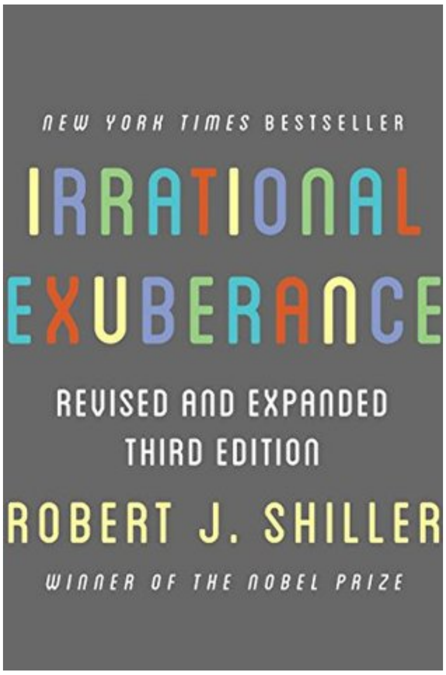

Irrational Exuberance

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In this revised, updated, and expanded edition of his *New York Times* bestseller, Nobel Prize–winning economist Robert Shiller, who warned of both the tech and housing bubbles, now cautions that signs of irrational exuberance among investors have only increased since the 2008–9 financial crisis. With high stock and bond prices in the United States, and rising housing prices in many countries, the post-subprime boom may well turn out to be another illustration of Shiller's influential argument that psychologically driven volatility is an inherent characteristic of all asset markets. In other words, *Irrational Exuberance* is as relevant as ever.

But *Irrational Exuberance* is about something far more important than the current situation in any given market because the book explains the forces that move all markets up and down. It shows how investor euphoria can drive asset prices up to dizzying and unsustainable heights, and how, at other times, investor discouragement can push prices down to very low levels.

Previous editions covered the stock and housing markets—and famously predicted their crashes. This new edition expands its coverage to include the bond market, so that the book now addresses all of the major investment markets. This edition also includes updated data throughout, as well as Shiller's 2013 Nobel Prize lecture, which puts the book in broader context.

In addition to diagnosing the causes of asset bubbles, *Irrational Exuberance* recommends urgent policy changes to lessen their likelihood and severity—and suggests ways that individuals can decrease their risk before the next bubble bursts. No one whose future depends on a retirement account, a house, or other investments can afford not to read it.

For more information, including new developments and regular data updates, please go to www.irrationalexuberance.com

Irrational Exuberance Details

Date	:	Published January 25th 2015 by Princeton University Press (first published January 2000)
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From Reader Review Irrational Exuberance for online ebook

Omar Halabieh says

This book serves as an awakening call from "the present...whiff of extravagant expectation, if not irrational exuberance, in the air. People are optimistic about the stock market. There is a lack of sobriety about its downside and the consequences that would ensue as a result." The author advances that "we need to know if the price level of the stock market today, tomorrow, or any other day is a sensible reflection of economic reality, just as we need to know as individuals what we have in our bank accounts." That being said, the purpose of the book is to advance "a better understanding of the forces that shape the long-run outlook for the market."

This book covers a myriad of factors ranging from technology, to cultural to psychological that aid the formation and reinforcement of speculative bubbles. It ends with a section on implication of these findings on the various members of society whether individuals, institutions or government.

Below are key excerpts that I found particularly insightful:

1- "Many of the foregoing factors (that are candidates for causing a market boom) have a self-fulfilling aspect to them, and they are thus difficult, if not impossible, to capture in predictive scientific explanations."

2- "There are many ultimate causes for this exuberance...and the effect of these causes can be amplified by a feedback loop, a speculative bubble, as we have seen in his chapter. As prices continue to rise, the level of exuberance is enhanced by the price rise itself...The changes in thought patterns infect the entire culture and they operate not only directly from past price increases but also from auxiliary cultural changes that the past price increases helped generate."

3- "The role of the news media in the stock market is not, as commonly believed, simply as a convenient tool for investors who are reacting directly to the economically significant news itself...The news media are fundamental propagators of speculative price movements through their efforts to make news interesting to their audience. "

4- "Ends of new eras seem to be periods when the national focus of debate can no longer be upbeat. At such time, a public speaker may still think that it would be good business to extol a vision of a brilliant future for our nation's economy, but it is simply not credible to do so. One could, at such times, present a case that the economy must recover, as it always has, and that the stock market is underpriced and should go up, but public speakers who make such a case cannot achieve the command of public attention they do after a major stock run-up and economic boom. There are times when an audience is receptive to optimistic statements and times when it is not."

5- "We have explored the justification people have given, at various points in history, for changing market valuations, and we have seen evidence of the transitory nature of these cultural factors. Ultimately, however, the conclusions we draw from such evidence depend on our view of human nature and the extent of human abilities to produce consistent and independent judgements."

6- "Two kinds of psychological anchors will be considered here: quantitative anchors, which themselves give indications for the appropriate levels of the market that some people use as indications of whether the market is over-or underpriced and whether it is a good time to buy, and moral anchors, which operate by determining the strengths of the reason that compels people to buy stocks, a reason that they must weigh against their other uses for the wealth which they already have (or could have) invested in the market."

7- "The effects of new stories on the stock market sometimes have more to do with discovery of how we feel about the news than with any logical reaction to the news. We can make decisions then that would have been impossible before the news was known. It is partly for this reason that the breaking off of a psychological anchor can be so unpredictable: people discover things about themselves, about their own emotions and inclinations, only after price change occur. Psychological anchors for the market hook themselves on the strangest things along the muddy bottom of our consciousness."

8- "Rationale response to public information is not the only reason that people think similarly, nor is the use of that public information always appropriate or well reasoned."

9- "Policies that interfere with markets by shutting them down or limiting them, although under some very specific circumstances apparently useful, probably should not be high on our list of solutions to the problems caused by speculative bubbles. Speculative markets perform critical resource-allocation functions, and any interference with markets to tame bubbles interferes with these functions...Most of the thrust of our national policies to deal with speculative bubbles should take the form of facilitating more free trade, as well as greater opportunities for people to take positions in more freer markets. A good outcome can be achieved by designing better forms of social insurance and creating better financial institutions to allow the real risks to be managed more effectively. The most important thing to keep in mind as we are experiencing a speculative bubble in the stock market today is that we should not let it distract us from such important tasks."

Robert P. Hoffman says

This is a book that needs to be reread in order for the points to absorbed.

Shiller starts out with three chapters that present statistics showing that stocks and real estate are not investments that people can count on to earn a good long-run return. He shows that if people got into the market at the wrong time they could end up having to wait for a long time before the value of stocks returned to the price that people paid for the stocks. He shows similar statistics for real estate.

In the chapter on bonds he talks about how bonds do not do a good job of forecasting future inflation rates.

In Chapter Four and Five he presents his view of how booms get going and how they are amplified. It took me a few readings to understand his main point. I believe his main point is to show that sometimes the price of stocks and the price of real estate go up for no good reasons.

In Chapter Four he identifies precipitating factors that he argues are not connected to fundamentals. They are factors that should not drive prices upward. In Chapter Five he talks about how booms are like Ponzi schemes--and there is sometimes fraud and sometimes just people telling a story that is not supported by any evidence.

Shiller presents detailed examples that are designed to show that when prices fall rapidly they do so for reasons not connected to anything that would justify the price declines. Further, he argues that the metaphor of a bubble is misleading: the bubble doesn't suddenly burst. Instead a decline might be followed by a brief recovery, a time of stability, and then further decreases in the price.

I think Shiller argues this because he wants to demonstrate that prices change for no good reasons--either in an upward or downward direction.

Shiller argues that every time there are booms in stock prices that someone will talk about their being a New

Era that justifies the rise in stock prices. One explanation for the boom would be that there really was a New Era and as people tried to take the consequences of the New Era into account they would bid up prices too high. Once they realized what was going on then stock prices would fall.

Shiller rejects this argument. He argues that in almost all the cases stock prices first go up and then after the fact people start to put stories together to justify the rise in stock prices.

Below is what I prepared for class to discuss this:

One point that comes up again and again the book is that investing in stocks and real estate is not a strategy that can be counted on to generate high returns.

Even if we accept this claim we might argue that at least if put money into the stock market that we can count on getting a return that exceeds the return on bonds. That claim is addressed by the author in Chapter Eleven of his book—the chapter Efficient Markets, Random Walks, and Bubbles.

In addition to these two claims, the last chapter in the book: Speculative Volatility in a Free Society, is of great importance

It is important for three reasons.
(1) It states one of the main themes of the book: there are times when high stock prices and high real estate prices come about "for no good reasons." A corollary (or maybe it is an analogy) of this is that when prices fall they do so "for no good reasons." (p. 225)
(2) Bubbles do real damage to people's well-being. "All of our plans for the future, as individuals and as a society, hinge on our perceived wealth, and plans can be thrown into disarray if much of that wealth evaporates tomorrow." (p. 227) The chapter contains a great example of the damage stock market bubbles have done: we have saved too little and underfunded pension obligations. Why? Because of the belief that home prices would continue to rise and stock prices would continue to rise and therefore we didn't need to save as much.
(3) Instead of giving investment advice to individuals that is not supported by the evidence, we should work on developing financial instruments that would help people hedge against risks that they face from interruptions in their flow of income.

Who is Shiller Arguing With and What is the Basis of the Argument
We have talked about efficient markets and in Chapter Eleven Shiller explicitly introduces the theory of efficient markets.

Economists who believe in the theory of efficient markets argue that when market prices go up or down we should be able to point to fundamental factors that can account for the change in the price. The fundamental factors are connected to the current and future cash flows. While economists believe that future prices of financial and real assets are unpredictable, they believe that after the fact we can explain the changes in prices: they must have changed because something that mattered in the world around us.

It is that claim that that Shiller is attempting to show is false.

Much of what is contained in the book is directly related to Shiller's attempt to show that the claim is false. Here are some examples:

(1) From the very beginning Shiller is interested in showing how changes in stock prices, real estate prices, and bond prices cannot be accounted for by changes in fundamentals. I view this as clearing the decks. If we think fundamentals explain most of the changes in stock prices then there is no need for any other explanations.

Shiller in the chapter on efficient markets focuses on examples of where assets were mispriced and remained mispriced for a long period of time.

I think this is also the reason why Shiller doesn't believe that the housing boom resulted from the introduction of new financial instruments.

(2) Given that efficient markets is the accepted theory, even if Shiller is able to cast doubt on this theory, people are not going to abandon it unless there is a compelling alternative explanation. In two critical chapters, Chapters Four and Five, Shiller offers an explanation of how we can see volatility in prices without there being anything having to do with fundamentals. I missed this the first few times reading the chapter. But on p. 40 Shiller states that "I will concentrate here mostly on factors that have had an effect on the markets not warranted by rational analysis of economic fundamentals."

I read Chapter Four as offering explanations about how things can get going and Chapter Five as offering an explanation as to how we can get a sharp boom. If we buy what is being said we have an explanation as to why stock prices and real estate prices can go up "for no good reason." (And that is why I believe that understanding the stories of Ponzi schemes is crucial to understanding Shiller's point. A Ponzi scheme is based upon fraud. He is arguing that while there is no fraud going on that the same mentality and dynamic is occurring when we have amplifying factors that push stock prices up.)

(3) Shiller spends much time going through detailed examples that only make sense if you realize his main point: stock prices do not change for good reasons.
• The chapter on New Era thinking is an attempt to show that stories as to why prices rose were after the fact storytelling.
• The chapter on herd behavior and epidemics is an attempt to show how people are drawn into the market not because of changes in fundamentals but because of the influence of authority, because of behavior that can be described by models of epidemics.
• The chapter on the news media (which you were not assigned) goes through examples that are designed to show that there was no news that could have justified the stock price changes that occurred.
• The chapter on whether people have a new view of the stock market presents his argument that this isn't an adequate explanation: stock prices rise "for no good reasons."

(4) When bubbles collapse they so for reasons that are not related to fundamentals. In addition Shiller makes two other points.
First: there is a gap between the collapse and any financial crisis.

Second: the collapse isn't a complete collapse but rather there are downturns and then upturns.

Some other points that arose during class today:

(1) People believe things that are not supported by evidence (in particular they believe that stock prices and land prices will rebound, but there is no basis for such a belief).
(2) Role of emotions. In Chapter Nine Shiller states that "popular accounts of the psychology of investing are simply not credible. Investors are said to be euphoric or frenzied . . . [I]n both booms and crashes, investors are described as blindly following the herd like so many sheep." But Shiller argues that "people are more sensible during such financial episodes than these accounts suggest. Financial booms and crashes are, for most of us, not emotion-laden events."

But at various points Shiller talks about the role of emotions. I don't believe Shiller is inconsistent. On p. 80 of the third edition he talks about the emotions of regret and envy. Those emotions he argues play a key role in how people behave. I believe Shiller is rejecting that people lose control of themselves and act like some out of control mob.

(3) Shiller gives examples that are designed to show that prices are much more volatile than we would expect if prices are driven by fundamentals.

(4) Shiller has a statistic that is of great relevance to his argument. If markets are efficient then stock prices of firms in the same industry, even if they are located in different regions, should have great volatility then the stock prices of firms in different industries who are located in the same region. However, if some of the arguments made in Chapter Ten (Herd Behavior and Epidemics) are correct then we would expect the exact opposite. Be able to explain why the different theories have different predictions and be able to explain what results Shiller finds.

Hadrian says

In the 2009 e-book version, Shiller wrote a very modest introduction about the Great Recession. If he wanted to be a bit more succinct, he could just have written "I fucking told you so!"

A book in the long tradition started by Extraordinary Popular Delusions and The Madness of Crowds, with a less fancy prose style and more uses of the price/earnings ratio. It was rather astonishing how right Shiller was. Although maybe it was the publication of this book which led to the crash of the e-commerce bubble of 2000, which might have proven him right anyway.

Geoff Noble says

I really battled to get into this book. I didn't enjoy it at all. We all know that market bubbles exist and I really don't think Robert Shiller added much to the discussion (I will no doubt come under fire here from all the fans out there). This was summed up for me in the last chapter when he listed things that could go wrong in the future. He listed every conceivable scenario in the world. While I agree that you need to consider all possibilities and investing is about probabilities, it is in my opinion very easy to write a book saying all these things could go wrong and then listing everything that could go wrong.

Don't get me wrong. Robert Shiller is a very smart man but I really battled to enjoy this book. Not recommended.

Mike Thicke says

Shiller is rare among economists both for his sense of history and his openness to engaging with other disciplines (qualities that he shares with Thomas Piketty). In the first edition of this book, published in 2000, Shiller argued that the stock market was in the midst of a bubble. What is now known as the Dot-Com Bubble ended just as it was published. In the second edition, published in 2005, Shiller argued that the housing market was overvalued. In this edition, he argues that the stock market is again overvalued.

We'll see how that latest prediction turns out, but regardless in this book Shiller presents a compelling argument against the efficiency of markets and for applying psychology, sociology, and history to our understanding of market dynamics. Although I was already generally familiar with Shiller's work, I still found this book a valuable and nuanced presentation of his theory of market dynamics as well as a great source for understanding the various ups and downs of markets in the 20th century.

Andy says

This was pretty interesting and well written. The 3rd edition, updated in 2014 includes material on the 2008 mortgage driven crisis and even current "state of the economy" in 2014.
Shiller speaks very lightly: he doesn't say "The economy is going to go bust." He says: his CAPE ratio for the markets (a 10-year average PE) has only been higher at 2 times in history: 1929 and 2000. And that was 2014. That's scary but you just can't predict the future. We could have a booming economy and stock market for another 10 years, followed not by a bubble bursting, but by a slow deflation of sorts where average returns on stocks are low or negative. But we could also have a bubble burst.
Interesting notes include that bubbles like 2000 often are based on stories or reasoning that "The economy has changed!" Sure the internet was new and was going to make some companies more efficient and open opportunities for new business, but for many companies the effect of the internet would be small. It wasn't going to make every company in the S&P more profitable by huge amounts.
There is some good discussion of "efficient markets" and what makes markets act inefficient.
The book talks about bubbles in real estate, bonds and stocks.
Interestingly Shiller claims that real estate does not outperform stocks in the long run, and long term real estate prices in most places (that aren't running out of space) are driven mostly by construction costs, which have been going down over the years. And also interestingly, there is a claim that stocks do not outperform bonds over the long term, which is contrary to many things I've read, although I didn't see much data to support that claim. (I admit I was skimming when I read this section.)
Interesting book, but as you might guess there is little hard science on how to predict the exact time (within years) of a bubble, and not much to do about it (stay in stocks, but choose stocks with low CAPE). Still I'm worried enough to be thinking about how to prepare.

Jai Gupta says

The book gets its name and theme from the buzzwords used in Alan Greenspan's speech as the Chairman of the US Federal Reserve Board in 1996. It focuses on how the mood of 'irrational exuberance' is pushing up the stock prices and stretching the valuations and how the levels of the US Stock markets are way above rational. With thorough research and groundbreaking findings, Prof. Shiller convinces us about his theory of the unprecedented bubble. P/E ratios were dramatically out of line with historical precedent without any substantial reason. Though I found the book over-referenced and slightly repetitive, it nevertheless makes an interesting read. Prof. Shiller is an economist and not an investor, so, it is natural for him to inextricably link stock markets and economy. However, they are two separate entities and mostly do not explain each other. I don't deny that markets are not a gauge of economy or that they don't suffer from economic downturns, but there are individual stocks that can act independently. All in all, I recommend this book to anyone who is interested in economic analysis and not investing.

Aristidis Marousas says

A little dry for me. I actually ended up skimming through most of it because you could get the main point of each chapter in each chapters' final paragraph.

I can see why this is a popular book, as Shiller discusses a lot of history about the stock market. However, I do not feel as though I've really learned any new aspects about the markets, besides some small details of history discussed.

If you're reading this book then you probably already know that there's more to the stock market than luck, or the latest headline. If you're expecting Shiller to solve the stock market problem for you, move on.

Mehrsa says

I read this because I got to have dinner with Shiller recently and I wanted a reminder of his theories. I wonder if it's outdated or it's still true that markets are over priced. I think he's absolutely right that they're not efficient, but is it time to sell? He said he didn't know.

Daniel says

One of the best books on investments ever written. I wish I had read this when I was younger, rather than reading books like 'the Dow 20,000' etc. Painful lessons learnt.

Oren says

Robert Shiller is my favorite person to see interviewed on economics. He chooses his words carefully, always saying the economy is unpredictable while being heralded as a prophet. No matter how many times he stares into a camera and tells people he has never predicted the future of the economy, people still believe the myths. Like Kurt Cobain yelling songs about how much he hates his job and fans while growing more popular by the hour.

So I've been wanting to read this book for years. I've read some of Shiller's academic papers and enjoyed them. Shiller really digs into the complete picture of economics, delving, or forging even, into the area of psychology in order to fill-out the frame. In this book, Shiller and his research associates have put huge amounts of time into looking at past significant changes in the stock and housing markets in order to try and understand them. This time included data base and internet searches for news stories including certain phrases to try and understand the prevalence of certain ideas.

One of these ideas is economic bubbles. Bubbles are those events which can't reasonably be explained by fundamental ideas of business or economics. They are agreed to be strictly events of sociology or some outside influence that suddenly causes business or market changes by extraordinary force. One of the issues of studying economics is that much of it is learned from history. Few people understand this fact. Many believe that the future of economics can be predicted or calculated/modeled with certainty. Shiller is clearly in a camp of people who don't believe that but is also, as a scholar, open to what can be learned from such calculations and models. Several bubbles are identified and attempts are made to understand or explain them in hindsight.

The efforts to employ psychology come up short for me. They get very close but don't offer satisfying results. As an example, there is a section which talks about epidemic diseases and how they spread. These models are then applied, with agreed limitations, to the spread of information. This is done to try and explain how an idea like, 'Houses never lose money" spreads through society and causes changes in prices through buying activity. These ideas all made sense but I never quite got the exact connection. The psychology was too light. Perhaps it's there, if I were to scour the notes section and references. I suspect Shiller has been quite thorough but the words themselves left me wondering, "Exactly what is the connection with psychology?" I believe it's there. Perhaps another reading is in order. I wonder what his wife, a psychologist or social scientist of some kind, thinks about his efforts to combine psychology and economics. It comes off a bit "psychology light."

The ideas of psychology and economic fundamentals are contrasted toward the middle of the book with the "efficient markets" theory. This theory essentially says that the market, in the long term, will always obey supply and demand laws. All of the people transacting to make up the economy serve to even-out lawbreaking events and therefore, the economy lends itself to predictability and, even, calculation. Shiller even admits that perhaps the reason some of his ideas show problems with the idea of an efficient market is that there hasn't been enough time to adequately, statistically signficantly, measure.

This book covers huge ground. Toward the end there is even some scathing commentary on how the United States military preference might play into future states of economy. The killing of so many people will no doubt find some retribution.

While I've leaned on Shiller's ideas and information heavily in a decision not to spend a large percentage of my net worth on a house, I came away from this book thinking intensely about how much I've leaned on the stock market. Shiller's idea of wise investing is clearly different form that espoused by the 401k support brought-in by the financial institutions holding the funds. I will look closely again at how my money is invested.

Good luck to those trying to predict the future state of the economy. Experts agree that is not the point. One can only try to learn from the past by taking reasonable actions based on fundamentals and the hypothesis that the past presents tendencies which will be repeated. Luck might swing one way or the other so best to learn as much as you can and apply the ideas so as not to be unlucky.

Vonetta says

Two subjects I love: finance and psychology. Which is called behavioral finance, but whatever.

All I can say is, I read the wrong edition. Ugh. The third edition is Shiller's grand middle finger to the markets after the crash of 08/09 and subsequent recession. I should have read that instead, but this was a solid, still relevant (and eerily prophetic) blast from the past.

Samridhi Khurana says

It is a literature on the bubbles existing in the world of financial markets. Shiller takes us through the various bubbles that sustained themselves due to herd mentality and feedback mechanisms in the markets. The underlying message of the book is to question the efficient market hypothesis and to caution the investors against the soaring markets due to amplification effects. Apart from this key message, I found most of the content to be repetitive and redundant.

Ondrej Kokes says

I very much enjoyed this book. It may seem a bit dry to a non-economist (and admittedly even to me, an economist), but it offers a brilliant overview on financial economics and gives you a good idea why Shiller was awarded the Nobel prize in 2013.

It also offers a nice perspective on the economic climate between recession as the second edition was published in 2005 (the third ed is out now, 2015) and so it contains new material compared to the very first edition that came out just before the .com bubble. The newest edition should contain the Great Recession in full.

What I found most useful was Shiller's precise and conservative approach to researching things. He would offer a lengthy analysis of the news around crises, detail surveys he sent out at the time, focus on the impact of phrasing of these surveys etc. Even when he came to the efficient market hypothesis, his nemesis if you will, he would be very careful to dissect all the arguments of Fama et al. At one point he wrote somethign to the essence of "there is basically no evidence supporting this claim, but let's deal with it anyway."

This very friendly, polite and modest approach is what won me over, I simply like approaches like that.

Omar says

A read that supplemented my fledgling knowledge of finance. I had picked up some books from the library on related topics, and thought this would be a nice supplement to try to put my understanding to the test and triangulate some lessons learned and smarten up about what's going on when the DOW is above 23,000, among other things...

In short, it's is a dry read, and the author's academic background (exposition style) comes through; however, in a world of irrational exuberance, where communication happens so fast, and policies are still in flux, it feels like a valuable book to have read that will make more sense over the long term.
