Financial Fables

Ely Prudent Portfolios

The Paranoia is Real

GUERDON T. ELY, MBA, CFP®, AIFA®

May 2013

"Paranoia strikes deep. Into your life it will creep," may be lyrics by Buffalo Springfield but it appears to have been a state of mind for Jim Morrison, the lead singer of the Doors. His rhetorical question to his own definition of paranoia was a classic example of paranoia: "As I understand it, paranoia is defined as an irrational fear. But what if the paranoia is real?"

As a fellow paranoid, I empathize with Morrison. Dealing with irrational fears is difficult and it causes me to engage in some quirky behaviors. For one, I avoid intersections with traffic cameras whenever possible. That is especially true of the intersection of Cohasset and Mangrove Avenues that I avoid at all costs because I irrationally believe the light is timed to trap me. I think I got this particular paranoia from my Dad's constant harping about speed traps on our summer travels to visit my grandparents. Before we left on our road trips, Dad would go to the AAA office to get a map with the locations of known speed traps marked on it. It was my job to read the map and warn Dad when we were approaching one of those bad places.

While I have not been able to rid my mind of its paranoid thoughts, I have been able to funnel some of that destructive energy into useful purposes, like helping my clients avoid financial traps. Similar to how I helped my dad as a kid, it is now my job to pay attention to the financial journeys my clients are traveling and to warn them when they are approaching bad places.

In the past I have been critical of the financial services industry because it has, too often, taken clients into bad places they should avoid. However, I don't think that the people in the industry are bad. On the contrary, I think they are mostly good people. Unfortunately, they are usually very optimistic which, counter intuitively, is a bad temperament for investment advisors.

According to Daniel Kahneman in *Thinking, Fast and Slow*, "…optimistic individuals play a disproportionate role in shaping our lives." They tend to be the leaders, who "…got to where they are by seeking challenges and taking risks." They are talented and lucky, "…certainly luckier than they acknowledge." The combination of luck and optimism leads to overconfidence. And Nassim Taleb, in the *Black Swan*, argues that overconfidence causes investment advisors to have an "…inadequate appreciation of the uncertainty [of markets and] inevitably leads [them]…to take risks they should avoid."

To avoid excess risk ("bad places"), Kahneman says investors need advisors who have "…an unbiased appreciation of uncertainty…but [that]…is not what people want." They want advisors who are confident, even though the confidence is based on an optimistic illusion of control that is not supported by the facts. This leaves investors in a quandary because, as the Urban Dictionary correctly states, an "…optimist [advisor] is a person who doesn't have all the facts." So, investors would be better off with a pessimistic advisor because, by definition "…a pessimist is an optimist who does have all the facts." However, a paranoid advisor would have the best appreciation of the uncertainty of markets because, as the Urban Dictionary points out, "…a paranoid…has finally realized that the facts are after him [or her]." And the facts are that markets can be bad places, where investors need paranoid advisors to map out and warn them of approaching financial traps because, when it comes to investing, "the paranoia is real."

Ely Prudent Portfolios, LLC is a fee-only investment advisory service working with individuals in or near retirement and non-profits. The firm is accepting new clients with a minimum AUM of $1,000,000

ELY PRUDENT PORTFOLIOS, LLC
10 DECLARATION DR., SUITE D
CHICO, CA 95973

(530) 895-0636 OR (800) 560-0636
WWW.ELYPORTFOLIOS.COM
GTELY@ELYPORTFOLIOS.COM