Poker, Pandemics, Powder & Your Portfolio

What was your worst decision from the last five years? At the other extreme, what was your best?

When most of us describe our worst decision from the last five years, we almost always talk about a situation that had a terrible outcome. Perhaps money was lost, someone got hurt, or a life changed for the worse, forever.

At the other extreme, when most of us describe our best decision from the last five years, we almost always talk about a situation that had an amazing outcome. For instance, you might say that your best decision in the last five years was climbing K2, the world's second-highest peak, because the view from the summit filled you with awe and wonder.

The responses above are examples of what professional poker players call "resulting." Resulting means that we equate the quality of a decision with the quality of its outcome. Resulting can happen in both the positive and negative directions. For example, 29% of climbers die on K2. Was it really such a good decision to make the climb? In this case, perhaps climbing K2 was your worst decision of the year, but it resulted in a good outcome because you got lucky. At the other extreme, perhaps you decided that it was too risky to climb K2 (your best decision of the year), but while walking back to the hotel, a freak lightning bolt hit you and paralyzed you. In this scenario, your best decision resulted in a poor outcome, because you got unlucky.

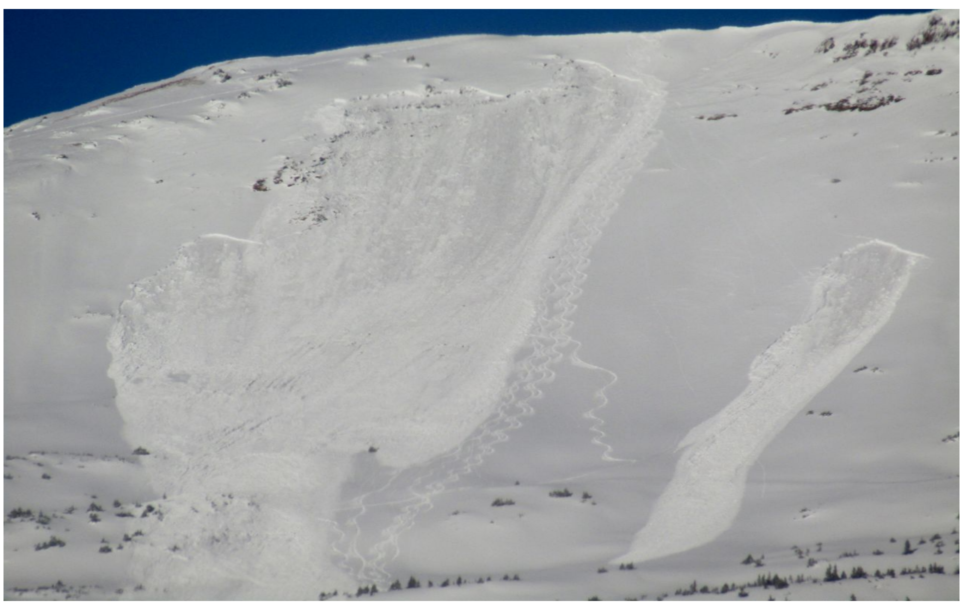
In professional poker, it is clear that poker is a mathematical game, and that to win, you must unemotionally compute how to play the odds of each hand. In poker, your opponent's cards are hidden, so you must make decisions without having a complete picture. Additionally, the odds change as cards are flipped from the deck. Due to the element of chance, you can calculate the probability of outcomes for each hand, but you will never know with 100% certainty how each hand will go.

Professional poker players understand that, in the long run, deviating from the mathematically-optimal decision-making strategy will have bad outcomes, even if it pays off for a hand or two. That is why poker players have named the psychological biases, such as resulting, which lead to non-optimal play. Biased professional poker players do not end up at the top.

Now that I have pointed out resulting, you will see it everywhere. Everyday life is a sequence of calculated bets, but most of us are far less diligent than a professional poker player is at assessing the thinking and calculating the risks that go into our decision-making. For instance, was it a good decision to drive while drunk or sleepy, even though you made it home safely? Is a diet of highly processed foods OK, since we haven't died yet? Is it a good decision to eat indoors right now at a restaurant, where the odds of disease transmission are 19x higher than outdoors -- just because we haven't yet been infected by COVID-19?

Let me share a personal example. Our family likes to ski. (In fact, as of this letter, Bear and I have skied for 21 straight calendar months, Amber has skied for 13 straight, Jade has skied for 10 straight, and Brooke divides her time between skiing and snowboarding.) When we decided to start skiing in the backcountry -- that is, climbing publicly-accessible mountains where there is no avalanche mitigation in order to do a single run -- I knew that I needed to better understand the risks. I took a 3-day avalanche hazard management course, and in that course, we learned that resulting is a key reason why skiers die in an avalanche. For instance, just because you see ski tracks down a slope, does not mean that it is a safe decision for you to ski down too.

The Red Lady Bowl avalanche of November 25, 2018 (pictured below) is a perfect example. Five of the best skiers in Colorado, including a champion ski mountaineering racer, climbed Mt. Emmons near sunrise. They tried to kick blocks of snow from the cornice in order to test the slope. However, they could only get small crumbles loose, so they recognized that their avalanche test was not very robust. Nevertheless, since they had skied this slope safely for the last 20 winters (resulting), they decided to proceed. As they later said, “they recognized they were rolling the dice” based on their past experience (resulting). After the first skier laid down 15 turns, an avalanche released. The avalanche overran the skier’s tracks, and a smaller avalanche released to his left. The skier ended up between 2 avalanches in motion, but fortunately, he was able to ski out.



Did that skier make a good decision, just because he survived the avalanche? Before that, should the 5 skiers have “rolled the dice” and proceeded with their run, since they weren’t able to dislodge enough snow to do a robust avalanche test? Was it a good decision for them to assume that, since they’d skied this slope without incident for 20 years, they could ski it again that day? Was it wise for them to think that the existing ski tracks down the bowl indicated a green light to ski?

As interesting as this discussion is, does it apply to investing? Absolutely. Just like poker, investing is a mathematical game. As your portfolio manager, my job is to carefully estimate the odds of good vs. bad outcomes when I decide whether or not to invest in a business. However, once I make that decision, the outside world generally uses resulting to assess the quality of my decision. Suppose someone made millions investing in bitcoin. Was that a good decision, given bitcoin's risks and speculative nature? Or do we just say that decision was good, because of the good outcome? At the other extreme, say that you invested in a good-quality business that had a high probability of an attractive return -- but then COVID-19 torpedoed that business. Was that decision a bad one, just because of a bad outcome?

Two of my favorite books on this subject are Thinking in Bets by Annie Duke, a World Series of Poker champion, and A Spy's Guide to Taking Risks by John Braddock, a retired CIA case officer. In Thinking in Bets, Annie Duke writes:

> *"Thinking in bets starts with recognizing that there are exactly two things that determine how our lives turn out: the quality of our decisions and luck. Learning to recognize the difference between the two is what thinking in bets is all about."*

Just like poker, successful investing hinges on making the best decisions possible when you do not have all of the facts, and when the future is uncertain. Superior investors may not be unemotional, but they force themselves to act -- and to decide -- as if they are. Good luck may cause a bad decision to result in a favorable outcome, and bad luck may cause a good decision to result in a poor outcome. The best investors learn to separate the effects of luck from the quality of their decisions so that they can improve their decision-making ability. As Warren Buffett said:

> *"We don't have to be smarter than the rest. We have to be more disciplined than the rest."*

Now that you see resulting, where else does it impact your life?

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