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A Systematic Review on Investors' Behavior in Stock Market

Dr. N.L. Balasudarsun [1]
Dr. M. Sathish[2]
Dr. Mansurali Anifa[3]
Ms. Hema[4]

Abstract

The arising field in the study of behavioral finance has the more prominent psychological factors like emotion and cognitive biases that impact the decision-making process of individual, groups and organizations. The aim of this paper to study about behavioral finance places an emphasis upon investor behavior leading to various market anomalies and study different emotional swing variables and its influence on investors decisions. Also, how to mitigate the biases and provide some suggestion to make investor to gain the more profit.

Keywords: Behavioural Finance, Psychological factors, Stock market and Investment Biases

1. Introduction

In recent years it is found that investor's emotions have a major role for making investment decisions rather than the rational decision (Shah, 2014). Behavioral finance is the subject which helps us to analyze how financial investors reacting while trading in the market. It is all about psychology-based study which is being used on the behavior of financial practitioners and the corresponding reactions on markets (Sewell, 2007). Besides it helps to understand how humans are different in terms of the psychology factors such as investor decision, behavior, well-being (Rabin,1996). Behavioral finance mainly concentrates on the individual attributes, psychological factors that shape common financial and investment practices (Ritter, 2003). Behavioral finance helps to understand and to predict the systematic financial market of psychological decision-making process. It also focuses on the psychological and economic principles for the improvement of financial decision-making. Three stands of behavioural finance like Behavioral psychology or cognitive, Emotional responses and Social Psychology.

2. Literature Review

The main principle of behavioral finance is based on the prospect theory that an investor makes decisions (Minimal, 2016). Prospect theory is more focused with losses rather than the profit and as a result of person will significance to achieving profit and avoiding loss completely (Ricciardi and Simon 2000). Schwartz (1998) asserts that prospect theory makes the assumption that an investor will assess outcomes in terms of gains or losses in relation to a specific reference point instead of the final value within their overall investment portfolio (Ricciardi and Simon, 2000). Rajarajan (1997a and 1997b) concluded that the size of the investment in financial assets gives significant information about the preferences of the investors for particular financial instrument and particular investment approach. Zaghlami (2009) study discovered that some psychological particularities that are not much expected by the financial behavioral literature, the study was conducted on Tunisian investors. Kliger (2010) observed that irrational investment decision making is a widespread phenomenon and behavioral finance biases are impacting the decision making.

[1] *Assistant Professor (Selection Grade)PSG Institute of Management, (PSG College of Technology), Coimbatore* *bala@psgim.ac.in*
[2] *Assistant Professor , School of Contemporary Knowledge System, Chinmaya Vishwavidyapeeth* *sathish.m@cvv.ac.in*
[3] *Assistant Professor (Senior Grade), PSG Institute of Management, (PSG College of Technology), Coimbatore* *mansurali@psgim.ac.in*
[4] *Associate – Projects, Cognizant Technology Solutions,* *phemapsg@gmail.com*

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2.1 Behavioral Biases

2.1.1 Representativeness:

Investor gets motivate to buy stocks with recent positive abnormal return when they consider as last price trend is representative of the future price (Kumar, 2001). Investors over react the future return based on the experience of recent return. Investors conclusion based on the recent earnings surprise and hence overreact to subsequent earnings surprise. (Kaestner 2005). The Investor maintain and judge the probabilities frequently. People published the common elements in completely different event when people adapting the different and new events into already existing event (Tversky and Kahneman,1974).

2.1.2 Availability & Anchoring

Here Investor ease with relevant problems come to mind which creates a selection bias in decision making (Tversky and Kahneman, 1973, 1974). When the stock price reaction and index returns are accompanied in the same direction, the reaction of stock price recommendation revision is stronger (Kliger and Kudryavtsev,2010). When investors planning for the subsequent investment plan, fuse to last trading information and are reluctant to change for the new information prevailing in the market (Talha,2015; Hoguet, 2005).

2.1.3 Overconfidence

Overconfidence is closely related to the human inclination to have the positive view of world. It can be helpful to recover from life's disappointments more quickly, also which avoid to take wrong decision making (Barber and Odean, 1999). Over confidence increases trading activity in investors that in turn depletes their wealth due to higher trading costs (Barber and Odean, 2000). Investors get overconfident based on the past successes in trades and it leads to high trading volume in future periods (Gervais and Odean, 2001).

2.1.4. Herding describes

Scharfstein & Stein (1990) investigated the presence of herding using cross-sectional standard deviation (CSSD). Analyzed that herding exists in periods of market extreme (Christie and Huang, 1995; Lakonishok et al. 1991). The social influence has more powerful on individual judgment. In everyday living, it is learned that when a large group of people is 40 unanimous in its judgments, they are certainly right (Shiller, 2000)

2.1.5 Loss aversion

Loss brings regret and people try to avoid losses in order to avoid subsequent regret (Kahneman and Tversky, 1979). Level of loss aversion changes depending on market conditions. Investors become more loss averse in bull markets than bear markets (Hwang and Satchell , 2010).

2.1.6 Mental accounting & Optimism

Investors make mental accounts of their wealth which have an impact on stock selection decisions (Thaler, 1999). Change in investor's mental system of accounting affects asset prices (Barberis and Huang, 2001). Optimistic investors selectively incorporate only good news in their decision-making process (Toshino and Suto, 2004). Optimistic individuals exaggerate their abilities and skills and believe that they are likely than their peers to develop serious diseases (Kahneman and Riepe, 1998).

2.1.7 Disposition Effect & Status quo Bias

Investor's disposition effect ratio can be calculated by proportion of gains realized to proportion of loss realized. (Odean ,1998b). Evidence of the disposition effect in Finnish stock market (Grinblatt and Keloharju, 2001). Status quo prevails in an environment in which there are very low costs of identifying better performing stocks (Brown and Kagel, 2009). Identified factors affecting the status quo bias as framing, investors' emotion and information structure.

2.1.8 Narrow Framing

People evaluate a new gamble in isolation, separated from their other risks, even if it is just one of many that determine their overall wealth risk (Barberis and Huang,2005). When investors trading in the complex derivatives market, they can easily become susceptible to narrow framing. Factors like professionalism, sophistication and experience can reduce this bias to a certain extent (Liu and Wang, 2010).

3. Objectives of the study

- To understand behavioral biases and investment decision-making.
- To study about the emotional swings to decide whether investor made successful investment or not.
- How to make the successful investment in stock market.

4. Behavioral Finance: Emotional Swing

The nature of the emotion may be either constructive or destructive. Different emotions explore their cognitions towards the market. The investor's emotions will decide the success or failure of their investment (2012). To make a successful investment, we need to analyze the emotional swing There are 14 Parameter of emotional swing like Excitement, Thrill, Euphoria, Anxiety, Denial, Fear, Desperations, Capitulation, Despondency, Depression, Hope, Relief etc. Among these emotional swings Euphoria, Despondency and Depression play a vital role on the success of investors' investment decisions (Charles and Kasilingam, 2015)

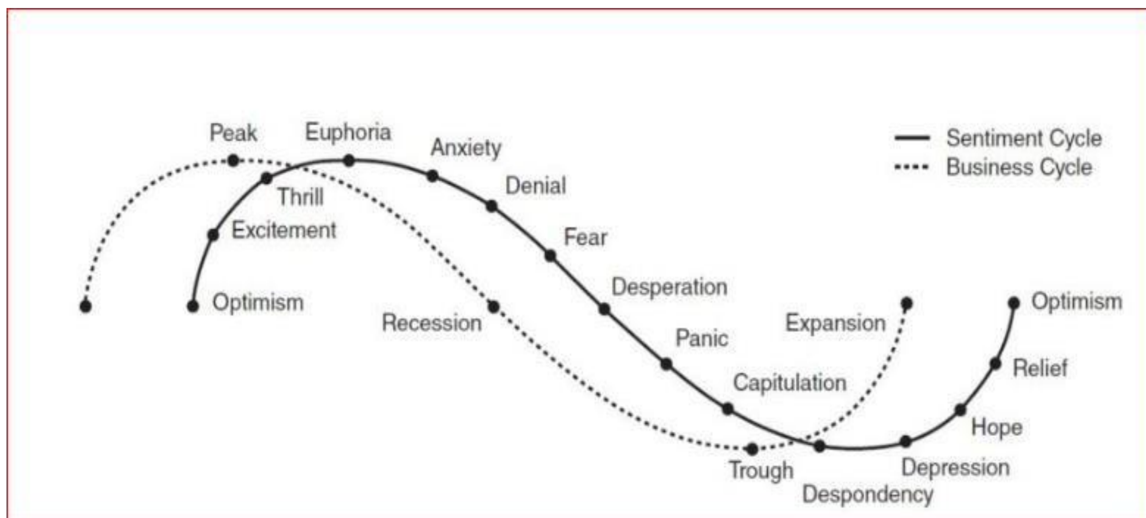

Figure 1: Proposed research model

5. Implication of the Study

Many people are taking decision very well in day to day activities but they are unhelpful when achieving success for long term financial decisions such as investing. No one can completely cure the biases but can avoid major faults. Advisers might develop an awareness of the different biases and the influence they have on investing behaviour. Also, advisers may wish to understand the biases that will impact their clients and think about how to reduce their adverse influence. They understand the risk and return. Some investors and advisers formulate their investment goals and policy which will helps to another type of investment. If market moves and hold the emotion and figure out the records which can helps to prevent the snap judgment. Framing is a valuable adviser tool. Portfolio discussions can be framed in terms of long-term investment. When thinking about market risk, the advisers suggestions should be responded to market downturns by reviewing long-term risk and return characteristics of stocks. The wide framing may help to avoid the loss averse. More generally, we can mitigate the behavioral biases when investors considering feedback from others. The result of the past experience decision should help investors learning to make a good decision.

6. Conclusion

Behavioral finance provides details about anomalies like over confidence**,** lack of information, fear of loss and so on. Investor faces many behavioral biases that influence their investment decision making processes. Also studied some behavioral biases and how to mitigate them. As we are humans, should take effective decision-making, but with wrong decision that can cause problems in realms such as investing. An understanding of the nature of these flaws can help us avoid these problems and invest better.

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