Human-Centric Investing Podcast

Episode 33 – Back From the Future, Part 3 The Siren Syndrome

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Featured Guest: Annie Duke, decision strategist and former poker pro

Intro: This is the Human-Centric Investing Podcast with John Diehl where we look at the world of investing for the eyes of our clients. Take it away, John.

John Diehl: Hello, financial advisors. This is John Diehl, Senior Vice President of Strategic Markets at Hartford Funds. Welcome to Episode 33 of the Human-Centric Investing Podcast.

Joining me again for this podcast is Annie Duke. This will actually be part three of our conversation with Annie. So if you haven't heard the previous two podcasts, it would probably make sense to go back and listen to episode 31 and 32 because this one, Annie, I think has come to the grand finale. We've talked about a lot of concepts around resulting and some of the negative impacts on decision-making.

We've talked about envisioning what it would look like if we met our goals, but maybe more importantly, envisioning what it would look like in the future, had we not met our goals and some of the things we might have done that led to us not achieving our goal, so that we could, kind of think about how we would deal with these things.

So in this episode, Annie, I'd like to talk to you about the things that advisors and clients can put in place based on all these discussions that we talked about, these concepts.

I know in your – in your book and in your concept, you have something you call a Ulysses contract. So bridging off of what we talked about last time in terms of doing pre-mortems and post-mortems, how – what is a Ulysses contract, and how does it relate to that whole conversation?

Annie Duke: Yes. So for people who are familiar with the Odyssey, actually the Odyssey is by Homer, an ancient Greek poet – a very famous story. Odysseus is trying to get home to Penelope, his wife.

He's sailing; he's got a crew, and he knows in advance that there are going to be some obstacles in his way. So we can think about that is he's done the pre-mortem work. He – he's identified their – these are – there are going to be some obstacles in my way, and I'm going to have to deal with those obstacles.

So, for example, one of the obstacles that's in his way is Scylla and Charybdis; it's where we get a rock and a hard place, where there's going to be a fork in the path, and neither of them is particularly good. They're both actually really hard to navigate and both can kill you. And he has to sort of decide which side he's going to go down in advance. But the – for the purpose of Ulysses contracts, the key obstacle, the key challenge that Odysseus is going to face is the Island of the Sirens.

So, Odysseus has been told through myths from other sailors that there's an island of the Sirens, the Sirens are these beautiful creatures that sing a song that is so irresistible to any man's ears that a man will not be able to resist steering the ship toward the island in order to get to the Sirens and their song. And if you do that, the rocky shoals that surround the island will break the ship apart, and it will be certain death.

So if you steer the ship toward the song, which is what the Sirens are calling you to do, you will die. So Odysseus knows this and he says, "Well, what can I do in order to make it so that I don't do that? That I don't actually steer the ship?" So he does two things. One is he puts bees wax in the ears of his crew. So now, his crew can't actually hear the song.

But he wants to actually hear the song, but he doesn't obviously want to steer the ship toward the shoals, so what he does is he has his crew bind his hands to the mast. And by binding his hands to the mast, what it means is that no matter how much he has the desire to act on this temptation, he can't actually do it. So he can't actually grab the wheel of the ship, the steering wheel of the ship, and turn toward the Sirens.

So by doing this, he actually gets past the Sirens safely. So this really sets up for us the idea of a Ulysses contract. So why is it called the Ulysses contract? I just told you a story about Odysseus. The reason is that the Roman name for Odysseus is actually Ulysses. I'm not actually sure why it ended up being Ulysses contract instead of Odysseus Contract, because obviously Odysseus is much more famous.

Maybe Ulysses is easier to spell or something.

John Diehl: I think it's easier to say. That's probably what it was.

Annie Duke: Yes. So now we have a Ulysses contract; Ulysses and Odysseus are the exact same person. So we could generally think about – now we can see this combination of pre-mortems and then Ulysses contracts.

So Odysseus basically does a pre-mortem. He knows – he knows the temptation that's going to be lying in his path in the future, and now he does something in advance that prevents him from acting on that temptation.

So, let's think about a really, really simple Ulysses contract that a lot of us use in our lives. If I'm going to a place, a cocktail party, or I'm going out to dinner where I know that I may drink wine, I will take a ridesharing service. I'll just Uber there. And back in the day, you used to give your keys to somebody; you would have a designated driver. People don't really need to do that anymore because now we have ridesharing services like Uber and Lyft, which is now the new designated driver.

But those kinds of things were very, very good examples of Ulysses contracts. If I imagine something going really wrong. If I imagine that I might get in a car drunk, how do I prevent that from happening?

So, it – you bind your hands by handing the keys to somebody else, or you bind your hands by actually not taking your car to the bar the first place, understanding that in that moment when I've had a few glasses of wine, I'm unlikely to be a very good judge of whether I should be driving or not, just as in that moment when Ulysses is hearing the song of the Sirens, Ulysses is going to be a very poor judge of whether he should steer the ship toward the rocky shoals or not.

So now we could think about this in terms of the last discussion that we had. If we know that when the market is down, that we're likely to panic and move our money into cash or bonds, we can think in advance now because we've seen that – we've seen that temptation. We've seen that bad decision sitting in our path. We can think in advance about, well, how can we actually reduce the chances? How can we reduce the chances that we're actually going to react to that in that way? What kind of hand binding can we do?

Likewise, if we know that when some factor is really hot, say, some commodity is just going through the roof or the tech sector is going crazy or just stocks in general are booming, and we know that we might be tempted to move our money into different asset classes or into different sectors.

If we know that those temptations are going to lie in our path when things are actually going well, that we're going to kind of get in on it, we can think about what we can do in advance that can prevent us from actually reacting that way.

And that answer is going to be different for different people, the way that you actually hand those things, but that's exactly the, kind of thing that you want to go through with your advisor and there are certain things that we know how. So for, example, if you can get the client to agree in advance, having really walked through this with them, to agree in advance to not check their portfolio so often, then that's really helpful.

So what we want to do is, kind of hide those things from view. These would be, kind of the bees wax method. We want to get some bees wax into the crews of the ear into the – sorry. We want to some bees wax into the ears of the crew so that they simply can't hear the song.

Not checking your portfolio so often is a way to get bees wax in your ears. If you don't see it, you won't react to it. And if we know that you're investing for the long-term, and what happens in a given month is not particularly important and, in fact, what happens in the month is going to do more harm than good – than good for you to be able to see, let's not look at it. Let's put some bees wax in your ear.

So that would be like one thing that you could do.

John Diehl: Annie, if I could – if I can interrupt you.

Annie Duke: Yes, please.

John Diehl: I just – I know it's hard for a lot of us to remember, but go back to the great recession, it's 2009, '10, '11. And I just remember so many advisors saying how nice it was when the weekend rolled around because no matter how many times they turned on CNBC or they tried to find one of those channels with the ticker across the bottom, it didn't matter, the market was closed. And we learn to go outside, take a walk, breathe in some fresh air and realize that the world was still spinning around us.

It was still – the sun still came up and there were other priorities in our lives that needed to be valued. And then when I think about your bees wax example, think about where technology is now versus where it was 10 years ago. And do you think the next time that that happens, it won't be even more intense than it was in 2009 and 2010?

So, yes, I think – I think developing a rule like that I think would be especially important, given where we are with technology these days versus 10 years ago.

Annie Duke: Right. And here's – this is – this is such a great example of this. Imagine that I had – I had a well-balanced portfolio in 2007, and then I was Rip Van Winkle. So I fall asleep and I don't wake up, and I wake up in 2015. So I was asleep during the whole thing.

So I wake up in 2015. How's my portfolio look?

John Diehl: It's doing great.

Annie Duke: Right.

John Diehl: Yes. Yes.

Annie Duke: There was a lot of bad stuff in between, but I happened to be asleep for it. So what you, kind of want to do is say, "Look, this is – this is something that – this is something that we're doing for the long-term. We're going to schedule when we're going to evaluate this," and it's not going to be very often, because what happens on a given day is super irrelevant. It's only going to cause you harm. It's not going to cause you any good.

And we've recognized this because we've done the pre-mortem. We understand that one of the things that goes wrong is that you're checking your portfolio on a daily basis because that's causing you to have all this emotional reaction. It's causing you to want to steer the ship toward the – toward the shore. So let's just reduce – let's set when we're going to look at it; let's set when we're going to have a discussion about when we're going to reevaluate this, and let's really try to make a pre-commitment and stick to it.

And by the way, if you actually write it down and make someone sign their name to that, it really improves the chances that they're going to comply. You say, "Let's make a contract" because we're agreeing, looking in advance, that this is going to be better off, this is going to make you better off, because you really, kind of want to Rip Van Winkle it.

So we're going to commit in advance that we're not going to look at that portfolio. So like that's one of the things that you can do. Another thing that you can do is you can put in what I call a decision interrupt so you can commit to a decision interrupt, which goes like this. If you know that, when there's a sharp downturn, you're going to panic, that's fine.

But before you do anything about it, we have to have a conversation, and when we have that conversation, what I'm going to do is I'm going to pull out the pre-mortem that we did when we first sat down to design this portfolio. We're going to talk about the fact that we saw this day coming, when you were going to call me up in a panic because the market was down, and we're going to put that into the context of the pre-planning that we did.

Now what's really wonderful about that is that you're not saying to the person, I'm never going to allow you to move your money out of this – out of this out asset class that happens not to be performing or out of this particular sector that seems to be tanking.

It's that you're going to have to have some calm down time where we're going to get you out of reacting emotionally, because we're going to have a discussion that's going to require you to engage the parts of your brain that are more involved in rational thought, because we're get look at this plan.

We're going to talk about the plan. We're going to talk about why we made the plan. I'm going to remind you of the pre-commitment that you made. And it's not that a client's never going to still react; it's that the chances that they react are going to go down, or maybe they're going to react but it's going to be a little bit.

Maybe instead of saying, "I want to move a hundred percent of my money out of this sector," you say, "Well, what if – what if we just – what if we just moved 30 percent of your money out of that sector? Like 30 percent of your holdings in that sector out of it." So you can – you can just – it's a way for you to help them really reduce the impact of this.

I mean, obviously, ideally, the client would look at their portfolio, and they would be pretty non-reactive to ups and downs. Like, getting to that is going to be really hard. But think about if you could just reduce the chances of that happening, if you could reduce how much your client was reacting to that, how much good that would do for the way that their portfolios would perform.

It's the same thing if you think about like, "I don't want to eat sugar for the next six months, how do I actually stop myself from doing that?" And I think about it six months from now, and here are all the ways that I failed. And one of them is just every single birthday, I'm having cake, and we all know a lot of people who have birthdays.

And then I say, "OK, so every single birthday, I have cake." And now I just see that in advance, and I make a commitment that when I know that I'm going to somebody's birthday, I'm going to bring another option, or maybe when I know that I'm going to so somebody's birthday, I'm going to explain to them in advance.

Before I go to the birthday I'm going to say, "Hey, listen. I just want to let you know in advance that I'm not going to have cake, and it's not that I'm not happy for you and I'm not so excited about your birthday, but I really made this commit my – commitment to myself that I'm going to try to not eat sugar."

So you think about what are the things that I can do, what are the Ulysses contracts that I can put in place that are going to help me not do this. Now it doesn't mean that you're going to be successful a hundred percent of the time. No, but what if out of 10 opportunities to have cake, you now, instead of eating cake at all 10, you only ate cake at four of them. Think about the impact that has on your life in the long-term; it's huge.

So, this is what we're trying to do.

John Diehl: And Annie, I'd like to ask you, in terms of the overall practice of an advisor, so let's say I'm a – I totally am on board with what you're talking about with Ulysses contracts and things like that. How might I implement this process on a more widespread basis?

We talked a little bit in our conversations, our private conversations, about the concept of tribalism and how tribalism can be used in a positive way. Kind of saying, "Look, I'm a – I'm a client of John's, and John explained to me that all of his clients kind of react this way or this is what we do."

Can you – can you talk just a little bit in the closing minutes here of our – of our podcast, about what tribalism is, how it can be used for good and how an advisor might create an environment, if you will, of positive reinforcement around this process that we've been talking about for the past couple of podcast episodes?

Annie Duke: Yes, absolutely. Thanks for bringing that up, by the way. This is one of my favorite topics.

John Diehl: Sure.

Annie Duke: I appreciate it. So, I think that in the news recently, we've heard a lot about tribalism as it relates to politics, and I think that most of the – most of the news about it feels very negative, that tribalism is very bad.

But if you think about it, we're tribal for a reason, because it actually helped us survive. So as animals, if we think about our physical selves, we're really 90-pound weaklings compared to other animals that are of our size.

I mean, John, I'm assuming that if you came across some sort of wild animal that was the same size as you, you would not be looking for a fight.

John Diehl: That's right.

Annie Duke: Right? Because that would not go well for you.

John Diehl: No.

Annie Duke: I mean – right. So yes, if you think about it, a mountain lion, a mountain lion might weigh less than you, and I'm pretty sure it would beat you pretty handily.

John Diehl: Oh, yes.

Annie Duke: Right. So we don't have – we don't have sharp claws, and we don't have really big fangs, and we're not particularly strong. And so, obviously – but we're very dominant on this planet because what we have going for us is very big brains. In particular, what's special about our brains is that they're very social.

So as the human species was evolving, we formed these kinship groups, these tribes generally related genetically in some way by kin, where we were sort of protecting our gene pool together. And we banded together into this social structure that helped us to fight off these beasts that were stronger than us.

Now, this is where tribalism really gets good. If you're standing on the savannah and a hyena comes and attacks you, there's no way that you're engaging in a fight with that hyena, you're – if you're alone. You're just – you're going to run away. You're going to try to get away from the hyenas.

But if you're in that same position and your tribe is behind you, so now it becomes – this is part of the tribe – this is a way for you to protect the social structure that you're in –

now you'll actually – you'll go after the hyena in order to protect the tribe. So this is where we can start to see the good of the tribe. The good of the tribe is that it helps us to do things that are really hard. It helps us to do things that normally we would run away from or normally we would react to.

And a lot of the ways that we derive our feeling of value, our feeling of self-esteem, our feeling of belongingness is through how are we distinct from other people. So this is kind of what this is giving us. So here's the thing that we know, the thing we know is that sticking to this stuff is really hard.

It's really hard not to check your portfolio every single day. It's really hard not to have on CNBC and be looking at that ticker at all times, wanting to know exactly what the minute-to-minute movements of your money are, that – it's a – it's a hard thing to not do that. It's really, really hard when the market crashes to not react.

Likewise, it's really hard when the market soars – excuse me. It's really hard when the market soars to not react. It's really hard when someone else has 100 percent of their money in stocks and you have a well-balanced portfolio, and it's August of 2018, and they've just made money hand over fist, to not say, why wasn't I like them? Why didn't I have a hundred percent of my money in stocks as well?

So we know – we know that these things are very difficult. What helps you to overcome those difficulties and actually act in a more rational way is to think about it as tribe, to say, "I have a special secret. My secret is, I'm willing to imagine failure." By the way, most people aren't willing to do that.

There's a reason why most of us are wandering around, imaging all of the successes we're going to have, because failure doesn't feel good. In fact, when we imagine failure, it feels a little bit like we're failing. And so, as the advisor, you can say, "I have a secret for you. I'm going to unlock the secret for you." Most people are unwilling to do these hard things. But if you're – in this tribe, we're willing to do this.

And this group were willing to imagine failure because we understand the value of it and other people don't. We understand the value of imagining that things have gone wrong, because it allows you to see the obstacles in your path. So that's number one, is you're going to engage in this really hard thing, and that's what's going to make you distinct from other people, because you're willing to engage in it.

Other people are going to be checking their portfolio every single day, but you're not. And that's what's going to make you distinct and special, because you're part of the tribe that knows what's the danger of doing that is. Other people are going to immediately react to some major downturn in the market. You're going to take a moment. You're going to ask the right questions.

You're going to look back on – at your plan. You're going to – you're going to not panic, and that's hard, but that's what makes you distinct. And when you're buddy is crowing about how his portfolio did in August of 2018, because he was way over allocated to stocks, you're going to see that he's not part of the tribe, and you're going to know the danger he's putting himself in, as opposed to thinking, why not me? Why couldn't I be that person? Because you're going to know you don't want to be that person because that person doesn't have – doesn't have the right plan.

And that's what's going to make you distinct. So I think that – I think that when you describe it as this is what this team does. This is – this is what we do because we have a secret, and we're doing things that are really, really hard for other people.

But what we know is that in the long run, people who can – people who are part of this tribe, this is how they end up doing, and people who are part of the tribe that are crowing about how their stocks are doing in August of 2018 – by the way, in the long run, look what happened.

But this is why they do it, this is why this happens to them because they don't have the secret. They're not thinking – they're not willing to do the hard work in advance of thinking about failure. They're not willing to do the work of figuring out what kind of pre-commitment contracts, what kind of Ulysses contracts they need to put into place.

They're not willing to do the work of actually avoiding those temptations to check their portfolio, avoiding the temptation of moving your money around when one sector soaring or one is not, and so on and so forth. And when you actually think about it that way from the sense of you belong to this group that has this secret and it makes you distinct from people who don't have the secret, that's what allows you to run at the hyena instead of run away from it.

John Diehl: And Annie, I just think – I've seen so many presentations on developing value propositions over the past 10 years, I can't even begin to count.

But if the advisors listening to this really sat down and started thinking about the – how they – how being a part of their practice differentiates their clients from others, or if they were to develop rules and practices about how members of our team, people who belong to our practice, how they react differently than the world around them, I mean, imagine having a conversation with a client that not only where you describe your own value, but where you also describe some expectations of the client who is coming into your practice.

It almost is getting them to put some skin in the game. It's not just a – it's not just a one-way street. It's a two-way street where both parties have something to offer. And I just don't think, Annie, I've ever heard that conversation really happen in the context of financial services as we just described, but I think it's incredibly valuable for advisors to think about.

Annie Duke: Well – and I think that actually – I mean, when you talk about value, it makes it so much clearer. I mean, everybody's dealt with advisors where the standard thing is, what are your goals? How much money do you have to invest? How much do you make? What are your assets? So on and so forth. How many children do you have. How close are they to college?

John Diehl: And from the client standpoint, how much is this going to cost me, and how long is this going to take?

Annie Duke: Right. And then – right. And then the advisor says, "OK, here's what I recommend." But when you really – when you really create – when you really look at the client as a partner in the process, what happens is that the client is definitely more invested in the relationship because they're part of the relationship.

You're saying I – in order for you to be in this relationship with me, I'm going to ask some things of you. I'm going to ask you to agree to certain things. That raises the value – you know, that's value. The client definitely sees that as value. Oh, oh, OK. And now they're actually much more likely to stick to it and then what's going to happen?

Now, because of this advance work because you said here's what I'm going to expect of you, I'm going to do a whole bunch of stuff, I'm going to be your partner in it, I'm going to help you see the obstacles in your way, I'm going to help you see the decisions that could go wrong and right, I'm going to help you think about what are the appropriate hedges, how should we have every – given what your goals are, I really know this landscape and I'm going to help you figure out how to actually allocate your money.

But you have responsibilities also. And here are the responsibilities about how I'm expecting you to engage in this process. Now, they're much more likely to stick to it.

Why? Because you've made them part of your tribe. You've created these agreements, you've made it much more likely that they're going to stick to it and less likely that they're going to make the kind of common errors that we all know cost people to underperform what they would do if they just didn't touch it, if they just Rip Van Winkle the whole thing.

So it ends up being good for everybody in the long run. Their clients are going to attend to be more loyal because they have a partner and it is – as you said, they now have skin in the game. Back when I was playing poker, I was very lucky.

So there was a particular temptation that occurs in poker which is that when you lose, it's very, very tempting – well let me make this clear, when you lose because of something that has to do with luck, which obviously happens all the time in poker. Like I have aces and you have two fives and I lose, OK.

So when I lose because of something to do with luck, there's a very strong temptation to go complain about it, it's called moaning, actually you go moan about it. You tell bad beat stories, right, they're called bad beat stories. And it's a very strong temptation and if you listen to most of the conversations that poker players have, that – they're mostly bad beats stories, they're mostly me telling you about some unlucky thing that happened.

Now, I was very lucky because I essentially had an advisor in both my brother and somebody named (Eric Sidel) and (Eric Sidel) in particular had a very strong influence on me in this because he was my mentor. He was the one, kind of showing – in a large part showing me the way and he said, "No, I don't want to hear a bad beat story, this doesn't do any good for you."

I was a little taken aback because I'm like, "Yo, but I want to tell you about my bad beat story," and he said no. And his point was, it doesn't do anybody any good. He said, "I don't learn from it." I'm not – I'm not giving anything out of it. But more importantly, you're not learning from it. Because things that – losses that have to do with luck don't have a whole lot to teach you."

So he said to me, "If you want to come and tell me about a mistake that you made in a hand, be my guest." And this is something that people generally don't talk about in poker, why? Because it means that you're taking responsibility for the fact that you lost which doesn't feel very good.

But (Eric Sidel) made me do that and that it's a really hard thing to go up and say, "You know what, I think I really butchered this hand. I think I really made a mistake. I think I really played badly." But he helped me overcome that because he gave me a different kind of good feeling to replace it.

When I overcame the urge to go complain about bad luck, I felt distinct from other poker players that I heard complaining about their bad luck. When I went and asked him about a mistake that I thought I had made, it overcame the pain of that, because he made me feel good about it. He gave me a whole bunch of positive reinforcement.

He made me his partner in talking about that and I could hear that other people weren't doing that, and that allowed me to stick to it, and that was amazing for me because it meant that I learned more, it meant that I became better faster by doing this thing that normally would have been hard. But (Eric) managed to make it something that felt really good to me.

And that – it – when the advisor unlocks that secret, that's an amazing thing for the advisor and the client.

John Diehl: Well Annie, I'll tell you. I just have enjoyed our conversation so much. Obviously, I think we're just scratching the surface on this whole topic of decision making, but I am sure that people who listen to this podcast episodes are really going to be interested in how they could learn more or hear more or read more and I just, again, want to point out the name of Annie's book is Thinking in Bets: Making Smarter Decisions When You Don't Have all the Facts.

And I am sure that our marketing folks are going to put out all of the related materials that we have relating to these last three podcast episodes both in the show notes for the podcast and on our website, www.hartfunds.com.

So Annie Duke, I can't thank you enough for the stimulating conversation and all of the things that you've given us to think about, and I hope that you'll consider coming back and joining us again for some future podcasts.

Annie Duke: Yes, absolutely. And this is really fun. Thank you.

John Diehl: My pleasure. And for all of you listening, we hope that you enjoyed this podcast as well as all the other podcasts that we have available and we look forward to welcoming you to a future episode of the Human-Centric Investing Podcast. Thanks very much.

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