Abstract

When agents are more likely to remember some experiences than others but update beliefs as if the experiences they remember are the only ones that occurred, their limit strategy are selective memory equilibria. We illustrate how selective memory equilibrium can be used to understand the long-run effects of several well-documented memory biases. We then extend our analysis to cases where the expected number of recalled experiences is bounded and experiences that are recalled once are more likely to be recalled again, and to agents who are only partially naïve about their selective memory.
1 Introduction

We study agents whose actions influence what they observe and who have selective memory in the sense that they are more likely to recall some events than others. We assume that this selective memory is stochastic and exogenous. In most of the paper, we also assume that agents are unaware of their selective memory, so they update their beliefs as if the experiences they remember are the only ones that occurred. These assumptions fit evidence from both experimental and real-world settings.\footnote{Memory has been informally described as stochastic since the early stages of the psychology literature, as in James [1890], and recent neuroscience (e.g. Shadlen and Shohamy [2016]) supports this interpretation. Schacter [2008] and Kahana [2012] discuss evidence that some experiences are recalled more often, and e.g. Reder [2014], Zimmermann [2020], Gödker, Jiao, and Smeets [2021] provide evidence of partial or complete unawareness of memory biases.} Although our work is inspired by the neuroscience and psychology literature on memory, we do not try to develop a model that fully matches the process of memory formation and retrieval. Instead, we develop a tractable model of how selective memory influences behavior in decision problems that allows us to analyze situations where the agent’s actions determine the distribution of their observations.

Our focus is on selective memory’s long-run implications. We show that if an agent’s behavior converges, their beliefs converge to a memory-weighted KL minimizer, i.e., a distribution that minimizes the Kullback-Leibler (“KL”) divergence from a version of the true outcome distribution that gives more weight to realizations that are more likely to be remembered.\footnote{Berk [1966] showed that when a Bayesian agent observes a sequence of exchangeable outcomes, their beliefs concentrate on the elements of their prior that minimize the Kullback-Leibler divergence with the true distribution. Our results extend this insight to an agent with selective memory whose observations can depend on their actions.} Moreover, the agent’s strategy then converges to a selective memory equilibrium, which is a strategy that myopically maximizes their expected payoff against a probability distribution over these minimizers. If all experiences are recalled with the same probability, then memory limitations have no long-run effect. However, if memory is selective and agents are more likely to remember some experiences than others, selective memory can have a persistent effect. For example, an agent who is more likely to recall when they performed well in a task than when they performed poorly will underestimate the task’s difficulty and do it too often.

Our framework is rich enough to encompass several commonly studied forms of memory bias, such as pleasant memory bias (Adler and Pansky [2020] and the related ego-boosting bias Zimmermann [2020]),\footnote{Chew, Huang, and Zhao [2020] find that people selectively forget some negative events and create} cognitive dissonance (Elkin and Leippe [1986]),
Chammat et al. [2017], Gödker, Jiao, and Smeets [2021]), associativeness (Thomson and Tulving [1970], Tulving and Schacter [1990], Enke, Schwerter, and Zimmermann [2020]), confirmanatory bias (Hastie and Park [1986], Snyder and Uranowitz [1978]), and the overweighting of extreme outcomes (Cruciani et al. [2011]).

Under pleasant memory bias, the agent is more likely to recall experiences that induced a larger utility. For example, Zimmermann [2020] finds that subjects who received poor scores on an IQ test are more likely to state that they “cannot recall” their test results, even though that answer is payoff dominated in the experiment, and there were only three things for subjects to recall. We show that pleasant memory bias can endogenously generate the same long-run behavior as overconfidence in a fixed learning environment. However, we argue that the overconfidence that arises from selective memory is more susceptible to external manipulation through changes in the feedback provided to the agent. Under associativeness, it is easier to recall situations that are similar to the current decision problem, for example, past experiences in which the agent had a similar mood (Matt, Vázquez, and Campbell [1992]). This is a “bias” if it leads the agent to underweight data relative to its true informativeness. The simplest version of associativeness, similarity weighting (Bordalo, Gennaioli, and Shleifer [2020]) does not alter the possible long-run outcomes for a correctly specified agent: We prove that all the selective memory equilibria are self-confirming. The last memory distortion we study is the extreme experience bias that makes experiences with more extreme payoffs more memorable. We show that moderate risk aversion paired with this bias may explain the extreme risk aversion revealed by the prices of safe and risky assets in financial markets.

Selective memory equilibrium resembles Berk-Nash equilibrium (Esponda and Pouzo [2016]), which applies to agents with perfect memory but a misspecified prior. Indeed, we show that every uniformly strict Berk-Nash equilibrium (Fudenberg, Lanzani, and Strack [2021a]) is equivalent to a uniformly strict selective memory equilibrium for some memory function and a full support prior, and that every uniformly strict selective memory equilibrium is equivalent to a uniformly strict Berk-Nash equilibrium with the appropriate prior support. However, this equivalence fails for Berk-Nash equilibria that are not uniformly strict.\(^4\) In addition, unlike Berk-Nash equilibria, in general, selective memory equilibria do not reduce to self-confirming equilibria (Fudenberg and

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\(^4\)A selective memory equilibrium is uniformly strict if it is the unique best reply to all the beliefs supported on the memory-weighted minimizers.
Levine [1993a]) when the agent is correctly specified. Importantly, the form of misspecification that would lead to the same behavior as a given form of selective memory depends on the environment. That is, particular forms of misspecification and selective memory that coincide under one information structure could lead to very different comparative statics with respect to changes in what the agent observes. We illustrate this point by showing that combining positive and negative feedback has qualitatively different effects on agents that have ego-boosting memory than on agents who are dogmatically overconfident.

In our baseline model, the agent typically recalls more and more periods as time goes on, and with probability 1 the number of recalled experiences converges to infinity, just as they would if the agent had perfect memory. If the agent always plays the same action, the distribution of realized experiences converges to its theoretical distribution, and the distribution of recalled experiences converges to the memory-weighted version of the true distribution. We can thus extend Berk [1966]’s result to show that asymptotically the agent’s beliefs will concentrate on the memory-weighted KL minimizers.

We then extend our model to allow for the possibility that the expected number of recalled periods is bounded. Here typically, the agent’s beliefs would not converge to a deterministic limit even if the action is held fixed, so the action process does not converge. Instead, we show that whenever the action frequency converges the limit frequency is a stochastic memory equilibrium, meaning that the action distribution is generated by a best response to the distribution of memories it generates. We use this to model the effect of “rehearsal,” where an experience recalled in one period is more likely to be recalled again. We also extend the model to allow for agents who are only partially naïve about their selective memory.

Related Theoretical Work Mullainathan [2002] studies selective memory where the probability of recalling an observation is the linear sum of a base rate, an “associativeness” term that measures the experience’s similarity to the current observation, and a “rehearsal” term that is an indicator for whether the experience was recalled in the previous period. Like us, the paper assumes that agents are naïve about their selective memory. It also assumes that signals are normal and are not influenced by the agent’s actions. Afrouzi et al. [2020] also studies an agent who is forecasting the next realization of an AR(1) process. It assumes the agent knows the data generating process and chooses which experiences to recall at a cost. Bordalo, Conlon, et al. [2021]
considers an agent with a fixed sample size who assesses the relative likelihood of a set of hypotheses by sampling their memory with replacement. In addition to similarity-based sampling, the paper models the “interference” of some memories with others. None of these papers addresses our question of determining the agent’s long-run beliefs and actions.

Schwartzstein [2014] studies the long-run effects of a different, but related error: rather than not recalling some observations at a later date, the agent may misallocate attention and not observe them in the first place. As with selective memory and misspecified beliefs, this can lead the agent to make systematically biased forecasts. Wilson [2014] and Jehiel and Steiner [2020] study the optimal use of a finite memory, and Battigalli and Generoso [2021] proposes a formalism to separate assumptions on the players’ information and memory. Bénabou and Tirole [2002] studies deliberate memory distortion by a time-inconsistent agent in a two-period model with two signals, and Jehiel [2021] proposes a multi-self solution concept to model “forgetful liars.” Further afield, Malmendier and Nagel [2016], Malmendier and Shen [2018], and Malmendier, Pouzo, and Vanasco [2020] consider models where agents apply a weight to events that depends on their age at the time the event happened.

2 Setup

We study a sequence of choices made by a single agent. In every period \( t = 1, 2, \ldots \) the agent observes a signal \( s \) from the finite set \( S \) and then chooses an action \( a \) from the finite set \( A \). The realized signal \( s \) and the chosen action \( a \) induce an objective probability distribution \( p^*_{a,s} \in \Delta(Y) \subset \mathbb{R}^Y \) over the finite set of possible outcomes \( Y \).\(^5\) A (pure) strategy is a map \( \sigma : S \rightarrow A \). The agent’s flow payoff is given by \( u : S \times A \times Y \rightarrow \mathbb{R} \).

We assume that the agent knows the fixed and i.i.d. full-support distribution \( \zeta \in \Delta(S) \) over signals.\(^6\) They also know that the map from actions and signals to probability distributions over outcomes is fixed and depends only on their current action and the realized signal, but they are uncertain about the outcome distributions each signal-action pair induces. To model this uncertainty, we suppose that the agent

\(^5\)We denote objective distributions with a superscript \( ^* \).
\(^6\)This assumption lets us focus on our key points. When beliefs about the signal distribution are independent of beliefs about the contingent outcome distributions, the analysis of the paper is unchanged.
has a prior \( \mu_0 \) over data generating processes \( p \in \Delta(Y)^{A \times S} \), where \( p_{a,s}(y) \) denotes the probability of outcome \( y \in Y \) when signal \( s \) is observed and action \( a \) is played.\(^7\) The support of \( \mu_0 \) is \( \Theta \); its elements are the \( p \) that the agent initially thinks are possible. The prior is *correctly specified* if its support contains the true data generating process \( p^* \in \Theta \); if not, the prior is *misspecified*.

**Assumption 1.** For all \( p \in \Theta, y \in Y, a \in A, \) and \( s \in S, p^*_a(y) > 0 \) if and only if \( p_a(s) > 0 \).

This assumption means that the experiences that the agent initially thinks are impossible are objectively impossible, and vice versa.

**Recalled Histories** We assume that the agent always recalls the signal they just observed. The agent’s memory of past periods is distorted by a collection of signal-dependent *memory functions* \( m_{s,a} : S \times A \times Y \to [0, 1] \), where \( m_{s,a}(s, a, y) \) specifies the probability with which the agent remembers a past realization of the signal, action, outcome triplet \((s, a, y)\) when they observe signal \( s' \). We call these triplets *experiences*, and we assume that for each \( s, s', a \) there is at least one \( y \) with \( m_{s,a}(s, a, y) > 0 \).\(^8\)

Let \( H_t = (S \times A \times Y)^t \) denote the set of all histories of length \( t \), and \( H = \cup_t H_t \) the set of all histories. After history \( h_t = (s_\tau, a_\tau, y_\tau)_{\tau=1}^t \) and signal \( s_{t+1} \), the *recalled periods* \( r_t \) are a random subset of \( \{1, \ldots, t\} \). Period \( \tau \) with experience \((s_\tau, a_\tau, y_\tau)\) is remembered with probability \( m_{s_{t+1}}(s_\tau, a_\tau, y_\tau) \), independently of which other periods are remembered.\(^9\) The *recalled history* is the subsequence of recalled experiences \( h_t(r_t) = (s_\tau, a_\tau, y_\tau)_{\tau \in r_t} \).

**Beliefs** We assume the agent is unaware of their selective memory and naively updates their beliefs as if the experiences they remember are the only ones that occurred,\(^{10}\)

\(^7\)For every \( X \subseteq \mathbb{R}^k \), we let \( \Delta(X) \) denote the set of Borel probability distributions on \( X \) endowed with the topology of weak convergence and the associated Prokhorov metric \( d_p \). We also identify each \( p \in \Delta(Y)^{A \times S} \) with an element of \( \mathbb{R}^{|S| \times |A| \times |Y|} \) and for \( x \in \mathbb{R}^n \) we let \( ||x||_\infty = \max\{|x_1|, \ldots, |x_n|\} \).

\(^8\)Here we assume that the agent either remembers an experience perfectly or not at all, as opposed to remembering only certain aspects of it, such as one or two components. We relax this in Appendix B.8. We also suppress the possible dependence of the agent’s memory function on an exogenous state, though that would be easy to add, and allow us to capture e.g. the effect of an exogenous endowment on beliefs in Hartzmark, Hirshman, and Imas [2019].

\(^9\)Thus, the distribution over subsets \( B \subseteq \{1, \ldots, t\} \) is given by \( \mathbb{P} [r_t = B | h_t = (s_\tau, a_\tau, y_\tau)_{\tau=1}^t, s_{t+1}] = \prod_{\tau=1}^t (1 - m_{s_{t+1}}(s_\tau, a_\tau, y_\tau)) + \mathbb{1}_{r_t \in B} (1 - m_{s_{t+1}}(s_\tau, a_\tau, y_\tau)) \).

\(^{10}\)See, e.g., Reder [2014] for evidence supporting this assumption. In particular, agents often do not make inferences about their forgotten observations from the actions they remember taking. We consider partial naïvete in Section 6.
so that their belief at $t + 1$ equals
\[
\mu(C|h_t(r_t)) = \frac{\int_{\Theta} \prod_{\tau \in T_t} p_{a_{\tau}, s_{\tau}}(y_{\tau})d\mu(p)}{\int_{\Theta} \prod_{\tau \in T_t} p_{a_{\tau}, s_{\tau}}(y_{\tau})d\mu(p)} \quad \forall C \subseteq \Theta. \tag{1}
\]

**Remark.** In our model, the set of recalled histories is not only stochastic but non-monotonic: the agent might remember a past event one day and not another, which fits the evidence on memory retrieval Kahana [2012]. Online Appendix B.9 analyses the limit implications of an alternative model where the memory function determines the probability that an experience is recalled in the period just after it occurs. If it is recalled, it is never forgotten, and if it is not recalled, it is never remembered. Because experiences recalled at later dates include all those that were recalled earlier, in this alternative model the agent’s past actions don’t convey additional information. As with the model we present here, any limit action must be a selective memory equilibrium.

**Best Responses and Optimal Policies** The agent’s belief $\mu$ determines the subjective expected utility of each action. Denote by $BR(s, \mu)$ the actions that maximize expected utility when signal $s$ is observed:
\[
BR(s, \mu) = \arg\max_{a \in A} \int_{\Theta} \sum_{y \in Y} u(s, a, y)p_{a, s}(y)d\mu(p).
\]

A *policy* $\pi : H \to A^S$ specifies a pure strategy for every recalled history. We assume that the agent is myopic and uses an *optimal policy*, i.e., a map $\pi : H \to A^S$ such that for all $s \in S$ and recalled histories $h_t \in H$, $\pi(h_t)(s) \in BR(s, \mu(\cdot|h_t))$.\footnote{Note that this requires the agent to choose a pure strategy.}

### 2.1 Examples

We illustrate our model with five commonly studied examples of memory bias. In this subsection, assumptions about the memory function $m$ hold for all $s, s' \in S, y \in Y$ and $a \in A$.

**Example 1** (Utility-Dependent Memory). In some cases the probability of remembering an experience depends on its associated utility, so that $m_{s'}(s, a, y) = \Phi(u(s, a, y))$. Agents who are more likely to remember pleasant experiences correspond to monotone
increasing $\Phi$; agents who are more likely to remember extremely high or low utility realizations have $\Phi$ that is single-dipped.

**Example 2** (Positive Memory Bias). Positive memory bias is the tendency to over-remember experiences that reflect positively on oneself, such as a high test score (see Adler and Pansky [2020] for a survey of the evidence for positive memory bias). To model this, we let one dimension $y_1$ of the outcome $y$ reflect the self-image consequences of the experience, and specify that $m_{s'}(s, a, y) = \Phi(y_1)$ for some increasing $\Phi$.

**Example 3** (Cognitive Dissonance and Ex-post Regret). *Cognitive dissonance* is a memory bias where the pleasantness of a memory is relative instead of absolute, because the probability of recalling an experience depends on how well the chosen alternative performed compared to the counterfactual payoff the agent would have received under the ex-post optimal choice (Elkin and Leippe [1986]). This corresponds to $m_{s'}(s, a, y) = \Phi(\max_{a'\in A} u(s, a', y) - u(s, a, y))$ where $\Phi : \mathbb{R}_+ \to [0, 1]$ is decreasing.

**Example 4** (Associative Memory and Similarity Weighting). To model *associative memory* (Thomson and Tulving [1970]), assume that

$$m_s(s, a, y) > 0 \quad \text{and} \quad \frac{m_s(s, a, y)}{m_{s'}(s, a, y)} > \frac{m_{s'}(s, a, y)}{m_{s'}(s', a, y)},$$

so that a signal is more likely to trigger memories of experiences where the signal was the same. In general, signals represent the conditions under which the choice is made. For example, when in a particular mood, agents tend to recall more situations in which they were in the same mood (Matt, Vázquez, and Campbell [1992], Mayer, McCormick, and Strong [1995]). A leading special case is *similarity-weighted memory*, where the probability of recalling a past experience only depends on the context in which the choice is taken: Here there is a metric $d$ on the space of signals, and $m_{s'}(s, a, y) = \Phi(d(s, s'))$ for some decreasing function $\Phi : \mathbb{R}_+ \to [0, 1]$.

**Example 5** (Confirmatory Memory Bias). Suppose that $\Theta = \{p_0, p_1\}$, and that $\mu(p_0) > \mu(p_1)$. The agent has *confirmatory memory bias* (Hastie and Park [1986]) if they are more likely to remember experiences that the prior deems more likely:

$$\frac{p_{a,s}(y)}{p_{a,s}^{p_0}(y')} > \left( \frac{p_{a,s}^{p_1}(y')}{p_{a,s}^{p_1}(y')} \right) \implies m_{s'}(s, a, y) > (>) m_{s'}(s, a, y').$$

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12See Koszegi, Loewenstein, and Murooka [2021] for an approach that makes mood endogenous.
3 Long Run Outcomes

Let $P_\pi$ denote the probability distribution on $H$ induced by the objective action-contingent probability distribution $p^*$ and the agent’s policy $\pi$.

**Definition 1.** A strategy $\sigma$ is a limit strategy if there is an optimal policy $\pi$ such that $P_\pi[\sup\{t: a_t \neq \sigma(s_t)\} < \infty] > 0$.

In words, a strategy is a limit strategy if there is positive probability that it will be played in every period after some random but finite time. This section gives some general results about limit strategies. These results make no assumptions about the memory function and thus can be used to study the effects of different memory biases. Section 4 then discusses the consequences of specific memory biases.

3.1 Selective Memory Equilibrium

To characterize the strategies that can arise as limit behavior, we define for each strategy $\sigma$ the set of memory-weighted KL minimizers after signal $s'$:

$$KL_{s'}^{\Theta, m}(\sigma) = \arg\min_{p \in \Theta} \left( \sum_{s \in S} \zeta(s) \sum_{y \in Y} m_s(s, \sigma(s), y)p^*_s(s, y) \log p^*_s(s, y) \right). \quad (2)$$

These are the elements of $\Theta$ that maximize the log-likelihood of the memory-weighted outcome distribution induced by $\sigma$. Note that only the relative sizes of the weights $m$ matter for determining $KL_{s'}^{\Theta, m}(\sigma)$: if $\hat{m}(\cdot) = \lambda m(\cdot)$ for some $\lambda > 0$ then $\hat{m}$ and $m$ have the same memory-weighted KL minimizers.

**Definition 2.** A strategy $\sigma$ is a

1. Selective memory equilibrium if for all $s \in S$ there is $\nu_s \in \Delta(KL_{s'}^{\Theta, m}(\sigma))$ such that $\sigma(s) \in BR(s, \nu_s)$.

2. Uniformly strict selective memory equilibrium if for all $s \in S$ and all $\nu \in \Delta(KL_{s'}^{\Theta, m}(\sigma))$, $\{\sigma(s)\} = BR(s, \nu)$.

In a selective memory equilibrium $\sigma$, the action played after each signal $s$ is a best reply to some belief over memory-weighted KL minimizers from the distribution of experiences generated by $\sigma$. The uniformly strict version adds the restriction that there is the same unique best reply for each of these minimizers. Both concepts allow
the actions played in response to different signals to be justified by different beliefs because which memories are triggered depends on the current realization of the signal.

**Theorem 1.** *Every limit strategy is a selective memory equilibrium.*

The idea of this theorem is that when the agent plays a fixed strategy, the empirical distribution converges, and the distribution of recalled experiences after each signal converges to a deterministic limit where the best-fitting models after each signal $s$ are the memory-weighted KL minimizers $KL_{\Theta,s}^{m}(\sigma)$.

The theorem is proved by contradiction. We fix a strategy $\sigma$ that is not a selective memory equilibrium and observe that there is at least one signal after which $\sigma$ does not prescribe a best reply to the memory weighted KL-minimizers. A compactness-continuity lemma guarantees that this also holds for beliefs concentrated on a neighborhood of the minimizers. So it is enough to show that beliefs concentrate on these neighborhoods. A preliminary lemma shows it is sufficient to obtain this concentration under the counterfactual (and possibly suboptimal) policy where the agent always plays $\sigma$. Under such policies, the empirical frequency after each signal $s$ converges to the distribution given by $p_{s,\sigma(s)}^{*}$, and the Borel-Cantelli lemma implies that almost surely the recalled history is large and representative. With this, we can extend Berk [1966]'s concentration result to the product of actual and recalled experiences to show that under representative recalled histories, the distributions that don’t minimize the memory weighted KL divergence have vanishing posterior probability.

Proposition 10 in the Online Appendix establishes a partial converse: every uniformly strict selective memory equilibrium is stable, meaning that play converges to it with arbitrarily high probability for an open set of beliefs.

Theorem 1 provides a learning foundation for some equilibrium concepts that have been used in recent work. For example, Koszegi, Loewenstein, and Murooka [2021] proposes an equilibrium concept where the agent is more likely to remember successes than failures if they are in a good mood, and the agent’s mood is determined by their self-esteem, which is a function of the number of past successes they remember. This is a case of our model where the agent’s mood is an action chosen to match their perceived probability of succeeding at a task (i.e., their perceived ability). Our equilibrium concept then coincides with Koszegi, Loewenstein, and Murooka [2021]’s “self-esteem personal equilibrium,” and Theorem 1 shows that any long-run learning outcome must be such an equilibrium.
Berk-Nash equilibrium is another example of an equilibrium concept for which we can provide a learning foundation based on selective memory. For example, Section 4.2 positive memory bias can lead to overconfidence. Overconfidence has been modeled as the result of exogenous misspecification; the fact that it can be endogenously derived from a well-documented memory bias provides a micro-foundation for Berk-Nash equilibrium in this context. More generally, Proposition 6 shows that any Berk-Nash equilibrium can be micro-founded through selective memory, though how economically convincing such a micro-foundation is depends on the specific application. Finally, Section 5.1 shows that our model of selective memory leads to the same long-run predictions as underinference (Phillips and Edwards [1966]) and can thus micro-found it.

4 Specific Forms of Selective Memory

4.1 Similarity-Weighted Memory and Self-Confirming Equilibrium

Definition 3. Strategy \( \sigma \) is a self-confirming equilibrium if there is \( \nu \in \Delta(\Theta) \) such that for all \( s \in S \) and \( p \in \Theta \), \( p_{\sigma(s),s} = p^*_{\sigma(s),s} \) and \( \sigma(s) \in BR(s, \nu) \).

Fudenberg and Levine [1993b] shows that self-confirming equilibrium corresponds to the steady states of a learning model with long-lived but myopic Bayesian agents; it requires that agents have correct beliefs about the consequences of their equilibrium action but allows them to have incorrect beliefs about actions they do not use.

Proposition 1. For a correctly specified agent with similarity-weighted memory (Example 4), a strategy is a selective memory equilibrium if and only if it is a self-confirming equilibrium.

This result follows from the fact that since \( m_\phi(s, a, y) \) does not depend on \( a \) or \( y \), when the agent is correctly specified and has an accurate sample, the true distribution is the best fit for every signal, so the weight assigned to each signal does not matter. However, similarity weighting can change the set of selective memory equilibria when the agent is misspecified. Whether this occurs depends on how the agent thinks the outcome distribution varies with signals. For example, suppose the agent thinks that the outcome distributions associated with different signals are independent. In that
case, the similarity is irrelevant whether or not the agent is correctly specified: The set of selective memory equilibria coincides with the set of Berk-Nash equilibria with or without this bias. At the other extreme, the agent might think that the distribution of outcomes is the same for all signals. In this case, similarity weighting can change the set of selective memory equilibria, as shown by Example 11 in the Online Appendix.\(^\text{13}\)

### 4.2 Ego-Boosting Memory Bias and Overconfidence

It is well established that many people are more likely to recall situations that reflect positively on themselves.\(^\text{14}\) This can lead to a particular kind of pleasant memory bias: they are more likely to remember experiences that boost their self-assessment than those that reduce it.

Consider a situation where the agent observes i.i.d. outcomes \(y_t \in Y \subset \mathbb{R}\) that reveal information about an ego-relevant characteristic such as IQ or the ability to be a successful investor. There are no signals, and the agent (correctly) believes that their action does not affect the realized outcome. The next proposition shows that, in this case, a larger bias leads to a more positive limit belief and higher limit action.

**Proposition 2.** Suppose that \(m, m'\) and \(p^*\) are constant in \(a, m'(a, y) = f(y)m(a, y)\) for some increasing function \(f\), \(u(a, y)\) is supermodular, and that \(\Theta = \Delta(\Delta(Y))\). The agent’s long-run belief with memory \(m'\) concentrates on a distribution of outcomes higher in first-order stochastic dominance than the distribution under the long-run belief with memory \(m\), and the limit action with memory \(m'\) will be higher than the limit action with memory \(m\).

Intuitively, because the prior has full support, the KL minimizer will be the distribution that exactly matches what the agent remembers. The agent’s selective memory makes this recalled history more favorable than the true one, and because the agent’s utility function is supermodular their limit action is higher than the objective optimum.

**Example 6.** Suppose that each period the agent takes an action \(a \in \{0, 1\}\), with \(u(a, y) = a(y - z), z \in (0, 1)\). Here \(y\) is the outcome of an IQ test, which is either pass, \(y = 1\), or fail, \(y = 0\), so \(a = 1\) is optimal if and only if the probability of passing the test

\(^{13}\) Also, even when there is a unique selective memory equilibrium, and it is objectively optimal, the speed of convergence to the equilibrium can be influenced by similarity weighting. This is similar to kernel density estimation, where the optimal bandwidth trades off having enough observations with relying too much on distant values.

\(^{14}\) See, e.g. Mischel, Ebbesen, and Zeiss [1976] for an early experiment.
exceeds $z$. The agent passes the test with probability $p^*$. They always recall passed IQ tests, and they recall failed tests with probability $\phi$:

$$m(a, y) = \begin{cases} 
1 & \text{if } y = 1 \\
\phi & \text{if } y = 0
\end{cases}.$$ 

In the long run the agent believes that the probability of passing an IQ test is

$$p = \frac{p^*}{\text{Successes}} + \frac{p^* (1 - p^*) \times \phi}{\text{Failures}} = p^* + \frac{p^* (1 - p^*)}{\phi/ (1 - \phi) + p^*}.$$ 

For example, if the true probability $p^*$ is .5, and the agent remembers failing an IQ test with probability .8, in the long run believe they believe that they pass the test with probability .556. Consequently, they will behave like an exogenously misspecified agent who dogmatically believes their ability to pass is at least .556. Moreover, the difference between $p$ and $p^*$ is monotonic in the agent’s selectivity bias $\phi$. ▲

This example relates to an experiment by Zimmermann [2020] in which subjects took an IQ test and received three noisy observations of how well they performed relative to other subjects. Zimmermann [2020] finds that all subjects can recall the signals immediately after observing them, but subjects who received negative feedback were less likely to recall the feedback a month later than subjects who received positive feedback: subjects are roughly 20% more likely to state that they “cannot recall” the result of the IQ test if the feedback was negative, even though that answer is payoff dominated in the experiment and there were only three things for subjects to try to recall.15 Thus, here, selective memory is a better explanation for long-run overconfidence than selective attention.

Example 6 and Proposition 2 also relate to the literature on overconfidence and financial decision-making. Walters and Fernbach [2021] finds investors are 10% less likely to recall an investment that led to a loss compared to an investment that led to a gain. It also finds that selective forgetting is a significant predictor of investor overconfidence, and that overconfidence is reduced when investors rely less on their memory. In an incentivized experiment, Gödker, Jiao, and Smeets [2021] finds that subjects

15Zimmermann [2020] finds that “negative feedback is indeed recalled with significantly lower accuracy, compared to positive feedback.” Here lower accuracy means both that the agents are more likely to report that they do not recall the experience and that they misreport the experience.
over-remember good investment outcomes and under-remember bad investment outcomes. In line with the prediction of Proposition 2, this leads subjects to have overly optimistic beliefs about their investments and to hold bad investments longer.

**Ego Boosting Bias and Misattribution** We next show how an agent with ego-boosting bias can misinterpret data about other aspects of the world.

**Example 7.** Suppose that besides taking an IQ test, the agent works on a group project with a coworker. The outcome distributions \((p_1, q) \in [0, 1]^2\) and outcome \((y_1, y_2) \in \{0, 1\}^2\) are two dimensional, where the first component denotes whether or not the agent passed an IQ test and the second component denotes whether a group project succeeded. The agent passes the IQ test with probability \(p_1\), and the group project succeeds with probability \(p_2 = \alpha p_1 + (1-\alpha)q\), so the success of the group project depends on the ability of the agent’s \(p_1\) and their coworker’s ability \(q\). The agent always remembers experiences with positive IQ test results, and remembers experiences with negative test results with probability \(\phi\). If \((p_1^*, q^*)\) denote the true ability of the agent and coworker then the agent’s long-run beliefs will satisfy

\[
p_1 = p_1^* + \frac{p_1^*(1-p_1^*)}{\phi/(1-\phi) + p_1^*}, \quad q = q^* - \frac{\alpha}{1 - \alpha \phi/(1-\phi) + p_1^*}.
\]

The agent thus underestimates the coworker’s ability as a consequence of selective memory, and the underestimate grows as memory becomes more selective. The induced long-run beliefs are similar to the attribution bias derived in Heidhues, Kőszeri, and Strack [2018] for exogenously overconfident agents, where low outcomes are attributed to an exogenous state.

To generalize this example, we consider a two dimensional outcome space \(Y = Z \times Z \subset \mathbb{R}^2\), where \(y_1\) corresponds to an ego-relevant characteristic, and is distributed according to \(p_1^*\). The second component \(y_2\) is independently drawn, with \(p_2^*(y_2) = \alpha p_1^*(y_2) + (1-\alpha)q^*(y_2)\) for some \(\alpha \in (0, 1)\). The agent knows that the outcomes are independently drawn each period according to a \(p^*\) satisfying these conditions, but does not know \(p_1^*\) or \(q^*\), and their prior belief has full support over \(\Delta(Z \times Z)\).

**Proposition 3.** Suppose that \(m\) and \(p^*\) are constant in \(a\), and \(y_2\) and \(m\) is increasing in \(y_1\). Then the agent’s long-run belief about \(p_1\) concentrates on a distribution that is higher in first-order stochastic dominance than \(p_1^*\) and the agent’s long-run belief about \(p_2\) concentrates on a distribution that is lower than \(p_2^*\).
In Section 5.2 we will see that the long-run belief induced by selective memory can be replicated by exogenous misspecification in any fixed environment, and vice versa. However, the two models can lead to very different comparative statics. Suppose for example that negative feedback is delivered along with positive feedback about an unrelated trait of the agent. Combining positive and negative information in this way is known as a “feedback sandwich”; it is suggested as a way of making feedback more impactful in the management and psychology literature.\footnote{Procházka, Ovcari, and Durinik [2020] describes an experiment where bundling negative feedback with positive feedback about an unrelated domain helps agents perform better.} If the positive feedback makes the experiences where the agent failed the IQ test less unpleasant, an agent with positive memory bias would be more likely to remember them, and their long-run belief about their own ability would move closer to their true ability. So they would become less biased about their coworker’s ability. This is in contrast to exogenous misspecification, where positive feedback about an unrelated state would not affect the agent’s beliefs about their own or their coworker’s ability.

4.3 Extreme Experience Bias and Risk Attitudes

This section shows that for choices over lotteries, memory distortions can generate the same behavior as a distorted risk preference. We again simplify by supposing there are no signals, and let the outcome $y \in \mathbb{R}$ be the amount of money received by the agent, with $u(s, a, y) = v(y)$ for some concave $v$.

**Extreme Experience Bias** Suppose the agent chooses between a safe action $a = 0$ that induces outcome $y_0$, and a symmetric risky lottery $a = 1$ with expected value $\bar{y}$. We say that the agent has an *extreme experience bias* if the probability of remembering an experience $m$ is an increasing function of the distance of the outcome $y$ from its expected value, i.e.:

$$m(s, a, y) = h(|y - \bar{y}|)$$  \hspace{1cm} (3)

for some increasing $h : \mathbb{R}_+ \rightarrow \mathbb{R}_+$.

Our next result, together with Theorem 1 shows that choosing the lottery is the long-run outcome with extreme experience bias only if it is the long-run outcome with perfect memory. Moreover Example 12 in the Online Appendix shows that extreme experience bias can shift the long-run outcome from the lottery to the safe action.
To state a result that holds for all concave utility functions, we assume that the true
distribution of outcomes is symmetric.\(^{17}\)

**Proposition 4.** Suppose \( p^* \) is symmetric\(^{18}\) and that the agent thinks all outcome
distributions are possible under the risky action.\(^ {19}\) If choosing the lottery is not a selective
memory equilibrium with perfect memory, it is not a selective memory equilibrium with
extreme experience bias.

Because the agent over-remembers extreme experiences, the environment seems
more risky than it truly is, so in the long run they do not take the risky action if
it would not be optimal for an agent without extreme experience bias.\(^ {20}\) By making
the tail realizations relatively more memorable, extreme bias can make a risk-averse
agent act as if they were even more risk averse. This may help explain why the risk
aversion needed to match the real-world investment choices is unrealistically high: the
agents can be attracted by safe alternatives because they are moderately risk averse
and their memory exaggerates the riskiness of the uncertain alternatives. For example,
a single day where the stock market crashed might be more easily remembered than
many days of average returns, and lead to a biased perception about its riskiness.
Indeed, the plausibility of this channel is supported by several studies that show that
higher working memory is associated, either directly or through a proxy measure of
cognitive ability, with lower risk aversion at both the intra- and interpersonal levels
(see, e.g., Cokely and Kelley [2009], Boyle et al. [2012], and Benjamin, Brown, and
Shapiro [2013]).

**Rare Experience Bias**  Similarly, some forms of selective memory are equivalent to
preferences that arise from distorting outcome probabilities. Suppose that the agent is
more likely to remember experiences that happen more rarely, i.e., there is a decreasing
function \( h : [0, 1] \to [0, 1] \) such that \( m(s, a, y) = h(p^*_s(y)) \). In this case, in the long run
the agent believes that the outcome distribution for the risky action is

\[
\frac{h(p^*_s(y))}{\sum_{z \in Y} h(p^*_s(z))}.
\]

\(^{17}\)Extreme-experience bias can have the opposite effect of encouraging risk-taking behavior when
the true distribution is very asymmetric, with a very low probability of a large payoff, as with lotteries.

\(^{18}\)\( p^*_s(\bar{y} + \delta) = p^*_s(\bar{y} − \delta) \) for all \( \delta \in \mathbb{R} \).

\(^{19}\)Thus \( \Theta = \{ p \in \Delta(Y) \times \Delta(Y) : p_y(y_0) = 1 \} \).

\(^{20}\)This behavior can also be induced by a misspecified belief with overly fat tails.
They will thus act as if they distort probabilities, as in prospect theory (Kahneman and Tversky [1979]).

5 Alternative Models

This section compares our selective memory model with underinference and misspecification, which are two other ways to model similar effects.

5.1 Underinference

The phenomenon of underinference (Phillips and Edwards [1966]) is distinct from selective memory but has similar long-run implications, as we establish in Proposition 5. Here agents remember (or are presented with) a record of past observations, so memory is not an issue, and the agent’s beliefs are a deterministic function of the sequence of observations. However, they underweight a given observation \((s, a, y)\) when applying Bayes rule. In particular, they use the deterministic updating rule

\[
\mu^{U}(C|\{(s_i, a_i, y_i)\}_{i=1}^{t}) = \frac{\int_{p \in C} \prod_{i=1}^{t} (p_{a_i, s_i}(y_i))^{m(s_i, a_i, y_i)} d\mu(p)}{\int_{\Theta} \prod_{i=1}^{t} (\hat{p}_{a_i, s_i}(y_i))^{m(s_i, a_i, y_i)} d\mu(p')},
\]

(4)

where \(m(s, a, y) \in [0, 1]\) is the underinference distortion applied to experience \((s, a, y)\).

As with selective memory, this memory distortion leads beliefs to concentrate on a set of weighted KL minimizers, and as as the next result shows the underinference distortion maps directly to a selective memory function.

Proposition 5. If \(\sigma\) is a limit strategy with underinference distortion \(m\), it is a selective memory equilibrium with memory function \(m\).

A leading special case is uniform underinference where \(m(s, a, y) = c < 1\) and the agent discounts all observations by the same amount. In this case, Propositions 1 and 5 imply that the limit strategy for a correctly specified agent must be a self-confirming equilibrium. A natural question is whether the two theories can be distinguished from observable data. Most of the current evidence on overconfidence only regards agent beliefs, and not the recalled histories, which makes it difficult to tell the two distortions apart (see Benjamin [2019]).

If signals are absent and actions are real-valued, the way actions respond to outcomes can be used to distinguish underinference and selective memory. Under over-
confidence, the realization of \( y_t \) is sufficient to predict whether \( a_{t+1} \) is more or less than \( a_t \). Under selective memory, the set of past experiences retrieved at time \( t+1 \) may differ from those at time \( t \), so in general the previous period’s outcome and action are not sufficient to predict the way that actions change. Moreover, the action sequence features a sort regression to the mean: after an action that is particularly high, it is likely the next action will be lower.

In general, with an exogenous data generating process the agent’s beliefs will converge to the same limit as with underinference, so their limit action will be the same. If instead the data generating process is endogenous, random memory realizations can induce switches in actions, so actions are less likely to converge. The next example illustrates this possibility.

Example 8. Suppose \( A = \{a, b\}, Y = \{0, 1\} \), there are no signals, \( u(a, y) = y \), and that the agent knows that the probability of \( y = 1 \) given action \( a \) is some \( c \in (0, 1) \), i.e. \( p_a(1) = p_a^*(1) = c \) for all \( p \in \Theta \). The agent does not know the probability of outcome 1 under action \( b \). Their initial belief is that it is larger than that of action \( a \), so \( BR(\mu_0) = b \), although there is \( p' \in \Theta \) with \( p'_b(1) < c \). The truth is that \( p_b^*(1) > c \), so action \( b \) is optimal, but if \( m \) is strictly positive, both \( a \) and \( b \) are selective memory equilibria. In the underinference model both \( a \) and \( b \) have positive probability of being limit actions, and moreover if \( a_t = a \) then \( a_\tau = a \) almost surely for all \( \tau > t \), while if \( m(b, 1) \geq m(b, 0) \) with the selective memory model we have \( \lim_{t \to \infty} a_t = b \) almost surely.

5.2 Selective Memory and Misspecification

We can relate the long-run implications of selective memory to those of misspecification in the sense of the statistics literature, where the true model is not in the support of the agent’s prior. Let

\[
KL^{\Theta,1}(\sigma) = \arg\min_{\sigma \in \Theta} \sum_{s \in S} \zeta(s) \sum_{y \in Y} p_{\sigma(s),s}^*(y) \log p_{\sigma(s),s}(y)
\]  

be the set of KL minimizers for \( \Theta \) when the function \( m \) is identically equal to 1, so the agent does not have selective memory.

Definition 4. A strategy \( \sigma \) is a
1. Berk-Nash equilibrium if for all \( s \in S \), there exists \( \nu \in \Delta(KL^{\Theta,1}(\sigma)) \) such that \( \sigma(s) \in BR(s, \nu) \).

2. Uniformly strict Berk-Nash equilibrium if for all \( \nu \in \Delta(KL^{\Theta,1}(\sigma)) \) and all \( s \in S \), \( \{\sigma(s)\} = BR(s, \nu) \).

Esponda and Pouzo [2016] shows that Berk-Nash equilibrium is a necessary condition for a strategy to be the long-run outcome of a possibly misspecified learning process. Fudenberg, Lanzani, and Strack [2021a] shows that uniformly strict Berk-Nash equilibrium is a necessary condition for a strategy to be the long-run outcome with probability near 1.

Berk-Nash equilibrium is the special case of selective memory equilibrium where memory is perfect as opposed to selective. Moreover, even beyond this case there is a close relationship between the uniformly strict versions of these equilibrium concepts: For a given prior support \( \Theta \) and objective distribution \( p^* \), every uniformly strict Berk-Nash equilibria is equivalent to a selective memory equilibrium with full support prior for some memory function, and every uniformly strict selective memory equilibria is equivalent to a Berk-Nash equilibrium for some support. To formalize this idea we will need to consider two different priors \( \mu_0 \) and \( \mu'_0 \) with possibly different supports \( \Theta \) and \( \Theta' \).

**Definition 5.** A Berk-Nash equilibrium \( \sigma \) with support \( \Theta \) and a selective memory equilibrium \( \sigma' \) with support \( \Theta' \) are belief equivalent if \( \sigma = \sigma' \), and for all \( s \in S \) there exists a belief \( \nu \in \Delta(KL^{\Theta,1}(\sigma) \cap KL^{\Theta',m}(\sigma)) \) such that \( \sigma(s) \in BR(s, \nu) \).

Two equilibria are belief equivalent if they prescribe the same strategies, and behavior after each signal can be justified by the same belief. Note that in a selective memory equilibrium the signal can influence the agent’s memory and the set of KL minimizers, while in a Berk-Nash equilibrium the KL minimizers are the same regardless of the signal.

**Proposition 6.**

1. Every uniformly strict Berk-Nash equilibrium with support \( \Theta \) is belief equivalent to a selective memory equilibrium with support \( \Theta' = \Delta(Y)^{A \times S} \) for some memory function.

2. Every uniformly strict selective memory equilibrium with support \( \Theta \) is belief equivalent to a uniformly strict Berk-Nash equilibrium for some \( \Theta' \).
The idea behind the first part of the proposition is that if we start from a KL minimizer \( p \) with perfect memory but incomplete support, we can choose a memory function that rescales the probability of an outcome by \( p_{\sigma(s),a}(y)/p_{\sigma(s),a}(y) \), making the recalled frequency equal to \( p \). This makes \( p \) a weighted-memory minimizer, so \( \sigma \) is a best reply. The second part of the proposition is trivial: to construct a strict Berk-Nash equilibrium that leads to the same beliefs and behavior as in the selective memory equilibrium we can endow the agent with a degenerate belief that equals the long-run belief in the selective memory equilibrium.22

**Remark 1.** As we prove in Online Appendix B.2, the uniform strictness conditions of Proposition 6 are needed:

1. There are Berk-Nash equilibria that are not belief equivalent to any selective memory equilibrium with support \( \Theta' = \Delta(Y^{A_S}). \)

2. There are selective memory equilibria that are not belief equivalent to any Berk-Nash equilibrium.

3. Moreover, unlike Berk-Nash equilibria, selective memory equilibria do not reduce to self-confirming equilibria when the agent is correctly specified. In particular, selective memory equilibria need not be objectively optimal when the distribution of outcomes is independent of the agent’s action.

To illustrate the equivalence result, consider a buyer who submits an offer for a good in double-blind two-sided auction where the price \( z \) is set at the buyer’s bid, so the seller’s dominant strategy is to bid their value. Suppose that the buyer has an exogenous fixed conviction that the price sellers ask is independent of the quality of the good they are selling. If the buyer’s value of the good is \( x + v + \varepsilon \) where \( x \) is the value for the seller, \( v \) measures the gains from trade, and \( \varepsilon \) is a noise term, and if after every interaction the buyer observes their payoff and the ask price \( x \), then in the Berk-Nash equilibrium they submit a bid that is too low, as in Esponda [2008]. Proposition 6 shows that memory distortions can over time lead the agent to believe that value and bid are independent, and thus have the same long-run behavior and

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21Every \( p'' \) that is outcome-equivalent under \( \sigma \) is also a minimizer, and these \( p'' \) may not have been elements of \( \Theta \). Because \( \sigma \) need not be a best response to some of them, it need not be a uniformly strict selective memory equilibrium.

22Formally, we take \( \Theta' \) to be a singleton \( p \) with with \( p_{a,s}(y) = p'_{a',s}(y) \) where \( p''_{\Theta',m}(\sigma) \).
beliefs. This is obtained with a memory function that gives more weight to experiences with a larger gap between buyer’s values and ask prices.\textsuperscript{23}

While Proposition 6 implies that selective memory and misspecification will have similar long-run implications in a fixed environment, in Section 4.2 we have shown that the two models have different comparative statics with respect to changes in the environment.\textsuperscript{24} Therefore, empirical work that distinguishes between the two models based on variation in information is needed.

6 Partial naïvete

So far we assumed that agents are unaware that they are forgetful, and treats the experiences they remember as if these were the only ones that happened. This section considers agents who are partially aware of their memory limitations.\textsuperscript{25} We suppose throughout this section that actions have no effect on the outcome distribution. We also assume that the agent either does not remember their own actions or believes their actions convey no information, so that they do not draw inferences about the experiences they forgot from their actions. Finally, we suppose that agents know the current period and so know how many observations they have forgotten.

Suppose the agent believes that they remember an occurrence of signal $s$ and outcome $y$ with probability $\hat{m}(s, y)$, instead of the true probability $m(s, y)$. The subjective log-likelihood of a remembered history $h_t(r_t)$ after signal $s'$ under data generating process $p$ is then

$$
\left(1 - \frac{|r_t|}{t}\right) \log \left[ \sum_{s \in S} \zeta(s) \sum_{z \in Y} p_s(z) (1 - \hat{m}_{s'}(s, z)) \right] + \frac{|r_t|}{t} \sum_{y \in Y} \sum_{s \in S} f_t(s, y, r_t) \log (p_s(y)\hat{m}_{s'}(s, y)) \right),
$$

\textsuperscript{23}Note also that since memory cannot affect the perceived relative likelihoods of experiences that are not observed, and only some distributions for the counterfactual justify the equilibrium strategy, the resulting equilibrium may not be uniformly strict.

\textsuperscript{24}There is a sense in which selective memory can also be viewed as a form of misspecification, as the agent is not aware of their memory limitations. From that perspective, our results show that the classic misspecification studied in Bayesian statistics is closely related to a psychologically-founded form of misspecification.

\textsuperscript{25}To focus on the learning implications of selective memory, we restrict to myopic agents. Without myopia, one has to take a stance on the commitment power of the agent and on how they try to affect their future memory, as in Piccione and Rubinstein [1997].
where $|r_t|$ is the number of events the agent remembers. (Note that the first term does not appear when the agent believes they remember everything, which corresponds to $|r_t|/t = 1$.)

Because the expected value of $|r_t|/t$ is $1 - \sum_{y \in Y} \sum_{s \in S} p(y) m_s'(s, y)$, (6) suggests the following generalization of (2):

$$KL_{s'}^{\Theta, m, \hat{m}}(\sigma) = \arg\min_{\theta \in \Theta} \left( 1 - \sum_{s \in S} \sum_{y \in Y} m_s'(s, y) \zeta(s) p_s^*(y) \right) \log \left( 1 - \sum_{s \in S} \sum_{y \in Y} \zeta(s) p_s(y) \hat{m}_s'(s, y) \right)
+ \sum_{y \in Y} \sum_{s \in S} m_s'(s, y) \zeta(s) p_s^*(s, y) \log \left( \hat{m}_s'(s, y) p_s(y) \right).$$

Notice that when $\hat{m}_s'(s, y) = 1$ for all $s$ and $y$, the second term of the equation is equal to the minimized function in (2), and the first term is independent of $p$ and has no impact on the minimization.

**Definition 6.** A **selective memory equilibrium** for a partially naïve agent is a strategy $\sigma$ such that for every $s \in S$ there exists a belief $\nu \in KL_{s'}^{\Theta, m, \hat{m}}(\sigma)$ with $\sigma \in BR(s, \nu)$.

For an agent who is aware of their own forgetfulness, but not aware that their memory is selective, i.e., who believes that their memory function $m$ is constant, $KL_{s'}^{\Theta, m, \hat{m}} = KL_{s}^{\Theta, m}$ and the selective memory equilibria of a partially and fully naïve agent coincide.26 This shows that for our results what is important is that the agent unaware of the selective nature of their memory, not that they are unaware of their forgetfulness. At the other extreme, if agents are fully aware of their memory function and correctly specified then $\delta_{p*} \in KL_{s'}^{\Theta, m, m}$ and thus any action that is optimal for the true data generating process is always a selective memory equilibrium.27

The next result, whose proof is omitted, follows from an argument analogous to the proof of Theorem 1.

**Proposition 7.** When the agent is partially naïve, every limit strategy is a selective memory equilibrium.

Moreover, as with notions of partial naïveté in cursed equilibrium and quasi-hyperbolic discounting, one can define a parametric notion of partial naïveté by assuming that $\hat{m}_s'(s, y) = (1 - \alpha) + \alpha m_s'(s, y)$. For $\alpha = 0$ the agent is fully naïve and unaware of their

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26 This follows from simple computations, see Online Appendix B.10.

27 More generally, if the agents are misspecified but fully aware then selective memory equilibrium reduces to Berk-Nash equilibrium.

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21
memory limitations. For $\alpha = 1$ the agent is sophisticated and understands their memory limitations which in consequence implies that the agent will have correct long-run beliefs.

As the next proposition illustrates, the degree of naïvete can amplify existing memory biases. Consider again the setting of Section 4.2 which studied positive memory bias by assuming that $y$ is a scalar and $m(y)$ is increasing in $y$.

**Proposition 8.** Suppose $m$ and $p^*$ are constant in $a$ and $m$ is increasing in $y$, that $\hat{m}(y) = (1 - \alpha) + \alpha m(y)$, $\Theta = \Delta(\Delta(Y))$, and the utility function is supermodular. Then the agent’s long-run belief concentrates on a distribution of outcomes that is increasing in first-order stochastic dominance in $\alpha$, i.e., the naïvete of the agent.

## 7 Finite Expected Memory

### 7.1 Stationary Bounded Memory

In our base model, the number of recalled experiences goes to infinity as the agent’s sample size increases. This section modifies the model so that even when the actual sample size goes to infinity, the expected number of instances recalled by the agent remains bounded. This provides an explanation of why time-changing behavior may persist in apparently stationary environments that complements explanations based on recency bias (see Foster and Young [2003], Fudenberg and Levine [2014], Fudenberg and Peysakhovich [2016], and Erev and Haruvy [2016]).

We suppress the signals for simplicity, and assume that the agent’s memory at time $t$ is distorted through a memory function that now depends on calendar time $t$: For some fixed integer $k$,

$$m_t(a, y) = \min\{1, k/t\} m(a, y). \quad (7)$$

With this specification, as the number of experiences $t$ grows to infinity, the probability that any specific experience is recalled decreases at rate $k/t$. Thus asymptotically the expected number of recalled experiences is no more than $k$, so even when the action process converges, the recalled outcome frequency can have a non-degenerate distribution.

After history $h_t = (a_i, y_i)_{i=1}^t$, the recalled periods $r_t$ are a random subset of $\{1, .., t\}$
with probability distribution
\[
P[r_t = B|h_t] = \prod_{i=1}^{t} \left( \mathbb{1}_{i \in B} m_i(a_i, y_i) + \mathbb{1}_{i \notin B} (1 - m_i(a_i, y_i)) \right) \quad \forall B \subseteq \{1, \ldots, t\}.
\]

The recalled history is the subsequence of action-outcome pairs \( h_t(r_t) = (a_i, y_i)_{i \in r_t} \) of the recalled periods, and \( \mu_{t+1} \) is the random period-\( t + 1 \) belief \( \mu(\cdot|h_t(r_t)) \) induced by the recalled history \( h_t(r_t) \).

To simplify notation let
\[
\eta_\alpha \in \Delta(N^{A \times Y})
\]
be the product distribution where the marginal for the action outcome pair \((a, y)\) is Poisson distributed with parameter \( \alpha(a)p^*_a(y)km(a, y) \). We are going to show that \( \eta_\alpha \) is the limit distribution of the recalled experiences if the action frequencies converge to \( \alpha \). Intuitively, the expected number of times a pair \((a, y)\) is recalled is proportional to the frequency of the action \( \alpha(a) \), the probability of the outcome given the action \( p^*_a(y) \), and how memorable that experience is, i.e., \( m(a, y) \). Let \( F_\alpha \) be the distribution of beliefs induced by \( \eta_\alpha \), i.e., \( F_\alpha(B) = \eta_\alpha \{h : \mu(\cdot|h) \in B\} \) for all \( B \subseteq \Delta(\Theta) \).

**Definition 7.** A stochastic memory equilibrium is a mixed strategy \( \alpha \) for which there is a Markovian mixed policy \( \rho : \Delta(\Theta) \to \Delta(A) \) such that

1. at every belief \( \mu \) the action is optimal, i.e., \( \rho(\mu) \in BR(\mu) \), and

2. \( \alpha \) equals the action frequencies induced by \( \rho \), i.e., \( \alpha = \mathbb{E}[\rho(\mu)|\mu \sim F_\alpha] \).

In words, the action distribution \( \alpha \) in a stochastic memory equilibrium is characterized by a fixed point condition: there is an optimal Markovian policy that maps the distribution over beliefs \( F_\alpha \) induced through by \( \eta_\alpha \) into \( \alpha \) itself.

For every \( t \in \mathbb{N} \), define the action frequency at time \( t \) by
\[
\alpha_t(h_t)(a) = \frac{1}{t} \sum_{\tau=1}^{t} \mathbb{1}_a(a_{\tau})
\]
for all \( h_t \in H_t \) and for all \( a \in A \).

---

\(^{28}\)Note a small abuse of notation: \( \eta_\alpha \) defines a probability measure over the number of times each experience is recalled, and not over the set of histories, as histories with the same experiences in a different order are distinct. But all such histories induce the same posterior, so the definition of \( F_\alpha \) is unambiguous.
Theorem 2. If $\alpha_t \to \alpha$ with positive probability, then $\alpha$ is a stochastic memory equilibrium.

The proof shows that if play converges to a limit that is not a stochastic memory equilibrium, the distribution of actions would not correspond to the distribution of best responses generated by the agent’s beliefs. We first show that when the $\alpha_t$ converge to $\alpha$, the distribution of recalled experiences is the $\eta_\alpha$ defined above, which follows from the Poisson limit theorem on the sum of binomials. We then show that beliefs converges to $F_\alpha$, and use the Benaim, Hofbauer, and Sorin [2005] extension of stochastic approximation to differential inclusions to show that if $\alpha$ is not a stochastic memory equilibrium, the agent’s best response to their beliefs would lead the distribution of actions to move away from $\alpha$.

In a stochastic memory equilibrium, the agent will sometimes rely on a small number of past instances to make decisions. This can induce long-run underreaction of beliefs and insensitivity to sample size, a form of representativeness bias first documented by Kahneman and Tversky [1972]. We can calibrate the memory capacity parameter $k$ to match various aspects of the evidence. For example, the probability that the agent decides only on the basis of their prior decreases exponentially in $k$, and is equal to:

$$\prod_{(a,y) \in A \times Y} \exp(-\alpha(a)p^*_{a}(y)k m(a,y)).$$

There is a similar formula for the probability of making a decision based on at most seven experiences, which is claimed to be the “magical” number for working memory (Miller [1956]), so we can calibrate the model by choosing $k$ that makes the probability of choosing based on 7 or fewer memories close to 1. Moreover, a falsifiable implication of the model is that the decrease in the probability of recalling an additional $t$-th experience decreases factorially regardless of the value of $k$.

While Theorem 2 shows that the every limit point of the empirical frequency must be a stochastic memory equilibrium the same is not true for the expectation of the empirical frequency. We illustrate this with Example 10 in the online appendix.

**The Role of the Prior under Finite and Infinite Expected Memory** One important difference between finite and infinite expected memory is the role of the prior. To see this in the starkest form, we compare limit behavior with a selective memory function $\hat{m}$ and that in a stochastic memory equilibrium with memory $m_t =$
min\{1, k/t\} \hat{m}. We first consider the case of an exogenous data generating process where the action does not influence the outcome distribution.

**Corollary 1.** Fix $\Theta \subseteq \Delta(Y)^{\times S}$ and $m : A \times Y \to [0, 1]$. Suppose $m, p^*, p$ do not depend on $a$ and there exists a unique uniformly strict selective memory equilibrium $\hat{a}$:

1. The limit action is $\hat{a}$ when the agent has infinite expected memory.

2. For every action $a$ that is not weakly dominated in $\Theta$ and every expected memory capacity $k \in \mathbb{N}$, there exists a prior belief such that if the empirical action frequency converges to $\alpha, \alpha(a) > 0$.

When the data generating process is exogenous and memory is unbounded, the empirical distribution of recalled outcomes converges almost surely, and the agent ends up playing the best reply to this distribution. With finite memory, there is a positive fraction of periods in which agent recalls so little that they play a best reply to their prior. Since weakly undominated actions are best replies to some prior, the result follows. More generally, when the action does influence the distribution of outcomes, the prior may influence the probability of converging to a specific selective memory equilibrium, but the set of selective memory equilibria is the same for every prior. This is not the case with bounded memory, because the prior influences the chosen action when the number of recalled experiences is small.

### 7.2 Rehearsal

We expand the model to incorporate the effect of rehearsal: If an experience is recalled in one period, it is more likely to be recalled in subsequent periods, see Kandel et al. [2000] and the references therein. To model this phenomenon we assume that the agent’s memory at time $t$ is distorted through a rehearsal memory function that can depend on the history recalled in the previous period

$$m_t(a, y|r_{t-1}, (a_{t-1}, y_{t-1})) = \min\{1, k/t\} \left( m(a, y) + R \mathbbm{1}_{(a, y) \in r_{t-1} \cup \{ (a_{t-1}, y_{t-1}) \}} \right), \tag{8}$$

where the experiences $r_{t-1} \cup \{ (a_{t-1}, y_{t-1}) \}$ that were recalled or experienced last period have an additional probability of $R \leq 1 - \max_{a \in A, y \in Y} m(a, y)$ of being recalled.\(^{29}\)

\(^{29}\)Rehearsal is a key feature of Mullainathan [2002]'s model of memory, which analyzed the period-ahead impact of rehearsal but not its long-run implications. To make it simpler to compare our results, we maintain the same assumption that only what was recalled yesterday affects what is recalled today.
After history $h_t = (a_i, y_i)_{i=1}^t$, the recalled periods $r_t$ are a random subset of $\{1, ..., t\}$ with probability distribution

$$
\mathbb{P}[r_t = B|h_t, r_{t-1}] = \prod_{i=1}^t (1 - m_t(a_i, y_i|(r_{t-1}, (a_{t-1}, y_{t-1})))) + \mathbb{1}_{i \notin B}(1 - m_t(a_i, y_i|(r_{t-1}, (a_{t-1}, y_{t-1}))))
$$

for all $B \subseteq \{1, ..., t\}$. We call the experiences the agent recalls the recalled history.

We now define a Markov chain over histories, where the expected number of times a pair $(a, y)$ is recalled is proportional to the frequency of action, the probability of the outcome given the action, how memorable that realization is, and whether it occurred or was recalled in the last period.

**Definition 8.** For every $t \in \mathbb{N}$ and $h' = (a_i, y_i)_{i=1}^t$, let $\eta_{\alpha, h'}$ be the distribution where the number of occurrences of each action-outcome pair $(a, y)$ has a Poisson distribution with parameter

$$
\begin{align*}
\alpha(a)p^*_{a}(y)k[m(a, y) + \mathbb{1} & \sum \mathbb{1}_{i \in B}m_t(a_i, y_i|(r_{t-1}, (a_{t-1}, y_{t-1})))) + \mathbb{1}_{i \notin B}(1 - m_t(a_i, y_i|(r_{t-1}, (a_{t-1}, y_{t-1})))) \\
\alpha(a)p^*_{a}(y)k[m(a, y) & + Rp^*_a(y))] & \text{ if } \exists i \in \{1, ..., t\}: (a, y) = (a_i, y_i) \\
\alpha(a)p^*_{a}(y)k & m(a, y) \text{ otherwise }
\end{align*}
$$

independent of the number of the instances for the other pairs. The induced Markov chain $\eta_{\alpha}$ has state space $H$ and Markov kernel $\eta_{\alpha, h'}(h)$.

We will show that this Markov chain admits a unique stationary distribution, and that this distribution is the limit time-average distribution over recalled histories. Indeed, at any time every subset of $H$ has positive probability of being the recalled history, so the chain is irreducible on the subsets of histories that can be reached with positive probability starting from the empty history. A calculation in the appendix shows it is positive recurrent, which yields the following lemma.

**Lemma 1.** $\eta_{\alpha}$ admits a unique stationary distribution $\mathcal{H}_{\alpha} \in \Delta(H)$.

Let $F_{\alpha, h'}$ be the distribution of beliefs induced by $\eta_{\alpha, h'}$, and let $\chi_{\alpha, h'}$ denote the distributions over actions induced by an optimal Markovian mixed policy $\rho$ and random beliefs $\mu$:

$$
\chi_{\alpha, h'} = \{\alpha' \in \Delta(A) : \exists \rho \in \Pi_{\alpha} \text{ such that } \alpha' = \mathbb{E}[\rho(\mu)|\mu \sim F_{\alpha, h'}]\},
$$
where $\Pi_0$ is the set of all measurable selections from the correspondence $\mu \mapsto \Delta(BR(\mu))$.

**Definition 9.** An *ergodic memory equilibrium* is a mixed strategy $\alpha$ such that there exists $(\alpha^h)_{h \in H} \in \Delta(A)^H$ with $\alpha^h \in \chi_{\alpha,h}$ for all $h \in H$ and $\alpha = \mathbb{E}_{H_\alpha}[\alpha^h]$. Ergodic memory equilibria are fixed points: for every recalled history $h \in H$, a mixed action $\alpha$ determines a probability distribution over what is recalled next period, and thus through the Markovian policy determines a mixed action $\alpha^h$. Ergodic memory equilibrium requires that the expectation of $\alpha^h$ with respect to the induced stationary distribution over recalled histories is $\alpha$.

**Theorem 3.** If $\alpha_t \rightarrow \alpha$ with positive probability, then $\alpha$ is an ergodic memory equilibrium.

### 7.3 Income Forecasts and Asset Pricing

Our model of finite expected memory and rehearsal lets us generalize the findings of Mullainathan [2002] about income forecasts beyond the specific parametric structure it assumed. It also lets us provide a novel memory-based explanation of the equity-premium and equity-volatility puzzles. We suppose that the outcome $y_t$ is i.i.d. $y_t = \theta + \epsilon_t$, independent of the action of the agent, where the $\epsilon_t$ are mean-0 shocks.\(^{30}\)

**Memory Rehearsal and correlated prediction errors** The rehearsal memory function of equation (8) generates the same predictions about one-period correlations as Mullainathan [2002], without assuming associativeness. First, a high outcome last period triggers memories of equally high past realizations, so that the forecasting error will be negatively correlated with the most recent information.\(^{31}\) Second, when the baseline probability of remembering an event is low, and the rehearsal effect is strong, the forecast errors in successive periods will be positively correlated for the same reason as in as Mullainathan [2002]: memories that are forgotten are more likely to be forgotten again.

\(^{30}\)Both Mullainathan [2002] and Weitzman [2007] assumed that the outcomes follow an AR1 process, so that a standard Bayesian would always place non-vanishing weight on the most recent outcome; our assumption of finite expected memory has the same implication.

\(^{31}\)Mullainathan [2002] supposes that $y$ has a positive density on the real line, so that some form of associativeness is needed for rehearsal to have any effect.
**Asset pricing** Suppose that the agent can choose between purchasing a safe asset $a_0$ and purchasing a (representative) equity portfolio $a_1$ at prices $p_{0,t}$ and $p_{1,t}$. If held one period, the safe asset has net return $i$, while the risky asset provides net return $1 + i + \theta$, where $\theta$ is a random variable whose distribution is unknown. In this setting, the equity premium puzzle is that if the distribution of $\theta$ were known and equal to that observed in the data, a very large amount of risk aversion would be needed to justify the observed difference in asset prices.

Weitzman [2007] explains this with the combination of an overly pessimistic prior and the assumption that the agent believes $\theta$ changes over time, so they discard old observations. Ergodic memory equilibrium predicts the same effect even with a perceived constant risk premium. Theorem 3 guarantees that even in the long run the agent will rely on a limited number of observations, so that the pessimistic prior is able to sustain the premium.\(^{32}\)

Moreover, if we add signals back to the model and assume extreme experience bias and similarity-weighted memory, our model predicts excess volatility with respect to fundamentals as in the equity-volatility puzzle. As an example, suppose the signal $s$ is a mean-zero shift to the outcome distribution, and the similarity-weighted memory takes the form $d(s, s') = 1$ if $s'$ and $s$ have the same sign and 0 otherwise, and that the extreme experience bias has the form assumed in (3), with reference point the return of the low asset, i.e., $1 + i$. Similarity-weighted memory implies that after a negative signal the agent is more likely to sample negative realizations, and extreme experience bias implies that the most negative realizations will the most remembered, inducing an excessively low willingness to pay for the asset. The same qualitative feature holds if the similarity between negative signals is high compared to the correlation of different-sign signals. Here the prediction of excess volatility is not obtained from recency alone: If memory is limited but not selective, the prediction is underreaction to signals.

### 8 Discussion

This is the first paper to explore the long-run implications of selective memory. This let us explain how overconfidence can arise from an ego-boosting memory bias, and why agents may underestimate their co-workers’ abilities even when they are correctly

\(^{32}\)Of course, as the size of the average number of recalled events grows, the premium shrinks, just as the premium in Weitzman [2007] shrinks as the fundamental’s rate of change goes to 0.
specified. It also allows to explain the excessive levels of risk aversion implied by asset choice as the result of only moderate risk aversion paired with an extreme experience bias that leads agents to overestimate the riskiness of the assets.

There are several natural extensions that could be pursued in future work. One is to generalize i.i.d. signals to a Markov process. This would let us capture some other relevant biases; for example, the gambler’s fallacy (see Rabin and Vayanos [2010] and He [2021]) would arise if a signal is more memorable when it is different than the signal in the previous period.\textsuperscript{33} Or it might be much easier for agents to recall whether an experience happened at all than whether it happened five or six times; we could capture this by supposing that less frequent experiences are more likely to be recalled. Another generalization would be to memory functions with recency bias, such as $m_{s',t}(s_t, a_t, y_t) = m_{s',t}(s_t, a_t, y_t) f(t - \tau)$ where $f$ is a decreasing function. As with associative memory, when the outcomes are exogenous this bias only leads to slower learning, but when actions are endogenous it can prevent the agent from locking on to the optimal action.

A Appendix

A.1 Preliminaries

We begin by stating a few lemmas whose proofs are in the Online Appendix. For every $h_t \in H$ let $\hat{f}(h_t) \in \Delta(S \times A \times Y)$ denote the empirical distribution over signals, actions, and outcomes in history $h_t$, and for every nonempty recalled history $r_t$ let

$$\hat{f}(h_t, r_t)(s, a, y) = \frac{1}{|r_t|} \sum_{i=1}^{t} \mathbb{1}_{(s_i, a_i, y_i) = (s, a, y)} \mathbb{1}_{i \in r_t}$$

\textsuperscript{33}This extension can be obtained by using the belief concentration result for misspecified agents with Markov models developed in Fudenberg, Lanzani, and Strack [2021b].
denote the recalled empirical distribution in history $h_t$ when the recalled periods are $r_t$. For all $\mathcal{C} \subseteq \Theta$ equation (1) can be rewritten as

$$
\mu(C|h_t(r_t)) = \frac{\int_{p \in \mathcal{C}} \prod_{(s,a,y)} (p_a, s(y)) \sum_{t=1}^{1} 1(s, a, y) = (s, a, y) d\mu}{\int_{p \in \Theta} \prod_{(s,a,y)} (p_a, s(y)) \sum_{t=1}^{1} 1(s, a, y) = (s, a, y) d\mu} = \frac{\int_{p \in \mathcal{C}} \exp(|r_t| \sum_{(s,a,y)} \log(p_{a,s}(y)) f(h_t, r_t)(s, a, y)) d\mu}{\int_{p \in \Theta} \exp(|r_t| \sum_{(s,a,y)} \log(p_{a,s}(y)) \hat{f}(h_t, r_t)(s, a, y)) d\mu}.
$$

(9)

Also, for every $\gamma \in \Delta(S \times A \times Y)$ and $p \in \Delta(Y)^{A \times S}$ let $D(\gamma||p) = -\sum_{(s,a,y)} \gamma(s, a, y) \log(p_{a,s}(y))$.  

**Lemma A.1.** For all Borel measurable $C, C'^{A \times S}$, $t \in \mathbb{N}$, $h_t \in H_t$ and $r_t \subseteq \{1, ..., t\}$,

$$
\frac{\mu(C|h_t(r_t))}{1 - \mu(C'|h_t(r_t))} \geq \frac{\mu(C)}{1 - \mu(C')} \exp\left(|r_t| \inf_{\hat{f} \in \Theta^C, C'} D(\hat{f}(h_t, r_t)||p) - \sup_{\hat{f} \in \mathcal{C}} D(\hat{f}(h_t, r_t)||p)\right).
$$

**Proof of Lemma A.1.** Using (9) we have that

$$
\frac{\mu(C|h_t(r_t))}{1 - \mu(C'|h_t(r_t))} = \frac{\int_{p \in \mathcal{C}} \exp(|r_t| \sum_{(s,a,y)} \log(p_{a,s}(y)) \hat{f}(h_t, r_t)(s, a, y)) d\mu}{\int_{p \in \Theta \setminus C} \exp(|r_t| \sum_{(s,a,y)} \log(p_{a,s}(y)) \hat{f}(h_t, r_t)(s, a, y)) d\mu} \geq \frac{\mu(C)}{1 - \mu(C')} \exp\left(-|r_t| \sup_{p \in \mathcal{C}} D(\hat{f}(h_t, r_t)||p)\right). \tag*{\qed}
$$

Let $KL^{\Theta,m}_{\varepsilon}(\sigma, \varepsilon) = \{ p \in \Theta : \exists q \in KL^{\Theta,m}_{\varepsilon}(\sigma), \|p - q\|_\infty \leq \varepsilon \}$. The next lemma shows that posteriors that assign sufficiently high probability to these balls around the minimizers induce the expected behavior: it makes actions that are not selective equilibria not best replies, and makes a uniformly strict selective equilibrium the unique best reply.

**Lemma A.2.** If $\sigma$ is not a selective memory equilibrium, there are $s' \in S$ and $\varepsilon, C \in$
such that

$$\nu(KL^\Theta_m(\sigma,\varepsilon)) > C \implies \sigma(s') \notin BR(s',\nu).$$

If $\sigma$ is a uniformly strict selective memory equilibrium, there are $C \in \mathbb{R}_{++}$ and $\varepsilon$ such that for all $s \in S$

$$\frac{\nu(KL^\Theta_m(\sigma,\varepsilon))}{1 - \nu(KL^\Theta_m(\sigma,\varepsilon))} > C \implies \{\sigma(s)\} = BR(s,\nu).$$

For any $t \in \mathbb{N}$, strategy $\sigma$ and sequence of actions $a^t$ let $\pi^\sigma,a^t$ be the decision rule that prescribes action $a_t$ at period $t$ and action $\sigma(s_\tau)$ at all periods $\tau > t$. Let $\mathbb{P}_{\pi^\sigma,a^t}$ be the probability measure jointly induced by the objective data generating process and this decision rule.

The next lemma states a necessary condition for $\sigma$ to be a limit strategy. For each time $t$, there must be a finite sequence of actions $a^t$ such that if the agent plays accordingly in the first $t$ periods and then $\sigma$ forever there is positive probability that the induced sequence of beliefs makes $\sigma$ optimal at all periods $\tau \geq t + 1$.

**Lemma A.3.** If, for every $t$, every sequence of actions $a^t$, and every optimal policy $\tilde{\pi}$, $\mathbb{P}_{\pi^\sigma,a^t}[\sigma(s_\tau) = \tilde{\pi}(h_\tau(r_\tau),s_\tau) \text{ for all } \tau \geq t] = 0$ then $\sigma$ is not a limit strategy.

For every $\sigma \in A^S$ and $s' \in S$ let

$$M_\sigma(s') = \min_{p \in \Theta} \left( -\sum_{s \in S} \zeta(s) \sum_{y \in Y} m^*_{s'}(s,\sigma(s),y)p^*_{\sigma(s),a}(y) \log p_{\sigma(s),s}(y) \right)$$

denote the divergence of the weighted memory minimizers under strategy $\sigma$.

**A.2 Theorem 1**

**Proof of Theorem 1.** Suppose towards a contradiction that $\sigma$ is a limit strategy under the optimal policy $\pi$, but not a selective memory equilibrium. Then by Lemma A.2 there are $s' \in S$ and $\varepsilon,C \in \mathbb{R}_{++}$ such that if $\frac{\nu(KL^\Theta_m(\sigma,\varepsilon))}{1 - \nu(KL^\Theta_m(\sigma,\varepsilon))} > C$ then $\sigma(s') \notin BR(s',\nu)$. Let $h_t$ be a history with positive probability under the optimal policy $\pi$. We show that if the agent plays $\sigma$ at every period after $h_t$ almost surely the belief $\mu_t$ reaches a region where no optimal policy prescribes $\sigma(s')$ after signal $s'$. By Lemma A.3 this is enough to obtain the desired conclusion.
By the strong law of large numbers, the frequency \( f(h_{\tau})(s, a, y) \) converges a.s. on \( h_{t} \) to
\[
\lim_{\tau \to \infty} f(h_{\tau})(s, a, y) = \begin{cases} 
\zeta(s)p_{a,s}^{*}(y) & \text{if } a = \sigma(s) \\
0 & \text{otherwise}
\end{cases}.
\]

Define \( \tilde{p}(\sigma, s') \in \Delta(S \times A \times Y) \) to be the induced distribution over remembered experiences
\[
\tilde{p}(\sigma, s')(s, a, y) = \begin{cases} 
\frac{\zeta(s)m_{\sigma}(s, \sigma(s), y)p_{a,s}^{*}(y)}{\sum_{\delta,s} \zeta(s)m_{\delta}(s, \sigma(s), y)p_{a,s}^{*}(y)} & \text{if } a = \sigma(s) \\
0 & \text{otherwise}
\end{cases}.
\]

Since for every two periods \( \tau' > \tau \) and \( B \subseteq \{1, ..., \tau'\} \) the probability of recalling \( B \) at time \( \tau' \) conditional on the actual history \( h_{\tau} \) is independent of the history \( r_{\tau} \) recalled at period \( \tau \), i.e., \( \mathbb{P}[r_{\tau'} = B| h_{\tau'}] = \mathbb{P}[r_{\tau'} = B| h_{\tau}, r_{\tau}] \), by the second Borel-Cantelli lemma (see, e.g., Theorem 8.3.4 in Dudley [2018]), for every \( \varepsilon \in \mathbb{R}_{++} \), \( s' \in S \) and \( k \in \mathbb{N}_{++} \) almost surely there is a \( \tau > t \) such that \( s_{\tau} = s' \), \( |r_{\tau}| > k \) and \( ||\hat{f}(h_{\tau}, r_{\tau}) - \tilde{p}(\sigma, s')||_{\infty} < \varepsilon \).

We show that eventually \( \frac{\nu(KL_{\sigma}^{\Theta,m}(\sigma, \varepsilon))}{1 - \nu(KL_{\sigma}^{\Theta,m}(\sigma, \varepsilon))} \geq C \) on the histories where these two conditions are satisfied. Since they hold almost surely, the result follows.

Let \( \varepsilon', \kappa \in \mathbb{R}_{++} \) be such that
\[
\kappa > \inf_{\{\nu' \neq KL_{\sigma}^{\Theta,m}(\sigma, \varepsilon)\}} \left( - \sum_{s \in S} \zeta(s) \sum_{y \in Y} p_{a,s}^{*}(y)m_{\sigma}(s, \sigma(s), y) \log p_{a,s}^{*}(y) \right) - M_{\sigma}(s')
\]
and
\[
\frac{\kappa}{2} < \sup_{\{\nu' \in KL_{\sigma}^{\Theta,m}(\sigma, \varepsilon)\}} \left( - \sum_{s \in S} \zeta(s) \sum_{y \in Y} p_{a,s}^{*}(y)m_{\sigma}(s, \sigma(s), y) \log p_{a,s}^{*}(y) \right) - M_{\sigma}(s')
\]

So, by Lemma A.1
\[
\frac{\mu(KL_{\sigma}^{\Theta,m}(\sigma, \varepsilon)|h_{\tau}(r_{\tau}))}{1 - \mu(KL_{\sigma}^{\Theta,m}(\sigma, \varepsilon)|h_{\tau}(r_{\tau}))} \geq \frac{\mu(KL_{\sigma}^{\Theta,m}(\sigma, \varepsilon))}{\frac{1}{1 - \mu(KL_{\sigma}^{\Theta,m}(\sigma, \varepsilon'))} \exp \left( |r_{\tau}| \left( - \inf_{\{\nu' \neq KL_{\sigma}^{\Theta,m}(\sigma, \varepsilon)\}} D(\hat{f}(h_{\tau}, r_{\tau}||p)) - \sup_{\{\nu' \in KL_{\sigma}^{\Theta,m}(\sigma, \varepsilon)\}} D(\hat{f}(h_{\tau}, r_{\tau}||p)) \right) \right)
\]

32
The last expression goes to $+\infty$ as $|r_\tau| \to \infty$, and by the definitions of $\kappa$ and $\epsilon'$

$$
- \lim_{t \to \infty} \sup_{\{p \in \mathcal{KL}_d^{\Theta,m}(\sigma,\epsilon')\}} \sum_{(s,a,y)} f(h_\tau, r_\tau)(s,a,y) \log(p_{\sigma,s}(y))
+ \lim_{t \to \infty} \inf_{\{p \notin \mathcal{KL}_d^{\Theta,m}(\sigma,\epsilon')\}} \sum_{(s,a,y)} f(h_\tau, r_\tau)(s,a,y) \log(p_{\sigma,s}(y))
= - \sup_{\{p \in \mathcal{KL}_d^{\Theta,m}(\sigma,\epsilon')\}} \sum_{s \in S} \sum_{y \in Y} \zeta(s) m_{\hat{s}}(s,\sigma(s),y)p^*_\sigma(s,s,y) \log p^*_\sigma(s,s,y)
+ \inf_{\{p \notin \mathcal{KL}_d^{\Theta,m}(\sigma,\epsilon')\}} \sum_{s \in S} \sum_{y \in Y} \zeta(s) m_{\hat{s}}(s,\sigma(s),y)p^*_\sigma(s,s,y) \log p_\sigma(s,s,y) > \frac{\kappa}{2} > 0. \Box
$$

**A.3 Proposition 1**

**Proof of Proposition 1.** We show that only data generating processes $p$ for which $p_{\sigma(s),s} = p^*_\sigma(s,s)$ are memory-weighted KL-minimizers after signal $s$.

Suppose that $p$ is such that for some $\hat{s} \in S$, $p_{\sigma(\hat{s}),\hat{s}} \neq p^*_\sigma(\hat{s},\hat{s})$. By the Gibbs inequality,

$$
\sum_{y \in Y} p^*_\sigma(s,s,y) \log p_{\sigma(s),s}(y) \geq \sum_{y \in Y} p^*_\sigma(s,s,y) \log p_\sigma(s,s,y)
$$

for all $s \in S$, with a strict inequality for $s = \hat{s}$. This, together with $d(\hat{s}, \hat{s}) = 0$ and $f(0) > 0$, implies that

$$
\sum_{s \in S} \sum_{y \in Y} \zeta(s) m_{\hat{s}}(s,\sigma(s),y)p^*_\sigma(s,s,y) \log p_{\sigma(s),s}(y) = \sum_{s \in S} \sum_{y \in Y} \zeta(s) f(d(s, \hat{s})) p^*_\sigma(s,s,y) \log p_{\sigma(s),s}(y)
> \sum_{s \in S} \sum_{y \in Y} \zeta(s) f(d(s, \hat{s})) p^*_\sigma(s,s,y) \log p^*_\sigma(s,s,y)
= \sum_{s \in S} \sum_{y \in Y} \zeta(s) m_{\hat{s}}(s,\sigma(s),y)p^*_\sigma(s,s,y) \log p^*_\sigma(s,s,y)
$$

proving that $p \notin \mathcal{KL}_d^{\Theta,m}(\sigma)$. \Box

**A.4 Proposition 2**

**Proof of Proposition 2.** We first derive the long-run belief for $\hat{m} \in \{m, m'\}$. Because the memory function $\hat{m}$ and the probability distribution over outcomes $p^*$ are independent of the agent’s action, we suppress the dependence of $p$ and $\hat{m}$ on $a$. 

33
Because $\Theta = \Delta(\Delta(Y))$, for every $\sigma$ the KL minimizer is the distribution:

$$p^m(y) = \frac{\bar{m}(y)p^*(y)}{\sum_{z \in Y} \bar{m}(z)p^*(z)}.$$  

Thus $p^{m'}(y) = w(y)p^m(y)$ where $w(y) = \frac{f(y)}{\sum_{z \in Y} f(z)p^*(z)}$ is non-decreasing, so the function

$$z \mapsto \sum_{x \leq z} (p^{m'}(x) - p^m(x)) = \sum_{x \leq z} p^m(x)(w(x) - 1)$$

is quasi-convex. As it equals 0 for $z < \min_{y \in Y} y$ and for $z \geq \max_{y \in Y} y$, it is non-positive for $z \in [\min_{y \in Y} y, \max_{y \in Y} y]$, so $p^{m'}$ dominates $p^m$ in first-order stochastic dominance. Every long-run action must be optimal given $p^{m'}$ by Theorem 1, so the agent’s action must be higher than objectively optimal. 

\[ \square \]

### \A.5 Proposition 3

**Proof of Proposition 3.** Because $(y_1, y_2)$ are subjectively independent conditional on the value of $p_1$, the learning problem decouples across the two dimensions. By Proposition 2 the long-run belief about $p_1$ is higher than the true distribution $p_1^*$. The probability with which an outcome is remembered is independent of the second component, so the agent learns $p_2^*$. They infer $q$ to be

$$q(y_2) = \frac{p_2^*(y_2) - \alpha p_1(y_2)}{1 - \alpha}.$$  

Thus $q - q^* = \frac{\alpha}{1 - \alpha}(p_1^* - p_1)$, and as $p$ is greater than $p^*$ in first-order stochastic dominance, it follows that $q$ is lower than $q^*$ in first-order stochastic dominance. 

\[ \square \]

### \A.6 Selective Memory Equilibrium and Misspecification

**Proof of Proposition 6.** To prove part (1), let $\sigma \in AS$ be a uniformly strict Berk-Nash equilibrium, and let $p'$ be an arbitrarily element of $KL^{Y,1}$. Since $\sigma$ is a uniformly strict Berk-Nash equilibrium, for all $s \in S$ we have $\{\sigma(s)\} = BR(s,\delta_{p'})$. Moreover, by assumption (1), $p^*_{\sigma(s),a}(y) = 0$ implies $p'_{\sigma(s),a}(y) = 0$, so $M := \max_{(s,y) \in S \times Y} \frac{p'_{\sigma(s),a}(y)}{p^*_{\sigma(s),a}(y)} < \infty$. Define $\bar{m}$ by $\bar{m}_{s,a}(s,a,y) = \frac{p'_{s,a}(y)}{M p^*_{s,a}(y)}$. Then for an agent with full support prior and

\[34\] We use the convention that $0/0 = 0.$
memory function \( \tilde{m} \) the memory-weighted KL minimizers for strategy \( \sigma \) after signal \( s' \) are the elements of

\[
\arg\min_{p \in \Delta(Y)^{A \times S}} \sum_{s \in S} \sum_{y \in Y} \tilde{m}_{s'}(s, \sigma(s), y) p^*_{\sigma(s), s}(y) \log p_{\sigma(s), s}(y)
\]

\[
= \arg\min_{p \in \Delta(Y)^{A \times S}} \sum_{s \in S} \sum_{y \in Y} p'_{\sigma(s), s}(y) \log p_{\sigma(s), s}(y) = \arg\min_{p \in \Delta(Y)^{A \times S}} \sum_{s \in S} \sum_{y \in Y} p'_{\sigma(s), s}(y) \log p_{\sigma(s), s}(y).
\]

Thus \( p' \) minimizes the KL divergence for all \( s' \in S \), so \( \sigma \) is a selective memory equilibrium with a full-support prior. i.e.,

\[
\text{Part (2), the converse direction, is trivial: simply take } \Theta' \text{ to be a singleton } p \text{ such that for all } a \in A \text{ and } s \in S, p_{a, s}(y) = p'_{a, s}(y) \text{ for some } p' \in KT^{\Theta, m}_{s'}(\sigma).
\]

A.7 Theorem 2

The proof of Theorem 2 builds on the techniques of Esponda, Pouzo, and Yamamoto [2021a]. The key complication is that even when the action process converges beliefs remain stochastic, so we lack a counterpart to their Theorem 1. Instead, we prove a lemma on the convergence of the belief distribution that, paired with our assumption of expected utility maximization, lets us mimic the other steps of their proof. Let \( (d_t)_{t \in \mathbb{N}} \) be a sequence of empirical joint distributions over actions and outcomes.

Lemma A.4. If for some \( \alpha \in \Delta(A) \), \( d_t(a, y) \) converges to \( \alpha(a) p^*_{\sigma}(y) \) for all \( (a, y) \in A \times Y \), then the distribution of \( \mu_t \) given \( h_{t-1} \) weakly converges to \( F_{\alpha} \in \Delta(\Delta(\Theta)) \), and \( F \) is continuous.

Proof. This is a special case of the more general A.5, which is proved below.

Next, we write the empirical action frequency at time \( t + 1 \) as a function of its expected error and a mean-0 error term:

\[
\alpha_{t+1}(h_{t+1})(a) = \alpha_t(h_t)(a) + \frac{1}{t+1} (\delta_{a_{t+1}}(a) - \alpha_t(h_t)(a))
\]

\[
= \alpha_t(h_t)(a) + \frac{1}{t+1} (\mathbb{E}[\delta_{a_{t+1}}(a)|\mu_{t+1}] - \alpha_t(h_t)(a)) \tag{10}
\]

where the second equality follows from the fact that the agent uses a stationary pure policy. Note that equation (10) is a particular case of the differential inclusion

\[
\alpha_{t+1}(h_{t+1})(a) \in \left\{ \alpha_t(h_t)(a) + \frac{1}{t+1} (\delta_{a'}(a) - \alpha_t(h_t)(a)) : a' \in BR(\mu_{t+1}) \right\}.
\]

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The continuous-time interpolation of \( \alpha_t \) is the function \( w : \mathbb{R}_+ \to \Delta(A) \)

\[
w(\tau_t + c) = \alpha_t + c \frac{\alpha_{t+1} - \alpha_t}{\tau_{t+1} - \tau_t}, \quad c \in \left[0, \frac{1}{t + 1}\right),
\]

where \( \tau_0 = 0 \) and \( \tau_t = \sum_{i=1}^{t} \frac{1}{i} \) for all \( t \in \mathbb{N} \).

**Proof of Theorem 2.** Let \( \chi_{\alpha} \) be the distribution of actions induced by the distribution of beliefs \( F_\alpha \) and some best response selection \( \rho \in \Pi_o \):

\[
\chi_{\alpha} = \{ \alpha' \in \Delta(A) : \exists \rho \in \Pi_o \text{ such that } \alpha' = \mathbb{E}_{F_\alpha}(\rho(\mu)) \},
\]

We will use the results of Benaim, Hofbauer, and Sorin [2005] to show that (11) can be approximated by a solution to

\[
\hat{\alpha}_t \in \chi_{\alpha_t} - \alpha_t. \tag{12}
\]

A solution to (12) with initial point \( x^* \in \Delta(A) \) is a mapping \( x : \mathbb{R}_+ \to \Delta(A) \) that is absolutely continuous over compact intervals such that \( x(0) = x^* \) and (12) is satisfied for almost every \( t \). Since \( F \) by Lemma A.4 is upper hemicontinuous, a solution exists. Let \( X^T \) be the set of solutions to (12) over \( [0, T] \) with initial conditions \( x^* \).

We next establish that the continuous-time interpolation of \( \alpha \) defined in (11) can in the long run be approximated arbitrarily well by a solution to (12). Define the random variable \( U_t = \alpha_{t+1} - \bar{U}_t \), where \( \bar{U}_t \) in an arbitrary measurable selection of \( \arg\min_{\alpha' \in \chi_{\alpha_t}} ||\alpha_{t+1} - \alpha'|| \). Since both \( \chi_{\alpha_t} \) and \( \alpha_{t+1} \) are uniformly bounded, \( U_t \) is uniformly bounded. Moreover, by Lemma A.4 and the definition of \( \chi_{\alpha_t}, U_t \) converges almost surely to 0, so condition (i) of Proposition 1.3 in Benaim, Hofbauer, and Sorin [2005] is satisfied. Condition (ii) is also satisfied because \( ||\alpha_{t+1} - \alpha_t||_{\infty} < 1/(t + 1) \), \( w \) is Lipschitz continuous of order 1, and \( \alpha_t \) is uniformly bounded because it takes values in \( \Delta(A) \), so \( w \) is a perturbed solution of (12). Thus by Theorem 4.2 in Benaim, Hofbauer, and Sorin [2005],

\[
\lim_{t \to \infty} \inf_{\alpha \in X^T_{w(t)}} \mathbb{P}_{x^*} - \text{almost surely for all } T \in \mathbb{N}^{35}. \tag{13}
\]

\[35\text{The proof of Theorem 4.2 in Benaim, Hofbauer, and Sorin [2005] invokes an implication of their Theorem 4.1 that is not correct. However, the statement is correct, as shown in Part 3 of the proof of Theorem 1 in Esponda, Pouzo, and Yamamoto [2021b].}
If $\alpha \in \Delta(A)$ is not a stochastic memory equilibrium, since $\chi_\alpha$ is convex by the separating hyperplane theorem there exists $f \in \mathbb{R}^A$ with $\alpha \cdot f > \max_{\delta \in \chi_\alpha} \bar{\alpha} \cdot f$. Let $K = \alpha \cdot f - \max_{\delta \in \chi_\alpha} \bar{\alpha} \cdot f$. By Lemma A.4, there exists $\varepsilon \in \mathbb{R}_{++}$ such that for all $\alpha' \in B_\varepsilon(\alpha)$, $\max_{\delta \in \chi_{\alpha'}} \bar{\alpha} \cdot f < \max_{\delta \in \chi_\alpha} \bar{\alpha} \cdot f + K/4$ and $\alpha' \cdot f > \max_{\delta \in \chi_\alpha} \bar{\alpha} \cdot f + K/4$. Therefore, for every initial condition $\alpha^* \in B_\varepsilon(\alpha)$ and every solution in $X_{\alpha^*}^T$, $\alpha \cdot f$ decreases at rate at least $K/2$ until the solution leaves $B_\varepsilon(\alpha)$. So there exists $T \in \mathbb{N}$ such that for every initial condition $\alpha^* \in B_\varepsilon(\alpha)$ and every solution in $X_{\alpha^*}^T$, the differential equation leaves $B_\varepsilon(\alpha)$ by time $T$.

We conclude the proof by combining an argument similar to Proposition 1 of Esponda, Pouzo, and Yamamoto [2021a] with equation (13) to rule out convergence to a non-equilibrium point. We will prove that $\alpha_t$ does not converge to $\alpha$ on any path $(h_t)_{t \in \mathbb{N}}$ where (13) applies. Since the set of such sample paths has probability 1, $\alpha_t$ can only converge to stochastic memory equilibria.

Let $\hat{T} \in \mathbb{N}$ be such that on the chosen path $(h_t)_{t \in \mathbb{N}}$

$$\inf_{\tilde{\alpha} \in X_{w(\hat{T})}^T} \sup_{0 \leq s \leq T} ||w(\hat{T} + s) - \tilde{\alpha}|| \leq \varepsilon/2.$$  

(14)

If there is no $t > \hat{T}$ such that $w_t \in B_{\varepsilon/2}(\alpha)$, $\alpha_t$ does not converge to $\alpha$. But if $w_t \in B_{\varepsilon/2}(\alpha)$ for some $t > \hat{T}$, then the differential equation leaves $B_\varepsilon(\alpha)$ by time $T + t$, and by (14), $\alpha_t$ does not stay in $B_{\varepsilon/2}(\alpha)$. This proves Theorem 2.  

A.8 Theorem 3

Proof of Lemma 1. Let $H'$ denote the set of histories that can be reached with positive probability starting from the empty history. At any recalled history $h = (a_i, y_i)_{i=1}^n \in H'$, the probability of a transition to the empty history is bounded below by $Q := \prod_{(a, y) \in A \times Y} \exp(-\alpha(a)p_\alpha^*(y) k [m(a, y) + R]) > 0$, so $H'$ is a closed communicating class. Moreover, for any $h' \in H'$ there is $\tau \in \mathbb{N}$ such that the probability of a simple path of length $\tau$ from the empty history to $h'$ is some $M > 0$. Therefore the expected time of return to $h'$ is bounded from above by $\tau + \sum_{i=\tau+1}^\infty i(1 -QM)^i \leq \infty$, so $h$ is positive recurrent. Since there is zero probability to leave $H'$, the Markov chain is irreducible on $H'$ and all the states in $H'$ are positive recurrent, $\eta_\alpha$ has a unique invariant distribution.  

To prove Theorem 3 we extend Doeblin’s Theorem\textsuperscript{36} to non-homogeneous Markov

\textsuperscript{36}Doeblin’s theorem (see, e.g., Theorem 2.2.1 in Stroock [2013]) says that if all entries in a column
chains whose entries in one column are uniformly bounded away from 0.\footnote{Cerreia-Vioglio, Corrao, and Lanzani [2021] proves a related extension for finite-state chains.} For every $R \in \mathbb{R}^{N \times N}$ let $\|R\|_{TV} = \sup_{t \in \mathbb{N}} \sum_{j \in \mathbb{N}} r_{ij}$. Given $\varepsilon > 0$, let $\mathcal{T}_\varepsilon$ be the set of (row) stochastic matrices $R$ for which there exists $l \in \mathbb{N}$ such that $r_{ij} \geq \varepsilon$ for all $j \in \mathbb{N}$. Define $V_0 = \{x \in \mathbb{R}^N : \sum_i x_i = 0\}$.

**Proposition 9.** If $\{P_t\}_{t \in \mathbb{N}} \subseteq \mathcal{T}_\varepsilon$, and $P_t \to P^*$, then there are $\bar{\xi} \in \Delta(\mathbb{N})$ and $K \in \mathbb{N}$ such that for each $\xi \in \Delta(\mathbb{N})$, $\xi_n \to \bar{\xi}$, where $\xi_n = \prod_{t=1}^n P_t \xi$ and $\|\xi_n - \bar{\xi}\|_{TV} \leq 3 (1 - \varepsilon)^n$ for all $n > K$. Moreover, $\bar{\xi} P^* = \bar{\xi}$.

**Proof of Theorem 3.** We use stochastic approximation for differential inclusions (Benaim, Hofbauer, and Sorin, 2005) to show that (11) can be approximated by

$$\hat{\alpha}_t \in \mathbb{E}_{\hat{\mathcal{H}}_t} [\alpha^h_t] - \alpha_t.$$  

**Lemma A.5.** Suppose there is $\alpha \in \Delta(A)$ such that $d_t(a, y)$ converges to $\alpha(a)p^*(a, y)$ for all $(a, y) \in A \times Y$. The distribution of time $t$ belief $\mu_t$ conditional on a recalled history $h'$ weakly converges to $F_{\alpha, h'} \in \Delta(\Delta(\Theta))$, and $F_{\alpha, h'}$ is continuous.

**Proof.** Given a length $l$ history $(a_i, y_i)_{i=1}^l$, let $n_{a,y}((a_i, y_i)_{i=1}^l) = \sum_{i=1}^l 1_{a_i,y_i} (a_i, y_i)$ be the number of times the action-outcome pair $(a, y)$ appears in $(a_i, y_i)_{i=1}^l$. Given an history $h' = (\bar{a}_i, \bar{y}_i)_{i=1}^l$ recalled in period $t - 1$, the recalled history at time $t \geq k$ is distributed as a product of multinomial distributions:

$$\mathbb{P}_t \left[(a_i, y_i)_{i=1}^l | (\bar{a}_i, \bar{y}_i)_{i=1}^l = (a_i, y_i)_{i=1}^l \right] = \prod_{(a,y) \in A \times Y} \left( \frac{d_t(a, y) t}{n_{a,y}((a_i, y_i)_{i=1}^l)} \right)^{n_{a,y}((a_i, y_i)_{i=1}^l)} \times \left( 1 - \frac{k}{t} (m(a, y) + R(1_{(a,y) \in (\bar{a}_i, \bar{y}_i)_{i=1}^l} + 1_{(a,y) \notin (\bar{a}_i, \bar{y}_i)_{i=1}^l} 1_{(a, y) = \pi(h')\pi^*(a, y)}) ) \right)^{n_{a,y}((a_i, y_i)_{i=1}^l)}$$

$$\times \left( 1 - \frac{k}{t} (m(a, y) - R(1_{(a,y) \in (\bar{a}_i, \bar{y}_i)_{i=1}^l} + 1_{(a,y) \notin (\bar{a}_i, \bar{y}_i)_{i=1}^l} 1_{(a, y) = \pi(h')\pi^*(a, y)}) ) \right)^{n_{a,y}((a_i, y_i)_{i=1}^l)}.$$
\[
\lambda(h')_{a,y} = \lim_{t \to \infty} d_t(a, y) t \left( \frac{k}{t} (m(a, y) + R(1_{(a,y)\in(\tilde{a},\tilde{y})}^{t}_{i=1} + 1_{(a,y)\notin(\tilde{a},\tilde{y})}^{t}_{i=1} 1_{(a=\pi(h'))p^*_a(y)}) \right) \\
= \alpha(a)p^*_a(y) k (m(a, y) + R(1_{(a,y)\in(\tilde{a},\tilde{y})}^{t}_{i=1} + 1_{(a,y)\notin(\tilde{a},\tilde{y})}^{t}_{i=1} 1_{(a=\pi(h'))p^*_a(y)}) \right).
\]

Thus the random number of times \((a, y)\) is recalled when the previous history is \(h'\) converges to a random variable \(N_{a,y}(h')\) that is Poisson distributed with parameter \(\lambda(h')_{a,y}\). Moreover, let \(f : \Delta(\Theta) \to \mathbb{R}\) be a continuous and bounded function, and \((\alpha_n)_{n\in\mathbb{N}} \in \Delta(A)\) be a sequence converging to \(\alpha^*\). Let \(\varepsilon \in \mathbb{R}^+\). Since all the \(N_{a,y}(h')\) have Poisson distributions, there exists a \(K \in \mathbb{N}\) such that \(\mathbb{P}_{\alpha^*}[\max_{(a,y)\in A \times Y} N_{a,y}(h') > K] < \varepsilon\). Let \(M \in \mathbb{N}\) be such that \(\mathbb{P}_{\alpha_n}[\max_{(a,y)\in A \times Y} N_{a,y}(h') > M] < 2\varepsilon\) and \(\mathbb{P}_{\alpha_n}[N_{a,y}(h') = c] - \mathbb{P}_{\alpha^*}[N_{a,y}(h') = c] < \varepsilon\) for all \((a, y) \in A \times Y\), for all \(c \leq K\) and \(n > M\). Then for all \(n > M\), we have

\[
\left| \int_{\Delta(\Theta)} f(\nu) dF_{\alpha_n,h'} - \int_{\Delta(\Theta)} f(\nu) dF_{\alpha,h'} \right| < \max_{\nu \in \Delta(\Theta)} f(\nu)((K + 1)|A \times Y|) \varepsilon
\]

so \(F_{\alpha_n,h'}\) weakly converges to \(F_{\alpha,h'}\).

We now apply Proposition 9 to prove that the distribution of recalled histories converges to \(\mathcal{H}_\alpha\). Lemma A.5 shows that the transition matrices over histories converge. Moreover, from the definition of \(m_t\), the transition from histories that contain the same experiences (but possibly a different number of each) is the same, and since the set of experiences is finite, this convergence is uniform, as required by Proposition 9. Transition to the null history always has positive probability, so the transition matrices are in \(\mathcal{T}_\varepsilon\) and thus the proposition guarantees convergence to the stationary distribution \(\mathcal{H}_\alpha\). With this the rest of the proof follows the same steps of Theorem 2.

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B For Online Publication

B.1 Proof of Lemmas

Lemma A.2. If \( \sigma \) is not a selective memory equilibrium, there are \( s' \in S \) and \( \varepsilon, C \in \mathbb{R}_{++} \) such that

\[
\frac{\nu(KL_{s'}^{\Theta,m}(\sigma,\varepsilon))}{1 - \nu(KL_{s'}^{\Theta,m}(\sigma,\varepsilon))} > C \implies \sigma(s') \notin BR(s',\nu).
\]

If \( \sigma \) is a uniformly strict selective memory equilibrium, there are \( C \in \mathbb{R}_{++} \) and \( \varepsilon \) such that for all \( s \in S \)

\[
\frac{\nu(KL_{s}^{\Theta,m}(\sigma,\varepsilon))}{1 - \nu(KL_{s}^{\Theta,m}(\sigma,\varepsilon))} > C \implies \{\sigma(s)\} = BR(s,\nu).
\]

Proof of Lemma A.2. First observe that every \( \sigma \in A^S, s \in S \), and \( \varepsilon > 0 \), \( KL_{s}^{\Theta,m}(\sigma) \) and \( KL_{s'}^{\Theta,m}(\sigma,\varepsilon) \) are nonempty and compact. Indeed, by Assumption 1, the function

\[
p \mapsto \sum_{s' \in S} \zeta(s') \sum_{y \in Y} m_s(s',\sigma(s),y)p^s_{\sigma(s'),y}(y) \log p_{\sigma(s'),y}(y)
\]

is finite-valued and continuous on the compact set \( \Theta \). Therefore, \( KL_{s}^{\Theta,m}(\sigma) \) is nonempty and compact by Theorem 2.43 in Aliprantis and Border [2013]. The result for \( KL_{s'}^{\Theta,m}(\sigma,\varepsilon) \) is an immediate consequence given the continuity of the supnorm.

For the first part of the lemma, suppose \( \sigma \) is not a selective memory equilibrium. Then there is an \( s' \in S \) such that \( \sigma(s') \notin BR(s',\Delta(KL_{s'}^{\Theta,m}(\sigma))) \). By the upperhemicontinuity of the best reply map \( BR(s,\cdot) \) and the compactness of \( KL_{s'}^{\Theta,m}(\sigma,\varepsilon) \) imply that there are \( \varepsilon, C \in \mathbb{R}_{++} \) such that if \( \frac{\nu(KL_{s'}^{\Theta,m}(\sigma,\varepsilon))}{1 - \nu(KL_{s'}^{\Theta,m}(\sigma,\varepsilon))} > C \) then \( \sigma(s') \notin BR(s',\nu) \).

For the second part of the lemma, suppose \( \sigma \) is a uniformly strict selective memory equilibrium. The upperhemicontinuity of the best reply map \( BR(s,\cdot) \) and the compactness of \( KL_{s'}^{\Theta,m}(\sigma,\varepsilon) \) imply that there are \( C \in \mathbb{R}_{++} \) and \( \varepsilon \) such that for all \( s \in S \) if \( \nu(KL_{s}^{\Theta,m}(\sigma,\varepsilon)) > C(1 - \nu(KL_{s}^{\Theta,m}(\sigma,\varepsilon))) \) then \( \{\sigma(s)\} = BR(s,\nu) \).

Lemma A.3. If, for every \( t \), every sequence of actions \( a^t \), and every optimal policy \( \tilde{\pi} \), \( \mathbb{P}_{\pi_0,a^t}[[\sigma(s_{t}) = \tilde{\pi}(h_r(r_{t}),s_{t}) \text{ for all } t \geq t]] = 0 \) then \( \sigma \) is not a limit strategy.

Proof of Lemma A.3. Fix an arbitrary optimal policy \( \tilde{\pi} \) and a history \( (s^t,a^t,y^t) \) with \( \mathbb{P}_{\tilde{\pi}}(s^t,a^t,y^t) > 0 \). Let \( t = \min\{t' > t: \sigma(s_{t'}) \neq \tilde{\pi}((s_{t'},a_{t'},y_{t'})(r_{t'}))(s_{t' + 1})\} \) be the first time after \( (s^t,a^t,y^t) \) when \( \tilde{\pi} \) does not prescribe \( \sigma \). Note that since \( \tilde{\pi}((s^t,a^t,y^t)(s_{t+1}) = ... \)
\( \sigma(s_{t+1}) = \pi^{b,a'}(s_{t+1}, a^t, y^t) \) for all \( t \in [t, \tau - 1] \), the agent’s belief until period \( \tau \) is the same under \( \pi^{b,a'} \) and \( \tilde{\pi} \). As \( \mathbb{P}_{\tilde{\pi}}(s_{t+1}^{a''}, a''', y'''', r_{\tau''}) > 0 \) implies \( \mathbb{P}_{\pi^{b,a'}}(s_{t+1}^{a''}, a''', y'''', r_{\tau''}) > 0 \), the probability that the agent uses strategy \( \sigma \) forever (i.e., \( \tau = \infty \)) after history \( (s^t, a^t, y^t) \) equals 0 by the assumption of the lemma. So under every arbitrary optimal policy, after every history where \( \sigma \) is played a strategy different from \( \sigma \) is played with probability 1, so \( \sigma \) is not a limiting strategy.

\[ \square \]

### B.2 Proof of the Remark

**Remark 1.** The uniform strictness conditions of Proposition 6 are needed:

1. There are Berk-Nash equilibria that are not belief equivalent to any selective memory equilibrium with support \( \Theta' = \Delta(Y)^{A \times S} \).

2. There are selective memory equilibria that are not belief equivalent to any Berk-Nash equilibrium.

3. Moreover, unlike Berk-Nash equilibria, selective memory equilibria do not reduce to self-confirming equilibria when the agent is correctly specified. In particular, selective memory equilibria need not be objectively optimal when the distribution of outcomes is independent of the agent’s action.

**Proof of the Remark 1.** To prove the statements we give three examples with a null signal space \( S \).

1. Suppose that \( Y = \{-1, 1\} \), the probability of 1 is 0.5 regardless of \( a \), and that the agent does not have selective memory, but is misspecified, with \([0, .2] \cup [.8, 1]\) as the support of the prior beliefs over the probability of 1 under both actions. Then both .2 and .8 are KL minimizers, which cannot arise from selective memory with a full support prior. This is immediate if \( m = 0 \) for some experience, and follows from full support and the strict convexity of the memory-weighted KL divergence if \( m \gg 0 \).

2. Suppose that \( Y = \{-1, 0, 1\} \), the probability over outcomes is uniform regardless of \( a \), with \( \Theta = \{(1/3, 1/3, 1/3), (1/3, 1/6, 1/2)\} \) and \( m(a, y) = 1_{y=-1} \). Then both \( (1/3, 1/3, 1/3) \) and \( (1/3, 1/6, 1/2) \) are memory-weighted KL minimizers, but they cannot be both KL minimizers with perfect memory.

3. Suppose \( Y = \{-1, 1\} = A \) and \( u(a, y) = ya \). Then if \( m(-1, a) = 0 < m(1, a) \) for all \( a \in A \), and the agent has a full-support prior over the action-independent outcome distributions, the only selective memory equilibrium is \( a = 1 \) even if the true probability
of 1 under both actions is less than 1/2 so that the objectively optimal action is \(-1\).

\[\square\]

### B.3 Proposition 4

**Proposition 4** Suppose \(p^*_1(\bar{y} + y) = p^*_1(\bar{y} - y)\) and that the agent thinks all outcome distributions under the risky action. If choosing the lottery is not a selective memory equilibrium with perfect memory, it is not a selective memory equilibrium with extreme experience bias.

**Proof of Proposition 4.** If \(a = 1\) is not a selective memory equilibrium with perfect memory, then \(\sum_{y \in Y} u(y)p^*_1(y) < u(y_0)\). Because the prior assigns positive probability to all distributions induced by action \(a_1\), the unique memory-weighted KL minimizer \(\hat{p}\) under action \(a\) is such that

\[
\hat{p}_1(y) := \frac{p^*_1(y)h(|y - \bar{y}|)}{\sum_{z \in Y} p^*_1(z)h(|z - \bar{y}|)}.
\]

Therefore, if \(a = 1\) is a selective memory equilibrium with selective memory \(m(y) = h(|y - \bar{y}|)\) then

\[
u(y_0) \leq \sum_{y \in Y} \hat{p}_1(y)u(y) .
\]

We prove that this cannot be the case by showing that the distribution \(\hat{p}_1\) is second-order stochastically dominated by \(p^*_1\). To see this, observe that as \(p^*_1\) is symmetric around \(\bar{y}\) and \(h(|y - \bar{y}|)\) is symmetric around \(\bar{y}\) it follows that \(\hat{p}_1\) is symmetric around \(\bar{y}\). As \(h\) is increasing it follows that \(\hat{p}_1 - p^*_1\) changes its sign from positive to negative and back to positive so \(\sum_{y \leq z} p^*_1(y)\) and \(\sum_{y \leq z} \hat{p}_1(y)\) cross only once, at \(z = \bar{y}\). This implies that \(\hat{p}_1\) is a mean-preserving spread of \(p^*_1\), so the risky action is perceived as more risky. As \(u\) is concave, this implies that

\[
\sum_{y \in Y} u(y)p^*(y) \geq \frac{\sum_{y \in Y} p^*_1(y)h(|y - r|)u(y)}{\sum_{y \in Y} p^*_1(y)h(|y - r|)}.
\]

and the risky action cannot be a selective memory equilibrium. \(\square\)
B.4 Proposition 5

Proposition 5. If $\sigma$ is a limit strategy with underinference distortion $m$, it is a selective memory equilibrium with memory function $m$.

Proof of Proposition 5. Suppose towards a contradiction that $\sigma$ is a limit strategy under the optimal policy $\pi$, but not a selective memory equilibrium. Then by Lemma A.2 there are $s' \in S$ and $c, C \in \mathbb{R}_{++}$ such that if $\frac{\nu(KL_{s'}^{m,\sigma}(c))}{1 - \nu(KL_{s'}^{m,\sigma}(c))} > C$ then $\sigma(s') \notin BR(s', \nu)$. Let $h_t$ be a history with positive probability. We show that if the agent plays the strategy $\tilde{\pi}$ that coincides with $\pi$ until $h_t$ and prescribes $\sigma$ at every period after $h_t$, then almost surely $\mu_t$ reaches a region where no optimal policy prescribes $\sigma$ after signal $s'$. By Lemma A.3 this is enough to obtain the desired conclusion.

Under strategy $\tilde{\pi}$, by the Strong Law of Large Numbers, we have

$$\lim_{\tau \to \infty} f(h_{\tau})(s, a, y) = \begin{cases} 
\zeta(s)p_{a,s}^* (y) & \text{if } a = \sigma(s) \\
0 & \text{otherwise}
\end{cases}$$

almost surely on the cylinder $h_t$. Now we express the posterior as a function of the observed frequencies, and show that it concentrates on the memory-weighted KL minimizers, so that the result follows from the upperhemicontinuity of BR.

Choose $\kappa \in \mathbb{R}_{++}$ such that

$$\kappa < \inf_{\{p' \notin KL_{s'}^{m,\sigma}(c,c')\}} \left( - \sum_{s \in S} \zeta(s) \sum_{y \in Y} p_{\sigma(s),s}^*(y)m_{s'}(s, \sigma(s), y) \log p_{\sigma(s),s}^*(y) \right) - M_\sigma$$

and $c' < c$ such that

$$\kappa/2 > \sup_{\{p' \in KL_{s'}^{m,\sigma}(c,c')\}} \left( - \sum_{s \in S} \zeta(s) \sum_{y \in Y} p_{\sigma(s),s}^*(y)m_{s'}(s, \sigma(s), y) \log p_{\sigma(s),s}^*(y) \right) - M_\sigma.$$

By equation (18) and the definition of $\kappa$ and $c'$ almost surely on the cylinder $h_t$ we
have

\[
K := \lim_{t \to \infty} \inf_{\{p' \in KL_{\Theta,s'}^m(\sigma,c')\}} \left( \sum_{(s,a,y)} f(h_t(s,a,y))m(s,a,y) \log(p'_{a,s}(y)) \right)
- \lim_{t \to \infty} \sup_{\{p' \in KL_{\Theta,s'}^m(\sigma,c')\}} \left( \sum_{(s,a,y)} f(h_t(s,a,y))m(s,a,y) \log(p'_{a,s}(y)) \right)
= \inf_{\{p' \notin KL_{\Theta,s'}^m(\sigma,c')\}} \left( \sum_{s \in S} \sum_{y \in Y} \zeta(s) m'_s(s,\sigma(s),y)p_{\sigma(s),s}(y) \log(p'_{\sigma(s),s}(y)) \right)
- \sup_{\{p' \in KL_{\Theta,s'}^m(\sigma,c')\}} \left( \sum_{s \in S} \sum_{y \in Y} \zeta(s) m'_s(s,\sigma(s),y)p_{\sigma(s),s}(y) \log(p'_{\sigma(s),s}(y)) \right) > \kappa/2 > 0.
\]

By Lemma A.1 we have

\[
\frac{\mu(KL_{\Theta,s'}^m(\sigma,c)|(h_t))}{1 - \mu(KL_{s'}^m(\sigma,c)|(h_t))} \geq \frac{\mu(KL_{s'}^m(\sigma,c')) \exp(\sup_{\{p' \in KL_{\Theta,s'}^m(\sigma,c')\}} \sum_{(s,a,y)} t f(h_t(s,a,y))m(s,a,y) \log(p'_{a,s}(y)))}{(1 - \mu(KL_{s'}^m(\sigma,c')) \exp(\inf_{\{p' \notin KL_{\Theta,s'}^m(\sigma,c')\}} \sum_{(s,a,y)} t f(h_t(s,a,y))m(s,a,y) \log(p'_{a,s}(y)))}
= \frac{\mu(KL_{s'}^m(\sigma,c'))}{(1 - \mu(KL_{s'}^m(\sigma,c'))} \exp(tK),
\]

which goes to \(\infty\) as \(t\) grows since \(K > 0\).

\[\square\]

**B.5 Proposition 8**

**Proposition 8.** Suppose \(m\) and \(p^*\) are constant in \(a\) and \(m\) is increasing in \(y\), that \(\hat{m}(y) = (1 - \alpha) + am(y)\), \(\Theta = \Delta(\Delta(Y))\), and the utility function is supermodular. Then the agent’s long-run belief concentrates on a distribution of outcomes that is increasing in first-order stochastic dominance in \(\alpha\), i.e., the na"{i}veté of the agent.

**Proof of Proposition 8.** We first derive the long-run belief for a given subjective memory function \(\hat{m}\). For every \(\sigma\),

\[
KL_{\Theta,m,\hat{m}}(\sigma) = \arg\min_{p \in \Delta(Y)} \sum_{y \in Y} \log(p(y)\hat{m}(y))m(y)p^*(y).
\]

Taking first-order conditions of the associated Lagrangian shows there is a unique
element $p$ of $KL^{\Theta,m,\hat{m}}(\sigma)$, given by

$$p(y) = \frac{\frac{m(y)}{\hat{m}(y)}p^\sigma(y)}{\sum_{z \in Y} \frac{m(z)}{\hat{m}(z)}p^\sigma(z)}.$$

Thus the long-run beliefs under the objective memory function $m$ and subjective memory function $\hat{m}$ are the same as those of a fully naïve agent with memory function $\tilde{m}$ who is not aware of their selective memory. Note that for $\hat{m}_\alpha(y) = \alpha + (1 - \alpha)m(y)$ and $\alpha > \alpha'$,

$$\frac{m(y)}{\hat{m}_\alpha(y)} = \frac{\hat{m}_\alpha'(y)}{\hat{m}_\alpha(y)} = \frac{\alpha + (1 - \alpha)m(y)}{\alpha' + (1 - \alpha')m(y)}$$

is increasing in $m(y)$ and hence in $y$. This lets us apply Proposition 2 to conclude that the long-run belief under the subjective memory function $\hat{m}_\alpha$ will be higher in FOSD than that under the subjective memory function $\hat{m}_{\alpha'}$. \hfill \Box

### B.6 Proposition 9

Since the elements of $V_0$ can be interpreted as difference between stochastic vectors, the next two lemmas show that the matrices in $\mathcal{T}_\varepsilon$ have a contraction property.

**Lemma B.1.** If $R \in \mathcal{T}_\varepsilon$ and $x \in V_0$, then $xR \in V_0$ and $\|xR\|_{TV} \leq (1 - \varepsilon)\|x\|_{TV}$.

This follows immediately from the opening arguments in the proof of Theorem 2.2.1 in Stroock [2013] by setting $n = 1$.

**Lemma B.2.** If $\{R_t\}_{t=1}^m \subseteq \mathcal{T}_\varepsilon$, then for each $x \in V_0$

$$x \left( \prod_{t=1}^m R_t \right) \in V_0 \text{ and } \left\| x \left( \prod_{t=1}^m R_t \right) \right\|_{TV} \leq (1 - \varepsilon)^m \|x\|_{TV}.$$  \hspace{1cm} (19)

**Proof of Lemma B.2.** We proceed by induction.

**Initial Step.** The statement follows from Lemma B.1.

**Inductive Step.** We assume the statement holds for $m \in \mathbb{N}$. We show it holds for $m + 1$. Define $y = x \left( \prod_{t=1}^m R_t \right)$. By Lemma B.1 and since $R_{m+1} \in \mathcal{T}_\varepsilon$, this implies that

---

$^3$Given a sequence $\{P_t\}_{t \in \mathbb{N}}$ of stochastic matrices, $\prod_{t=1}^{n+1} P_t = \prod_{t=1}^n P_t P_{n+1}$ for all $n \in \mathbb{N}$
y \in V_0, yR_{m+1} \in V_0 and \ x\left(\prod_{t=1}^{m+1} R_t\right) = x\left(\prod_{t=1}^{m} R_t\right) R_{m+1} = yR_{m+1} \in V_0. By inductive hypothesis and Lemma B.1, this implies that

\[ \left\| x\left(\prod_{t=1}^{m+1} R_t\right) \right\|_{TV} \leq (1-\varepsilon) \left\| yR_{m+1} \right\|_{TV} = (1-\varepsilon) \left\| x\left(\prod_{t=1}^{m} R_t\right) \right\|_{TV} \]

\[ \leq (1-\varepsilon)(1-\varepsilon)^m \left\| x \right\|_{TV} = (1-\varepsilon)^{m+1} \left\| x \right\|_{TV}, \]

proving the inductive step. \qed

Given Lemma B.2 the proposition follows by a straightforward repetition of the arguments in the proof of Theorem 4.14 of Seneta [2006] with the only difference that the state space is infinite but countable.

B.7 Stability

**Definition 10.** A strategy \( \sigma \) is stable if for every \( \varepsilon \in (0,1) \), and every prior \( \nu \) with support \( \Theta \) there is an \( n \) such that if \( \sigma \) is used in the first \( n \) periods the probability that the best reply at period \( n+1 \) is \( \sigma \) is larger than \( 1-\varepsilon \).

**Proposition 10.** Every uniformly strict selective memory equilibrium is stable.

**Proof of Proposition 10.** If \( \sigma \) is a uniformly strict selective memory equilibrium, Lemma A.2 implies that there are \( \hat{C} \in \mathbb{R}_{++} \) and \( \varepsilon \) such that for all \( s \in S \) if \( \nu(KL_s^{\Theta,m}(\sigma,\varepsilon)) > \hat{C}(1-\nu(KL_s^{\Theta,m}(\sigma,\varepsilon))) \) then \( \{\sigma(s)\} = BR(s,\nu) \).

By the Law of Large Numbers and the finiteness of \( S \times A \times Y \), for every \( C \) there exists \( n_1 \in \mathbb{N} \) such that if \( \sigma \) is used for the first \( n \) periods, \( n > n_1 \)

\[ \mathbb{P}(\|f(h_{n_1})(s,a,y) - f^*(s,a,y)\| < C) > 1 - \frac{\varepsilon}{2} \quad (20) \]

where

\[ f^*(s,a,y) = \begin{cases} \zeta(s)p_{a,s}(y) & \text{if } a = \sigma(s) \\ 0 & \text{otherwise} \end{cases}. \]

Define

\[ \tilde{p}(\sigma,s')(s,a,y) = \frac{\zeta(s)m_{s'}(s,\sigma(s),y)p_{\sigma(s),s}(y)}{\sum_{\hat{y} \in Y, \hat{s} \in S} \zeta(\hat{s})m_{s'}(\hat{s},\sigma(\hat{s}),\hat{y})p_{\sigma(\hat{s}),\hat{s}}(\hat{y})} \]

if \( a = \sigma(s) \) and \( \tilde{p}(\sigma,s')(s,a,y) = 0 \) otherwise. Since for every \( \tau' > \tau \) and every history \( B \subseteq \{1,...,\tau'\}, \mathbb{P}[r_{\tau'} = B|h_{\tau'}] = \mathbb{P}[r_{\tau'} = B|h_{\tau'},r_\tau] \), by the second
Borel-Cantelli lemma and equation (20), for every \( \varepsilon \in \mathbb{R}^+ \), \( s' \in S \) and \( k \in \mathbb{N}^+ \) there is a \( n_{k,C} > n_1 \) such that for all \( \tau \geq n_{k,C} \)

\[
P\left[ |r_\tau| > k \text{ and } \|\hat{f}(h_\tau, r_\tau) - \tilde{p}(\sigma, s')\|_\infty < C \right] > 1 - \varepsilon. \tag{21}
\]

As in the proof of Theorem 1 choose \( \kappa, C' \in \mathbb{R}^+ \) and \( \varepsilon' < \varepsilon \) such that

\[
\kappa < \inf_{f : \mathbb{R}^2 \to \mathbb{R}} \left( \sup_{\{p' \in KL_{s'}^\Theta_{s,m}(\sigma, \varepsilon')\}} \left( - \sum_{s \in S} \zeta(s) \sum_{y \in Y} p^*_s(y) \log p'_s(y) \right) - \sup_{\{p' \notin KL_{s'}^\Theta_{s,m}(\sigma, \varepsilon')\}} \left( - \sum_{s \in S, a \in A, y \in Y} f(s, a, y) \log p'_s(y) \right) \right).
\]

On the set of remembered histories where \( \{ |r_\tau| > k \text{ and } \|\hat{f}(h_\tau, r_\tau) - \tilde{p}(\sigma, s')\|_\infty < C' \} \) identified by equation (21), Lemma A.1 implies that

\[
\nu(KL_{s'}^\Theta_{s,m}(\sigma, \varepsilon)|h_\tau) \frac{1 - \nu(KL_{s'}^\Theta_{s,m}(\sigma, \varepsilon)|h_\tau)}{1 - \nu(KL_{s'}^\Theta_{s,m}(\sigma, \varepsilon'))} \exp \left( |r_\tau| \left( \sup_{\{p' \in KL_{s'}^\Theta_{s,m}(\sigma, \varepsilon')\}} D(\hat{f}(h_\tau, r_\tau)|\log(p')) - \inf_{\{p' \notin KL_{s'}^\Theta_{s,m}(\sigma, \varepsilon')\}} D(\hat{f}(h_\tau, r_\tau)|\log(p')) \right) \right) \geq \nu(KL_{s'}^\Theta_{s,m}(\sigma, \varepsilon')) \exp (k\kappa).
\]

The result follows by setting \( n = n_{k', C'} \) where \( k' = \left\lceil \log \left( \frac{(1 - \nu(KL_{s'}^\Theta_{s,m}(\sigma, \varepsilon'))}{\nu(KL_{s'}^\Theta_{s,m}(\sigma, \varepsilon'))} \right) / \kappa \right\rceil + 1. \)

\[\square\]

**B.8 Partially Recalled Histories with Partial na"ivete**

Here we suppose that the outcome space has a product structure, i.e., \( Y = \times_{i \in I} Y_i \) and that the agent may recall only some components of the outcome. Moreover, we continue to allow for partial na"ivete as in Section 6. To model this case, we use a collection of signal-dependent memory functions \( m_{s'} : (S \times Y \times 2^I) \to [0, 1] \), where \( m_{s'}(s, y, B) \) specifies the probability with which an agent remembers the \( B \) outcome
components of a past realization of the signal, outcome pair \((s, y)\) and with

\[
\sum_{B \in \mathcal{I}} m_s(s, y, B) = 1.
\]

Moreover, the agent believes that they remember an occurrence of signal \(s\) and outcome \(y\) with probability \(\hat{m}_s(s, y, B)\). The case studied in the main body of the paper is the one in which \(m_s(s, a, y, B) = 0\) for every \(B \notin \{\emptyset, I\}\) with the interpretation that \(m_s(s, a, y, \emptyset)\) means that the agent does not recall the experience \((s, a, y)\) at all. Thus the recalled history at time \(t\) is the of recalled experiences \(r_t = (s_t, y_t, B_{t,t})_{\tau=1}^t\) where \(B_{t,t}\) denotes the components of the period \(\tau\) outcome recalled at time \(t\). We obtain

\[
\mu(C|r_t, s') = \frac{\sum_{s \in C} \prod_{\tau=1}^t \tilde{m}_s(s_\tau, \prod_{i \in I} \tilde{Y}_{\tau,i}, B_{\tau,t})p_s(\prod_{i \in I} \tilde{Y}_{\tau,i})d\mu(p)}{\sum_{s \in C} \prod_{\tau=1}^t \tilde{m}_s(s_\tau, \prod_{i \in I} \tilde{Y}_{\tau,i}, B_{\tau,t})p_s(\prod_{i \in I} \tilde{Y}_{\tau,i})d\mu(p)} \quad \forall C \subseteq \Theta
\]

where \(\tilde{Y}_{\tau,i} = Y_i\) if \(i \notin B_{\tau,t}\) and \(\tilde{Y}_{\tau,i} = \{y_{\tau,i}\}\) if \(i \in B_{\tau,t}\). With this, the results of the paper carries through with the following adaptation of the concept of memory-weighted KL-minimizers:

\[
KL^{\Theta, m}_{s'}(\sigma) = \arg\min_{\pi \in \Theta} \sum_{s \in S} \sum_{B \in \mathcal{B}} \sum_{y \in Y} m_s(s, y, B)p_s(\tilde{Y}(y)) \log \tilde{m}_s(s, y, B)p_s(\tilde{Y}(y))
\]

where \(\tilde{Y}(y) = Y_i\) if \(i \notin B\) and \(\tilde{Y}(y) = \{y_i\}\) if \(i \in B\).

**Example 9** (Ego-Boosting Memory plus Cognitive Dissonance Reduction). Suppose that the agent can either pass or fail two tasks, a main one, component 1, and a secondary one, component 2, i.e., \(Y_1 = Y_2 = \{0, 1\}\), and there is no signal. The agent is more likely to recall successes in each component, but they are also more likely to recall the secondary tasks if it confirmed the outcome of the first task. For example, we could have

\[
\begin{align*}
m((1, 1), \{1, 2\}) &= 1, \\
m((1, 0), \{1, 2\}) &= 0.1, \quad m((1, 0), \{1\}) = 0.8, \quad m((1, 0), \emptyset) = 0.1 \\
m((0, 1), \{2\}) &= 0.7, \quad m((0, 1), \emptyset) = 0.3 \\
m((0, 0), \emptyset) &= 0.9, \quad m((0, 0), \{1, 2\}) = 0.1.
\end{align*}
\]

As in the case with a unique component, the partial naiveté of the agent can be described
by a perceived memory function that combines perfect memory with the true memory function:
\[ \hat{m}(y, B) = \alpha m(y, B) + (1 - \alpha)1 \quad \forall y \in Y, B \subseteq \{1, \ldots, I\}. \]

Suppose that the initial belief of the agent is that the probability of success is independent and equal across tasks and is either \( p = 0.9 \) or \( p' = 0.1 \) with equal prior probability. Then after one period, if there was success only in task one, if the agent only recalls component 1 their posterior belief is

\[
\mu(p|((1,0),\{1\})) = \frac{[\alpha m((1,1),\{1\}) + (1 - \alpha)] p(1,1) + [\alpha m((1,0),\{1\}) + (1 - \alpha)] p(1,0)}{[\alpha m((1,1),\{1\}) + (1 - \alpha)] p(1,1) + [\alpha m((1,0),\{1\}) + (1 - \alpha)] p(1,0) + [\alpha m((1,1),\{1\}) + (1 - \alpha)] p'(1,1) + [\alpha m((1,0),\{1\}) + (1 - \alpha)] p'(1,0)} \]

\[
= \frac{(1 - \alpha)0.9^2 + (0.8\alpha + (1 - \alpha)) 0.9 * 0.1}{(1 - \alpha)0.9^2 + (0.8\alpha + (1 - \alpha)) 0.9 * 0.1 + (1 - \alpha)0.1^2 + (0.8\alpha + (1 - \alpha)) 0.9 * 0.1}.
\]

In particular, a completely sophisticated agent (\( \alpha = 1 \)) ends up with a posterior equal to the prior, as they understand that the fact that they do not recall the second component means it was a failure, and that the update to success in one dimension and failure in the other leaves the prior unchanged. A completely naive agent (\( \alpha = 0 \)) instead ends up with a posterior probability of 0.9 for the optimistic distribution \( p \).

### B.9 Permanent Memories

Suppose that the memory function \( m \) determines the probability that a particular experience is recalled in the period just after it occurs. If is is recalled it is never forgotten, and if it is not recalled it is never remembered. Then the belief process has the recursive formula:

\[
\mu_{t+1}(C) = \begin{cases} 
\int_{y_t \in C} p_{a_t}(y_t) d\mu_t(p) \\
\int_{y_t \in C} p_{a_t}(y_t) d\mu_t(p) \\
\mu_t(C) \\
\mu_t(C)
\end{cases} 
\quad \text{with probability } m(a_t, y_t)
\quad \text{with probability } (1 - m(a_t, y_t)).
\]

It is easy to see that if the actions converge under this dynamic system, they converge to a selective memory equilibrium. However, just as with in Example 8 on underinference, the fact that memory here is “less stochastic” allows some selective memory equilibria to be limit actions that are not there limit actions under our main
Remark. For $m_s$ constant, the minimized function is 

$$
\sum_{y \in Y} \sum_{s \in S} m_s(s, y) \zeta(s) p_s^*(y) \log(p_s(y)) + \left[ \sum_{s \in S} \sum_{y \in Y} \zeta(s) p_s^*(y) m'_s(s, y) \log(m'_s(s, y)) \right] \log(1 - \hat{m}_s'(s, y)).
$$

The last two terms are independent of $p$ so $KL_{\Theta, m, \hat{m}} = KL_{\hat{0}, m}$. 

Example 10. [Limit distribution may not be a stochastic memory equilibrium] Suppose that $k = 1$ and that there are three actions, $\{l,r,c\}$. The outcome has a product structure: $Y = \{0, 1\} \times \{l,r\}$, and $u(a, y) = y_1$. The agent considers two possible data generating processes, $p$ and $q$, and $\mu$ assigns probability $\frac{1}{2}$ to both. Action $c$ delivers an expected payoff of $\frac{1}{2}$ under both $p$ and $q$, and it is very informative about the identity of the true data generating process through the realization of the second component of the outcome:

$$p_c(y_1, l) = 0.45 = q_c(y_1, r) \quad \forall y_1 \in \{0, 1\}$$
$$p_c(y_1, r) = 0.05 = q_c(y_1, l) \quad \forall y_1 \in \{0, 1\}.$$

Action $l$ performs very well under $p$ and badly under $q$:

$$p_l(1, l) = 0.701 \quad p_l(0, l) = 0.299$$
$$q_l(1, l) = 0.1 \quad q_l(0, l) = 0.9.$$

Action $r$ performs very well under $q$ and badly under $p$:

$$p_r(1, r) = 0.1 \quad p_r(0, r) = 0.9$$
$$q_r(1, r) = 0.7 \quad q_r(0, r) = 0.3.$$

Moreover, let $p_c^* = \text{unif} Y, p_l^* = \delta_{(1,l)}$ and $p_r^* = \delta_{(1,r)}$. In the first period the agent will choose the safe action $c$. If the second component of the first period outcome is $l$, the agent plays action $l$ from the second period onward, and if it is $r$, the agent plays $r$ from the second period onward. Therefore

$$a_t \stackrel{d}{\to} \hat{\alpha} = \frac{1}{2} \delta_l + \frac{1}{2} \delta_r.$$
However, $F_{\alpha}(\mu_0) > 0$, so that the induced limit frequency of action $c$ is larger than 0 and $\alpha$ is not a stochastic memory equilibrium.

**Example 11.** Let $S = \{s_{-1}, s_1\}$, $A = \{-1, 1\}$, $Y = \{-1, 1\}$, $u(a, y) = ay$, $p^*_{s_{-1}, a}(-1) = 3/4$, $\zeta(s_{-1}) = \zeta(s_1)$ and $p^*_{s_1, a}(-1) = 1/5$, and $\Theta = \{p : p_{s,a} = p_{s',a'}$ for all $s, s' \in S, a, a' \in A\} \in \Theta$. Under perfect memory the unique equilibrium is to always play 1. If the agent has similarity weighted memory with $f(d(s_{-1}, s_1)) = 1/10$, $f(0) = 1$, then the unique selective memory equilibrium is the objectively optimal $\sigma(s_{-1}) = -1$, $\sigma(s_1) = 1$.

**Example 12.** In the setting of Section 4.3, let $Y = \{0, 3, 4, 8\}$ with $y_0 = 3$, $p_1(0) = p_1(4) = p_1(8) = 1/3$, and $v(y) = \sqrt{y}$. Then the unique selective memory equilibrium with perfect memory is to play the risky lottery. However, under the extreme event bias where $m(0) = m(8) = 1$, $m(3) = 1/2$, $m(4) = 1/10$ the unique selective memory equilibrium is to play the safe action.