A SHORT REVIEW: FINANCIAL MARKET THEORY'S BEHAVIOURAL FINANCE

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ABSTRACT

Behavioral finance is a branch of finance that aims to comprehend and explain the systematic financial market consequences of psychological decision-making processes. It applies cognitive psychology, social sciences, and anthropology knowledge to explain irrational investor behaviour that isn't captured by typical rational-based models. The study of the impact of psychology on the conduct of financial practitioners and the resulting effect on markets is known as behavioural finance. Behavioral finance is fascinating because it explains why and how markets can be inefficient. It is a relatively young topic of economics that has recently piqued the interest of investors. Behavioral finance is a relatively young field that attempts to explain why people make illogical financial decisions by combining behavioural and cognitive psychological theories with traditional economics and finance. The planet and its inhabitants, according to mainstream finance theory, are mostly rational "wealth maximizers." However, there are many times when emotion and psychology play a role in our actions, prompting us to act in unreasonable or unanticipated ways. The purpose of this paper is to provide an overview of behavioural finance.

Keywords: Behavioral Finance, Market, Business Models.

INTRODUCTION

The study of the impact of psychology on the behaviour of investors and financial analysts is known as behavioural finance. It also takes into account the market's reaction. It emphasises that investors are not always rational, have self-control limitations, and are impacted by their own prejudices. The psychology of financial decision-making is studied in behavioural finance. Emotions play a role in investment decisions, as most people are aware (Mahajan, 1992).

The role of greed and fear in driving stock markets is frequently discussed among industry professionals. The role of biases in decision making, such as the adoption of simple rules of thumb for making complex financial decisions, is explored in behavioural finance. In other words, behavioural finance applies psychological study findings to financial decisions. Traditional models cannot explain the majority of financial market oddities. Behavioral finance makes it simple to understand why an individual made a certain decision, but it is more difficult to understand how future decisions will be made. The Efficient Markets Hypothesis, which states that because everyone has access to the same knowledge, it is impossible to change the market position because stock prices are efficient and reflect what we know as investors, is a cornerstone of classical finance (Lamont & Thaler, 2003).

A market that is efficient is one in which prices always "*completely reflect*" available information. The Hypothesis of Synthesizing Efficient Markets assumes that capital markets are informationally efficient. "*Market efficiency survives the test from the literature on long-term return anomalies*," Eugene Fame, the founder of the efficient market hypothesis, says. Overreaction to information is roughly as often as under reaction, and post-event persistence of

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pre-event abnormal returns is about as frequently as post-event reversal, which is consistent with the market efficiency hypothesis that anomalies are random outcomes. Most on-term return abnormalities tend to dissipate with acceptable modifications in approach, which is consistent with the market efficiency prediction that apparent anomalies can be attributable to methodology. Behavioral finance, on the other hand, assumes that financial markets are sometimes inefficient in terms of information (Asness, 2000).

Human nature can be improved, but it isn't flawless. Investors are those that exhibit numerous departures from rational conduct and frequently make irrational decisions. The importance of psychological variables in investment decision-making is clear in the current global financial context. Traditional financial theories imply that investors are rational and risk averse, and that they hold diversified, optimal portfolios, based on efficient market hypotheses. Based on mathematical models and ideas, this assumes how investors should act. This, however, does not always work in practise. Behavioural finance, on the other hand, is based on an understanding of how individuals actually make financial decisions in the real world. According to behavioural finance, cognitive errors and emotional biases can have a negative impact on financial decisions. Cognitive errors can occur as a result of poor thinking or memory problems. Emotional biases are caused by reasoning impacted by feelings or emotions rather than essential facts (Barber & Odean, 1999).

Representativeness, Overconfidence, Anchoring, Gamblers fallacy, Availability bias, Market Psychology, Market Sentiment, Media Effect, Reflexivity, and others are some of the behavioural aspects that influence investors' stock market investment decisions. The goal of behavioural finance is to figure out how an investor's emotions and psychology influence their financial decisions. It is the study of how people, particularly investors, make typical financial mistakes as a result of their emotions (Statman, 1999).

It's nothing more than an investigation into why otherwise rational people make irrational investment choices. Behavioral finance research continues to have a bigger impact in academics than in real-world financial management. While theories point to a variety of reasoning flaws, the profession has few remedies for profiting from market manias. People are rational actors, free of emotion and the impacts of culture and social interactions, and self-interested utility maximizers, according to mainstream theory. By extension, it presupposes that markets are efficient and that businesses are rational profit-maximizing enterprises. Each of these assumptions is refuted by behavioural finance.

CONCLUSION

Behavioral finance gives a blueprint to assist us make better, more logical decisions in financial problems by understanding how and why people depart from rational expectations. Why do investors make irrational financial decisions? Behavioral finance explains it. It reveals how investors' decisions are influenced by their emotions and cognitive errors. Anchoring, overconfidence, herd behaviour, over and under response, and loss aversions are some of the causes that lead to behavioural finance. In this way, the behavioural finance method looks into how investors behave and seeks to figure out how these patterns influence investing decisions.

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