

Investment Perspective According to Behavioral Finance Science

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The first thing that comes to mind is the highly important question of whether there were some effects of human behavior and its fluctuations on the theories of the efficient market and the contemporary investment portfolio. According to what has been said by the proponents of these two theories; when the optimal return is realized, the efficiency of the market is achieved in terms of perfect information on prices and risk that supposed to be predetermined in a rational way.

he other question that imposed here is “at what time people should be rational in their investments in the security markets ?”. This means that investors are rational for their efforts devoted to utility maximization, which are perceived as a result of investing their wealth in the best possible manner.

Then, can those two questions be achieved in practice? Many ontological aspects are influenced in their relations by emotions and feelings more than by money as a financial resource . Investors may take irrational financial decisions because of the dominance of those emotions and feelings compared with what investors do toward other actions in their public and special daily life.

Understanding investors financial awareness without taking into account the human action is considered as an outstanding problem which can be assimilated as an attempt to sail with compass, but without guided maps. The importance and necessity of human psychological factor are arise when we are talking about investing common stocks in the security market. Then, this means that issues directing investment decisions of individuals in financial assets whether they were stocks or bonds, can be only interpreted with referring to principles of human behavior.

Absolutely there is no exaggeration if we said that the market in general be advanced, lagged behind , prospected , and crept when making collective decisions in buying securities through viewing psychological factors which capture individuals behaviors after information being collected and analyzed. The validity of an efficient market theory has been widely accepted by its proponents for a long time lasting almost a century so that any research on the psychological aspects of a security market encountered by objection till a close time of ten years .



As for the ten years period ago , it had witnessed a revolution that resulted in finding new ways for viewing some issues related with money in terms of studying human behavior and feeling of an investor in conducting an accurate accounts of financing with common stocks at security market .

Nowadays, the mix made of financial management and psychology sciences is known as behavioral finance. The specialists said that this specialization has conveyed from ivory towers of sublime universities into roundtable of discussion among amateurs of doing investment and its professionals. One said that among the basic assumptions deduced from opinions of behavioral finance scientists is that the better enemy for investors was not the security market by itself , it might be the individual by himself with his feelings , needs , suspicions, and perceptions .

So, as I believe, the behavioral finance as a new science develops the financial theory of investor behavior as a human being . In doing so , Professor Daniel Kahneman and his fellow Amos Tversky took the initiative in the earliest of 1970s . They developed the core results in that area when they emphasized via their successive research that most of people in their nature are irrational in making the relevance decisions of financial transactions , and unsystematic in hold themselves responsible for making investment decisions at the security market . This naturally expressed by the psychological aspects of investor and the nature of risks encountered in the market .

Then , money is considered to be the powerful factor that affects on changing investor behavior . In viewing loss or profit , probably there is some dissimilarity from one person to another . A loss of money in some amount might be a disaster for one person , and probably does not make sense for another.

For now, specialists in the financial management consider understanding financial behavior conscious as an outstanding issue that must be encountered . The purpose is to find some kind of a mental and thoughtful mix about what derives investor behavior , if we postulate that there is an accurate information on price movements and the risk degree in the mature or emergent markets .

Warren Buffett explained that there are three behavioral principles on investing securities , these are :

1. The view of security market as a business after taking into consideration that some investors has a view differs from other investors .
2. The investor is much concerns with the concept of margin of safety which gives him a competitive advantage in the market .
3. It is not necessarily means in absolute that the available information for use by all who concerned about, leads to identical estimations of the future returns and risks.

One who considers the cited above principles carefully observes that the development of investors orientations is a matter of conduct from the viewpoint of finance and psychology under market prosperity and decline other than a theoretical knowledge related with business being improved or wrinkled in the market .



There is a prerequisite for each individual to have a gravity to balance his psychological feelings in perpetuity . No doubt the psychological condition of an investor will be one of the important factors that leads to the efficient market establishment. The investor as a social being by instinct cannot isolates himself from the society where he lives and he cannot prohibit his feelings , suspicions , and desires from being affected by the surrounded environment conditions .

Accordingly, for decisions of the investor to be successful , he needs to recognize and conceptualize his psychological conditions beside those of other investors along with studying psychological readiness for dealing with the market including all of its potential facilities and challenges that closely or farther affect performance of the market . The reason is that some investors might be bored , frustrated, disappointed, and repentant when the market marked down .

Inversely , morale and self trust might be high when the market marked up . It might be beneficial to say that the most important characteristics of the sober investor are the self protection against risks and psychological excitement control that in terms of them, investor 's patterns are classified into the following :

1. The cautious , conservative , and afraid investor pattern that averts highly risk projects .
2. The emotional conservative investor pattern that makes some balance between minimum risk taking and minimum return .
3. The systematic formal investor that has a diverse knowledge and experience which are often devoted by the investor to manage his investments .

In addition to the three principles stated by Warren Buffett , the Graham point of view is also based on three basic assumptions :

1. The suitable reaction of the investor against deflation is almost the same whenever the owner ignores an unattractive price offer . This from other side means that the real investor is rarely enforce himself to sell his stocks , but he is at all times a free enduring one ignoring value of current prices .
2. The market is unstable by feelings and emotions so that whenever investors feel happy , they might be more promise and the vice versa . In contrast , the market probably presents very high prices of stocks in some days of the year . And in others , a prone to paralysis might be the case that individuals face along with a firmly appearing problems of a huge decrease in stocks prices .
3. The investor that let himself posed for widely divergent or worry of his ownership of stocks owing to unjustified decline of the market , his realized returns will be an adverse imperative damages .



According to the previous assumptions, it could be reached to many behavioral influences the most prominent ones are :

1. The investor should not run away or being scared about irrational investment decisions of other investors in the security exchange . At least , this means that each investor should accept the published prices regarding them as a postulate .
2. The successful investors need to make a sound investment decisions with the ability to protect themselves against the feelings hurricane thrown by the security exchange.
3. Investors should be characterized by rationality. Moreover, they must strive to maximize utility achieved by deployment of their resources. Despite that , the majority still behave irrationally or irrationally to some extent especially it has seen in the latest ten years an obvious change in behaviors owing to financial crises and dealing with the work life problems .
4. The fear and greediness are still to be gone through the security exchange. The foolish mistakes did not take long before they perpetrate by many investors in a successive way which may have an ample effect on prices of stocks .

It is clear from the previous discussions that a large number of relevant concepts or conceptualizations to behavioral and organizational sciences determine the behavior of investor, of which are:

1-Personality: Personality differs from one investor to another, according to their view of money and investment areas. And to achieve returns, it should go along with areas that fit their personality in terms of needs, desires and directions. If correct estimates are not achieved in a way that fit the personality and its tendency and mood , mistakes and repeated lapses will be occurred in making improper decisions in the market.

Accordingly, the investor should understand himself and the character of others, and be aware of informed, emotionally active, adventurous bold, cautious conservative, or a combination of that. The investor's personality in accordance with this framework is a set of features and characteristics that determine a specific pattern characterized by a kind of stability and relative steady to the individual's behavior in responding to the things , issues , questions, problems , situations, and people facing in the financial market.

2- Learning: Learning of the investor is characterized by change (in terms of learning something leads to change his behavior), continuity (in terms of the learning is not interrupted at a certain point or specific phase), expertise (in terms of gained knowledge and understanding on the subject learn), and the activity (in terms of his effective effort to achieve knowledge and skill).



Accordingly, the level of knowledge and skill achieved for the investor reflect the unique situation in the performance of the important and effective role in the study of the investment market, the movement of prices, the situation of risk, the use of financial, psychological, behavioral and social techniques in the selection of stocks, identify the preferences of investors based on the types presented in the financial market, develop options for investment portfolios, and thus take the appropriate decision in light of the assessment for all situations, circumstances and times.

Investor learning, then, is in fact represents the relative change in the behavior of investor in the investment market as a result of his distinctive effort that based on his experience, knowledge and skill in buying, selling, timing and assessment of alternatives and making most appropriate decision in a way that consistent with achieving the possible financial returns.

3- Attitudes: A set of beliefs and feelings held by the individual towards opinions, situations, issues, things and persons. The direction of the individual investor to the market may vary when it is mark up and mark down, to the extent where it is difficult to say that he is the same individual in both cases. In the accounts of money, it may took according to trends of the investor much sense to him if he feels it represents life in all its aspects and shape strength of his emotional, moral formation, and a behavioral component.

4- Motives: Namely, those psychological causes which work to arouse and direct behavior toward the goal, and maintain the walking direction which is consistent with achieving success and prevent failure by reasonable amount.

The motives achieve for the investor four important functions: they evoke behavior and urges him to make an effort to achieve a specific achievement, it's affecting the quality of his expectations and ambitions according to its activity, they guide behavior towards the interest of the information influential in determining the appropriate way to him, and they direct to good performance of the catalyst so.

The motives that belong to the investor are usually variable from time to time, and position to another, according to market prices, laws and regulations, and expectations about the returns and risk.

5 - Needs: The ultimate objective of the investor in the stock market is to achieve financial returns that satisfy shortages and the destitution that suffer and face the potential risk. Typically, the needs are great for investors and differ from one another, they may be pivotal in the stock market to stay in the market, the protection from loss, developing feelings of mutual shared love, understanding of others, participation and interaction, comfort and fun, innovation and creation, a sense of belonging, freedom of exercise of rights and much more.

6- Ethics: A set of principles, norms and behaviors that govern the behavior of the investor to determine right and wrong conduct in the financial market with the context of building highly confidence and advanced climate based on the principles of good faith, transparency, commitment and acceptance of the other party. Ethics for the investor is a form of human understanding and awareness which based on the control and regulate of his actions in the financial market with the identical and neutral understanding of the profit and loss.



7- Perception: all the perceptions, opinions and beliefs of the investor based on rational , logical , systematic, and valuable thinking to a project or a particular person. The sound perceptual system for the investor will be achieved with the evolution of investment behavior that is subject to evolution and improvement of the pool of understanding about the things and awareness of errors.

Perceptions and emotions may play a major role in business, so that the research in this area found that recognizing the risk and avoid loss will in the end earn a definite gains on the basis that consequences of the decisions taken by investors were satisfactory exiled for pain and suffering the disappointment and frustration. Perception of the investor is the process of psychological animated sequence of the receipt and processing of information about the market and what goes on in, and ending with access to outputs relevant to realization of the required situation.

8 - Decision Making: This is part of the process of thinking by the investor when there are analysis , evaluation , extraction , identification , and selection of alternatives to shape investment preferences. What is required from the investor is to take into account this aspect of the specification and diversification of investment portfolio as much as possible, interest in investment timing , implementation of successful management, and enhance competitive efficiency.

In the investment market there are many patterns of decision-makers Some flow, careful, planned, intuitive, impotent, submissive, slacker, cautious , and the distracted .

Experts say that the expansion of understanding on the subject of behavioral finance needs to go into five important behavioral concepts :

1. Overconfidence decisions of investment taken by the investors in the security market: usually over-confidence appears in the investment behavior for individuals in terms of experience abundance and accuracy of knowledge and their good skill on the financial returns achieved. It might be seen that some investors trading many shares, or / and retain risk shares , or/ and responding to the information in a similar case earlier. Overconfidence investors have strong belief in their abilities, where information is understood and translated, they are affected by incline toward the sale of the gained stocks thinking that is the self-confidence, keep the lost stocks fear of feeling regret and frustration .

However, overconfidence investors in the markup attribute their success to their own capabilities, and in deterioration attribute their failure to market itself, or turn the blame on others or to lament their bad luck. Psychologists and behavior scientists went toward talking about forms and models on the behavior of individual investors who overstate the confidence in their work in the market, which are classified in almost four, namely:



@ Investor has risky investment portfolios, but does not capture the size and extent of that risk.

@ Investor did not consider the value of the essential information, making appreciation for the market price is different from its fundamental value.

@ Investor does not have experience in this market, but he buys, sells and trade as much confidence in personal abilities.

@ Investor buys and sells in the market in the light of the earlier gains, and may not respond or responds slowly to the information available.

2. Over action Bias to the bad news, and slow to the good news: the pattern of the behavior of the investor in the stock market may make stock prices interact with the news before he felt it and correct the price. Ones who meditate carefully on statistics and data available in the long run find that the common stocks planned by the Financial Planners in order to achieve low profit will be oriented to show high leaps in the price at the dates of earnings announcement, while common stocks, which are planned to achieve the high profit-oriented show low leaps in the price at the dates of earnings announcement .

Financial analysts interpreted that the observer for a series of movements of last profits sequence, finds that the investor correct this mistakes just as bad news reach to him about the profits, and this reflects investor behavior during the initial bid to the market on the dates of the announcement as the case of reaction exaggerated.

3. Asymmetric loss aversion so that the psychological impact is much greater than the pleasure of profit. Man by nature abhors the loss and fear, or perhaps sensitive to many of them when compared to profit. It is said that the old saying that the loss weighed twice compared to the weight of profit, that the pain of loss is equal to two times compared to the joy of profit that are one time. When investor lose, he leaned towards doing another work in an effort to reduce fear and reduce the frustration, as conducting twisted discussions on another subject, or avoid going into the new information, or trading in other activities away from the trading business in the financial market.

4. Tendency of human beings in his Mental Accountings to put money in various forms: Most investors have tended to focus (as a humanity) toward the development of the events specified in mental parts or sections depending on the marginal thinking at a given moment. In other words, the focus will be to consider some issues and small problems both individually and independently, and thus an investor puts his money in a variety of forms depending on the configuration of the type of integrated investment, including providing his possession, in a naturally way that secures and protects money from the downside risk reaching to wealth.



Example of mental accountings common in the stock market is that in January as beginning of a year, where prices may be headed for stocks to rise, and in December as the end of year, where the price goes more towards stability and mark down times, the fact that the month is a time of accounting, assessment and self review. Behavior of investment may vary during the year, according to what is going on in the mind of the accounts in the management of risk and return.

5. Type of response to the risk and bear: when deteriorating market notes that even those who have the adventure picture will become wary. In the booming market, it is noted that not only investors and adventurers will add to their investment portfolios more shares and bonds, but even skeptics of them .Risk is considered as one of the most critical factors in making decisions to invest in stocks. By identifying the degree of risk , type of investor can be identified. Investor cautious behavior is heading towards no-risk, while the regular investor behavior tends to high risk for achieving higher returns.

On this basis, the investment risk is the volatility of a regular or irregular, periodic or non-periodic, comprehensive or partial occur in the value of investment assets and / or returns expected in the uncertain circumstances prevailing in the financial market . There is no doubt that this risk effects direct and indirect orientations of the investor , the investment behavior, and the determination of preferences.

Here we can already say that the degree of risk play a role in determining the pattern of investor behavior, in turn, also reflect the behavior of stock prices in terms of their impact on returns and their association with the return of the overall market. As emphasized by those concerned with financial management that the high volatility in stock's return reflects the property of the offensive stock , the moderate volatility reflects the property of a moderate stock , while a low volatility reflects the property of the defensive stock .

Finally, we would like to say that behavioral finance is the study to investigate the reasons that investors are looking forward for the interpretation of the inefficiency of the market by reference to psychological theories and principles that govern their behavior. Note that those individuals who sometimes make foolish mistakes and illogical assumptions in dealing with the funds are the pivot of this new focus. It is almost investor behavior is the basis of the thought of behavioral finance. A proper investment decision-making is the core of building theory in which, on the basis that each investor is different, each one with his financial targets is different. Possibilities to take risks, trends , needs, and motivations are also different.