EXCHANGE --- The Intelligent Investor: What Investors Can Learn From Gamblers' Behavior

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FULL TEXT

Even as stock markets sank again, one person (or group) made a lot of money this past week: the yet-to-be-identified holder of the single ticket that won the Mega Millions lottery. The lucky winner or winners hit a jackpot worth $1.54 billion in estimated annuity value (or $878 million in cash).

Only days ago, the scramble to buy tickets was highlighting some basic aspects of human nature: Money isn't only about wealth, and people don't understand probability. What's more, the feeling of control can lead any of us to take risks we wouldn't otherwise run. Even if you didn't buy a Mega Millions ticket and never would, observing other people's lottery fever should teach you these investing lessons as little else can.

In fiscal 2016, Americans spent $80.5 billion on lottery tickets. That's partly because a ticket is a taste of hope: Experiments in the Netherlands show about two out of three people prefer to stagger their ticket buying out over more than one day, presumably to savor the prospect of winning for even longer.

If someone told you that your odds of winning a lottery had just improved to 1 in 100,000 from 1 in 100,000,000, you would probably be mildly interested. If, however, you found out that the jackpot had just gone from $100,000 to $100,000,000, your pulse would probably quicken. Probabilities are pallid and impersonal. Money is vivid and emotional.

Companies and governments have been exploiting that human quirk for centuries.

Before issuing shares of stock became a common means of attracting capital, companies often raised money with lotteries. The Virginia Co., which funded the settlement of Jamestown and other early toeholds in the American wilderness, was financed largely by the sale of lottery tickets in London and other British cities.

Governments also have long financed their operations with lotteries, but they didn't become a booming business in the U.S. until, a few decades ago, states started allowing people to pick their own numbers. In the 1970s, the psychologist Ellen Langer, then of Yale University, offered to buy people's lottery tickets before the prizes were drawn. Holders demanded more than four times as much money to sell a ticket they had chosen for themselves as they did to sell one randomly assigned to them.

That's presumably because by choosing a ticket yourself, you have charged it with a spark of your own personal magic -- so, if it turns out to have been the winner, you will kick yourself all the harder for having sold it. One randomly assigned to you doesn't inspire the same regret if you sell it before it wins.

No wonder investors -- professionals and individuals alike -- tend to be far more likely to repurchase stocks they previously sold for a gain rather than a loss. And traders who erroneously believe themselves to be partly in control of market movements have been shown to earn lower returns than those who don't.

In early 2005, the number 53 finally turned up in an Italian lottery drawing after a nearly two-year dry spell. Families had gone into a frenzy, betting a total of $4.5 billion on tickets including that number, or more than $250 per household. (The ultimate winners divided about $770 million.) Some Italians reportedly mortgaged their homes or went bankrupt after betting obsessively on the number.

A study of more than 16 million tickets in the Swiss lottery found that bettors bought number combinations arrayed in a diagonal on the ticket more than 24,000 times; they played the numbers that had won the previous drawing 12,000 times. An analysis of 5.1 million lottery combinations in the Netherlands found that people picked

their own birthdays 21% of the time. Californians seem to bet disproportionately on 9, 7, 3, 8, 11 and 6.
You can make money betting on unpopular numbers, however, only in relatively small lotteries. In wildly popular drawings like Mega Millions and Powerball, where the dollar volume of ticket sales has historically far exceeded the total jackpot, the expected return is negative, according to mathematicians Aaron Abrams of Washington and Lee University and Skip Garibaldi, director of the Center for Communications Research in La Jolla, Calif.
Still, the feeling of "someone is bound to win, so it might be me" is hard to shake: In one British survey, 22% of people said they would win the national lottery jackpot during their lifetime.
It's no surprise, then, that investors love taking an occasional flyer on an individual stock or an active fund: Someone is bound to be at the top of the charts, so it might as well be me.
Charles Clotfelter, an economist at Duke University, has studied lotteries for decades. "Let the machine pick a random number for you," he says. "Your chance of winning with any given number is the same, but your chance of sharing your winnings is a lot lower on a random number, because you're not picking on a diagonal or some other pattern."
For investors, too, figuring out what other people are likely to do, and then persisting in doing the opposite, is the best way to come out ahead in the long run.
Credit: By Jason Zweig

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