you just rely on your own memory, your memory works in that it is almost like it's not this perfect recording of what happened. It's a replay of what you kind of think happened, and the more that it sort of replays it tapes over it. And as it does that, it'll drop data points that might threaten your ego, actually. And so it will want to just get rid of those things that kind of make you question your own self worth. And it's just trying to protect you like it's not, you know, it's nothing malicious.

But it means that your connection to what actually was happening and what you were thinking at the time is a very tenuous connection when you go trying to just remember, and so writing it down, it's just such an advantage. And it's such an obvious good idea that, you know, I just really couldn't recommend it enough. If you're a beginning investor.

Andrew

36:57

Yeah, I'll also put emphasis on that, because I'll read some of the newsletters I wrote four or five years ago, I was recommending companies to people, it makes my stomach kind of turn a little bit to think. And what's funny about it is how much sometimes you can either be wrong or just have a blind spot on something and still make money on it, which to me is kind of encouraging that you can have a lot of thoughts that are really wrong, but still do pretty well, if you stick to some key principles with your messing.

Jake

37:26

Well, and I think that is you just hit on one of the biggest problems that is the investment world is that the feedback loops are incredibly long. And they're very noisy, which means it's a very difficult learning environment. It's what researchers would call a wicked learning environment as opposed to a kind learning environment. A kind learning environment is where feedback is unambiguous, it's instantaneous. It's every single time it happens.

But in the investment world, it can take years sometimes to figure out if you were right or wrong. And you can 100% be right or wrong for the wrong reasons, you could be right for the wrong reasons. So another thing that I recommend that a new investor does is to actually make probabilistic predictions about certain company fundamentals.

So you could say, I believe that Apple's revenue will grow at a 10% clip. And I'm 70% sure about that. And I think that profit margins will be you know, this, you know, let's say 20% or greater, and I'm 80% sure about that. And what you're wanting to do is accumulate a bunch of data of your projections. And the reason to do it probabilistically is that then when you can go back and look at all of them, you can see, okay, when I said 70%, that should happen seven out of 10 times as a base case. And if it's not, then I'm not calibrated correctly, right. And so that will reveal where you're overconfident or under confident.

But to have let's say, I'm making like five fundamental predictions every single year about a company whether it's, you know, the the revenue, growth rate, the profit margins, the multiple the dividend, share, count, whatever all these things that are sort of the natural drivers of returns, you can start to accumulate five data points for every one price data point that you would get over a year. And what you'll start to see then is like, the price could go up, and you could be way off on your projections. And that's a very dangerous place to be because you are actually, you're showing a lack of skill in your predictions, but your price, like your return is showing that you're doing well. And that's when you're gonna get your head cut off on the next time because you're wildly overconfident about how good you are at this. Or conversely, you could be doing great on your predictions and the market is not agreeing with you at all. And that could just tell you like,

Okay, I just need to kind of stay the course I'm doing the right thing. I'm going to end up where I need to eventually the market has to agree with what's happening. Fundamentally, it's just a time period that's a little bit unlucky. So untangling luck versus skill.

You can do it over 20 years of an investment career based only on price, but a lot of people want to know that answer sooner. And the way to find the answer sooner is to make You know, five predictions to every one price data point and start accumulating a bigger sample size faster so that you can start to get a sense of, do you have locker skill?

Dave

40:10

Yeah, that's interesting. Yeah, it's

Andrew

40:11

obviously you spend a lot of time thinking about that. And it kind of shows shines through how you're thinking about how can I make myself better my skills better knowing that over the long term, this is going to make better results in the market. It's not about what's my portfolio gonna do next year, but how can I make better and better choices probabilistically. And then my chances just improve, the more you invest?

Jake

40:33

Well, the only thing we really have control over is our process and our mindset. And so focusing on those things, I think, is the only smart thing to do, like the results are going to be what they're going to be, and you don't have a whole lot of control over them, the market can do can make you feel stupid for long periods of time, very long periods will test your resolve, you know, that's probably how it should be like, if it was super easy, I don't, you know, it would get competed away. And so the fact that it's difficult just means that there's that many less people who are likely to be following that same thing that you're doing, that's usually a good sign for when it's going to start working again, is when everyone hates it. So at least that's what I tell myself to, to keep going. But But yeah, I do you think that like process is, is the only real lever that we have to focus on is just try to get a little bit better every single day and you know, go to bed a little bit smarter than you woke up as Munger would say,

Andrew

41:22

it's a very important framework, I think there's a lot of wisdom and experience and knowledge behind it. And I highly recommend for people maybe store this download away for the next time you start losing faith, remind yourself that maybe how you're valuing yourself might have a blind spot. So Jake, we really, really appreciate your time. I've the time flew by for me, I mean, I thought there was so much good stuff.

Here, you have a great book, which we didn't even get a chance to talk about the rebel allocator. Just real quick, I think people should check that out. It was one of my favorite reads this summer. It's basically a fiction book about capital allocation. Investing. It's a great read for even if somebody who's not familiar with the business world, or investing to learn some of the key principles, and a lot of it reminded me of Buffett so that was a really cool read. And I highly recommend it, you have also software that's going to be coming out that we should be looking out for. So remind us again, what that is, and then also where people can learn more about you and what you got going on if they want to follow what you're doing.

Jake

42:25

Sure, yeah, the software that's coming out on decision making is called journalistic.com. And so you can go there now and sign up on the waitlist. And we've been onboarding people kind of at our own pace, because we want to make sure that it's a good experience. And really, like we're learning from, you know, each little cohort that comes through, you know, how do we do this better for the next one. So we're not completely open yet. But hopefully, it will be open in like I said, in the next few months, maybe by the end of the year. Yeah, I tend to put a lot of public stuff on Twitter, just as an easy place to kind of, if we want to keep up what I'm doing not all the time, like I try not to spend so much time on there.

But it is a little bit addicting to be honest. So on Twitter, I'm at Farnham F AR N am Jake one. So that's that's where I do a fair amount of kind of public dumping of sometimes what I'm thinking sometimes it's just pictures of hikes. Sometimes it's research papers that I like sometimes it's just promoting my own stuff. That's Twitter. Yeah. And then the book is Rebel allocator, available on Amazon and physical ebook and got a, I had a voice actor record the audio version, I thought he just did such a great job with it. I was very, so happy with how that turned out. And luckily for all of you, I didn't do it. And you didn't have to have my like nasally, drone and pretending characters. So that was definitely a big win for the audience.

Andrew

43:46

The female characters very well, yeah,

Jake

43:49

he was so good. Like he had all he had the range to get all the different characters in there. And I thought he did such a good job.

Dave

43:55

Yeah, he did do a great job. But he had great material to work with too. So it is a great book. I listened to it on a long drive back. And it actually made me cry. So it was very touching. And it was very informative. And I literally couldn't stop listening to it. So if you have not checked it out, I highly recommend it for whatever level you are. It's a fantastic book. It's very educational. And it's very emotional. So for me, it was so I enjoyed it touched me. So Jake, we really appreciate you taking the time out to come talk to us today. This was awesome. There was so much great stuff you weighed on us.

And I'm gonna be thinking a lot after we get off of here. So appreciate you doing that. And even though we didn't get to share the veggies, we didn't get to talk about some of your favorite stuff. So that was cool. So again, everyone check out everything that Jake's doing the value after hours podcast, if you've not listened to it, it's a lot of fun. The three of them have a great time talking to each other. And it really shines through. So it's one of my favorite podcasts. So let's do that every week. So without any further ado, I'll go ahead and sign us off you guys go out there and invest with a margin of safety. Emphasis on the safety. Have a great week and we'll talk to y'all next week.

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