

Perception is Not Reality

We have spent the past few weeks discussing the need to have a rules-based process in place that helps take the emotion out of investing when markets appear to disconnect from what we perceive as reality. This “perception” issue has long been studied within the field of behavioral finance and psychology. Humans are by nature risk adverse and will choose to forgo an opportunity to avoid a perceived risk. Humans also tend to perceive things to be as they *think* they should be. We find what we are looking for and ignore the rest. In this way, a person’s perception very much becomes their reality. These two human characteristics may have evolutionary benefits, but together they work to the detriment of many investors (professional and amateur alike).

I had a call with a client today to discuss investing more of his funds in one of our portfolios. This client is extremely smart, experienced, self-made, and wealthy. He watches the market closely and pays attention to economic data. Moreover, he has been with Cabana for some time and knows our process. By all accounts, this client has all the tools he needs to be a successful investor. There is just one problem right now. He cannot believe the market will keep going higher in the face of dire economic conditions. He “perceives” that the market is currently flawed and will inevitably collapse. He has the data to back up that perception. As we discussed his thoughts and the best way forward, it occurred to me that his perception had become more than a perception. It had become his reality. When something becomes reality for a person, it is very scary to act in opposition to that reality.

I often use the example of flying in an airplane. This is a subject that is near and dear to me. Those who know me know I don’t like to fly. I will avoid it at all costs, and it causes me days of great stress leading up to those flights that I simply must take. My perception is that flying is incredibly dangerous and something that I have no control over once I get on the plane. I perceive that traveling at more than 400 miles per hour is horrifically dangerous, not to mention doing so at 35,000 feet in the air. No one can dispute that moving at speeds of hundreds of miles an hour is exponentially more dangerous than traveling at 20 miles an hour. The same can be said of being thousands of feet off the ground. That is certainly more dangerous than keeping my feet safely planted on earth. I have carefully considered all this, and this has become my “reality”. The problem with my reality is that it only considers part of the picture. To make matters worse, it only considers the part of the picture that fits my preconceived expectations. The truth is that flying is one of the safest things that we can do. The data that I have relied on in developing my reality, is one of but a few data points that make up the much larger data set, which accurately describes the aerodynamics involved in flying. By focusing on those things that I expect to be true and that fit my narrow perception of reality, I have created my own false reality. In doing so, I have made my life more difficult than it should be. I have not enjoyed vacations to the fullest. I have forgone business opportunities. The list goes on. We can all relate to some degree to what I am describing. We all do it at various times and in various circumstances. My client is now doing it with investing. His reality is preventing him from acting objectively and continuing to invest capital into an investment process that he understands and can stick to. He knows that the key to long-term success is staying invested and compounding returns, but his new reality is in his way. He has become his own worst enemy.

This is a common problem with investors, and it is one area where a trusted advisor can help. He or she can walk through what is reality and what is perceived reality. Sometimes they overlap. It is never black and white, and that is ok. What is important is that we as advisors acknowledge what our clients are experiencing and work together to overcome it. This comes down to listening and communication. It is what separates good advisors from great advisors.

There is a very simple maxim in the investment world that perfectly summarizes the above described phenomenon and the appropriate response. The maxim is, **don’t fight the tape!** What that means is do not let your own perception of how things should be cause you to ignore the reality that is going on around you. Having a rules-based system does just that—and that my friends is why you must have one.

Last week’s market commentary can be found [here](#).



IMPORTANT DISCLAIMERS

This material is prepared by Cabana LLC, dba Cabana Asset Management and/or its affiliates (together “Cabana”) for informational purposes only and is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. The opinions expressed reflect the judgement of the author, are as of the date of its publication and may change as subsequent conditions vary. The information and opinions contained in this material are derived from proprietary and nonproprietary sources deemed by Cabana to be reliable, are not necessarily all-inclusive and are not guaranteed as to accuracy. As such, no warranty of accuracy or reliability is given and no responsibility arising in any other way for errors and omissions (including responsibility to any person by reason of negligence) is accepted by Cabana, its officers, employees or agents.

This material may contain ‘forward looking’ information that is not purely historical in nature. Such information may include, among other things, projections and forecasts. There is no guarantee that any forecasts made will come to pass. Reliance upon information in this material is at the sole discretion of the reader. Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy. All investment strategies have the potential for profit or loss. All strategies have different degrees of risk. There is no guarantee that any specific investment or strategy will be suitable or profitable for a particular client. The information provided here is neither tax nor legal advice. Investors should speak to their tax professional for specific information regarding their tax situation. Investment involves risk including possible loss of principal.

Cabana LLC, dba Cabana Asset Management (“Cabana”), is an SEC registered investment adviser with offices in Fayetteville, AR and Plano, TX. The firm only transacts business in states where it is properly registered or is exempted from registration requirements. Registration as an investment adviser is not an endorsement of the firm by securities regulators and does not mean the adviser has achieved a specific level of skill or ability. Additional information regarding Cabana, including its fees, can be found in Cabana’s Form ADV, Part 2. A copy of which is available upon request or online at www.adviserinfo.sec.gov/.

The Financial Advisor Magazine 2018 Top 50 Fastest-Growing Firms ranking is not indicative of Cabana's future performance and may not be representative of actual client experiences. Cabana did not pay a fee to participate in the ranking and survey and is not affiliated with Financial Advisor magazine. RIAs were ranked based on percentage growth in year-end 2017 AUM over year-end 2016 AUM with a minimum AUM of \$250 million, assets per client, and growth in percentage assets per client. Visit www.fa-mag.com for more information regarding the ranking.

The Financial Advisor Magazine 2019 Top 50 Fastest-Growing Firms ranking is not indicative of Cabana’s future performance and may not be representative of actual client experiences. Cabana did not pay a fee to participate in the ranking and survey and is not affiliated with Financial Advisor Magazine. Working with a highly-rated advisor also does not ensure that a client or prospective client will experience a higher level of performance. These ratings should not be viewed as an endorsement of the advisor by any client and do not represent any specific client’s evaluation. RIAs were based on number of clients in 2018, percentage growth in total percentage assets under management from year end 2017 to 2018, and growth in percentage growth in assets per client during the same time period. Visit www.fa-mag.com for more information regarding the ranking.

Past performance is no guarantee of future results. All investment strategies have different degrees of risk and the corresponding potential for profit or loss. Asset allocation and diversification will not necessarily improve returns and cannot eliminate the risk of investment losses. “Target Drawdown” is merely a descriptive term used to describe the general strategy and objective of the portfolio, it is not a guarantee, nor should it be construed to suggest safety or protection from loss. There is no guarantee that portfolio performance will remain consistent with the targeted drawdown parameter. While risk tolerance and targeted “drawdown” are identified on the front end for each portfolio, Cabana’s algorithm does not take any one client’s situation into account and there is no guarantee that Cabana’s strategies will be suitable for any investor. Investors and advisors should not simply rely on the name of any portfolio to determine what is suitable. It is the responsibility of investment advisors to determine what is suitable for their clients. Cabana manages assets on multiple custodial platforms. Performance results for specific investors will vary based upon differences in associated costs and asset availability.

Cabana claims compliance with the Global Investment Performance Standards (GIPS®). GIPS® is a trademark of the CFA Institute. The CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. To receive a GIPS Report and/or a firm’s list of composite/pooled fund descriptions please email your request to info@thecabanagroup.com.

The COVID-19 health epidemic has had substantial global economic impact on financial markets. As of March of 2020, restrictions to travel and business spanning the economy for activities not deemed essential have been imposed throughout the United States. These restrictions have caused unprecedented volatility and uncertainty in capital markets and have negatively impacted the economy. It is unknown how severe the impact to the economy and capital markets will be if the epidemic persists for an extended period of time. The epidemic may have a material adverse impact on Cabana’s investment advisory business including, but not limited to, the performance of our portfolio strategies.

For additional information regarding our services, including performance disclosures, please visit <https://thecabanagroup.com/disclaimers/>.

