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Investor Rationality and Financial Decisions

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Abstract

This study used questionnaires completed by MBA finance students to test the degree of investors' rationality when the latter construct a portfolio or make loan decisions. We found that with respect to stock decisions, irrationality cannot be established. Investment in stocks was found to be influenced by expectations, past experience in the capital market, and knowledge about the past performance of selected market indices. With respect to corporate bonds, we found that, as expected, expectations about interest rate changes influenced the decision to invest in those bonds, as did past experience in the capital markets. The decision to invest in government bonds was the decision least likely to be based on rationality. With respect to loans, we found an expected negative relationship between the willingness to take out loans based on the prime interest rate and expectations about changes in interest rates.

Keywords:

Rationality Survey Behavioral

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Notes

1. The Bank of Israel's prime interest rate at the time the research was conducted was 1.5%.

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