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BEHAVIORAL FINANCE "MIND OVER MARKET" – A CASE STUDY OF TECHNO BUBBLE

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Introduction:

General thought process is governed by the concept of traditional economic theory that says that markets are efficient and that people make rational decisions to maximize profits. In short, traditional finance may be represented as '1+1=2'

However, the new school of propounded by behavioral economic theory believes that, while traditional economic theory may hold true in the long run in the short run markets are not efficient and people do not make rational decisions. People have a mind and a heart, but people do not always make decisions only out of their mind. When decisions are made from the heart, they are emotional decisions and may not be rational. People donating to charities or celebrating their birthdays are examples of action driven by emotions, which do not possess the motive of profit maximization. Behavioral finance may be represented as '1+1+ emotion=2 or 8 or 50 or 0'.

Are stock and security markets really efficient? How do they explain abnormalities like the technology bubble of the late 1990s to early 2000s? A new field called behavioral finance may offer an explanation to these abnormalities. Behavioral finance is becoming increasingly valuable in explaining how people act, and the resultant effect on stock markets. In fact, while emotion may be hazardous to the health of many investors, it may be a significant source of profits for others. Emotional investing usually produces instantaneous and often inappropriate moves, which provide liquidity in markets, and an opportunity for others to jump in when prices don't reflect fundamental values.

What is Behavioral Finance?

Behavioral finance is an emerging field that combines the understanding of behavioral and cognitive psychology with financial decision- making processes. The tradition economic theory we understand talks about efficient markets and people making rational decisions to maximize profits. However, this new emerging school of behavioral economists argues that markets are not efficient, especially in the short run, and people do not make rational decisions to maximize profits. Human beings are susceptible to numerous behavioral anomalies, which become counter- productive to the wealth- maximization principle leading to irrational behavior.

Behavioral finance combines psychology and economics to explain why and how investors act and to analyze how that behavior affects the market. Behavioral finance theorists point to the market phenomenon of hot stocks and bubbles, from the Dutch tulip bulb mania that caused a market crash in the 17th century to the junk bonds in the 1980s and Internet stocks in the 1990s, to validate their position that market prices can be affected by the irrational behavior of investors which includes speculation also. Behavioral finance is in conflict with the perspective of efficient market theory, which maintains that market prices are based on rational foundations, like the fundamental financial health and performance of a company.

1.2 Nature and scope of the study

This study is historical research as it based on historical data that examines past events to arrive at an account of what has happened in the past.

The scope defines the coverage of the study. The study will be confined to the behavior of investor and effect of such behavior on investment and on market

1. The study will cover period of techno bubble i.e from 1995-2001
2. The study is covering behavior of investor as major cause for market bust.

1.3 Significance of the study

This study is serving as guide for the prospective investor for making their investment decision. From the technology bubble & crush it is clear that investor need not buy what is popular, they need not buy what all are buying, as that has already become expensive. Investor should not go for hot sector, as the stock in that sector is doing well, an investor is more likely to get into the growth trap because choice of a company in that sector may be wrong.

Alternatively, when a sector does wee, unscrupulous management enter the sector with weak business models, as a result of which investors pay high valuation based on the sector.

Judging by the above discussions, it is really does make sense to look at a sector with sustainable economic characteristics, which is doing poorly due to lack of investor interest. However, the challenge would be to identify the right company in the sector. Companies in out of favor sector can result in healthy investor returns.

1.4 Objective of the study

- To study the effect of speculation on P/E ratio with hypothetical example.
- To understand the concept of "Behavioral finance"
- To study the behavioral anomalies
- To explain the dotcom bubble & crush through behavioral finance theory

1.5 **Limitations of the study**

- This is an academic effort limited to cost, time and energy and geographical area
- The study as cover only behavior of investor for making market crush
- Period is restricted to 1997–2000.

Literature Review:

1.Earlier economics was closely attached to psychology, which was amply displayed in the book **"The Crowd: A study of the popular Mind" published in 1896** by Gustave le Ban. The book was one of the greatest and most influential books of social psychology ever written. But with the development of Neo-classical economics, it has been taught to us that People have rational preferences among outcomes that can be identified and associated with value. Individuals maximize utility and times maximize profits and People act independently on the basis of full and relevant information.

2."The little book of behavioral investment" by James monitor (2010), Author has highlighted important behavioral challenges faced by investors. Book reveals the most common psychological barriers. **"Behavioral finance and wealth management" by Michael pompian (2006),**he shows how to make a better investment decision. Author has taken a practical approach to the science of behavioral finance and put it in to the real world. His research based on 20 numbers of important individual investor's biases and help in wealth management.

3. **"Animal spirit: how human psychology drives the economy and why it matters for global capitalism" by akerl of & Robert. j. shiller (2010)** author has reflected the concept of 'animal spirit' –the term used to describe the gloom and despondence that led to the great

depression, they detail the most pervasive effect of animal spirit in contemporary economic life such as confidents, fear, corruption.

4.“Behavioral finance- investors, corporation and market” by H.kentbaker and john nofsinger, book shows the traditional finance theory, which shows that investor are rational. the efficient market hypothesis (EMH) indicate that investors have impounded all known information and probability concerning uncertainty about the future into current prices.

5.A book on “Value investing and behavioral finance” by parag parikh ISBN NO- 978-0-07-007763-8.the book is divided in to 12 chapters covering how behavior lead to success and failure .author has show the behavior trend in market .book has explain the fundamental investing and speculation investing further chapter 6,7,8 are dealing with sector investing how and individual invest in specific sector.it has show the trend of ups and down trend in technology sector automobile sector further auther has explain clearly the entire cysle of bubble and bust how bubble generate and due to behavior how it bust is explain very clearly in his book.

However apart from book we have gone through journal of Behavioral finance one of the publication **–**

6)“Are investors rational and does it matter? Volume-12 no-2 (2011)by john livanas .the author has argue that the analysis of investor is best serve by considering the behavior of a group as a whole rather than investor as individual and assessing their choice when faced with successive similar task.

7) “A STUDY OF INVESTOR BEHAVIOUR ON INVESTMENT AVENUES IN MUMBAI” By Dr. Shamira Maleker ,Asian journal of marketing and management research, vol:1,issue :1 ,September(2012). Study is based on explorative research. study reveal that in spite of being part of Mumbai residency, in spite of having sound knowledge about finance and investment still people lack the edge above the others as this field is very vast and unpredictable hence investor must be backed up by a financial planner. Data is collected by using structure questionnaire and personal interview technique of 100 respondent .data analysis is done by correlation and regression method. Researcher has correlated some of the factor like ability of investment decision, investor’s efforts with their behavior. Her analysis reveals that degree of relationship between ability of investment decision and investors’ behavior is moderate. Further researcher has used multiple regression method to show the relation between independent variable (ability of investment decision, investors efforts) and dependent variable (investors behavior).Analysis shoes that independent variable do have impact on investors behavior. Further researcher has used cluster analysis, where data is divided in to cluster i.e. data is sorted in group (people, things, events).

However study is done on only 100 respondents which don't give accurate result secondly, research is done on investor irrespective of gender. Study reveals that investment decision is mostly done by male then female. In modern world where female are more financial independent taking their investment decision, result might gives different result by taking these point in to consideration. Researcher has shown role of financial planner or agent for making financial decision but study fails to highlights the preference of working women as a single parameter. Comparison shows male are dominating in this area but if we seen the situation of workingwomen now in modern days do this result gives proper conclusion? To study modern scenario researcher has taken this current study.

All the above book and journal explain the application of theory in stock market, individual trader and corporate finance. After observing all this our research has applied behavioral finance theory in to the stock market and explain how the stock market start from bubble and end to crash via behavioral fiancé theory by taking case study of techno bubble in late 2000 This was the only sector which was badly affacted by investors behaviour during that period, after this period there was ups and downs in market but the impact of that that ups and down was not major and doesnt affacted investor much.

In recent year real estate sector is in boom due to investors behaviour and speculation but the sector is still in boom phase .in our research we have highlighted how the behaviour and speculation leads market from boom to crash ,There was no major crash after the tech bubble in stock market. Secondly as far as applicability is concern our research will serve as guide to new investor and existing investor to study the market condition for investment purpose. The research shows how the market run from boom to crush due to irrational behaviour of investors.

however still the irrational behaviour and speculation leads the market due to ignorance of investors.This research helps the investors to identify and differentiate the fundamental investment and speculation investment.

Research Methodology:

As it is a historical research primary data collection is not possible so the entire research is based on secondary data

Secondary data: The methodology used was survey of information available on internet, journals, and books. This gave a broad overview about behavioral finance

Sample period- 1997-2000

Findings:

The Story of Technology Bubble & Crush:

Market Bubble

While the EMH (efficient market hypothesis)) is generally regarded as the best theory that can describe the actions of market prices. It is not perfect and sometimes events occur that contradict the EMH.One of these events is that of the bubble. A bubble is when a specific industry's market prices do really well, so well that prices seem to rise higher than the EMH dictates. Eventually, the bubble bursts and prices return to a price more in line with EMH. One famous bubble was that of the dot.com bubble. EMH does not explain why this bubble exists in the first place. This is one of the major criticisms of the EMH.Many academics have turned to the relatively new theory of behavioral finance to explain the bubble.

How is a bubble formed?

A bubble can only be formed when there are many greedy investors who are willing to allow someone to exploit their greed. This crowd goes on increasing in size, as other greedy investors join the bandwagon out of envy. This has a snowballing effect, leading to creation of an illusion in the form of a bubble.

Rational Individual v/s Crowd Psychology

One of the most important factors leading rational individuals, on being part of the crowd, to mass hysteria is that the underlying reason for the start of the optimistic wave is always a valid one. For example, the notion that proliferation of internet and IT products is going to change the way businesses operate was a valid one. Just that “any good idea taken too far leads to bad results” was in play in here.

Change in Sentiment

Sentiments play an important role in the formation of a bubble. Along with sentiment, perception also changes. This new scenario is then extrapolated too much into the future. A change in the economic growth of a country, a change in the outlook of the sector, or a change in the fortunes of the company can be extrapolated to such an extent that irrational projections are expected to be real and excesses are committed based on these exceptions.

Dot. Com Bubble through Behavioral Finance Theory:

The dot-com bubble was a stock market bubble which popped to near-devastating effect in 2001. It was powered by the rise of Internet sites and the tech industry in general, and many of these companies went under or learned some valuable lessons when the bubble finally burst. Several factors combined to cause the dot-com bubble, which is usually defined as the period of investment and speculation in Internet firms which occurred between 1995 and 2001. 1995 marked the beginning of a major jump in growth of Internet users, who were seen by companies as potential consumers. As a result, numerous Internet start-ups were birthed in the mid to late 1990s. Investors begin to see the growth potential in a sector and invest large sums of monies in these new industries. Investors' enthusiasm about new technologies, particularly the use of the Internet for business purposes, drove technology stocks to a high peak in the late 1990s. As a result the new communication technology of the 1990's was exaggerated. Many people associate lavish lifestyles with the dot-com bubble, since companies regularly sponsored exclusive events filled with fine food and entertainers & they were influence by the company & started investing in it hoping that companies will give good return in future This lead to irrational behavior of investors. This can lead to investors becoming over confident in the technology or industry. . Another factor of this over enthusiasm is that it could attract herding behavior. The irrational investor will be more likely to invest in something that is being hyped up as they feel that others are doing the same thing. They will feel that if others are doing it then it must be a good idea for them to do it as well. A factor that will have led to the dot.com bubble is that of speculation. One such author that observed the speculation effect on the dot.com boom was Giombetti (2000). Many informed investors will have probably over invested in the technology industry going against market theory. They will have done this on the hope that their investment will pay off. Even if their investment was initially at a loss they would have stayed with it. Authors of behavioral finance outline this behavior. This behavior of these investors would have distorted the market conditions for other investors. Also, the herding effect would have been greater due to this. These factors would have led to the stock prices of the dotcoms being vastly overpriced.

Bubble crash:

The process of stock price falls entails similar processes to the price rises, but in reverse. There may then be an occurrence that causes prices to fall rapidly. One such occurrence might be the emergence of new companies. The new companies compete with existing ones and push down their profits. Also when the new companies float on the stock market, the additional supply of shares will help to depress share prices. Towards the end of the 1999-2000 technology stock bubble many new companies were issuing shares. This increased supply of shares overtook the growth in demand for shares. The result was that the prices of shares in the technology sector began to fall.

Rising interest rates could be another occurrence that leads to falling share prices. Bubbles often

Involve people borrowing money in order to buy shares. High interest rates could cause investors to sell

Shares in order to pay the interest. Such sales could set off a crash. Rising interest rates can also reduce the demand for shares by making alternatives such as bank deposits more attractive.

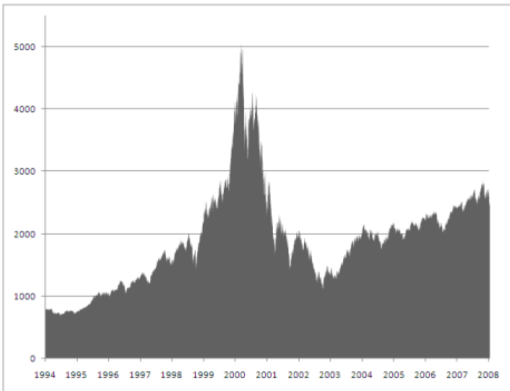
Other factors that can precipitate share price collapses include share sales resulting from negative

Statements by people who are looked upon as experts. These may be genuine experts such as governors of central banks, or self-appointed experts such as newspaper gurus. A sequence of negative news had led the dotcom bubble burst; the global economy went into recession; corporate profits fell; terrorism escalated on September 11th

2001; corporate scandals emerged from Enron, WorldCom, and Arthur Anderson; the likelihood of

Another gulf war appeared; and the consequent general fall in share prices was another form of bad news. Investors' reactions may have been to expect the flow of bad news to continue as a result herding effect would have on falling prices which leads to burst. This meant that when the bubble burst stock prices would have fell rapidly, causing investors to lose vast sums of money. This would cause them to pull out of the industry, which, in turn, causes the companies themselves to collapse. If it were not for irrational investment then investors might have pulled out earlier, before the collapse. This might have even meant that the collapse would not have happened.

The bubble and crash was particularly clear in the case of technology stocks. The NASDAQ index,Which focuses on technology stocks, rose more than six-fold between 1995 and early 2000. It then lost More than three quarters of its peak value by late 2002 showing graphically in below figure



The technology-heavy NASDAQ Composite index peaked at 5,048 in March 2000, reflecting the high point of the dot-com bubble.

A BEHAVIOURAL MODEL OF THE DOT.COM BUBBLE AND CRASH

Emergence of Internet

Justified increase in stock prices | **Enthusiasm for internet**

Momentum | **positive social mood**

Information cascade

Herding

Prices rise

Overconfidence

Prices rise

Confirmation bias → **BUBBLE** ← **Denial**

Emergence of new companies

Lower demand | **higher supply of shares**

Prices begin to fall

Information can no longer be ignored

Negative

Momentum | **Information cascade** | **Negative social mood**

Prices fall

Herding

Prices continue to fall

CRASH

Momentum

If monetary imbalance persists in one direction for a long period, extrapolative expectations can result. By extrapolative expectations is meant the tendency to expect that price changes will continue in the direction recently observed. Extrapolative expectations lead to momentum (positive feedback) trading with the effect that a price movement continues in a particular direction. The psychological bias of representativeness helps to explain the emergence of extrapolative expectations. If extrapolative expectations are widespread the result is herd trading, and herd trading can overwhelm any tendency for price trades to restore 'efficient' prices.

The rise in share prices, if substantial and prolonged, leads to members of the public believing that prices will continue to rise. People who do not normally invest begin to buy shares in the belief that prices will continue to rise. More and more people, typically people who have no knowledge of financial markets, buy shares. This pushes up prices even further.

There is a self-fulfilling prophecy wherein the belief that prices will rise brings about the rise, since it leads to buying. People with no knowledge of investment often believe that if share prices have risen recently, those prices will continue to rise in the future leads to boom stage and a euphoria stage in the boom stage share price rises generate media interest, which spreads the excitement across a wider audience. Even the professionals working for

Institutional investors become involved. In the euphoria stage investment principles, and even common Sense, are discarded. Conventional wisdom is rejected in favour of the view that it is 'all different this Time'. Prices lose touch with reality.

Social Mood

People transmit moods to one another when interacting socially. People not only receive information and opinions in the process of social interaction, they also receive moods and emotions. Moods and emotions interact with cognitive processes when people make decisions. There are times when such feelings can be particularly important, such as in periods of uncertainty and when the decision is very complex. The moods and emotions may be unrelated to a decision, but nonetheless affect the decision. The general level of optimism or pessimism in society will influence individuals and their decisions, including their financial decisions.

One factor that can affect mood, and the level of optimism, is the recent performance of stock markets.

A market rise is likely to improve the mood of investors, and their degree of optimism. A positive feedback cycle could emerge. Price rises improve mood and increase optimism. In consequence there are net purchases, so prices rise. These price rises positively affect mood and optimism. Such a positive feedback cycle could contribute to the development of a bubble. Conversely a downward vicious circle could arise with falling prices, worsening moods, and declining optimism.

Positive Feedback Trading

Positive feedback trading involves buying because prices have been rising and selling when prices have been falling. This may occur because price movements are seen as providing information about the views of other investors. Price rises indicate optimism and hence encourage buying, conversely with price falls. Buying pushes prices yet higher (and thereby stimulates more buying) and selling pushes prices lower (and hence encourages more selling). Such trading behaviour contributes to stock market bubbles and crashes.

Herding

people have a tendency to conform to the judgments and behaviours of others. People may follow others without any apparent reason. Such behaviour results in a form of herding, which helps to explain the development of bubbles and crashes. If there is a uniformity of view concerning the direction of a market, the result is likely to be a movement of the market in that direction.

Overconfidence

Self-deception is the process whereby people exaggerate their abilities. People tend to think that they are better than they really are. One psychological bias is Overconfidence. Overconfidence arises partly from self-attribution bias. This is a tendency on the part of investors to regard successes as arising from their expertise whilst failures are due to bad luck or the actions of others. This leads to excessive confidence in one’s own powers of forecasting. It is capable of explaining a number of types of apparently irrational behaviour.

Confirmation Bias and Denial

Conservatism renders people unwilling to change their opinions in the light of new information, so they may adhere to a view about the direction of prices even when those prices have moved too far. Confirmation bias is the tendency for people to pay attention to information that supports their opinions, and to ignore contrary evidence. Again this causes them to persist with market views, and trading behaviour, even when evidence suggests that those views may be incorrect. Confirmation bias is the tendency to ignore information that it is inconsistent with one’s opinions. If information and ideas are consistent with a person’s beliefs they are accepted, but if they are not consistent with those beliefs the information or idea is rejected. This is similar to the psychoanalytic concept of denial.

people do not share a common perception of reality; instead everyone has their
own psychic reality. These psychic realities will have varying degrees of connection with objective reality. Decisions are driven by psychic reality, which is a realm of feelings and emotions. Reason may be secondary to feeling. Feeling affects the perception of reality. People are seen as engaging in wishfulfilment wherein they perceive reality so that it accommodates to what they want. People see what they want to see. Unpleasant aspects of reality may be subject to denial, which is the pretence that unpleasant events and situations have not happened. Denial reduces the ability to learn from unpleasant andexperiences, since unpleasant experiences are removed from conscious awareness.

The Market Fall – CRASHES

Eventually social mood passes its peak and cognitive rationality comes to dominate social mood.

Investors sell and prices fall. If social mood continues to fall, the result could be a crash in which stock prices fall too far. The situation is then characterised by an unjustified level of pessimism, and investors sell shares even when they are already under-priced. Investors' sales drive prices down further and increase the degree of under-pricing. The process of stock price falls entails similar processes to the price rises, but in reverse.

From the technology bubble & crush it is clear that investor need not buy what is popular, they need not buy what all are buying, as that has already become expensive. Investor should not go for hot sector, as the stock in that sector is doing well, an investor is more likely to get into the growth trap because choice of a company in that sector may be wrong.

Alternatively, when a sector does wee, unscrupulous management enter the sector with weak business models, as a result of which investors pay high valuation based on the sector.

Judging by the above discussions, it is really does make sense to look at a sector with sustainable economic characteristics, which is doing poorly due to lack of investor interest. However, the challenge would be to identify the right company in the sector. Companies in out of favor sector can result in healthy investor returns.

Observations, Suggestions and Recommendations:

Suggestion for Investors

Investor cannot pay any price for growth or a new idea or a concept. Ultimately, it is the profits from an enterprise that matter. And for that stream of earnings there is a price to be paid. That is the value you attach to a stock. Paying high price for an expected future stream of earnings is a sure way to losses.

This is conventional wisdom. No new economy or the advent of any technology can change that. Remember the IT boom. The new adage was “eyeballs”. How many hits a site generated made the company owning that site very valuable. People gave crazy valuations to such companies. Profits did not matter, as in the so- called new internet economy what mattered were eyeballs.

Investing is all about earning a reasonable rate of return on one’s investment and that cannot happen if the company does not make profits. Such fads lasted for sometime until wisdom dawned and the prices of such internet stocks came crashing down.

Mid-Cap and Small-Cap Stocks

Once the highly capitalized stocks getting expensive, the market is looking at identifying new opportunities. Thus, the focus shifts to the mid-cap and the small-cap stocks. The growth stories of the hot sectors are woven around these stocks.

There is nothing wrong in mid-cap stocks, but the problem comes with representative thinking. In a market bubble, when the leaders go on becoming expensive, it is very easy to rig the mid-and small-cap stocks. Due to their lack of liquidity, their rise becomes fast and they become operator favorites. Unscrupulous management, operators and brokers take advantage of a bubble phase in certain stocks and sectors by rigging the mid-cap and the small-cap in these representative sectors.

During the IT boom, since IT stocks were doing very well, we found that many small and less-known companies attracted investor attention due to representative bias, and when the tide turned these stocks became worthless paper.

Examples of smaller companies affixing the words ‘dot com’ to their names became sought-after companies and investors paid a heavy price for chasing them.

Avoid Large Little-known Companies

In a bubble phase, little-known companies tend to become large due to the market capitalization going up because of the price increase. Such companies attract media and investor attention. Analysts always want new ideas and thus are born such growth ideas around little-known companies. These companies being in the limelight, become famous and their recall value in the minds of the investor increases.

Visual Soft during the IT boom is a fine example of a little-known Hyderabad-based company which became large because its stock price went up to as high as Rs. 10,000 for Rs. 10 face values. It was the talk of the town, recommended heavily by reputed investment bankers, brokers and analysts. Investors lost a fortune when the tide turned.

Financial technology is another little-known company which came into the limelight due to its presence in the fast-growing financial sector and its knowledge –base of stock exchanges. It promoted the Multi Commodity Exchange of India. It is a very good company, with able promoters and a good business model. However the triple digit valuation of over 120 PE, in the mid-cap category makes it an unattractive investment idea. There are many such examples in the hot sectors like real estate and infrastructure.

Every bubble phase has a new theme; however, the excesses are the same. Institutional memory of investors, through strong regarding the past mistakes in bubbles, fails to help as they believe that "this time it is different'.

Every bubble signifies excesses and irrational crowd behavior. This leads investors to buy expensive stocks; buy what others are buying, and buy what is fancy in the markets and buy dreams.

However, every new bubble has a new story justifying how this time this is very different from the past bubble. These are just new ideas and fads to act upon the new mania.

During the technology boom did we not hear "this is the new economy emerging", "the old rules do not apply", and "bricks and mortar is dead"?

There are certain universal principles that do not change, irrespective of other changes: A company has to make a profit to reward its shareholders, to earn returns one has to buy at the right price, valuations matter the most, there are no short-cuts, and you cannot sow today and reap tomorrow. Irrespective of different times and circumstances prevailing, the universal principles do not change. The euphoria of markets makes one forget the conventional wisdom.

Never Short-Sell

After understanding the signs of a bubble one may become confident and think of short selling, the act of borrowing shares and selling them with the intention of buying them back when the price drops. This is one temptation which needs to be avoided, as a bubble can last longer than one imagines. A stock at a triple-digit PE of 100 may be overvalued, but the euphoria of the market can take it up to even 600. No one can judge how long the madness will last.

There is another danger in short-telling. If one buys a stock at a price one knows the maximum loss one can make. However, when one short-sells, one does not know how much the stock will go up. If one buys a stock at Rs. 50 the maximum damage is Rs. 50 the loss is unlimited. The stock can go up to Rs. 100, 500, 1, 000. Or even Rs. 10,000.

Control emotion like greed and fear:

There are no two individuals who are identical and their emotional reaction may vary from person to person. For some people greed and hope are more pervasive and can co-exist with pride, love, euphonia or disbelief until fear or panic takes over. Some people may be too sensible to fall in love with a stock or become euphoric. Some people stay in a declining stock because of a combination of stubborn pride and disbelief. Others may experience fear but they will not surrender to panic. The fear of some investors will be so intense that they will not be able to stop perfect time. Thus greed and panic varies from person to person. There are very few investors who adopt the principal of profit booking and thereby controlling their greed.

No two individuals are identical and so does their emotional reaction may vary from person to person. For some investors, greed and hope are more pervasive and may co-exist with pride, love, euphonia or disbelief until fear or panic takes over their emotions. Few of them may be too sensible to detach themselves from the scrip. Majority may stay in a declining stock because of a combination of stubborn pride and disbelief. Others may experience fear but may not surrender to panic. The fear of some investors is so deep and intense that they might not have control over their emotions. Thus emotions like greed and panic has varied reaction. There are handful of investors who adopt the principal of profit booking and thereby controlling their greed.

Conclusion:

Investors would do better not only in investing, but also in all walks of life, if they keep in mind the behavioral biases that affect clarity in thinking. Money is good as long as it is in the pocket. It becomes dangerous when it goes in the head. That is when investors become irrational and start making blunders.

Human being have tendency to credit their successes to themselves, whereas their failures are attributed to external variables. This bias is termed as “attribution bias”. Money is made mainly backed by the overall increase in stock market levels because of increase in the demand for stock. People start attributing their successes to themselves and become more & more confident about their ability & methods. But any event is a confluence of internal & external factors & the same is the case in investing.

Thus when an investors makes money, he should reason his success by appreciating any unforeseen event, which led him to make money out of a trade and, accordingly, weigh his strengths against his weaknesses, rather than blindly attributing all the success to himself. If he fails to do so, he will cease to see the linkage between cause and effect and the result would not be favorable in the long run.

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