How biases affect investors behaviour

Business

The paper " How Biases Affect Investors Behaviour" is a wonderful example of an assignment on business. Behavioral finance influences investment decisions in various ways. Research indicates that behavioral fiancés involve a structure that indicates the interaction between corporate financial managers and investors. It tries to explain why investors buy certain securities and why they may not buy certain assets at all. Therefore, it can be observed that the manner decision varies from one person to the other. This may be attributed to the factors that influence their investment decision. Those factors that influence an investor’s decision are as investor’s biases. They include; investors traits/personality, emotions, mental biases to mention just but a few. The personality of an investor may significantly influence his/her investment decisions. Some investors are risks averse while others are risk-takers, and others risk neutrally. A risk-averse investor is more susceptible to avoid risky portfolios at all cost despite the fact that higher risk portfolio has higher returns (Baker & Ricciardi, 2014). On the contrary, an investor who has a personality of risk-taking is more likely to make investment decisions that attract higher risk and returns. On the other hand, a risk-neutral investor will remain indifferent between taking risky or less risky portfolios. In addition, emotional and mental biases influence investment decisions. The past mental and emotional experience may influence an investor in making a present investment decision. For example, an investor who had incurred a higher risk in the past may avoid making investment decisions that expose him/her to such risk. Other biases such as worry, anchoring, self-attribution, and familiarity biases may influence an investment decision. Some investors may have fear/worries that if they make a certain investment they may lose. On the other hand, anchoring,

biases entail holding a particular belief and using this belief subjectively in making an investment decision. Self-attribution biases entail where an investor attributes successful investment to their action and bad events to an external factor that they do not have control. The baseness of familiarity also influences the investment decision. Under these biases, Investors makes a decision based on what they know. In such a situation, investors are more likely to invest in the portfolio that they know about and ignore those that they do not know about their impact (Baker & Ricciardi, 2014).

2). The difference between contrary opinion rules and smart money rule may be discussed as follows; Contrary opinion rule involves an analysis that is by individual investors prior to making their investment decision. The investors who use contrary opinion rule viewed the majority to be on the wrong side/incorrect and chose to make their investments decision based on the opposite direction. Under this rule, various indicators may be adhered by investors. Such indicators include; put to call ratio, mutual funds cash indicator, and the advisory indicator. Under the put to call ratio indicator, if an investor views that the put to call ratio is large he/she would via the investments as bearish and undertake the opposite direction of bullish. Mutual fund indicator, the investor monitors the position of mutual fund and trade against it. Under the investor's indicator/opinion, the investors trade against the views made by the technical analyst (Lai, Reilly, Bu & Brown, 2002).

On the other hand, smart money rule involves a process where the investors view other investors as smart as compared to others. Under this rule, less smart investors follow the direction taken by smart investors when making

their investments decisions. The indicators under this rule include; index confidence and debt margin. The index confidence indicator displays are on the top ten corporate bonds over an average yield of forty bonds. On the other hand, debt margin indicator involves either a decrease or an increase in margin. It means that if the margin decreases, it is an indication that smart investors are bearish (Lai, Reilly, Bu & Brown, 2002).

3). The fundamental analyst uses factors such as prevailing market condition, management style and the overall economic condition to analyze and predict the future securities prices. The fundamental analysis tends to be more comprehensive as compared to technical analysis. The analysis takes into consideration numerous factors, unlike technical analysis. On the contrary, technical analysis entails the use of data and past statistics to predict the current securities prices. However, technical analysis has been criticized under the efficient market hypotheses (EMH). The hypothesis asserts that the stock market is an efficient market and that past, the present security information may not help to predict current security prices because the security market is self-correcting. It means that it adjusts immediately to incorporate any emerging information into the security prices. Therefore, the technical analyst may not predict with certainty the underlying value of particular security using the past or present statistics (Schwager, 1999).