



Epsilon Theory

The Country HOA and Other Control Stories

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Ahchoo: You don't have to do this. Look, this ain't exactly the Mississippi. I'm on one side, see? I'm on the other side. I'm on the east bank. I'm on the west bank. It is NOT that critical.

Robin of Locksley: Not the point! It's the principle of the thing.

Robin Hood: Men in Tights (1993)

I visited my parents in Texas last week.

They live on the periphery of Houston exurbs and East Texas country, although – and this is not unusual for Texas – their home is in a development. What’s more, it is a development with an HOA. The kicker is that it is a *gated* HOA. My parents couldn’t care less about whether the community is gated or not. This just happened to be where they found the home where they knew they wanted to retire.

But still, there’s a gate.

The nearest business – other than a gas station at the highway exit to get there – is a web-based thing some guy runs out of his house selling pretty rocks and healing crystals. The next closest are a lumber yard and two feed stores. Town doesn’t really have any crime to speak of. Doesn’t really have many people to speak of, for that matter.

And *of course* they change the code every couple of months. *Just to be safe*. So when I pulled up in the rental Hyundai with my wife and boys at, oh, around 9 PM, well, I had the wrong code. I sat there texting my dad for the new one, but my dad’s about as good at checking his phone as yours. No joy. Luckily, after a few minutes, some good ol’ boy in a white pickup pulled up. So I looped around the little island in the median where the gate control machine was positioned and got behind him.

He pulled through and did something I never thought I’d see. He stopped. Right past the opened gate. I mean that literally. He inched his truck forward so that there was a hair’s breadth between his tailgate and the now-closing community gate. He wasn’t going to let me in. Not only that. He *waited*, not for the gate to close completely, but for some new development in this high stakes drama of a family with *two kids in car seats* clearly visible to him as we looped around, parked in a purple SUV trying to get into a residential neighborhood in a crimeless community. Did he call the police? Did he summon the rent-a-cop working the HOA circuit checking on the length of everyone’s front lawns to make his way post-haste to enforce the community’s important security precautions?

I didn’t end up finding out, because I got the code from my parents and was able to open the gate. As soon as it opened, our knight on his shining white steed proceeded to his house. I hope his family was all present to hear this first rendition of his stirring tale of heroism.

Now, maybe you’re saying to yourself, “Rusty, this doesn’t sound that strange. Maybe there have been break-ins, and he’s just being conscientious of his neighbors.” I would be open to both of those arguments (I probably wouldn’t, actually – gated communities are uniformly ridiculous) if I didn’t have more information:

1. There is no continuous wall extending from the gate around any portion of the development. The gate is completely ornamental and isolated.
2. There are two other roads – one through a junk yard and another through a neighboring RV community, which connect to the community and are open at nearly all times to all comers willing to subject themselves to 1-2 minutes of inconvenience.
3. The gates are wide open and unmonitored every day between 8 AM and 5 PM.

I understand the intent of the gate. It’s an inward-facing narrative, a story to tell people living there that their community is a refuge, a place they can come home to without fear. There is (yes, still) some prestige attached to living in a gated community, and some people derive some pleasure from that. I’m not saying I agree with any of this, or that all of the people living there care about these things, but it isn’t hard to grok the intent.

What was so shocking to me was that someone actually believed in the gate.

The driver of that pickup truck would have blithely entered his community behind a smash-and-grab robber entering when most smash-and-grab robbers do (i.e. during daylight hours when people aren't there to make it inconvenient) without a second thought. He would never dream of monitoring ingress past this high security feature to the south (pictured below). Probably hasn't spared a single thought for the two neighboring and connecting properties.



But boy, when someone was trying to get in under a certain of circumstances over which he had some direct control, his hackles were up. He knew his duty.

It shouldn't have been shocking to me. This good ol' boy isn't strange. He's all of us, as investors and citizens alike.

Even when we know something is a story written for us, that we are being told how to think or feel about something to serve someone else's purposes, there is a visceral, emotional part of us that wants to believe it. Needs to believe it. We yearn to see it as an echo of some truth rather than a construction, and when some paltry data emerges to confirm it, it becomes almost irresistible. And when it is something where part of the narrative is control?

There's a reason why investors loved high-net long/short equity for so many years. Even after they had experienced bad results. Even after they figured out that the incentive fee-on-beta thing was too high a hurdle for even the most gifted stock picker. We wanted to believe the story, and the idea that doing so gave us the ability to be both long or short, to vary our net exposures to respond to market

opportunities. Nevermind that we'd never found anyone who was good at those things. It was a story we wanted to believe. More importantly, it was a Control Story.

It was the same thing back when every big asset allocator rotated from the usual awful MSCI macroregional classifications to ACWI and "Global Equities" about ten years ago, and then started rotating back to the old schemes after a couple more years of dominant US equity returns. Gotta be able to more easily overweight the asset classes that did really well in recent years, after all. The story was that managers would have all these levers to pull – Sectors! Countries! Currencies! Cash! Stocks! Even when we know in our heart of hearts that everyone is terrible at making each of these decisions (yes, the exception you're thinking of in your head is terrible at it, too), it is still a story we want to believe. It is a Control Story.

I leave you to muse about how this could be applied to the stories behind growth PE and buyout funds in 2019.

You and I – and the cowboy in the white pickup – we're vulnerable to Control Stories because we believe that we and our advisors will make decisions that matter. We will make better use of flexibility, options and control than others. And no matter how much we know in our heads and show in our actions that this is just an ornamental gate built to tell us a story, we will actively seek out 'evidence' to prove what we *want* to believe. If you seek out evidence in that way, you will always, always find it.

So how do we spot gates to a Country HOA in our portfolios, our frameworks and our daily conversations? Here's a few that spring to mind:

1. "Multiple Ways to Win" is always and everywhere a Control Story.
2. Decisions that are designed to allow you to take more risk elsewhere are always Control Stories.
3. Arguments for transparency and what we will do with it are Control Stories.

You've probably got a dozen more. Pop them into the comments below!

No, not every Control Story is wrong. Still, Clear Eyes means dialing up our skepticism when we hear them.

Especially when it's a story we are telling ourselves.

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