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The Psychology of Financial Decision-Making: Applications to Trading, Dealing, and Investment Analysis

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Abstract

This paper offers a whole range of areas in which the latest work on psychology, social psychology and behavioral finance could offer competitive advantage both to financial markets as well as individual firms. The aim is to identify potential applications of experimental and organizational psychology to improve the efficiency of financial institutions. The focus is on two major areas of application: trading and dealing in currencies, and investment decision-making.

The paper reviews the seven deadly sins in individual decision-making showing how the financial decision-maker may fall prey to them. It also suggests how this knowledge can be put to use in improving efficiency in financial strategy, marketing, and human resource management (selection, training, decision-aiding, and control). The paper concludes by identifying important questions for the financial markets to consider if they are serious about improving managerial practices.

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