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The Impact of Human Behaviour and Psychology on Stock Market

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ABSTRACT:

Economists usually ignore psychology while conducting their research but it's impossible for them to not take into account the human nature, economists should borrow the thoughts of psychologists while constructing their work as it is really necessary for their work to be real and practical. Behaviour is a major part of finance and investment world. Behavioural finance basically takes into account psychology, human nature and cognitive factors to know the decisions taken by investors which sometimes are irrational and not understandable.

This study helps us to understand why the markets might be inefficient and how psychology influences the behaviour of investors and financial practitioners and effect the market. According to conventional financial theory, "Most people are rational in their quest to maximise their wealth. However, there are many instances where emotions and psychology influence our decisions, causing us to behave in unpredictable or irrational ways"

This research paper provides a brief discussion on human behaviour, psychology and behavioural finance and how they affect the stock market. It shows how we make decisions where risk or possibility of losing wealth is involved. It also portrays how individuals irrationally take decisions influenced by the money they have lost in their past or unknown securities may seem riskier or a stock that has given loss to other investors may feel not investable and some individuals don't like to invest in a company which has given larger profits as they are worried it may give larger losses as well.

KEY WORDS: Behavioural finance, Traditional finance,Human psychology, Human behaviour, Stock market, Investment, Emotions, Investors, Finance, Market efficiency, Investment decision, Psychological factors.

INTRODUCTION

With the understanding of human psychology and impact of human behaviour on stock market, the importance of variables which are non-economic in nature such as feelings, emotions, mood swings, fear, greed and many more factors have highly increased.

These factors or variables determined by human psychology has provided a very interesting topic for exploration to all the students, researchers, investors and psychologists as well. As much as I have researched I can say that like a normal human being has mood swings, stock market has price swings and in both cases the chances of up and down are uncertain, but can human psychology help us understand stock market is the bigger question here and theories of behavioural finance provides light and answers the question that it can!

Behavioural finance concentrates on the brain science of monetary direction. The vast majority of investors realize that feelings influence speculation and investment choices. Individuals in the business normally talk about how the greed and fear of humans is driving stock markets. Human behaviour and behavioural finance dominates the market by playing the card of greed or fear or anger. At the end of the day, behavioural finance takes the experiences of mental examination and applies them to monetary navigation and investment decisions. The vast majority of the decisions taken in stock market can't be made sense with general guidelines of decision making factors.

When we take into consideration the impact of human behaviour on stock market it simply makes sense of why the individual has taken a particular choice, yet are not able to clarify or justify what their future decisions might be. Classical finance believes that everyone has similar data and so it is preposterous to change the market position, since that stock costs are, as a matter of fact, effective and accurately justified, reflecting all that we know as financial investors. An information is said to be efficient and enough in a market where value of shares reflect the available and collected information. The hypothesis of efficient markets therefore assumes that capital market is a data producing partner.

By understanding and getting the knowledge of how, when and why individuals get distracted from rational decision making and set irrational expectations, this paper has potential to help us gather knowledge on behavioural finance, human psychology and provide us with factors which might be of use when we take financial or investment decisions.

OBJECTIVES OF RESEARCH:

1. To concentrate on the concept of behavioural finance and different hypotheses related with it.
2. To showcase the central factors which are responsible for influencing investment and trading decisions of stock market investors.
3. To understand the certainty of investing individuals with regard to stock and securities market.
4. To spread awareness among the people on how the rational decisions should be taken considering all the factors.

TRADITIONAL FINANCE

Traditional finance is the way of taking decisions and performing actions based on efficient or worthy hypothesis of market. Traditional financial theories have made an assumption that the nature of investors are rational, risk acceptable, hold diversified portfolios and therefore act and trade based on technical or fundamental analysis and mathematical models only, which might not always be true.

BEHAVIORAL FINANCE

Behavioural finance is a new field which has developed after the findings of irrational impact on stock markets or markets in general. Behavioural finance is the study of human behaviour and psychology which takes place while making financial decisions. Behavioural finance provides an explanation on why people take decisions irrelevant to data or technical analysis. The view of humans while taking decisions related to finance influenced by psychological factors rather than the motive of wealth maximization making their decisions irrational is focused in this theory.

DIFFERENCES BETWEEN TRADITIONAL AND BEHAVIORAL FINANCE

TRADITIONAL FINANCE	BEHAVIORAL FINANCE
Market and investors are assumed to be Rational	Both are considered normal and not rational
Investors have perfect self-control	Investors have limitations to their self-control
They are not confused by cognitive errors	They might make errors and wrong decisions
They are not influenced by any biases or psychological factors.	They are influenced by their own biases and factors.

THE RELATIONSHIP BETWEEN BEHAVIOUR OR PSYCHOLOGICAL SCIENCE AND STOCK MARKET

If you thought that investment within the stock exchange is all concerning crunching numbers, you may be shocked to be told that your own psychology is as much necessary if not crucial once it involves creating important selections and decisions. The study of the mind and behaviour because it relates to how we tend to invest may be a subject that's not solely extraordinarily fascinating, however conjointly greatly helpful to investors. Since market moves tend to be erratic and infrequently irrational, cognisance will facilitate us recognise that our instincts aren't grounded in clear thinking. Nothing is more unlucky than losing cash despite having the proper analysis at one's fingertips, just because of the terribly human tendency to act and react in bound ways.

One vital space that stock-market psychology explores quite bit is thinking biases that investors suffer from. A Bias may be a faulty manner of thinking that we've grown up at home with. Take this instinct referred to as loss aversion for example. Investors react to losses intensely than they react to gains. Therefore the joy of earning a gain of Rs.50,000 isn't as intense because the pain of bearing a loss of Rs.5,000. This is often what makes investors sell their stocks in panic if the market goes down.

Now think about the confirmation and availability biases. When researching an organization, investors tend to concentrate on knowledge and data that are simply obtainable to them. This is often an example of the supply bias. Rather than trying to find vital, although less simply on the market knowledge, investors base their investment thesis on data they do not even need to search out. And if they have already got an opinion on something they fixate and accept their opinion on data that confirms their viewpoint, rejecting any conflicting knowledge. These 2 biases end in incomplete analysis, which regularly comes back to haunt them later with massive losses.

Then you furthermore may see herd behaviour play out in a really massive means within the stock exchange, so specific sectors or stocks become very expensive. The newest market craze is IPOs. In today's booming market, several IPOs have given bigger listing gains. This has attracted a growing cluster of individuals who consider themselves 'IPO investors', seeing this high spirits, more corporations are creating a path to the list. The matter is that herd behaviour usually results in 'market stampedes' that leave investors injured and wounded.

The iconic capitalist and Warren Buffett's partner, Charlie Munger has talked concerning the loving tendency of stock market, wherever investors often fall crazy with their stocks, the actual fact is that the companies have researched them, have control onto them for an extended time and maybe are even creating paper profits on them, stops them from being objective concerning them. They have a tendency to ignore any adverse business development. This eventually ends up in wealth destruction. Even at this time, the “loving tendency” causes investors to remain endowed in hope of a recovery.

REVIEW OF LITERATURE

This paper has been sourced from various literatures, articles and research papers and the review of few of the following have been given below and the link to the same is attached in the bibliography section with the same numbers:

(1) **Sangeetha Thakur** has tested how behaviour has impacted the stock market and how behavioural finance plays a vital role in financial decision-making. The study shows how investors take irrational decisions based on human emotions and how it affects them and their wealth. The study also briefly explains Traditional and Behavioural Finance and their impacts on stock market.

(2) **Glenn Curtis** has made a research on how important psychology is to trading and has explained how to overcome the responsible factor which influence decisions that is fear and greed and has briefly given helpful tips to follow for successful trading

(3) **Ben McClure** has briefly researched on behavioural finance and have explained the importance of losses and significance of gains. He has determined the practicality of behavioural finance and explained the major concern of the Herd vs. Self.

(4) **Abhijeet Chandra** has focused on decision making where he has explained the following, Investor's Risk perception, Decision-making for investment and Crafting of behavioural portfolios.

RESEARCH METHODOLOGY:

The Data is Secondary in nature and is collected from various sources mentioned in the Bibliography and sourced from the internet.

RESEARCH FINDINGS:

After brief research and study of the secondary data the paper has been worthy of finding the different Behavioural factors which impacts the decision-making of the investors and therefore impacts the stock market, overcoming which can help the reader in potential success in trading and investing.

VARIOUS BEHAVIORAL FACTORS THAT IMPACTS THE STOCK MARKET:

1. *REPRESENTATIVENESS:*

The decision making of investors can be influenced by the past success or failures because of which the investors misleadingly takes wrong decisions, to break this stereotype the investor should not consider his past experiences and focus more on the present.

2. *OVERCONFIDENCE:*

Confidence is the key to success and is required for successful trading. Confidence gives courage to investors to take risks but overconfidence makes investors overestimate their skills and therefore leads to huge losses. So overconfidence should not be encouraged by investors.

3. *ANCHORING:*

Anchoring is nothing but relying heavily on one piece of information while making decisions. We humans tend to rely on certain finding which we find important and not consider new information presented to us. Investors expect the trend to remain constant and get vulnerable to changes.

4. *GAMBLERS FALLACY:*

Gambling is nothing but investing blindly on something and taking chances in order to earn more profits but the prediction of profit has 50% probability of losses as well, so gambling should not be done and analysis of data has to be considered while making decisions.

5. *MARKET PSYCHOLOGY:*

The mutual feeling that market is experiencing at a time also has certain drawbacks as the decisions taken by that view is influenced by greed, fear and over expectations, so decisions must not be made by seeing the psychology of other investors.

6. *AVAILABILITY BIAS:*

The Investors trade based on the available piece of information rather than new research and this happens quite commonly in stock market. But it is advised not to take decisions on laziness as it might result in poor performances and heavy losses.

7. MEDIA EFFECT:

In this case, investors act on news, articles or some media influenced data and act quickly without thinking if the news is true or not, markets are influenced by media for their own profits and therefore it is uncertain for investors to get any profit from such news.

CONCLUSION:

Behavioural finance provides a thousand of worthy tips for investors both individuals and corporates and also helps investors in the evaluation of their investment strategies and recreation of strategies considering all the factors of human psychology and behavioural finance. This research paper identifies that demographics play a vital role in financial decision-making. It also identifies major factors affecting the attitude and decision making which leads to success or failure of the investor and the factors are, confidence level, ability to take risks, rational decision taking ability, certain achievable expectations and a positive attitude towards stock market.

The research have a potential for an investors to consider the factors and understand the importance of behavioural finance and human psychology while making an investment in the stock market as market value is highly influenced by behaviour and understanding which might help the investor to earn more profit and therefore maximise their wealth. The paper might also help investors to minimise their losses as the decision taken by them will be rational and not influenced by behavioural factors.

The bottom line for the research article is that there is a huge impact of human behaviour and psychology on stock market and therefore behavioural finance must be given importance to while making investments.

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