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BEHAVIORAL FINANCE: IMPACTS OF INVESTORS' EMOTIONS AND MOODS ON FINANCIAL DECISIONS

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Abstract

Behavioral Biases, which influence investors' decisions when buying and selling stocks, are one of the key determinants on their financial decisions. This study's contribution is to identify the prevalent Behavioral Biases among investors and their relationship to Emotions. As a result, the study aims to investigate how behavioral biases influence uncertain investment decision-making. Examine the effect of behavioral finance on the decision-making process based on this study's findings about how human rational and irrational behavior affects investment choices and alternatives. The conclusion shows a strong relationship between the given Moods flaws and the investor's Emotions. The findings show that there is a direct relationship between extroversion and openness and the availability, escalation of commitment, and hindsight biases as well as the overconfidence bias. Conscientiousness and randomness bias, as well as openness and availability bias, have a reverse corelation.

Keywords: Behavioral finance, Investing decisions, Behavioral Biases and biases, Big five Emotions model

1. Introduction

The concepts of output and risk taking are central to financial management. People frequently prefer to invest in highly productive scenarios. However, as we all know, reaching the high output requires taking the corresponding risks in order to increase efficiency. The majority of economic and financial theories hold that investors make truly logical decisions (Kim et al., 2008). The "rational economic man" theory is supported by this. When making an investment, investors weigh all potential outcomes and choose the best course of action. However, there are instances when certain circumstances related to the inefficiencies of the financial markets impact people's ability to make reasonable judgments. In order to reduce the effects of these deviations, as well as to reduce the deviation of long-term decisions and assist investors in achieving their long-term financial goals, we can provide programs through recognition of investors' Emotions and deviations. In order to help investors', make the best selections in the stock market, this study looked at the relationship between Emotions and Behavioral Biases.

A recent development in financial market studies is the study of behavioural psychology in financial conflicts. According to this incidence, behaviors and cognition can have an impact on financial qualities, contrary to common financial debates and beliefs. Such financial decisions and investments are the results of psychological choices made in financial markets, and they are preceded by perceptions and predictions. Studying financial behavior does indeed allude to the

important part that psychology plays in the field of finance. Despite the abundance of studies in this field, many people are still unaware of the covert nature of financial conduct 2002's Monttier Among the studies in their field are those conducted by Shiller and Andri Shifler. Additionally, studies by Roll (1986), Barberies and Thaler (2003), Line and et al. (2008), and others have examined different Behavioral Biasess and how they impact investors' financial decisions in the financial markets and have come to the conclusion that investors suffer losses due to some poorly placed perceptions Kim and Nolsinger (2008)

Schneider (1992), Weiss and Budescu (1989), and Thomas (1988) were among the researchers who published articles on financial behavior that played a crucial role in financial management and have a significant part in guiding investors for making financial decisions (Filbect et al.; 2005). These researchers were some of the others in their field. Kahneman and Tversky (1992) offered the theory of expecting which helped a lot in developing this science. In contrast to neoclassical theories, economic agents in behavioral models do not behave rationally due to their preferences or the outcome of Behavioral Biases (Farlin, 2006). Financial behavior is a general intellectual model in which financial markets are studied using the compound models of sociological, psychological, financial, and other related sciences. Irrational aspects that influence people's behavior in various decision-making scenarios include emotion, culture, religion, and ideology. 1992 (Macgoun).

The financial behavior paradigm explains how investors behave and how their actions may impact financial markets (Kim and Nogsinger, 2008) and aids in their development of rational conduct (Bhatla, 2009). In actuality, the foundation of financial behavior is the consistency between investors' emotions and decisions.

Financial behavior models represent a spectrum of investor behavior and market outcomes. Massive and minor financial activity have been categorized into two main types. Indeed, these two fields examine both conventional finance and financial behavior. Minor financial behavior concerns issue like whether or not individual investors act logically or whether their perceptions and emotions influence them.

However, in terms of significant financial conduct, the question that needs to be answered is how the market shortcomings are addressed and to what extent the efficient hypothesis can explain the financial markets' behavior (Eslami Bidgoli, 2009).

In order to decrease the number of errors, this paper focused on minor financial conduct. It examined the investor's individual behavior, distinguished psychological errors, and looked into the impact of such errors on investors' decisions.

The foundation of conventional financial science is the behavioral approach taken by investors to identify psychologically active phenomena in the financial markets. Although the financial behavior hypothesis is based on observable financial conduct, the conventional financial sciences create their theories based on an ideal financial behavior.

Fama (1991) asserted that in an effective market, prices reflect recent market news. An efficient market is one in which the majority of sane investors are working diligently to maximize their individual stock profits.

Numerous research has been conducted in reference to the data that provide credence to the efficient market concept. But investors' inability to obtain entire information is one of the problems with decision-making (Hirshleifer 2001). Therefore, market inefficiency results in irrational choices. However, numerous stable anomalies that defy the efficiency concept have been recorded by experts. Fundamental hypotheses, technical anomalies, and calendar anomalies are the three main categories of market abnormalities. Understanding these anomalies and working to mitigate them can aid investors in making thoughtful selections.

2. Rational decisions: real and unreal investing

Decisions about investing should be made logically. Though we can make decisions based on a variety of factors, generally speaking, rational thought and decision-making is the ideal approach. Therefore, it is advised to make decisions logically, without allowing emotions or personal feelings to cloud judgment (Harrison, 1975). However, the definition of a rational person is not sufficiently defined, and hence, a person's decisions may diverge from accepted presumptions (Bolhuis: 2005). According to Khoshnoud (2004), there may be circumstances that prevent the decider from acting rationally. This requires taking into account the investor's view and Emotions.

There have been numerous studies on investor behavior and the factors that may influence their gains; they have come to the conclusion that if dealers can successfully combine their portfolios so they can sell at a higher price and buy at a lower price, this can be considered rational behavior (Masonson; 2007). Economic methodology is evidence that it is possible to comprehend human nature and behavior, which refers to how people really behave rather than how they should (Frankfurter, 2004). In essence, a sensible economic person seeks to accomplish his objectives with the least amount of money spent. 2007 (Fridson). Given the prominence of this concept among economists, it came under fire from individuals like John Maynard Keynes and Thorstein Veblen. They believe that no one is capable of knowing all that has happened and consistently maximizing his expected desires by figuring out his expectations. They substitute "limited rationality" instead, according to which all of the decisions they make are based on how they organize and limit personal information (Frankfurter; 2004). According to Simon's limited rationality, a person's decisions are reasonable given his or her limited information and Moods abilities. Limited rationality is associated with decision-making processes that make the ultimate decision. Since logic covers a wide area of human conduct, even when we assume that all actions are rational and all decisions are intellectual, we nevertheless come across mistakes that cast doubt on the idea of rationality. (1992; McGoun). Financial behavior management looks into how managers gather, interpret, and analyze information. Prejudgments that are Moods and cognitive are the main focus of the field. Such prejudgments can influence choices and lead to outcomes that are below optimal levels because they let emotions take control and alter a person's behavior (Rizzi, 2008).

Catalyst Research Volume 23, Issue 2, September 2023 Pp. 715-724

According to behavioral scientists, humans make mental errors in their assessments under specific circumstances, which lead to incorrect expectations, inaccurate stock evaluations, and ultimately irrational decisions (Fuller; 2000). On the other hand, we are aware that perception plays a significant part in human decision-making. People with strong analytical and Moods skills make logical decisions and exhibit sensible behavior. According to a group of scientists, a person's unconscious elements and emotions have an impact on his mind and influence his thoughts. Therefore, while it's feasible that unconscious difficulties and their effects would be the main driving force behind a decision, the justifications he employs in his conscious mind may only be justifications (khoshnoud, 2004). In regard to this topic, our focus is on systematic mistakes that affect investors' perceptions. Since rational behavior is assumed, there is always a discrepancy between what individuals think and what they comprehend. Their inconsistency leads to psychological blunders, which is connected to the myth that most investors believe they are the best decision-makers. Additionally, they are seeking evidence to support this theory, which leads to them making poor decisions as the information they obtain is ineffective (Sheleifor; 2000).

According to Gholipour (2008), feeling is a psychological and physiological condition of interaction between an object, a person, or an event. People's emotions are impacted by factors such as shifting risk preferences, the media, society, and links between and challenges to illusion (Sheleifor, 2000).

After analysis, emotion transforms into perception, but perceptions don't always match reality because there are many intervening factors, which we shall explain later.

3. Behavioral Biases of investing decisions

We organize and make sense of environmental stimuli through perception in order to have expressive experiences. But the investor's false vision of reality is what gets him into difficulty with his choices. Confidence bias, availability bias, hindsight bias, escalation of commitment, and randomness bias are taken into consideration in this work to explain Behavioral Biasess, which are the consequences of psychological status in normal and abnormal settings (McGoun; 1992). The majority of investors are particularly concerned about their investment funds as a result of these blunders. Due to the fact that investors spend the majority of their money on the stock market, these mistakes may be related to the way they invest their money and other assets. This essay makes an effort to minimize these investing blunders (Down, 2003). Understanding these flaws as investing cognitive errors and making every effort to eliminate them lessens their influence on investment decisions and may even improve investment outcomes (Shefrin; 2000).

3.1 Overconfidence bias: In its simplest form, this prejudice can be described as an unwarranted belief in someone's cognitive powers, judgment, and observed reasoning. Overconfidence bias has a significant impact in the stock market. Most psychological investigations have been covered by overconfidence models. According to these theoretical models (Gervis and Odean, 2001), overconfident investors will deal (invest) more than logical investors.

Shiller explains the model in a way that makes the investor believe he knows more than he actually needs to. Such an error of judgment occurs when people are more concerned than ever with

protecting their privacy. Overconfidence is actually a person's tendency to overstate his judgment and predictions. (Razzi ; 2008)
As a result, investors seeking efficiency are more optimistic about the future. Due to their lack of information and their desire to purchase more expensive stocks, the stock market's price falls as a result, and their prospective efficiency declines. Typically, phony confidence leads an investor to purchase an expensive stock and then sell it for a loss (Zhu; 2003). Due to an increase in transactions, financial markets experience price bubbles (Johnsson et al., 2002).
3.2 Availability bias: The availability deviation is a general rule or a mental shortcut that enables individuals to estimate the likelihood of a result and the likelihood that it will manifest itself in their day-to-day lives. Those who engage in this aberration think that occurrences that are easily recalled are more likely than events that are difficult for them to envisage or observe.
Decisions about a portfolio may be effectively influenced by availability bias. (2004) Kim and Nofsinger. The term "availability bias" describes a person's propensity to make decisions and judgments based on readily available and understandable evidence.1982; Tversky and Kahneman. Man's brain prefers to make decisions rapidly based on information at hand. Human minds are capable of quickly recalling motivating and current occurrences. Events at the end of the year or the month are more readily available than those at the beginning, which influences how people see them. 2007 (Gholipour).
Information that is practically available and information that is published every day are not available mentally. Therefore, the decisions made by investors suffer when the necessary information is not readily available (Montier, 2002).
3.3 Escalation of commitment: This is another decisional deviation that could happen. It happens when decision-making procedures are carried out in succession. Escalation of commitment is the claim that even when a bad decision is made and the results support it, the person insists on carrying on, which makes the situation worse. Even when the person is accountable for his failure, he continues to insist on important commitments to demonstrate that his initial choice was not incorrect (Ghoilpour, 2007).
According to Schoorman and Holahan (1996), one of the reasons for the increase in commitment is justification for bad decisions, keeping a positive face on bad organization and evaluation at the start of the project, estimating low risk and failure and exceeding success, perception defines, and ignoring negative data.
3.4 Randomness bias: The man's view is somewhat influenced by superstitions and luck. However, it varies across cultures; for instance, superstition is highly valued in the east. This has to do with the control centre. People with exterior control centres are more likely to believe in superstitions and luck than people with internal control centres. People with an internal control centre believe they can influence their destiny and the outside world by making wise choices (Ghoilpour, 2007). These people even believe that luck plays a role in some events. When buying and selling stocks, it occurs frequently. The fact that each individual infers these lucks and coincident differently is what makes the outcome of these superstitions on decision-making so inefficient (Janes and Wells, 2002).

3.5 Hindsight bias: Simply put, deviation after an incident maintains that "I knew it all along" When an event is over, persons who are accustomed to recognizing deviation after occurrence frequently tend to imagine the event predictable even when it was not. Insight and prediction are opposed by hindsight. Sometimes people have a tendency to think they can accurately foresee the outcomes of an incident after it has already occurred. When an occurrence occurs and a person responds appropriately to the results, he can quickly come to the conclusion that it was as plain as he had foreseen. In most cases, more people than those who made their predictions prior to the game pick the winning football team (Gholipour, 2008). As a result, prediction should be given less weight than retrospect (Anderson; 1993). In these circumstances, a person's mind works selectively and adjusts its forecast in light of what really transpired (Christensen, 1991).

4. The role of Emotions on investing decisions

Since the decision-maker's perception plays a significant role in his investment choices, his Emotions also has an impact (Fromelt, 2001). Dealing and psychological characteristics are so intertwined that one cannot be studied without the other. Characteristics like intelligence, temper, and point of view all affect how judgments are made. Ideologists have always made an effort to exclude the decision maker's Emotions and personal ideals from their models. Despite this, he actively uses rationalization as a fundamental component of his decision-making. The decision-making process of an individual is influenced by his or her viewpoint, risk tolerance, and experience (Khoshnoud, 2004).

Financial literature is crucial for influencing investors' decision-making practices. The causes of behavioral variances include socioeconomic elements like age, gender, and output in addition to the importance of Emotions.

4.1 Big Five model

The big five model is one of the most well-liked Personality models. To increase the model's popularity, numerous investigations and researches have been conducted, and it is thought to be the foundation for all other models (Nichelson et al., 2005).

4.1.1 Extroversion: An extroverted person typically concentrates on and is influenced by external factors. Extroverted persons place a lot of weight on external factors and do not view their own actions as the outcome of cerebral analysis but rather as a result of other factors. Extroverts are warm-blooded, gregarious, and sociable; they readily fall in and out of love; they make decisions with ease and live in the present; they are not constrained by principles. They are not encouraged to exercise self-control or constraint. (Gholipour, 2007) Low intellectuality, admitting weaknesses, poor endurance and resistance, rashness, carelessness, poor ambition, flexibility, sense of humor, simulation, easily trusting, easily deciding, living in the present, valuing his social success and his properties, and unfaithfulness are characteristics of these people.

4.1.2 Agreability: Agreability is a reflection of a person's differences with regard to social interactions. This is a reference to a person's propensity to respect others; they are capable of winning over others' trust (Gholipour, 2007, 209). They are incredibly true and truthful, making it difficult for them to trick others. They also have few wants and prioritize those of others. These

people enjoy being accommodating of other people's wishes. Trust, straightforwardness, and modesty are examples of agreeableness manners (Farzanepey, 2006).

4.1.3 Conscientiousness: This is based on how trustworthy people are, and it has to do with how we manage and regulate our motivation. People who are conscientious are trustworthy, dependable, responsible, and sable. Man who is careless is less unreliable and poorly organized (Gholipour, 2007, 209). Conscientiousness is a tendency to reduce a person's risk potential (Nichelson, 2005, 161). According to Farzanepey (2006), conscientiousness behaviors include competence, order, duty, self-discipline, neuroticism, and caution while making decisions.

4.1.4 Neuroticism: Neurotic people lack sufficient and effective techniques to achieve their personal goals, are self-centered and selfish, and constantly strive for higher objectives. They therefore act adaptably to accomplish this, and despite their lack of social desire, they enjoy praise. Anxiety, anger, despair, impulsivity, and vulnerability are behaviors associated with neuroticism (Farzanepey, 2006).

4.1.5 A willingness to try new things is referred to as being open to experience (Gholipour, 2007). A flexible individual is more likely to accept novel concepts and unusual values and is open to learning about new political, social, and ethnic beliefs. Although they have a narrow range of interests, these people are more reliable in their fields and occupations. Instead of complexity and ambiguity, they favor simplicity and clarity. Fantasy, emotions, and ideas are examples of flexible behavior (Farzanepey, 2006).

5. Research method

This essay attempts to reduce investor errors in the stock market by examining the relationship between five criteria and investors' Behavioral Biases. This article is based on secondary data that was acquired from a variety of sources, including books, websites, and research journals. Generally, although our case study is descriptive in character, behavioral finance research is experimental in nature and may be carried out in a lab or in the field more effectively.

As opposed to making decisions based on logical analysis, investors, according to conventional finance, make decisions based on their beliefs and opinions, or as Adam Smith's father of economics put it, "notion of moral emotions." The founders of behavioral finance, cognitive psychologists Daniel Kahneman and Amos Tversky, asserted that investors are irrational and cannot be rational. Investors are irrational, according to Richard H. Thaler, the father of behavioral finance, who demonstrated this in a number of studies. Although some discrepancies cannot be addressed, those opposed to behavioural finance believe that investors are always rational despite the possibility that market efficiency theory may be abandoned in favor of behavioural finance. Many individuals think that these abnormalities are isolated incidents that will eventually be fixed. Depending on the variables that can affect research methods, such as the availability of resources and research investment choices. Feelings are the embodiment of moods, which influence decisions through ecological elements like the environment, biological rhythms, and societal influences that affect stock values. Making decisions would be effective in situations when emotions are brought on by ecological elements including the environment, the body's biorhythms,

and societal issues. Moods can be affected by changes in the environment, which can lead to deviations in decision-making because these environmental factors are directly related to changes in stock values. The stock's depiction is focused on the feelings that drive investor behavior. Distinctive events that control emotions lead to the emergence of ecological elements in decision-making. Investors occasionally have sentiments about a project, regardless of whether it is dangerous or offers a high return. For this reason, behavioral finance experts have suggested that feelings have a connection to risk phenomena. Predictable outcomes and probability serve as a guide to assess emotions using a cognitive framework to assess market risk and uncertainty. If there is a risk for unfavorable results, investor loss aversion feelings must be a deciding factor. If decision makers are aware of how investor feelings and emotions differ depending on the scenario, they can predict stock prices that are useful in making decisions. Investor sentiments and emotions are linked to psychology. Studying feelings and emotions aids in better decision-making for better outcomes.

6. Conclusion

The results are consistent with the study literature and support the aforementioned assumptions that there is a significant relationship between investor Emotions and Behavioral Biases in the Indian stock market. The findings were consistent with Anderson's research on Emotions and how it affects investors' behavioral blunders. Extroversion and hindsight bias have a positive relationship, according to the findings of the first hypothesis. Therefore, it is proposed that transparency be used in order to decrease stock market errors and aid investors in making the best choices. Holding training sessions might also help investors think more logically. There is less chance of availability bias in them. In order to lessen investing prejudices, it is proposed that the public be made aware of various investing fields through the media.

For further research, the following recommendation seems necessary: Some other Emotions models, such as the MBTI index, should be investigated for Moods flaws in investors; It is important to research the relationship between investors' attitudes and values and Behavioral Biases; investigating the perception errors and emotions of investors; investigating further mistakes such the hallo effect, which generalizes a company's favorable state to other factors and may have an impact on investor behavior; examining the connection between culture, Emotions, and the innovators' perception errors since culture has an impact on Emotions.

availability bias and openness have the opposite relationship.

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