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A Study on How Behavioural Finance Shapes Investment Decisions in Commodity Market

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ABSTRACT

Purpose: This study investigates the role of behavioural finance in shaping investment decisions within the commodity market, focusing on biases such as herd behaviour, overconfidence, loss aversion, and anchoring. It aims to assess the extent to which psychological factors influence investor choices, risk appetite, and market behaviour.

Design/Methodology/Approach: The research adopts a quantitative method, utilizing an online questionnaire targeted at retail investors, commodity traders, and finance students. Descriptive statistics and correlation analysis are used to study relationships between behavioural biases and investment outcomes.

Results: The findings show that behavioural biases have a significant impact on commodity trading decisions. Investors often act based on emotions rather than rational analysis, particularly during market volatility, leading to suboptimal financial outcomes.

Practical Implications: This study suggests strategies such as pre-commitment devices, diversified portfolios, investor education, and technological tools to mitigate the influence of biases, ultimately promoting rational decision-making in commodity markets.

Keywords: Behavioural Finance, Commodity Markets, Investment Biases, Herd Behaviour, Loss Aversion, Overconfidence, Anchoring Bias.

1. Introduction

The commodity market is a vital component of the global financial system, offering investors opportunities for diversification, speculation, and hedging. Commodities such as gold, oil, and agricultural products are traded globally, and their prices are influenced by geopolitical events, economic data, and market sentiment. Unlike stocks and bonds, commodities lack intrinsic valuation models, making them particularly vulnerable to behavioural factors.

Behavioural finance combines insights from psychology and finance to explain why investors sometimes act irrationally. Traditional finance assumes that investors are rational agents who maximize utility, but real-world observations often contradict this assumption. Behavioural finance introduces concepts such as heuristics, biases, and emotional responses to explain anomalies in financial markets.

This research paper investigates how behavioural finance affects investment decisions in the commodity market. It explores various psychological biases and their implications for investor behaviour and market outcomes.

2. Statement of the Problem

Despite the growing significance of behavioural finance, limited research has been conducted specifically on its impact in the commodity market. Investors in this market often make decisions based on emotions and cognitive shortcuts rather than objective analysis. This behaviour can lead to market inefficiencies, mispricing, and increased volatility. There is a need to understand how behavioural biases influence investment decisions in commodities and how these effects can be mitigated to enhance market efficiency and investor outcomes.

3. Objectives

1. To identify common behavioural biases among commodity investors.
2. To evaluate how these biases impact investment outcomes.
3. To examine the role of demographic factors in influencing bias susceptibility.

4. To analyse the influence of market volatility on emotional trading.
5. To propose strategies for minimizing the impact of behavioural biases in commodity investments.

4. Review of Literature

Behavioural finance challenges traditional notions of investor rationality by emphasizing the psychological elements influencing financial decision-making (Kahneman & Tversky, 1979).

- Prospect Theory: Investors experience losses more intensely than gains of the same magnitude, leading to risk-averse or risk-seeking behaviour depending on framing (Kahneman & Tversky, 1979).
- Herd Behaviour: Bikhchandani et al. (1992) found that individuals often mimic others' actions, particularly under uncertainty, which is frequent in commodities.
- Overconfidence Bias: Barber and Odean (2001) established that overconfident investors trade excessively, believing their information is superior.
- Anchoring Effect: Tversky and Kahneman (1974) illustrated how investors fixate on initial price levels or past trends, disregarding new information.

5. Hypothesis

- Null Hypothesis (H_0): Behavioural biases do not significantly affect investment decisions in the commodity market.
- Alternative Hypothesis (H_1): Behavioural biases significantly affect investment decisions in the commodity market.

6. Research Methodology

Research Design:

Descriptive and exploratory research based on a quantitative approach.

Data Collection Method:

Structured online survey distributed via Google Forms.

Sample Size:127 respondents including:

- Retail investors
- Professional traders
- Finance students

Sampling Technique:

Convenience sampling.

Data Analysis Tools:

Descriptive statistics, correlation analysis using MS Excel and SPSS.

Survey Focus Areas:

- Frequency of trading in commodities
- Experience of behavioural biases
- Emotional reactions during volatility
- Risk-taking behaviour and loss management practices

7. Findings and Analysis

1. Dominant Behavioural Biases

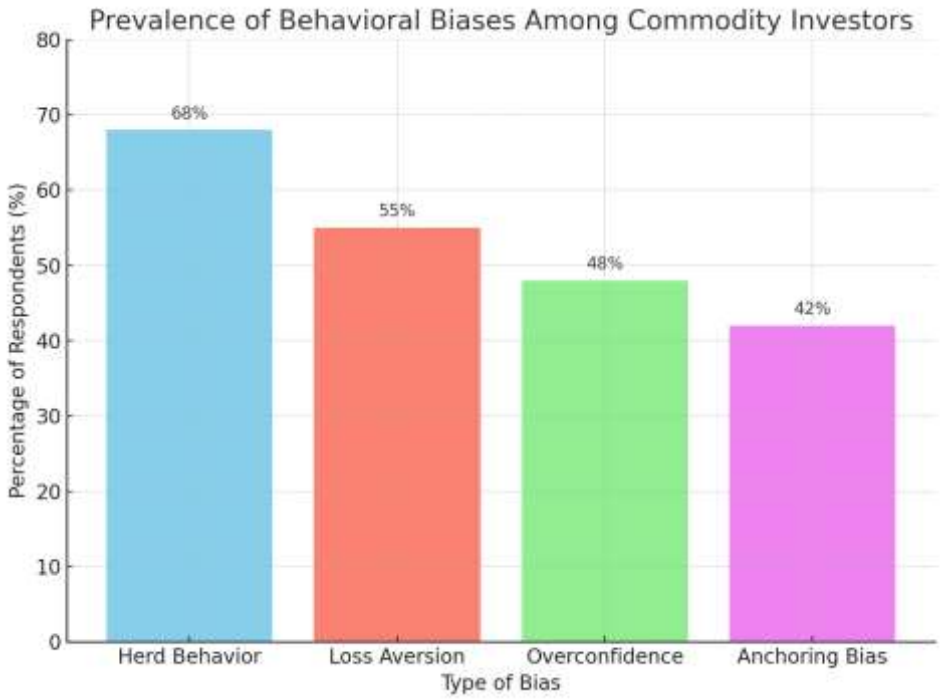
Bias Type Affected Respondents (%)

Herd Behaviour 68%

Loss Aversion 55%

Overconfidence 48%

Anchoring Bias 42%

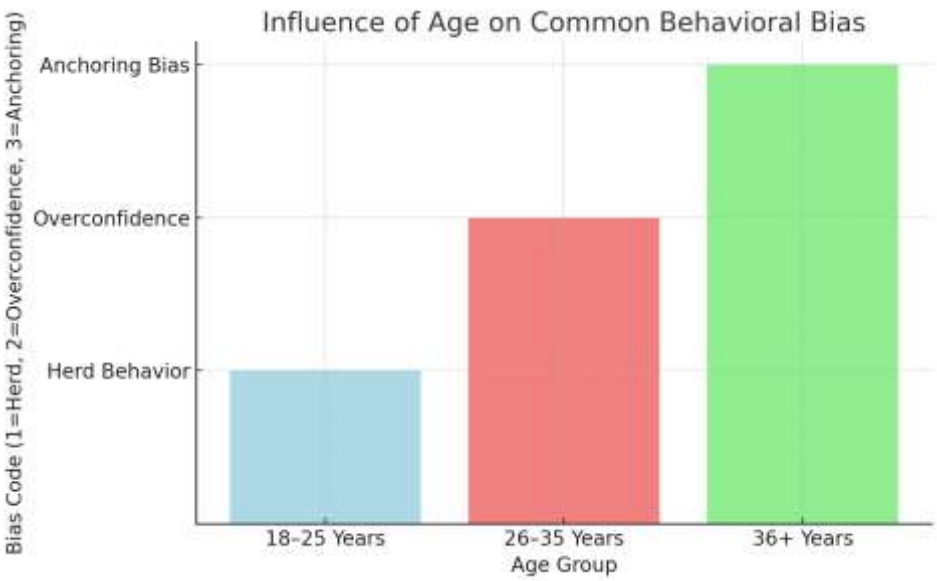


Interpretation:
Herd behaviour and loss aversion were the most prevalent, suggesting that many investors follow market trends blindly or hold onto losing positions for too long.

2. Influence of Age and Experience

Age Group

Common Bias	Comments	
18–25 Years	Herd Behaviour	High social influence
26–35 Years	Overconfidence	Belief in superior skills
36+ Years	Anchoring Bias	Fixation on historical prices

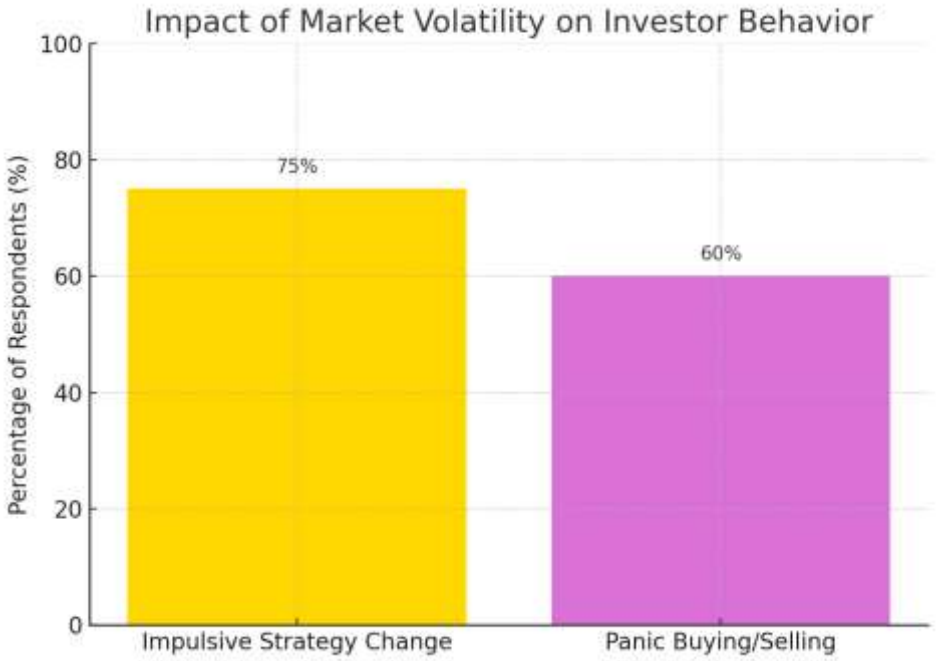


Interpretation:
Younger and inexperienced investors are more emotionally reactive compared to seasoned traders.

3. Impact of Volatility

75% of respondents admitted to altering investment strategies impulsively during major price swings.

60% reported panic buying or selling when commodity prices fluctuated drastically.



Interpretation:
Volatility intensifies emotional reactions, making disciplined investing challenging.

4. Investment Outcomes

Investors acting on herd behaviour achieved lower average returns compared to those following independent strategies.

Strategic investors reported 20–25% better returns.

Conclusion:
Behaviour-driven trading often results in suboptimal financial outcomes.

8. Recommendations

1. Investor Education: Promote awareness of behavioral biases through seminars, webinars, and training programs.
2. Use of Pre-Commitment Strategies: Encourage setting stop-loss and take-profit points before executing trades.
3. Diversified Portfolios: Advocate for diversification to minimize risk concentration driven by emotions.
4. Technological Tools: Utilize automated trading systems that execute strategies based on pre-set rules, reducing emotional decision-making.
5. Mindfulness Training: Incorporate psychological training and emotional intelligence development into trading education.

9. Conclusion

This study confirms that behavioural finance plays a critical role in shaping investment decisions in the commodity market. Investors often act irrationally under the influence of herd behaviour, overconfidence, loss aversion, and anchoring especially during periods of high volatility.

Mitigating these biases through education, disciplined strategies, and technology can significantly enhance investment outcomes and market stability.

Thus, the null hypothesis (H_0) is rejected, and the alternative hypothesis (H_1) is accepted:

Behavioural biases significantly affect investment decisions in the commodity.

10. Implications of the Research

Practical Implications:

- Financial advisors and brokers should integrate behavioural insights into advisory models.
- Trading platforms can design alerts and nudges to prevent emotional trading.

Future Research Scope:

- Studies across different countries and cultures.
- Longitudinal analysis of bias patterns over market cycles.
- Experimental interventions like AI advisory tools to counter emotional biases.

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