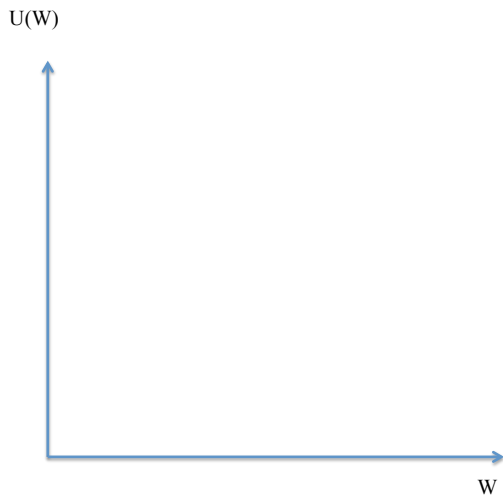


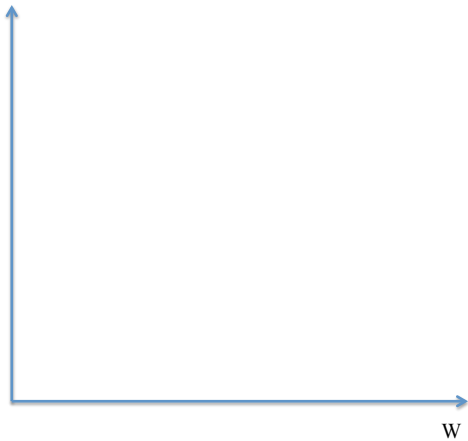
Review : Decision Making Under Uncertainty

- Risk averse



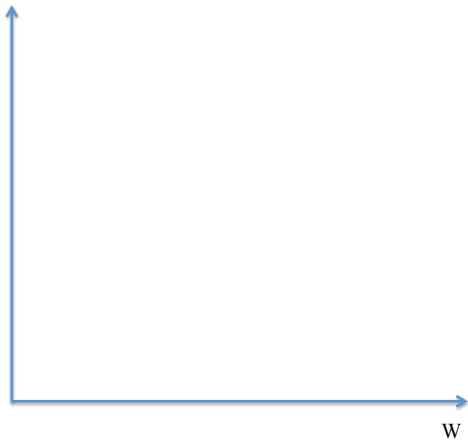
- Risk neutral

$U(W)$



- Risk lover

$U(W)$



- $EU(W) = p_1U(W_1) + p_2U(W_2)$
- $E(W) = p_1W_1 + p_2W_2$
- Will we prefer the actuarial value (expected value) of the gamble with certainty or the gamble itself?
- Risk averter : $U(E(W)) < EU(W)$, Risk premium 0
 - Risk averter the expected value of the gamble with certainty..... the gamble itself.
- Risk neutral : $U(E(W)) = EU(W)$, Risk premium 0
 - Risk neutral the expected value of the gamble with certainty the gamble itself.
- Risk lover : $U(E(W)) > EU(W)$, Risk premium 0
 - Risk loverthe gamble itself the expected value of the gamble with certainty.
- Fair price = expected value of the gamble.