The June 2018 AAII Journal is Now Available Online

Feature Article »

Making Better and More Rational Decisions

by Charles Rotblut, CFA and Annie Duke

Thinking about the various ways the future could play out can help you prepare for unfavorable outcomes and avoid irrational decisions.

First Cut »

Hagstrom's Essential Buffett Stocks

by John Bajkowski

These 25 stocks have characteristics matching Warren Buffett's approach, as presented by Robert Hagstrom in "The Essential Buffett."

Stock Strategies »

Tricking Investors With Merger-Related Accounting Shenanigans

by Howard Schilit

Acquisitions give managers opportunities to artificially boost performance or hide past mistakes. Learn how to spot these shenanigans.

Portfolio Strategies »

Quantifying the Value of Retirement Accounts

by Aaron Brask, Ph.D.

The golden goose of retirement accounts is the return boost attributable to avoiding taxes on capital gains, dividends and bond interest.

AAII InvestoGraphic »

Adjusting Overweight Positions

by AAII Staff

Guidance on how to pare down a position in a stock whose gains have caused it to have an outsized weighting relative to the other portfolio positions.

Behavioral Finance »

Grasshoppers and Ants in Retirement

by Robert R. Johnson, Michael Finke and Tao Guo

Though Aesop's fable is regarded as a lesson in thriftiness, "grasshoppers" are likelier to smooth their spending over their lifespans.

Trading Strategies »

A Quantitative Method for Asset Allocation

by Joseph Harding

The prevailing valuation of stocks and the relative valuation of bonds can be used to adjust an allocation above or below its target.

Level3 Passive Portfolio »

Guidance on How to Follow the Level3 Passive Portfolio

by John Bajkowski

This four-ETF portfolio should not have many changes. Many investors should be able to rebalance through additions or withdrawals.

Member News »

Member News 2018

by AAII Staff

This year's annual AAII member update details our upcoming Investor Conference in Las Vegas and highlights a local chapter that is building interest through a beginning investor series. In addition, we present our yearly financial summary, special member benefits and academic research awards.

Departments »

Briefly Noted

Current news items of interest to individual investors.

- Out-of-Pocket Health Care Spending for Retirees
- Returns for Social Trading Platforms Are Negative
- Return Gap Larger for Actively Managed Fund Shareholders
- Robo-Advisory Platform Found to Have Some Benefits

Letters

Members comments on recent articles covering REITs, bonds, life expectancy in retirement and IRS reporting of retirement distributions.

Editor's Note:

Charles Rotblut, CFA
AAII Journal Editor

This month's issue features something that, to the best of my knowledge, is a first for the *AAII Journal:* insights from a former professional poker champion. Annie Duke, whose interview can be found here, has among her achievements winning both the World Series of Poker and the World Series of Poker Tournament of Champions.

Though I enjoy playing poker, poker strategy was not the reason I spoke with Annie nor the reason I'm discussing the article here. Rather, I spoke to her about how to make better decisions. Prior to playing poker full-time, Annie was awarded a National Science Foundation Fellowship to study cognitive psychology.

Annie and her latest book, "Thinking in Bets: Making Smarter Decisions When You Don't Have All the Facts" (Portfolio, 2018), came to my attention through the Behavioral Scientist newsletter. I found out about this newsletter through Richard Thaler. As the newsletter's name suggests, it shares insights about behavioral science.

Those of you who are longtime AAII members are aware that behavioral finance has been a focus of mine since I became editor in 2010. How we think and react has a very significant impact on our long-term wealth and the ability to meet our goals. Often what trips us humans up is the inability to set aside our biases and emotions. We react too quickly to the stimulus in front of us while ignoring the long-term consequences and possible other outcomes. It's not that we are necessarily irrational, but rather that we're hardwired to deal with a completely different environment than what Mr. Market presents us with.

In investing, the outcomes of decisions can take months or, often, years to fully manifest. In poker, the outcomes can sometimes occur in seconds. Make a wrong decision and you can lose your entire wager very quickly. Poker gives instant feedback about one's actions. The challenge is interpreting how much of the outcome was due to luck and how much was due to skill. (Here's a hint, if you're not playing with a predefined strategy governing which hands you'll play and how you'll react to certain situations, your outcomes are going to be more attributable to luck than to skill.)

Many of the behavioral errors and biases we see in poker occur in the realm of investing too: loss aversion, overconfidence, succumbing to one's emotions ("tilting" in the poker lexicon), failing to think in terms of probabilities, etc. Annie has not only had a front-row seat to these errors but also had to develop strategies to prevent herself from succumbing to them.

After you read the interview with Annie, I encourage you to go online and reread the interview with Philip Tetlock from the September 2016 *AAII Journal* ("The Traits and Processes That Lead to Better Forecasts"). Philip authored the book "Superforecasting: The Art and Science of Prediction" (Crown Publishers, 2015) and has studied why some people make better forecasts than others.

A common thread through both interviews is the concept of thinking in terms of probabilities and scenarios. Rather than assume one outcome is a certainty, assign odds to it occurring as well as to other possible outcomes. Move away from absolutes to shades of gray. Doing so will help you to better incorporate new information and be less reactive when an investment or a portfolio strategy turns against you.

Even if you feel relatively confident or uncertain, you can still assign some odds to the outcome occurring. You can look at how asset classes have performed historically, how strategies have worked and how various characteristics (valuation, financial strength, credit quality, the economic backdrop, etc.) have influenced returns. While we can't predict with accuracy how the financial markets will perform over a given period of time, we can certainly set reasonable expectations and take steps to increase the odds of a desired outcome occurring. The mere process of doing this can help you approach investing from a more objective viewpoint; that alone can help make you a better investor.

Wishing you prosperity,

Charles Rotblut, CFA
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