How We're Doing After a Real Deal Gut Check

In response to a truly extraordinary and painful week in the world equity markets, I believe it is appropriate to update all those who have entrusted us with their hard earned money on where we stand following the drop from all-time highs in the broad U.S. markets that began on February 19. I also think it is important to convey just how hard we work to meet (and even exceed) the expectation we set for ourselves and each of you.

I will start by acknowledging that what we have seen over the past seven trading days is unprecedented in recent history. The pronounced selling has been rapid, sustained and can fairly be described as a “black swan” event. At yesterday's market close, the Dow was down 14.1%, the S&P 500 was down 13.01% and the Nasdaq was down 13.5%. This week alone saw the Dow lose more than 3,000 points. Trillions of dollars have been stripped from the market capitalization of U.S. stocks. The selling has been broad and deep. No risk asset was exempt. The benefactor of this selling has been bonds and, most notably U.S. treasuries, as money flowed to perceived safety.

As many of you know, we have a systematic and rules-based process of allocating money to asset classes that are attractive at various points within the repeating economic cycle. We constantly monitor important fundamental data, such as interest rates, the yield curve and year-over-year earnings of the best companies in the United States. We also monitor a variety of technical price information in conjunction with this all-important underlying fundamental data, which is the foundation of investing in general, and asset class performance in particular. This process allows us to provide investors with a novel and transparent way to invest. We attempt to identify and target the intended drawdown of each of our core portfolios during times of stress. Moreover, we provide a drawdown number, which represents in percentage terms the intended drawdown of the portfolios when market conditions deteriorate.

In simple terms, we seek to provide investors with a clear understanding of how much money they can be expected to lose in a bad market. Of course there are no guarantees on hitting the drawdown number or exceeding it, but at least an investor understands the intent and parameters of their portfolio. As our company has grown, I have spent a good deal of time talking with institutional investors and professional money managers of all types. I can tell you this, it takes a lot of guts to put a drawdown number on the front of our portfolios. I have been told more than once that I must be crazy. I don't think I am crazy. I think it is the right thing to do, and it is the only way I would want to invest if I didn't do this for a living. In fact, I didn't always do this for a living, and that is why we built it this way.

With all of that said, no system can be fully prepared for an event that is based upon factors outside the scope of the intended system. What we have seen over the past ten days is based upon fear of a biological illness whose short- or long-term impact is unknown. The effects that will be felt by things that matter to asset price, namely earnings, are speculative at best. While undoubtedly there will be some reduction in the supply chain due to ongoing (although improving) restrictions in China, the fact remains that as of today, the consumer in the U.S. is strong, earnings have been solid and demand in the U.S. remains robust. I do not want to minimize any illness that has sickened or caused the death of anyone, but novel coronavirus is much less of a relative threat to a human than the flu. The vast majority of those infected do not require medical treatment. Those that do require medical intervention usually have other conditions that complicate recovery, are very old or very young. The mortality rate outside of China is deemed to be less than 1%. These are objective facts. This, however, is not the collective perception of worldwide investors, and perception very quickly becomes reality.

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At Cabana, we have spent the better part of the last fifteen years building models that account for all kinds of market conditions, and it is important to continually add to that body of learning as we work to get better. The psychological panic we have seen, as well as the circumstances surrounding it, provide an invaluable opportunity to improve. By improve, I mean to build an investment methodology that is even more robust in the face of known and unknown circumstances.

While the past week has been unsettling and stressful to all of us, I am incredibly proud to report that ***all portfolios in our Target Drawdown Series remain inside their respective target drawdown***. This fact in and of itself is a significant accomplishment given the speed at which the losses occurred and the lag we have built into our software. It is important to not be over reactive in the vast majority of circumstances and to proceed deliberately and incrementally. Under the present circumstances, such caution was not advantageous, but our Cyclical Asset Reallocation Algorithm (CARA) has again proven broad enough to manage extreme and unforeseen conditions.

Below are our estimated performance returns since February 19, when each of our portfolios were at an all-time high.

Cabana Target Drawdown Income 5:

Gross: -3.88% Net: -3.89%

Cabana Target Drawdown 7:

Gross: -5.59% Net: -5.60%

Cabana Target Drawdown 10:

Gross: -9.08% Net: -9.09%

Cabana Target Drawdown 13:

Gross: -10.75% Net: -10.76%

Cabana Target Drawdown 16:

Gross: -10.45% Net: -10.46%

Cabana Target Drawdown 20:

Gross: -10.45% Net: -10.46%

Cabana Target Drawdown Efficient 10:

Gross: 9.79% Net: -9.80%

These results are unverified estimates and based upon preliminary average returns between custodians. Net performance includes a maximum investment advisory fee of 2%. Actual performance results, which can be found here, are independently examined by our GIPS verifiers and published on a monthly basis.

To be able to achieve broad market gains when times are good, while still protecting against large losses is what we are all about. CARA signaled a scene change on Wednesday of this week and each of our portfolios were reallocated on Friday to remove substantial risk in the event that this week's selling continues. All portfolios are in a position of relative safety at this time. Due to oversold conditions and the need for short sellers to cover their positions, we are likely to see an explosive rally during the next few days. When that process subsides, we will see whether perception really has become reality and selling resumes. If it does, we are allocated appropriately.

I want to specifically acknowledge our trading and operations team that worked 16-hour days on Wednesday and Thursday of this week to reduce our standard two-day blackout period to one day, so that trading could be accomplished ahead of schedule. I am incredibly proud of how much it matters to everyone in our firm that we get it right and fight for our clients every day. Lastly, I want to express how humbled I am by our professional advisor partners and other investors who trust in the process and stay on the path that is investing. It is not always easy, but the rewards can be life changing.

A great article that our CCO, Daniel Ippolito, provided to me regarding the coronavirus and similar pandemics over history can be found here.

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For additional information regarding our services, including performance disclosures, please visit www.thecabanagroup.com.

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