Markets and macroeconomics - macroeconomic implicationsof rational individual behaviour

Blackwell - Behavioral Economics

STUDY ON BEHAVIORAL FINANCE:
IS THE INDIVIDUAL INVESTORS RATIONAL?

Nik Maheran Nik Muhammad

Abstract

Behavioral finance models often rely on a concept of individual investors who are prone to judgment and decision-making errors. This article provide brief introduction of behavioral finance, which encompasses research that drops the traditional assumptions of expected utility maximization with rational investors in efficient markets. The article also review prior research and extensive evidence about how psychological biases affect investor behavior and prices. The paper found that the most common behavior that most investors do when making investment decision are (1) Investors often do not participate in all asset and security categories, (2) Individual investors exhibit loss-averse behavior, (3) Investors use past performance as an indicator of future performance in stock purchase decisions, (4) Investors trade too aggressively, (5) Investors behave on status quo, (6) Investors do not always form efficient portfolios, (7) Investors behave parallel to each other, and (8) Investors are influenced by historical high or low trading stocks. However, there are relatively low-cost measures to help investors make better choices and make the market more efficient. These involve regulations, investment education, and perhaps some efforts to standardize mutual fund advertising. Moreover, a case can be made for regulations to protect foolish investors by restricting their freedom of action of those that may prey upon them.

Keywords: Behavioral finance; Efficient Market Hypothesis; Investors psychology; Arbitrage; Rationality.

1. **INTRODUCTION**

According to *economic theorists*, investors think and behave "rationally" when buying and selling stocks. Specifically investors are presumed to use all available information to form "rational expectations" about the future in determining the value of companies and the general health of the economy. Consequently, stock prices should be accurately reflect fundamental values and will only move up and down when there is unexpected positive or negative news, respectively. Thus, economists have concluded that financial markets are stable and efficient, stock prices follow a "random walk" and the overall economy tends toward "general equilibrium".

In reality however, according to Shiller (1999) investors do not think and behave rationally. To the contrary, driven by greed and fear, investors speculate stocks between unrealistic highs and lows. In other words, investors mislead by extremes of emotion, subjective thinking and the whims of the crowd, consistently form irrational expectation for the future performance of companies and the overall economy such that stock prices swing above and below fundamental values and follow a some what predictable, wave-like path.

Investors behavior is part of academic discipline known as "behavioral finance" which explain how emotions and cognitive errors influence investors and the decision-making process. Behavior of the individual investors has long been the interest of academics and portfolio managers but not the investors themselves since the herd mentality sometimes dominates over

Description: -
-
Catalogs, Union -- India -- Hugli District
Bengali imprints -- Union lists
Mines and mineral resources - South Africa
Adolescent psychology.
Child abuse -- United States -- Prevention.
Abused children -- Services for -- United States.
Regional planning -- Ontario
Art, Austrian -- Austria -- Tyrol -- 20th century -- Exhibitions.
Art, Austrian -- Austria -- Tyrol -- 19th century -- Exhibitions.
Art, Italian -- Italy -- Trentino-Alto Adige -- 20th century -- Exhibitions.
Art, Italian -- Italy -- Trentino-Alto Adige -- 19th century -- Exhibitions.
Leicester (England) -- Pictorial works.
Leicester (England) -- History.
Mystery and detective stories.
Law -- Kuwait
Europe -- Foreign relations -- United States.
United States -- Foreign relations -- Europe.
Prelude automobile.
Honda Accord automobile.
Honda Civic automobile.
Macroeconomics.Markets and macroeconomics - macroeconomic implicationsof rational individual behaviour
-Markets and macroeconomics - macroeconomic implicationsof rational individual behaviour
Notes: Bibliography, p334-338. - Includes index.
This edition was published in 1984

Filesize: 63.23 MB

Tags: #Macroeconomic #Implications #of #the #Beliefs #and #Behavior #of #Foreign #Exchange #Traders

Rational Behavior Definition

The American Economic Review 93 5 : 1449—75. Alternatively, there are concepts that reject a vast part of the homo economicus concept, or which use other behavioural models as their basis. Anything that decreases the benefits or increases the costs will likely reduce the probability that the individual will choose that action.

Behavioral Economics vs. Traditional Economics: What is the Difference?

These observations are absolutely critical in understanding the theoretical landscape, but difficult to enact in practice.

Behavioral Economics

In comparison to other schools of thought, such as Austrian economics or Post-Keynesian economics, uncertainty is only a subordinate role and is only relevant to a subfield of behavioural economics. The properties of the macro order can be quite different from the properties of the micro order.

Behavioral Economics

In most theories and models they are treated as being static. Overconfidence has been shown to influence decisions that are more significant than assessments of driving or intelligence. Conclusion : Much progress has been made in the last three decades in developing solution methods for larger and larger models.

Related Books