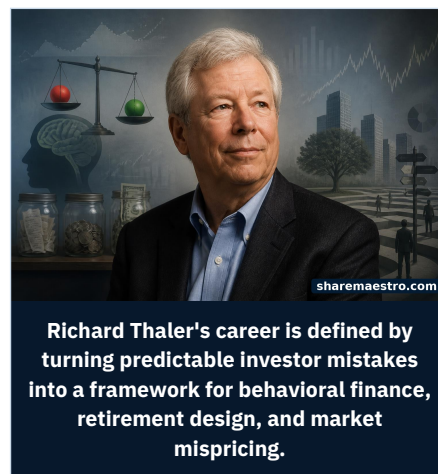


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Richard Thaler Made Investor Irrationality Impossible to Ignore

The Nobel-winning economist turned anomalies, mental accounting, loss aversion, and choice architecture into a durable challenge to rational-market orthodoxy and a practical language for investors.

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Richard Thaler's career is defined by turning predictable investor mistakes into a framework for behavioral finance, retirement design, and market mispricing.

In brief

Richard H. Thaler matters to finance because he changed the unit of analysis. Instead of assuming a perfectly rational investor and treating every deviation as statistical residue, he asked what markets look like when the people setting prices are emotional, inattentive, loss-averse, overconfident, and constrained. His work helped create behavioral finance, influenced retirement-plan design, underpinned a money-management firm built around overreaction and underreaction, and gave investors a vocabulary for mistakes that are common but not always exploitable.

- Thaler's importance lies in making behavioral assumptions central to finance rather than decorative exceptions to rational-choice theory.
- His core ideas include mental accounting, transaction utility, the endowment effect, loss aversion, self-control problems, naive diversification, and predictable investor overreaction or underreaction.
- The 1985 De Bondt and Thaler study found that portfolios of prior loser stocks outperformed prior winners by about 25 percent over the 36 months after formation, a landmark challenge to simple efficient-market interpretations.
- FullerThaler, the asset manager Thaler co-founded, applies behavioral finance to U.S. equity selection, especially by looking for signs that investors have overreacted to old bad news or underreacted to new good news.
- The record is mixed in the right way: behavioral insights have produced influential research and investable strategies, but market efficiency, implementation costs, small-cap liquidity, publication bias, and the limits of causal evidence keep the field honest.

Performance markers

Nobel recognition	2017 Thaler received the Nobel Memorial Prize in Economic Sciences for contributions to behavioral economics.
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De Bondt-Thaler reversal spread	24.6% after 36 months In the 1985 overreaction study, prior loser portfolios outperformed the market by 19.6% while prior winners lagged by 5.0%, producing a 24.6% cumulative average residual spread.
Save More Tomorrow savings increase	3.5% to 13.6% over 40 months Among participants in the first implementation, average saving rates rose from 3.5% to 13.6% by the fourth pay raise.
Save More Tomorrow take-up	78% joined, 80% stayed through fourth raise The first implementation reported high enrollment and persistence among workers offered the program, though later evidence review rated causal confidence as low.
FullerThaler reported net assets	\$33.099 billion as of December 31, 2025 The firm's ADV reported \$30.253 billion discretionary and \$2.846 billion non-discretionary net assets.
FTHSX 10-year annualized return	14.47% vs. 11.63% for Russell 2000 TR As of June 30, 2026, the FullerThaler Behavioral Small-Cap Equity Fund institutional shares exceeded the benchmark over the trailing 10-year period.
FTHSX since-inception annualized return	14.88% vs. 11.96% for Russell 2000 TR As of June 30, 2026, the institutional share class had outperformed since its September 8, 2011 inception date.
FTHSX one-year annualized return	29.51% vs. 40.78% for Russell 2000 TR The same 2Q 2026 fact sheet shows material one-year underperformance, a reminder that behavioral strategies can lag sharply in specific periods.

Charts and timelines

Risk	
Efficient-market challenge	Anomalies may be risk, method, or chance
Implementation risk	Mispricing is not free alpha
Small-cap risk	Higher volatility and lower liquidity
Causal-evidence caution	Save More Tomorrow evidence rated low causal confidence
Limits to arbitrage	Wrong prices can persist

Timeline	
Case Western Reserve degree	BA awarded
University of Rochester doctorate	PhD in economics
Mental accounting paper	Marketing Science publication
Stock overreaction paper	Journal of Finance publication
FullerThaler formed	Investment adviser organized
Naive diversification paper	American Economic Review publication
Save More Tomorrow	Journal of Political Economy study
Nobel Prize	Prize in Economic Sciences

Philosophy	
Mental accounting	Money is labeled in the mind
Loss aversion and endowment	Ownership changes value
Overreaction	Old bad news can be overcapitalized
Underreaction	New good news can be underprocessed
Choice architecture	Defaults and framing matter

Performance	
Prior losers vs. winners	About 25% outperformance
SMarT participant savings	3.5% to 13.6%
FTHSX 5-year annualized	12.66% vs. 6.99% benchmark
FTHSX 10-year annualized	14.47% vs. 11.63% benchmark
FTHSX 1-year annualized	29.51% vs. 40.78% benchmark

The man who put the investor back into the model

Richard H. Thaler did not become famous by discovering that people are irrational. That was too small a claim, and too easy to dismiss. His more radical move was to insist that their mistakes are patterned enough to matter for prices, portfolios, retirement savings, and public policy. In a field trained to admire elegant agents who optimize without friction, he kept pointing to the human being at the end of the trade ticket: distracted, loss-averse, proud, lazy, regretful, and still capable of moving markets.

The Nobel committee's 2017 recognition of Thaler for contributions to behavioral economics ratified a career spent making finance less immaculate and more accurate. At the University of Chicago Booth School of Business, the home of powerful efficient-market arguments, he built a body of work around the gap between textbook rationality and observed behavior. That setting gave the career its tension. Thaler did not reject markets. He rejected the habit of assuming away the people inside them.

His influence is visible in several different rooms. In academic finance, the De Bondt-Thaler work on stock-market overreaction became one of the canonical empirical challenges to a simple reading of market efficiency. In household finance, mental accounting and naive diversification explained why people make odd but predictable choices with their own money. In retirement policy, Save More Tomorrow turned present bias and inertia from obstacles into design inputs. In asset management, FullerThaler turned the same logic into a disciplined search for mispriced securities.

Thaler's profile belongs in a market-legends series not because he is a swashbuckling trader, but because he helped change what serious investors look for. After Thaler, mispricing was not merely a number on a screen. It could be a behavioral fingerprint.

An economist trained to mistrust his own textbook assumptions

Thaler's formal credentials were conventional enough. He earned a bachelor's degree from Case Western Reserve University in 1967, a master's degree from the University of Rochester in 1970, and a PhD in economics from Rochester in 1974. He later taught at Rochester and Cornell, had visiting stints at institutions including MIT, the University of British Columbia, the Russell Sage Foundation, and Stanford's Center for Advanced Study in the Behavioral Sciences, and joined Chicago Booth in 1995.

What made the career unusual was not the pedigree, but the questions he refused to set aside. Standard economics was powerful because it simplified. Thaler's early instinct was that some simplifications were too costly. People treated sunk costs as if they still mattered, ignored opportunity costs, framed the same money differently depending on where it came from, and preferred not to choose when regret loomed. To a strict rational-choice economist, these were mistakes. To Thaler, they were data.

The origin story he later told in his Nobel lecture had the right domestic scale: a bowl of cashews before dinner, guests glad when the temptation was removed, and an economist noticing that revealed preference had just misbehaved. If people were pleased to have fewer options, something important was missing from the model. Thaler's career would return again and again to that deceptively modest point. In finance, more choice, more disclosure, and more calculation do not automatically produce better decisions.

The first move was to stop treating mistakes as noise

Thaler's early project was descriptive before it became prescriptive. He wanted economics to explain how people actually behave, not only how they would behave if they solved every problem with unlimited attention, stable preferences, and perfect self-control. That stance sounds uncontroversial now because behavioral economics has entered the professional vocabulary. In the late 1970s and early 1980s, it was closer to a provocation.

The provocation had method. Thaler did not merely list anomalies. He tried to sort them into mechanisms: sunk-cost errors, underweighted opportunity costs, regret avoidance, precommitment, and self-control problems. The point was not that people were random. The point was that their deviations from the rational benchmark had structure. If the structure could be named, it could be modeled. If it could be modeled, it could be tested in markets and embedded in institutions.

This is why Thaler's work became so important for investors. A random error cancels out. A systematic error can accumulate. A market made up of analysts who underreact to some information, investors who sell winners too early, fund managers who window-dress holdings, and savers who postpone painful decisions is not the same as a market populated by frictionless optimizers. Behavioral finance began as a discomfort with the representative agent. It grew into a theory of where prices and portfolios can go wrong.

Thaler's genius was editorial as much as technical. He gave memorable labels to recurring behavior. Once named, mental accounting, the endowment effect, and naive diversification became hard to unsee. Finance professionals did not need to abandon valuation, risk, or diversification to use those ideas. They needed to ask where the human shortcut might distort the calculation.

Mental accounting and the portfolio in the head

Mental accounting is one of Thaler's most durable ideas because it describes a mistake that often feels like prudence. People separate money into internal accounts: rent money, bonus money, house money, vacation money, retirement money, emergency money. In a strict model, a dollar is a dollar. In lived financial life, a dollar's label changes how it is spent, saved, invested, or protected.

Thaler's 1985 Mental Accounting and Consumer Choice joined cognitive psychology with microeconomics. It developed the idea of transaction utility, where people evaluate not just whether an item is worth its cost, but whether the deal feels good relative to a reference price. In investing, that logic helps explain why entry price can become psychologically binding, why investors anchor on purchase cost, and why the same loss feels different in a taxable account, a retirement account, or a speculative side account.

Mental accounting is not always foolish. It can be a self-control technology. A household that walls off retirement savings may protect itself from impulsive spending. An endowment that separates liquidity reserves from risky capital may avoid selling equities in a crisis. Thaler's point was subtler: mental accounts can help people manage complexity, but they can also make them violate basic portfolio logic. The account label becomes a decision rule.

For a finance professional, the lesson is not to mock clients for having buckets. It is to understand when buckets clarify goals and when they hide risk. A concentrated employer-stock position may sit in an emotional loyalty account rather than in a risk account. A loss-making stock may be held in a hope account long after the investment case has failed. Thaler's vocabulary lets advisers and portfolio managers discuss those errors without pretending that spreadsheets alone will cure them.

Losses matter more than mirror-image gains

The endowment effect took another common behavior and gave it analytical force. People often demand more to give up an object than they would have been willing to pay to acquire it. In a celebrated example from Kahneman, Knetsch, and Thaler, a wine-owning economist drinks bottles that have risen sharply in market value, yet would neither buy more at the auction price nor sell what he owns at that price. Ownership changes the reference point.

For investors, the endowment effect is not confined to mugs, wine, or lab experiments. Securities become endowed too. A stock inherited from a parent, a founder's shares, a long-held winner, or a bruising loser can acquire a psychological premium unrelated to expected return. Loss aversion adds force: realizing a loss can feel more painful than the comparable pleasure of realizing a gain. The portfolio becomes a map of emotional entitlements.

That insight altered how finance thinks about selling. Classical theory focuses on expected returns, taxes, correlations, and constraints. Behavioral finance adds identity, regret, and the status quo. The investor asks not only what an asset is worth, but what selling it says about a prior decision. Thaler's contribution was to connect those personal frictions to market behavior. If enough investors resist realizing losses or cling to familiar positions, the aggregate effect need not be trivial.

From household quirks to stock-price reversals

The leap from consumer anomalies to asset prices required a harder claim. It was one thing to show that people mishandle a dinner-party temptation or overvalue something they own. It was another to argue that competitive markets, staffed by professionals and disciplined by arbitrage, could display similar biases. De Bondt and Thaler's 1985 Journal of Finance paper made that claim in empirical form.

Their study examined whether investors overreact to unexpected and dramatic news. Using CRSP monthly return data, they formed portfolios of past winners and losers and tracked subsequent market-adjusted performance. The result was striking: after 36 months, prior loser portfolios outperformed prior winner portfolios by about 25 percent. In one formulation, losers outperformed the market by 19.6 percent while winners lagged by 5.0 percent, producing a 24.6 percent spread.

The paper became a landmark because it forced efficient-market advocates to respond at the level of evidence. If markets fully and promptly incorporated available information, extreme past losers should not predictably rebound relative to extreme past winners. Yet the data suggested reversal. The January pattern complicated the story further, since a large share of the loser excess returns appeared around the turn of the year.

The result did not end the debate. It sharpened it. Was the reversal compensation for hidden risk, a data artifact, a tax-loss effect, a small-firm effect, or genuine overreaction? Thaler's importance was not that he won every argument. It was that he helped make the psychology of investors a serious candidate explanation for an observed return pattern.

Chicago's productive argument with efficient markets

Thaler's move to Chicago Booth in 1995 gave his career a useful intellectual contrast. Chicago was not a place where one could casually declare markets irrational and collect applause. Eugene Fama's efficient-market tradition had deep roots there, and its defenders had a disciplined answer to many behavioral claims: anomalies are often fragile, risk adjustment is difficult, and any test of efficiency is also a test of the asset-pricing model used to define normal returns.

Fama's 1998 critique of long-term return studies argued that market efficiency survived the behavioral challenge better than its critics allowed. Apparent overreaction and underreaction both appeared in the literature, post-event continuation and reversal could be found in different settings, and many anomalies weakened under changes in method. That critique remains essential to understanding Thaler. Behavioral finance did not triumph by repealing efficient markets. It survived by becoming more precise.

The best reading of Thaler is therefore not anti-market. FullerThaler's own regulatory brochure says the firm believes stock markets are efficient most of the time, while behavioral anomalies can arise under certain circumstances. That is a more modest and more investable proposition than the slogan that markets are irrational. It says that errors exist, but they have to be located, measured, and implemented against costs.

Predicting other people's mistakes

Thaler's investment philosophy is often summarized as a search for predictable mistakes. In a 2009 interview published by AQR, he described FullerThaler as looking for places where investors are most likely to be biased, especially in small-cap stocks. The firm was not, in his telling, a traditional value shop, even when its largest product had a small-cap value label. Internally, he said, the old language remained overreaction and underreaction.

That distinction matters. Traditional value investing often begins with price relative to estimated intrinsic value. Thaler's behavioral investing begins with a question about the source of the wrong price. Did investors panic over stale bad news? Did analysts fail to adjust quickly enough to new information? Did professional incentives, attention limits, or emotional reactions leave a stock temporarily mispriced? Valuation still matters, but it is paired with a behavioral diagnosis.

The phrase small-cap is not incidental. In smaller companies, information can be thinner, analyst coverage lower, liquidity more uneven, and institutional attention more selective. Those features do not guarantee inefficiency, but they create the conditions under which biases may persist long enough to matter. Thaler's edge was never mystical. It was the disciplined observation that even professionals are human and that some human errors cluster in particular market corners.

A fund firm as a laboratory with clients

FullerThaler was organized as a California corporation in April 1993 and registered with the SEC as an investment adviser in May of that year. Its advisory brochure describes the firm as 100 percent employee-owned and focused on exploiting market inefficiencies drawn from behavioral-finance insights. As of December 31, 2025, it reported total net assets of \$33.099 billion across discretionary and non-discretionary mandates.

The firm gives Thaler's academic influence an unusual practical test. This is not a celebrity economist lending a name to a generic fund complex. The brochure identifies Richard Thaler as co-founder and principal, alongside co-founder Russell Fuller, and says the firm's investment philosophy draws on the behavioral-finance work of scholars including Daniel Kahneman and Thaler. Strategies are mainly U.S. equity, primarily long-only, and organized across small-cap, mid-cap, micro-cap, all-cap, value, growth, and core categories.

The most visible public record is the FullerThaler Behavioral Small-Cap Equity Fund, whose institutional share class uses ticker FTHSX. The fund's 2Q 2026 fact sheet lists a September 8, 2011 inception date, 116 holdings as of March 31, 2026, and a Russell 2000 Total Return benchmark. It describes the strategy as seeking to capitalize on overreaction to old negative information and underreaction to new positive information.

The same fact sheet also shows why performance evidence should be handled carefully. As of June 30, 2026, FTHSX institutional shares trailed the Russell 2000 Total Return Index over one year, 29.51 percent versus 40.78 percent. Yet they led over longer trailing periods: 19.38 percent versus 18.60 percent for three years, 12.66 percent versus 6.99 percent for five years, 14.47 percent versus 11.63 percent for 10 years, and 14.88 percent versus 11.96 percent since inception. The data are impressive, but they are still past performance, not a law of nature.

The investment process is behavioral, not confessional

FullerThaler's process is not a therapy session for the market. Its ADV says the firm uses both fundamental and quantitative research, while not fitting neatly into either traditional category. In practice, the behavioral claim must become observable evidence. The brochure refers to markers of possible overreaction and underreaction, combined with measures of expectations and valuation, before a stock reaches a long portfolio.

The FTHSX fact sheet makes those markers more concrete. For overreaction, the fund looks for signs such as significant insider buying or stock repurchases. For underreaction, it looks for large earnings surprises. The logic is straightforward: insiders or repurchasing companies may be acting against excessive pessimism, while earnings surprises may expose situations where the market has not fully processed improving fundamentals.

This is one of Thaler's central contributions to investment practice. He did not tell investors simply to trust their gut because markets are emotional. He pushed in the opposite direction. If investors are biased, the professional response is to define the bias, build a process around it, test whether it survives transaction costs and risk controls, and accept that many apparent errors will not be tradable. Behavioral investing is only useful when it becomes a repeatable discipline.

Where the strategy can break

The danger in popularizing behavioral finance is that every losing trade can be recast as someone else's irrationality. Thaler's work is strongest when it resists that temptation. A mispriced stock may stay mispriced longer than a manager can tolerate. A cheap stock may be cheap because the business is deteriorating. An earnings surprise may be quickly competed away. A repurchase may not signal undervaluation if management is itself overconfident.

The firm's own disclosures are a useful antidote to romance. The ADV and fund documents warn that securities investing involves risk of loss, that value judgments can be wrong, that small-cap stocks carry greater volatility, business risk, less liquidity, and competitive threat, and that management decisions may not work as expected. Those warnings are not boilerplate in a behavioral strategy. They describe the precise zone where the theory can fail in practice.

The one-year underperformance shown in the 2Q 2026 FTHSX fact sheet is also instructive. Behavioral signals can work over time and still lag badly in particular market regimes. If a factor, style, or behavioral pattern never disappointed its adherents, its price would adjust or its capacity would vanish. Thaler's lasting lesson is not that behavioral finance creates easy alpha. It is that investor error is real, but extracting it is costly, competitive, and uncertain.

The retirement revolution hidden in a payroll form

Thaler's most socially consequential finance work may have occurred far from the trading desk. With Shlomo Benartzi, he studied how workers make retirement-saving decisions in defined-contribution plans. Their research on naive diversification found that some participants follow a $1/n$ strategy, dividing contributions evenly across the funds offered, so the share invested in stocks depends strongly on the menu presented by the plan.

That was a severe finding for the age of self-directed retirement. If workers build portfolios by menu arithmetic rather than by risk tolerance, horizon, and expected return, plan design becomes a fiduciary force even when no one calls it advice. The supposedly neutral architecture of a retirement plan can push participants toward more or less equity exposure simply by changing the number and type of available funds.

Save More Tomorrow turned the diagnosis into a design. Rather than asking workers to cut current take-home pay, Thaler and Benartzi proposed that employees commit in advance to allocating part of future raises to retirement savings. In the first implementation, 78 percent of those offered the plan joined, 80 percent of participants remained through the fourth raise, and average saving rates for participants rose from 3.5 percent to 13.6 percent over 40 months.

The caveat is important. The U.S. Department of Labor's evidence review notes that the causal evidence for the study is low, meaning it is not confident that the differences resulted solely from participation in the plan. Still, the idea's influence is hard to miss. It converted inertia from an enemy of savings into a mechanism for increasing contributions. It also showed the practical power of Thaler's method: find the bias, then design around it.

Nudge made behavioral finance a public language

Thaler's collaboration with Cass Sunstein in *Nudge* carried behavioral economics beyond academic finance and into the design of choices in health, wealth, retirement, and public policy. The book's financial relevance is direct. Defaults, automatic enrollment, contribution escalation, menu design, salient fees, and simplified disclosure all turn on the same insight: the way a choice is presented can change the decision even when formal options remain open.

Choice architecture can be misunderstood as a soft substitute for economics. Thaler's better version is more demanding. It says incentives still matter, but so do attention, framing, inertia, and timing. A retirement saver who intends to increase contributions someday may need a payroll system that makes someday arrive. A consumer who ignores compounding fees may need disclosure that is not merely complete, but usable.

The political and ethical debate around nudging is part of its significance. The word paternalism was always going to raise objections, even in its libertarian form. In finance, that tension is familiar. Advisers, employers, platforms, and regulators constantly structure choices. Thaler's question is whether that architecture should be accidental and commercially convenient, or explicit, tested, and designed to help people make decisions they are less likely to regret.

The clearest market error was arithmetic

If the overreaction literature raised questions about return patterns, the tech-stock carve-out work with Owen Lamont attacked an even cleaner target: the law of one price. Their 2003 *Journal of Political Economy* paper examined cases in which holders of a parent company were expected to receive shares of a subsidiary, yet the parent traded for less than the value of the subsidiary shares it owned. The most famous example involved 3Com and Palm.

This was not a subtle dispute about beta. It was arithmetic. If a share of the parent entitled its holder to a known claim on the subsidiary, the parent should not trade below that claim while its remaining businesses were implicitly valued at less than zero. Lamont and Thaler argued that short-sale constraints prevented arbitrageurs from forcing prices back into line. The expensive asset could be overpriced but difficult or impossible to short in size.

The episode captures the mature Thaler view of markets. Prices can be wrong, but not every wrong price is a free lunch. Limits to arbitrage matter. Funding, borrowing constraints, career risk, transaction costs, and institutional rules can all stop rational traders from correcting irrational prices quickly. That is why behavioral finance became more persuasive when joined to market frictions. Psychology creates the pressure; frictions explain why it can remain visible.

A record measured in adoption, argument, and results

Thaler's record cannot be reduced to a single fund return, citation count, or policy program. His achievement is cumulative: a set of ideas that migrated from anomalies columns and lab-style examples into asset-pricing debates, retirement-plan design, law and economics, public policy, and active equity management. Chicago Booth lists him as a member of the National Academy of Sciences and the American Academy of Arts and Sciences, a fellow of the American Finance Association and the Econometric Society, and 2015 president of the American Economic Association.

In markets, the record is purposely contested. De Bondt and Thaler helped open the door to a generation of reversal, momentum, sentiment, limits-to-arbitrage, and behavioral-asset-pricing research. Fama and other efficient-market defenders forced the field to confront data mining, risk adjustment, and model dependence. That tension improved behavioral finance. It could not survive as a pile of anecdotes. It had to become empirical, comparative, and implementable.

The FullerThaler data provide a narrow but tangible market test. A public mutual fund with a behavioral process has shown strong long-term trailing results through June 30, 2026, especially in the 5-year, 10-year, and since-inception windows for FTHSX institutional shares. But the same record includes periods of underperformance and the usual limitations of manager evaluation. Thaler's influence is larger than any product, yet the product record matters because it shows the ideas can be operationalized rather than merely admired.

What remains useful, and what remains dangerous

The enduring usefulness of Thaler's work is that it gives investors a checklist of human failure modes. Are they treating a purchase price as destiny? Are they judging a manager by a short recent streak? Are they refusing to sell because selling would admit a mistake? Are they dividing money into accounts that hide aggregate risk? Are they relying on a plan menu to solve an allocation problem it was not designed to solve?

The dangerous version is just as clear. Behavioral finance can become a flattering story investors tell about others. The market is emotional, but my analysis is rational. Other people overreact, but my conviction is insight. Other investors are anchored, but my price target is objective. Thaler's best work cuts both ways. It offers a theory of market error and a mirror for the person trying to exploit it.

His continuing relevance is strongest in a market saturated with information but still short of attention. Earnings arrive instantly, yet interpretation remains slow. Fund platforms offer thousands of choices, yet many savers default into inertia. Social media accelerates narratives, yet loss aversion still makes investors freeze at the wrong time. Algorithms can process data faster than humans, but humans still define objectives, incentives, constraints, and panic thresholds.

Thaler made finance more humble. He did not prove that markets are foolish or that experts can easily beat them. He proved something more durable: any theory of markets that excludes human behavior will eventually have to smuggle it back in. The investor in his work is not a caricature of irrationality. The investor is recognizable, which is why the theory still bites.

Disclosure

Educational financial journalism and market research only. Not financial, investment, trading, tax, or legal advice.
Market data and analysis may be delayed, incomplete, or inaccurate.

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