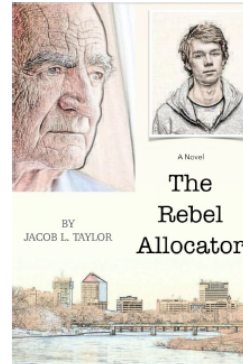

Author Interview:

Jake Taylor



Jake Taylor is the CEO of Farnam Street Investments, the host of the author interview series Five Good Questions, creator of the world's first hikecast, and was an adjunct professor at UC Davis's Graduate School of Management for several years. *The Rebel Allocator* is Jake's first literary effort. He lives in Folsom, California with his wife and two boys where he enjoys being the second best-selling author in the house. Please see more of his fabulous work on:

@farnamjake1

<http://fivegoodquestions.co/about>

<https://farnam-street.com/>

<http://fivegoodquestions.co/rebel>

And you can pre-order the book on Kindle here: <https://amzn.to/2OKxlfD>

InvestingByTheBooks: Jake – thank you so much for taking the time out to answer some of our questions. We really appreciated the opportunity to spend time with your book at an early stage. Even though a printed pdf is far from the feel of an actual hard-copy book, with covers and all...But how does it feel to be “on the other side of the table”, where you are the one getting questions instead of the other way around?

Jake Taylor: It's a nice change of pace. I'm honored to have the opportunity for a fun Q&A session.

IBB: We won't just be asking five questions, you know...

JT: That's OK. I originally named the series Five Good Questions because I knew I had to put a constraint on myself. Otherwise, I'd ask fifty mediocre questions and every interview would be interminably boring because of me.

IBB: “The Rebel Allocator” – take us to the very beginning of how this book came about. How long have you worked on it in a sense from conceptual idea to finished product?

JT: I had the incredible good fortune of having lunch with Warren Buffett in my first year of business school. Like many others, I was so impressed I started reading everything about Buffett. So you could say the journey started in Omaha more than a decade ago. One of Mr. Buffett's observations that struck me

early was how many CEOs weren't very good at capital allocation when it's clearly so important. It's not their fault though—they get to the top spot by being good at other things like sales, engineering, or organizational politics. Mr. Buffett describes it as if the final step for a talented musician was not to perform at Carnegie Hall, but instead to be named Chairman of the Federal Reserve. No wonder they struggle! One of the early working titles I had was “From Carnegie Hall to the Fed.” (Yes, I have a lot of bad ideas.) I started really working in earnest on the book about three-and-a-half years ago. I guess I'm no John Grisham.

IBB: You talk about some of the thought-processes in the foreword (which is fantastic!). At first starting down the more traditional non-fiction path, doing a tremendous amount of research, but then “a thousand little nudges from the universe convinced me I had to tell a story if I wanted the work to have a lasting impact”. Tell us more about those nudges.

JT: Right, I was working hard on a non-fiction guide to proper capital allocation. It felt like different books, podcasts, and conversations at that time were telling me I needed to write a fictional story if there was any chance of my book still mattering in ten years. The emotion of a story is all that persists. Around that same time I lost a close friend my age to a tragic hiking accident. It was a wake up call. If I were to disappear tomorrow, what kind of book would I want to leave as a literary legacy for my two young boys? It certainly wasn't a dry, non-fiction, vanity project that no one would care about in six months. I had to try something radically different and tell a story. This led to researching hero's journeys and even screenplay writing to learn about character arcs and dynamic pacing to engage the reader. I hope the book reads a little like watching a movie. (And no, there aren't any plans for *The Rebel Allocator* coming to the big screen.)

IBB: Towards the end of that introduction, there is a fantastic quote from Henry David Thoreau along the lines of “the price for something is the amount of life you exchange for it”. It also resonates with Charlie Munger's sentiment that our main asset is our time. So, is Jake Taylor's balance sheet stronger now than pre-book?

JT: I learned a TON researching and writing this book. I taught a class on value investing at UC Davis for a number of years and I used to think having to teach was the best way to learn a subject. I was wrong. Writing a book takes it to a whole new level of necessary understanding. The medium is too permanent to risk faking your way through it. So yes, I would say I added assets to the balance sheet. Unfortunately, I also accrued some liabilities. Writing a book is an emotionally draining rollercoaster. My friends and family have been very supportive during the process, even when they weren't getting my best.

IBB: Admittedly, it is difficult to do it completely right when it comes to the topic of capital allocation. There is the trade-off of describing after-the-fact success stories (nice, but just documenting history with winner-bias) or trying to decipher a journey of capital allocation done right here and now (better, but risk looking like a fool after five years). But as far as “lasting impact” goes, “The Outsiders” by William Thorndike seems to fit that mold...?

JT: Capital allocation decisions face all the same problems as judging an investor. Luck versus skill gets separated over a long enough timeline, but who has twenty or thirty years to observe before checking the scoreboard? That's where process can help. Does the decision-maker's process make sense to you? I purposely built a framework to help a capital allocator navigate any environment and make more thoughtful decisions—giving them a better process. I start at the individual customer transaction level and build all the way up through dividends, share buybacks, and more. I absolutely loved Thorndike's “The Outsiders.” It's one of my all-time favorite books. Yet it's more descriptive of the success stories. I wanted to provide the framework that would inspire confidence in a new batch of outsider CEOs to trust their judgement and work a better process. Especially if they were starting at a deficit where the default becomes seeking the safety of following the herd.

IBB: Excluding your kids, who do you see as the book's target audience? Or is that an outdated question in today's direct-to-consumer world, making "target-groups" a product of the world of Mad Men and ad-agencies in the 60s?

JT: No, I think any product should have a target audience you're trying to help if you want it to resonate. My desire is to have an impact on business decision-makers. CEOs are obviously part of that group, but there are lessons in the book for boards, small business owners, even venture capitalists. I chose the coming-of-age genre of a recent college grad finding his way on purpose. I wanted to skew younger toward the leadership of tomorrow. The clay is still wet for them and I think this book could make a big difference when embraced by young people. Especially if it's given as a gift from a mentor. I purposefully included overtones that celebrate the miracles of capitalism in our everyday lives. When business is done right, it conspires to delight customers, provide meaningful jobs, and conserve natural resources. It's remarkable how it gets us all on the same page. Profit doesn't have to be a four-letter word. I tried not to be preachy, but it's easy to forget and take these mundane miracles for granted.

IBB: The cover shows two people, the main characters of the book ("Nick" and "Mr. X"). Are the portraits inspired by anyone?

JT: Not really. I just thought it'd be nice to give the reader faces for the main characters.

IBB: Without spoiling the plot too much, the question still needs to be asked: assuming the Nick-character leans heavily on the real-life Jake Taylor, and assuming Mr X. has borrowed heavily from Charlie Munger (the gruff personality, wise-ass jokes, a few similar events in his family and so on) – what other persons and why have you baked into these two personalities?

JT: They say to write what you know, so I tried to put Nick into situations I have been in so I could add realistic color. Nonetheless, I took a lot of liberties to keep it interesting. Nick's upbringing was very different from mine, and I've never had Nick's overwhelming sense of feeling lost (poor kid). People who know me well said they enjoyed figuring out what was Nick and what was Jake. Mr. X is an amalgam of a lot of heroes: Charlie, Warren, Henry Singleton, Ray Croc, Sam Walton, among many others.

IBB: The Guy Spier-experience working for a ruthless investment bank (chronicled in his great book "The Education of a Value Investor") is déjà vu'd in my mind when the book paints a similar picture of the culture of Nick's work at "Big Rock"...

JT: I confess my description of Big Rock is simplistic and paints private equity in broad, unflattering strokes. I don't believe that's a fair treatment, but I needed Big Rock to be extreme to provide contrast for Mr. X's approach to business: focusing on doing right by customers, being a fiduciary for his shareholders, conserving resources, and maintaining the highest ethics. A light shines brightest in a sea of darkness.

IBB: Another smallish spoiler-alert: Why hamburgers (as the book's "third main character")?

JT: I chose a business that anyone could understand. I also wanted something that would still be around in 100 years that the reader could relate to—restaurants aren't a bad bet. Plus, I just love hamburgers!

IBB: We mentioned “Outsiders”. Are there other non-fiction books you have liked and found inspiration in that deal with the topic of capital allocation?

JT: Warren Buffett’s letters to shareholders (and Cunningham’s arrangements of them) are great places for capital allocators to start. Michael Mauboussin has also written several canonical white papers on the subject. He’s one of my heroes. There are a few academic corporate finance books that have value. But a useable framework for a business person is notably absent from the lineup. My goal for this book was to fill that gap in an entertaining way that might still be useful twenty years from now. I would have gladly saved three years of my life had someone already written that book!

IBB: Actually, let’s step back. Why capital allocation as the topic of the book? Out of all aspects of business-life and investing?

JT: David Foster Wallace told a joke I like: Two young fish swim passed an older fish heading the other way. The elder says, “Morning boys, how’s the water?” The two younger fish swim on. Eventually one looks at the other and says, “What the hell is water?” Capital allocation is the water surrounding all of our business fish. From seemingly mundane budgeting processes to boardroom strategy to mergers and acquisitions, capital allocation is ubiquitous in business. Yet its effects remain highly under-appreciated; it simply blends into the background. The thoughtful allocating of resources is one of the most important societal functions entrusted to business leaders. If I thought it might help, how could I NOT write a guidebook on capital allocation and try to get it into leaders’ hands? It sounds grandiose to say, but I truly believe the ripple effects of a book like this could be massive, though impossible to measure. The wasteful expense that gets cut to make room for an initiative that wows the customer. The doomed factory that doesn’t get built just because everyone else is building factories. The jobs that aren’t trained for and now lost. The abuse of shareholders via buybacks at silly prices. Enough little improvements and they start to become meaningful.

IBB: The “three straws” as an illustration of a framework for dealing with immensely complex business challenges – tell us how you came up with it? Because it is certainly genius in the Einstein-sense of making a problem as simple as possible but not simpler than that...

JT: Thank you—that’s very nice of you to say. Nick Gogerty wrote a terrifically underrated book called “The Nature of Value.” In it he describes the Iron Law of Economics: the **cost** to produce < the **price** you charge < the **value** you deliver. Anything other than [cost < price < value] is unsustainable. I spent a lot of time tinkering around with that idea and it yielded some interesting insights, like the tradeoffs between profit and brand. The straws were a natural extension of props that would be laying around a restaurant. I had one person tell me the book was worth reading for that mental model alone.

IBB: We would agree, even if that grossly diminishes the other treats one gets as a reader. On another note, there are a fair amount of sad streaks in the book. But I think the underlying tone is very optimistic and inspirational, driving the story forward. Is that how you approached it as well?

JT: I wanted the book experience to be like you were reading Nick’s diary during a formative phase. There are some sad moments in the book, just like in real life. The gravitas is tempered by Nick’s (hopefully funny) inner-dialogue as he navigates the world. Not to spoil it, but ultimately, there is redemption as Nick finds his purpose after being adrift. And like it is for all of us, the dots only connect in hindsight. There’s nothing more beautiful than someone discovering their true calling. I’m generally an optimistic person, which no doubt leaks into the writing.

IBB: On a more technical note – a substantial portion of “The Rebel Allocator” is made up of conversation and dialogue. Why did you choose this method of telling the story?

JT: I submitted an early draft to a friend who is an accomplished writer. She had the courage to call me out and tell me the writing stunk (which it did!). She also pointed me toward some great books on the writing process which helped immensely. One of the big takeaways was to trust that your reader is smart—you don’t have to over-explain everything. Another was show, don’t tell. Let the characters’ personalities come out through their conversations and actions, rather than be explained by narration. The lessons I was hoping the reader might learn are buried in the conversations. I’m probably still guilty of over-explanation (ask my wife), despite my best efforts at mitigating the problem.

IBB: On a more private note. I guess your answer will follow along the Buffett-route of “I am a better investor because I am a businessman, and...”, but how do you juggle being CEO at Farnam Street work with doing “5GQ”?

JT: Being the CEO of Farnam Street is my dream day job. Although the position comes with a feeling of immense responsibility for the financial well-being of our clients (they’re nearly all close friends and family), I’m blessed with a lot of day-to-day autonomy. It’s controversial to say, but professional investment management is probably better practiced less than full time. I’m not saying it’s a hobby, just that you have to be careful how you direct your efforts. It depends on the market you’re in. There are periods with a lot of bargains and you don’t have enough research hours in the day. Conversely, there are markets where you probably shouldn’t be digging that hard, lest you talk yourself into marginal ideas (which is very easy to do—I can talk myself into anything with enough idle time). If it’s not blindingly obvious that you’re getting a bargain, maybe you’re better off being productive in other ways. For me, staying productive has taken different forms. With *The Rebel Allocator*, I’m hoping to educate a generation of business decision-makers. The Hikecast is about getting out in nature for blue sky conversations. Five Good Questions is all about connecting with authors of interesting books. I’ve needed worthwhile projects to keep me from making unforced errors during the recent expensive market period. And interestingly enough, I believe these side-projects have each made me a better investor in unforeseen ways that will prove beneficial for decades to come.

IBB: Could you see yourself quitting one of your two day-jobs?

JT: The only thing I can imagine prying me away from investment management would be a Berkshire or Fairfax type of situation with permanent capital and the opportunity to be a cheerleader of great operating businesses run by wonderful people. Farnam Street has an amazing collection of clients who give me wide investment latitude. Yet there’s something to be said for the long time horizon of truly permanent capital. I serve on the board of a private energy consulting company and I have to admit I love staying involved with high-level business operations and strategy. I’m weird, but it’s just flat out fun. Maybe I can scratch that itch with friendly activism at Farnam Street and by joining a few public boards. I’m not in a big hurry to quit anything though. I wake up every morning excited about what I’m going to work on that day. And I have about five other businesses I’d start tomorrow if I wasn’t already worried about my lack of focus.

IBB: We have taken up too much of your time. One of the beauties (and scary things!) about writing a book is, I guess, that two people can read and interpret the same sentence entirely differently - not to mention an entire book. But, what key concepts do you hope your readers will take to heart after they put down "The Rebel Allocator"?

JT: My sincerest hope is the reader is so engrossed in the story, they don't realize they're learning a lot about capital allocation and the importance of business in making our lives better. Granted, that's a tall order, but that was the book I felt compelled to write. That was the book that wouldn't let me sleep at night until I had dislodged it from inside my guts. That was the book I felt could have the biggest impact on helping humanity, if I could pull it off.

IBB: Thank you very much Jake. We would urge everyone with any interest at all in business, investing or life's serendipitous ways to read this book. Check Amazon daily for when you can pre-order! One copy for your own notes, scribbles and to keep. Then to hand out to people around you whom you care for and want to impact. There are few things in the world apart from jewelry that carry the weight of giving someone a book especially for them, that you think would impact that specific human being in a particular way. As I read "The Rebel Allocator", the list of names I want to give this book to grew fairly long! But compared to stepping into Tiffany's, the Value vs Price gap is obviously still massive...

JAKE TAYLOR IN 10 SECONDS

California or Midwest?

I've lived in Cali for 35 years. In 90 minutes I can be on a Tahoe ski slope or downtown San Francisco. Hard to imagine living anywhere else.

Five Good Questions or The Hikecast?

That's like asking which of my kids do I love more?! 5GQ is probably more useful to humanity so it gets the nod.

Traditional Value Investing or **Compounders**?

I'll always be a sucker for dirt cheap garbage stocks that everyone hates, but there's something comforting knowing your money is being looked after by a quality capital allocator. Very anti-fragile.

Another book or **Interviewing Other Authors**?

The idea of starting work on another book right now makes me queazy. Let me get back to interviews please!

Fairfax or **Berkshire**?

I love Prem's infectious positivity, but Berkshire is the gold standard.

Henrik Andersson

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