



It's all about the odds and managing risk

Poker and Investing

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- A simple game, but not easy
- A game of incomplete information
- A game of skill, strategy and decision making under uncertainty
- If it sounds a lot like investing, it is

Rules of the game – Texas Hold em



- Table layout shown below
- Each player dealt two cards called hole cards which are face down and hidden
- Four rounds of betting – one after the first two cards
- Three cards dealt (flop) – one round of betting after that
- One more card dealt (turn) – one round of betting
- Final card dealt – last round of betting



Rules of the game – Texas Hold em



- At each round of betting a player has the option to match the bet, raise the bet or fold the hand
- Player knows his cards, can see the common cards (called community cards) and has to guess/ estimate opponent cards based on various factors
- After last round of bet, show of cards
- Best of 5 cards (2 hole and 3 community) gets the pot (all the money in the middle) as per the ranking



A game of probability



Player knows his cards, can see the common cards (called community cards) and **has to guess/ estimate opponent's** cards based on various factors

- A game of probabilities where you have to estimate the likelihood of having the best hand or improving your hand based on the available information
- Some starting hands have the highest probability before any common cards are dealt (AA, KK, AK etc.)
- Probabilities change as new cards are dealt

A game of probability



An investor can study the past history of the company, its competitive advantage, management, charts etc. and guess the probable returns

- A game of probabilities where you estimate the likelihood of having a winner
- Some companies have a higher probability of returns based on growth, valuation, management, industry structure
- Probabilities change as we get new information

Role of betting



- In poker how your opponents bet gives you some idea of the probabilities. It also changes the odds (pot odds)
- Based on the betting by investors, valuation (odds) change
- Odds change the amount of gain when you are right versus losses when you are wrong
- The job of the poker player or investor is to evaluate the odds and make +EV decision ($EV = \text{probability of gain} * \text{gain} - \text{probability of loss} * \text{loss}$)

Making positive EV decisions



- Making positive EV decisions means choosing actions that will result in a positive outcome in the long run, even if they may not work out in every single situation
- Making positive EV decisions requires discipline, patience, and rationality, as you have to avoid emotional biases
- Making positive EV decisions requires adaptability, as you have to adjust your strategy based on changing circumstances and new information.

Making positive EV decisions



For example

- Start with an AA hand, but opponent makes a 2 pair or better. What should you do ?
- Start with a good stock in the hotel industry, but get hit with Covid. What should you do ?
- A good company is not always a good stock

- Variance is the term used to describe the fluctuations in results that occur due to randomness and luck
- Variance can cause lucky streaks and bad beats , which are situations where you win or lose a hand despite having a low or high probability of doing so
- Sounds a lot like investing ? Your style may be out of favor and or the sector of your choice may not be in fashion

- **“Process over results”** means focusing on making good decisions rather than worrying about the outcomes of individual hands or sessions.
- Process over results is important because it helps you cope with variance , learn from your mistakes , and improve your skills .
- Process over results also applies to investing , as you have to follow a sound investment strategy rather than chasing returns or reacting to market fluctuations

So, why play poker ?



- Velocity of decision making, and feedback is in minutes versus month/years
- Ability to learn concepts of probability, odds and variance in a structured setting and at low stakes
- Observe irrationality and poor decision making in yourself and others (emotional decision making)
- The most important : learn how to take losses (fold) when odds change and move to the next hand (even when you opened with an AA)
- And finally, its fun and a social game



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