How poker taught me to make better decisions

Psychologist, bestselling author and professional poker player, Maria Konnikova, recently inspired delegates at the Allan Gray Investment Summit 2019 to make better decisions, by looking at the metaphor of poker.

5 August 2019: As with life and investing, poker players are faced with a dynamic and uncertain environment. You have to learn how to parse skill from chance, when to bet, and when to fold. Sometimes you also have to bluff. But, according to Maria Konnikova, a keynote speaker at the recently held Allan Gray Investment Summit, what separates the winners from the losers during this uncertain environment, are those that tune out the noise and take control of their own state of mind.

"One of the biggest discoveries I made, is that by taking control of the only thing that you can, that is, your mind, you will ultimately be able to make better decisions," says Konnikova, who graduated from Harvard University and holds a PhD in Psychology from Columbia University.

She is also a professional poker player – a member of PokerStars Team Pro – initially inspired by the work of John von Neumann, one of the founders of Game Theory. A mathematician by trade, Von Neumann noticed that poker was not solely a game of probability. It differs from pure gambling in that it involves a high degree of skill. Yet it also differs from Chess or Go in that one can never discern which is the best move in a given situation.

Konnikova explains that sometimes even a dream hand isn't enough to win. In a game of Texas Hold'em the best possible starting hand is known as pocket aces, the probability of which is a mere 0.0045% or once in every 221 hands. Yet this hand's usefulness can be dramatically reduced by the number of players, the quality of the hands they're dealt, and how they play those hands. In that sense, poker mirrors life. It's possible to play a good hand poorly and still win, or play it very well and still lose. What's more, there are almost 2.6 million possible five-card hands in a 52-card deck. That makes predicting the best way to play any hand - and how others will play theirs - exceedingly difficult.

Within a year of learning the basics of poker, Konnikova started winning. After a major international poker victory she began taking it seriously and now plays full time. She admits that after her initial run of success, she has not fared as well in 2019. Just over halfway through the year she has lost more money than she's won. The psychologist in her sees the lesson in this rather than the loss.

Quoting Daniel Kahneman, a behavioural economist noted for his work on the psychology of decision-making, she points out that the combination of overconfidence and optimism can be a dangerous mix. Overconfidence can lead to the illusion of control. Known as the hot hand fallacy, this can lead people who have experienced a run of success to overestimate their ability. She cites a study in which people were asked to predict the outcome of a coin toss. Those who experienced initial success quickly began to believe that they had a hidden talent for predicting the outcome of coin tosses. From this they concluded that not only could they replicate this success in future, but that they could improve on it.

"For investors this can be particularly dangerous," says Konnikova. "Once they think they understand the environment, they stop taking negative feedback from the environment."

By the same token, an unusual run of bad luck doesn't mean that you're due for a win, a phenomenon known as the Gambler's Fallacy. "Probabilities don't have a memory. They don't care what happened the last one-hundred times."

Investors also tend to react way too strongly to one off events.

“Often when we think we’re making a decision based on all available data, we’re actually not. We overweight certain data, depending on things like what we believe about the world, and our own perspective. In environments where we can’t observe causal factors, we create them. This influences our investment successes.”

Konnikova cites the Matthew Effect, which refers to the notion that if a child struggles or fails at early reading they will tend to dislike it, leading them to fall behind their peers. In the world of investing, this can lead to placing too much faith in people who have enjoyed initial success. The opposite of the Matthew Effect is the Hot Stove Effect: Get burnt once by a bad investment and you’re unlikely to risk your money there again.

“This is despite the fact that you are as likely to make money than to lose money if you go there again,” says Konnikova.

But, by continuing to back someone who enjoyed initial success which then begins to falter can cause you to fall victim to the Sunk Cost Fallacy. When the expected value of an investment is higher than its actual value, investors can persist in throwing good money after bad instead of cutting their losses.

“What poker teaches you is that in an uncertain environment outcome does not always equal decision quality,” says Konnikova.

As with life, poker is a wicked learning environment. Things are hidden and uncertain. Feedback can be poor as frequently you don’t find out if your decisions are correct until long after you’ve made them, by which time circumstances may have changed. Although learning from experience is usually better than learning from description you’re also never going to learn everything no matter how much effort you put into it.

“If you play enough rounds of poker you learn that the only thing you can really control is yourself,” says Konnikova. “But perhaps the most important lesson is that the hand you’re dealt is less important in determining your future, than how you play it.”

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