Key Wealth Institute

Key Questions

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What Can Tiger Woods Teach Us About Investing?

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The Key Wealth Institute is a team of highly experienced professionals from across wealth management, dedicated to delivering commentary and financial advice. From strategies to manage your wealth to the latest political and industry news, the Key Wealth Institute provides proactive insights to help grow your wealth.

Professionals and amateurs alike are beset with biases. How we manage them can have important implications for our wealth.

This week, The Open Championship (formerly known as The British Open and often referred to as "The Open") will take place at the Royal Liverpool Golf Club in England. Dating back to 1860, it is the world's oldest golf tournament, and one of the most prestigious and considered as one of the "four major" golf events in a calendar year.

The Open is always played on what is known as a "links course," a type of course which many view as the way in which golf was intended to be played when the game was conceived in the 15th century. The terrain is generally open, it appears somewhat barren, and its contours are shaped by nature rather than being "built." Weather usually has a significant influence on how the game is played and the risks the players are willing to undertake or outright avoid. In particular, the wind introduces a substantial amount of uncertainty and variability for it changes considerably – both in terms of direction and speed – over the course of the four-day tournament. Tiger Woods is indisputably one of the best golfers the world has ever known. His 82 PGA Tour wins is tied for first amongst all golfers of all time; his 15 major championships is second only to the legendary Jack Nicklaus; he has the lowest career scoring average in golf history; he amassed the most career earnings of any golfer (even after adjusting for inflation); he was declared "Player of the Year" for a record 11 times, and his list of accomplishments goes on from there.

In 2006, Woods won The Open, also played at Royal Liverpool. It was his second consecutive Open Championship. Moreover, he led the tournament "wire-to-wire," that is, once he established his lead, he never relinquished it, a testament to Woods' consistency and durability. But equally remarkable is the way in which he won the tournament.

For most golfers, the driver (next to the putter) is the most frequently used club. It is also the longest (designed to achieve the greatest distance), and the club most golfers use at the beginning of almost every hole. When Woods won the 2006 Open, however, over the course of 72 holes, he used his driver once, a tangible example of Woods' strategic acumen, but also a sign of his respect for the course's conditions.

A year later, in 2007, Woods gave an interview discussing his strategy. He also provided an important glimpse into a professional golfer's mind when he said the following: "You don't ever want to drop a shot. The psychological difference between dropping a shot and making a birdie, it's bigger than making a par putt."

Said another way, Woods views securing a par (and

presumably undertaking less risk) and avoiding losing a shot more favorably than attempting for a birdie (a score of one under par) and undertaking more risk. To behavioral economists, this is a classic example of "loss-aversion," a key component of the larger Prospect Theory, and a concept that has significant implications for investors.

Prospect Theory was developed by Daniel Kahneman and Amos Tversky, two professors who are the "Tiger Woods of their profession" – behavioral economics, an important derivation from economics which studies how individuals and institutions actually behave. In contrast, traditional economics studies how individuals and institutions should behave, assuming they are rational. (FYI… they are not.)

In their research, which led to Kahneman being awarded the Nobel Prize in 2002 (Tversky died in 1996), it was revealed that people derive twice as much regret at the prospect of losing versus the prospect of winning. Stated plainly, we enjoy making money, but losing money is far more painful.

Later research would expand this idea and provide concrete evidence that loss aversion not only exists in golf and professional sports more broadly (see endnotes below[1] if you are interested in learning more), but it can also have major consequences.

Similarly, for investors, the stakes can be extraordinarily high. For example, Prospect Theory suggests that people prefer certainties over probabilities. Thus, investors may miss out on significant long-term growth because they are overly fearful that the market may go down and they prefer the certainty of earning a modest return versus the probability of earning a higher return over time.

Prospect Theory also highlights that some investors take profits prematurely by panic-selling when the market is in a sharp decline (as some may have done in March 2020) or cutting their losses too late. Selling an investment at a loss can feel as an admission that we were wrong, and loss aversion highlights the reason why: losing is twice as painful as winning. Yet, on many occasions, selling an underwater position may make good sense. Conversely, over-confidence can also be problematic, and Prospect Theory further asserts that people underestimate (or even ignore) low probability, but high impact, events.

The bottom line is this: In both golf and investing, sub-par decisions frequently result from behavioral biases that we all possess. Positively, however, there are things we can do to help manage these biases and mitigate the negative outcomes that frequently result.

First and foremost, by acknowledging our biases, we increase our odds of overcoming them. To some, however, that may not be enough, and thus they should consider working with a trusted advisor/coach who is sympathetic to their emotions will not be overtaken by them. Lastly, a carefully crafted investment policy statement can help serve as a useful game plan to refer to, especially during periods of adverse market conditions.

1.See "Is Tiger Woods Loss Averse" Persistent Bias in the Face of Experience, Competition, and High Stakes," and also "Loss Aversion in Professional Golf."

For more information on this topic, please refer to our white paper: "Investors Behaving Badly: Why Investors Often Make the Wrong Decisions at the Wrong Time" (2019). In addition, the author wishes to acknowledge Jessica Rabe, Co-Founder of Data Trek Research for also highlighting this topic.

For more information, please contact your advisor.

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