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Decision Making in the Stock Market: Incorporating Psychology with Finance

National Conference on Forecasting Financial Markets of India, 2008

28 Pages

Posted: 8 Nov 2009

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Date Written: December 29, 2008

Abstract

The decision-making by individual investors is usually based on their age, education, income, investment portfolio, and other demographic factors. The impact of behavioural aspect of investing is, however, often ignored. The objective of this paper is to explore the impact of behavioural factors and investor's psychology on their decision-making, and to examine the relationship between investor's attitude towards risk and behavioural decision-making.

The research uses the literature relevant to behavioural decision-making and investor's psychology. The research is based on the secondary data relating to investments, finance, and economics available on the Internet, previous publications of the author, and some other publications as well. The information is then integrated in order to understand the interrelationships of investor's perception of risk, behavioural factors, and decision-making in the Indian context.

Through this research, the author finds that unlike the classical finance theory suggests, individual investors do not always make rational investment decisions. Their investment decision-making is influenced, to a great extent, by behavioural factors like greed and fear, cognitive dissonance, heuristics, mental accounting, and anchoring. These behavioural factors must be taken into account as risk factors while making investment decisions.

Investment advisors and finance professionals must incorporate behavioural issues as risk factors in order to formulate effective investment strategies for individual investors.

With an objective to create investor's confidence in the stock market, behavioural issues are the newest of the things which must be considered while formulating investment strategies. This research will help investment advisors and finance professionals judge investor's attitude towards risk in a better way, thus leading to better investment decision-making.

Keywords: Behavioural Finance, Asset Allocation, Cognitive Dissonance, Rationality**JEL Classification:** G11, G00[Suggested Citation](#) >[Show Contact Information](#) >[Download This Paper \(Delivery.cfm/SSRN_ID1501721_code1181506.pdf?abstractid=1501721&mirid=1\)](https://papers.ssrn.com/sol3/cf_dev/Delivery.cfm/SSRN_ID1501721_code1181506.pdf?abstractid=1501721&mirid=1)[Open PDF in Browser \(Delivery.cfm/SSRN_ID1501721_code1181506.pdf?abstractid=1501721&mirid=1&type=2\)](https://papers.ssrn.com/sol3/cf_dev/Delivery.cfm/SSRN_ID1501721_code1181506.pdf?abstractid=1501721&mirid=1&type=2)

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