Prospect Theory

How people actually evaluate gains and losses.

Economics

The core findings.

Findings

- Losses loom larger than gains
- Outcomes judged against a reference point
- Diminishing sensitivity as size grows
- Risk-averse for gains, risk-seeking for losses
- Small probabilities overweighted

Consequences

- Holding losing positions too long
- Endowment effect on owned items
- Status quo bias in defaults
- Insurance bought against unlikely events

> The reference point is the key variable: the same outcome is a gain or a loss depending on what it is compared to.