ROLE OF INVESTORS SENTIMENTS IN STOCK MARKET

A Review of Behavirol Finance

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Abstract :Stockmarket plays vital role in the economic growth of the country this leads to motivate the foreign institutional investor's to invest their savings. The aim of the paper is tointerpret efficient market and also includevarious forms of EMH. It also expose that investors don't act rationally all the time when making investment decisionandthe role of irrational behavior of investor to deviate the fundamental value of security prices. The article also provides the concise introduction of behavioural finance and literature of various behaviour biasessuch as overconfidence, herding and representative.

IndexTerms **- Market Hypothesis,Behaviour biases, Institutional investors,anomaly**

1. INTRODUCTION

The growth of the stock market is quite impressive particularly in terms of market capitalisation, Number of listed companies; turnover rate. It plays a vital role in the growth of economy which reflects in terms of increasing rate of GDP (Narayan et. al.,2014).

The demand of the capital of the large size firm also induces the stock market activity. Stock market is profitable but this profit varies from sector to sector. The investment has been made by the FII and the trend in international stock exchange both are significant factor in the stock market fluctuation. Institutional investor and individual investor both reactions also needed to be considered to analyse stock market volatility. For a long time the economic professional thinking about the functioning of stock market was dominated by efficient market hypothesis (EMH) (lux,1995).

Security prices incorporate all the availableinformationwhich is called efficient market hypothesis, it has two implication i.e.(i)The immediate new information incorporate price and investor can only earn the normal profit . (ii) Company alsocan't take the advantageover price andonly receive the fair value of security.EMH has three form week form, semi strong form and strong form. Week form is related to thepast informationit states thatit is impossible to earn superior risk adjusted profit with the past priceor return of the stock price. Semi strong form is relatedto public information it states that investors cannot earn superior risk adjusdprofit using any publicly available information where as,A strong form is related to public or private information to incorporate stock price. There are three argument exist rationality, not fully rational and arbitrage which does not hold in the true sense and this leads to the introduction of behavioural finance.(Andrei shleifer,2000)

Behaviour finance is the study of the psychology of a financial practitioner thatinfluencesthe financial decision making process and financial market. It also helps to understand that how and why market might be inefficient (sewell,2010). Behaviour finance is much broader than traditional conjecture of expected utility maximization with rational investors in efficient market. It has two building block cognitive psychology and limit to arbitrage. Cognitive psychology describe aboutthe thinking process of individual and how their thinking leads to systematic error they make in the decision making. They are over confident and give more weightage in recent experience as well as their preference form misrepresentation (Ritter,2003).

2. INSTITUTIONAL INVESTORS:

There are various groups of market participant such Retail Investors, market makers, hedge-fund managers, pension fund each of them behave in a common manner (Andrew w. lo,2006). These investors are motivated by the host countries stock market performance .Expanding capital market, High gross GDP growth rate, and moderate interest rates made the nation as a favourite destination for FII and motivate to invest in these emerging economies (Chattopadhyayet.al., 2017).

FII plays significant role in the growth of the economy and leads to financial resources and liquidity to the market. It was studied the impact of institutional investment on host country stock market and found the flow of these capital destabilise the price of stock from fundamental value, with no reversion (froot et.al. 2001).

It was investigated on 20emergingmarketthat the foreign capital flow creates short term price increase in the host country and momentum effect in long term (Bekaert, 2002).It was tried to understand the trading impact of DII and FII on Korean stock market and generalised both the investors trade in patternand change their trading strategy very infrequently which construct a momentum effect on share price (Chae and 2004).

Tried to analyse from the 25 countries dataset over a five year period of 1994-1998and analysed that the cross/ border institutional investment depends on the country fundamental, which construct a price pressure in short run in stock market(froot and Ramadorai,2008) same result found in addition with price reversal happen in lateral stage(jotikashitra,2013).

3. Behavioral Baises

3.1 Herding :

Herding arises when investor decide to imitate the other decision or movement in the market rather than follow his own beliefs and piece of Financial information. This behaviour may be seen on a number of grounds and not necessary leads to efficient market outcomes. The psychological definition of herding has evolved as a scenario in which individual abide by the group decision and follow them even when they perceive that the group to be wrong. Individual investor rely more on public information for their trade as they are influenced by market sentiments and attention grabbing events (Hwang, 2004).

It was found the herding tendency of fII over different phase with the help of daily data from January 2003 -2014of Indian stock market with auto regression model and multivariate regression models .It was analysed that the buy side herding dominate the sellside which destabilise the security price from fundamental price(Garg and Mitra, 2015).

The risk and return relationship in institutionalherding also investigated from the data collected January 1,2005-December 31,2013 on the Taiwan stock exchangewith the help of multiple regression analysis and found weak acrossthe period. It was revealed thenegative correlation of return with change inriskwhen institutional herding occurs in stocks(Huang et. al., 2016).

It was examined and compared herding behaviour of two emerging economy such as Chinese and Indian stock market from the sample of 1999-2009. It was found high in the extreme market condition in both emerging market. Itwas greaterwhenmarket is declining and high trading volume in chinese market whereas it occurs during upswings the market and unrelated with trading volume in Indian market (Paulo lao, harminder singh,2011)

It was detected that the herding iscomparatively more noticeableinlarge capitalization and most liquid stock than smallcapitalisation and less liquid stocks. It was also detected the causes and consequences of herding in financial institutioninGerman stock from period of July 2006 to march 2009. It was also found with the help of panel regression that herding is mostly unintentional and its intensity depends on stock characteristics which include past returns and volatility (Stephanie kremer and Deter Nautz, 2013).

3.2 Ovrconfidence

Theoritical model suggest that overconfidence investor trade excessively. The model is tested with the help of data collected over 35000 household from febuary 1991tojanuary 1997by the partition of investor on the gender basis. It was found that the men are more confident than women. It is quite complicated to mitigate the trading need with trading volume observed by rational investor in equity market.Rational investors made periodic investment and withdrawal tomaintain the balance in their invested portfolio as well as to minimize their taxes(Barber&odean,2001).

It was analysed through answers and brokerage records and reports and studied that men less rely on brokers and make more transactions with this belief that return are highly predictable and anticipate higher possible return by spending more time and money. In these ways men behave more confident than do women and it was evidenced that overconfidence create bubbles on financial market(Lewellen lease and schlarbaum’s,1997).

It was studied in the developed models in which the overconfident investor overestimates the accuracy of their knowledge about the value of the financial security. They quantify the belief that their personal assessments of the security value are more than the assessment by others. They belief more vigorously their own belief and concerned less other belief about the security valuation. These boost the difference in opinion and cause trading.

They spend excessamount of resources (e,g time and money) on investment information and hold an unrealistic belief that their estimation is so effective and it will convert in high return.Overconfidenceinvestor hold riskier portfolio whereas rational investor do with the same degree of risk aversion. It is pointed that the overconfidence is outcome from investoroverestimate exactness of their private signalsand their abilities to correctly interpret public signals(Odean,1998).

It was deployed the double threshold GARCH Modeling Taiwan stock market from the data collected 5January 2001 to31December 2004and foundboth individual and institutional investorbehave overconfident when the market return is high, low volatility and high liquidity than the low return regime(liu 2016).

3.3Representative

Overreaction refers to overweight the surprising and dramaticInformation. Itcauses the return reversal and auto correlation in the long term horizon. Individual violate the bay’s rule and trend which consequently overweight the near information than distantinformation called representative (De Bondt and thaler,1985).

Representative means people estimate the probability of uncertain event or sample under uncertain situation by the degree to which it is (i)similarity is essential property to its parents population.(ii) it reflect in the form of sailent features of the processby which it is generated(Kahneman and Tversky,1972).

It was studied that in the stock market an investor used these past performance of the firm as a representative of a general performance that will continue in near future as well.Investor assume that consecutivepositive earnings surprises to generate the good performance where as on the other hand consecutive negative earning will continue to generate poor performance.

to test the representativeness/ overreaction hypothesis examined the sample of 4081 firms listed on NYSE, NASDAQ and AMEX over the period of 1983-1999 and found that a series of similar past earnings surprises causes an increasing overreaction phenomenon which derives

stock prices below their rational level and vice versa. The magnitude of the market overreaction has positive relation with number of similar past earnings. It means that investor tend to strongly extrapolate similar information under representativeness effect(Kaestner,2006).

In the study of529commercial aired and their likability effect the stock market returns. It was tested with the help ofevent study method and check whether the more likable commercialexperience higher returns. It was also found that the firm arising top 10 and bottom 10 commercialsbothdisplay positive abnormal returns but the gainis not significant in the immediate days. The result was found that investor positively react towards more likability commercial than less liked ones(chang, 2009).

CONCLUSION

In summary, the paper highlightsthe role of stock market in economy. It also explainthat the price provides the accurate signal andreflect all the information that make market efficient.In real world investorsdon't always act rational but also irrational which leads to the emergence of the idea of behavioural finance. The presence of the various sentiments such as herding,overconfidence and representative biasesdestabilise the security prices from the fundamental value.Investors sentiments plays important role to anayse the stock market movements.Price, probability and preference these are the fundamentals but preference is the most complicated to understand.When environment change it has no surprise that the heuristics of the old one does not suited to the newone in such case we observe the behavioural biases but rather the term used behavior irrationalthe more accurate term for such behavior might be maladaptive.

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