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Role of Behavioral Finance in stock market price movements- with special reference to stocks of D SIBs in India

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ABSTRACT

Behavioral finance is the study of the influence of psychology on the behavior of investors or financial analysts. It is a psychological effect on investment decisions (Shefrin, 2001). According to conventional financial theory, the world and its participants are, for the most part, cogent "wealth maximizers". However, there are many instances where emotion and psychology influence our decisions, causing us to behave in unpredictable or irrational ways. Investors' enthusiasm that drives the assets higher than that those justify is called as irrational exuberance. The key objective of this research is to analyze the stock price increase or decrease in a year and its correlation with investor's behavior. The study also focuses to find out whether irrational exuberance is another reason for price rise of stocks. To narrow down this study, the three Domestic Systemically Important Banks (D-SIBs) in India SBI, HDFC, and ICICI are chosen. Prior five years stock data are collected and graphed using moving average method to analyze the relationship between investors' behavior and stock price. The study also focuses to learn the magnitude of behavioral finance, which is very imperative concept, should be focused by every company, financial institutions, and trading companies.

Introduction

Behavioral Finance

The idea of behavioral finance has gone through many change and improvement. Coordinated investigation of social money starts from crafted by Daniel Kahneman and Amos Tversky (1973) where they interestingly banter about the different heuristics affecting speculation choices. They are the organizer of well-known Prospect hypothesis in Tversky and Kahneman (1979). They found that people react distinctively as per the circumstances with regards to misfortunes or gains, and they are more worried about the misfortunes than the same additions. Statman Meir (2009), an educator from Santa Clara University put down in an article gave in the Wall Street Journal that the dominant part financial backers were sharp individuals, neither silly nor crazy. However, Behavioral money expresses that human minds are frequently full and the feelings which flood tends us to act keen now and again and dumb at others. Conduct account is a nearly new field that looks to joint social and intellectual mental hypothesis with traditionalist financial aspects and money to offer clarifications for why individuals settle on irrational money related choices. With regards to cash, even the most pertinent individuals can be convinced by inclination and opinion. Social account applies brain research to clarify why financial backers settle on shocking monetary choices.

In the middle of sensitive market instability, financial advisors will require to focus on behavioral facets of wealth management and widen a better perceptive of how biases can blow clients' savings decisions. Incorporating behavioral finance into their run through is a solution to enhancing the client experience, intensify the relationships, keep hold of clients and potentially convey better outcomes.

Review of Literature

Conduct account with its source in the mental investigation of human dynamic, it takes into examination diverse mental predispositions that human has. These predispositions ultimately lead to silly choices. Social money considers the speculations dependent on the brain science to explain the abnormalities in the monetary business sectors. Conduct account is only to see what brain science means for the venture dynamic (Shefrin, 2001). The example of venture or the social factor that influence the speculation incorporate dread, love, eagerness, hopefulness, and crowd nature (Fischer and Gerhardt, 2007). Aside from the elements, it is additionally influenced by the feeling, carelessness, under certainty, securities exchange bubble, and so forth an examination explored the presence of conduct inclinations and their impact on venture execution in Amman Stock Exchange. This examination zeroed in on presumptuousness, commonality, misfortune revulsion, attitude, accessibility, affirmation, and crowding inclination (Alrabadi et al., 2017).

Chuang & Lee (2006) found that overconfidence makes investors overweigh their own private information at the expense of ignoring publicly available information, and they justified their research by studying other academic' research and studies to prove that overconfident investors mistakenly attribute market gains to their own ability to pick winning stocks. The view of Phung (2004) was that overconfident individuals overestimate or exaggerate their ability to successfully perform a particular task.

The current research study is focused to bring out the buying and selling decisions of invertors. Islam (2012) was more specific in explaining behavioral finance by emphasizing the buying and selling decisions concerning stock market investors. According to Gachter et al. (2010) behavioral finance is the enhanced perceptive of the investment decisions that influence market prices which relay to human and social cognitive and emotional biases. Ritter (2003) also cleared that, behavioral factors disturbing individuals' decision-making are called as behavioral finance. As per Appiah & McMahon (2002) research study, behavioral finance is the learning of how financial practitioners act and interrelate on financial information and the succeeding effect on markets.

At the point when an individual, take part in the capital business sectors and he/she are helpless against the individual and market practices that control the results of their choices. Target speculation choices include shaping assumptions regarding what will occur, making taught surmises by social event however much data as could be expected and utilizing it as could really be expected. Pompain (2006) contended that social account handles the conduct factors that influence monetary choices.

Need for the study

Financial investors are human, and hence the tendency to make sentimental decisions or biased investment decisions are always possible. A thorough understanding of psychological or sentimental aspects that influence investor's decisions to behavioral biases can assist the financial institutions or companies to make their moves better.

Nature of human is overly complex, and study on financial behavior involves emotional, cognitive, and psychological factors in decision making process. Though thousands of studies had confirmed investor's decision-making process is completely irrational in terms of investment, studying the behavior will help the financial institutions or companies to differentiate expectations of a rational behavior and actual behavior.

Scope of the study

As the objective of this study revolves around investors buying and selling behavior of stocks, the research would be beneficial if it is made on especially important companies in India. The focus and hypothesis of this study is to find out whether investors buying and selling pattern of stock can change the stock price. For this study, Domestic systematically important banks (D-SIBs) in India were chosen. SBI, ICICI Bank, and HDFC banks are proceeding to be recognized as Domestic Systemically significant Banks, under the equivalent bucketing structure as in the 2019 rundown of D-SIBs. The Reserve Bank of India has held SBI, ICICI Bank and HDFC Bank as Domestic Systemically significant Banks that are considered as "too enormous to come up short". They are sorted dependent on the size, Cross-jurisdictional exercises, intricacy, absence of substitutability and interconnectedness. The discernment 'Too large to Fail (TBTF)' assumes for government support for these banks at the hour of pain. SIBs are subjected to additional policy measures to deal with the systemic risks and moral hazard issues created by them. Fundamental danger can be characterized as the danger related with the breakdown or disappointment of an organization, industry, monetary establishment, or a whole economy. This is the significant explanation for choosing the three banks with the end goal of the examination. Knowing the importance of these banks for the Indian economy created an urge to study about the stock behavior of these banks. While analyzing many interesting major facts could be plotted this led us to study the investor behavior regarding purchase and selling of stocks. The confused disappointment of these banks can possibly make critical interruption the fundamental administrations they give to Indian Banking framework, and thus, to the in general financial movement.

Objective of the Study

As the focus of the study is to analyze the behavior of the investors with regards to purchase and sale of stocks, the objective of this research is narrowed as under

I. To analyze and understand the behavioral pattern of investors while buying and selling of stocks with special reference to stocks of SIFIs in India.
II. To find out the relationship exist between behavioral finance and stock price increase and decrease.

Behavioral Finance and Investment Strategies

If we analyze the factors affecting stock market move invariably in one or the other directions, the reason discovered may include economic data, geopolitical events, and stock market sentiments. For example, the tech stock collides in the early 2000s was the outcome of a bubble in dotcom stocks as investors were euphoric about the market and speculated irrationally. If investors over leverage their investments, there is a substantial risk that there could be a descending spiral if the market budges in an objectionable direction. Investors may be enforced to sell a stock, which impels prices down.

Majority of the people or investors know market price moves upward and downward because of buying and selling pattern. But the clear understanding of buying and selling causing market price movement is missing. Behavioral finance efforts to clarify and amplify the indulgent of the reckoning patterns of investors, including the emotional processes occupied and degree to which they influence the decision-making processes.

Fundamentally, Behavioral finance attempts to explain what, why, and how of finance and investing, from a human perspective. For example, behavioral fiancé studies financial markets as well as providing explanations to many stock market anomalies (such as the January effect), speculative market bubbles and crashes. There have been substantial discussions over the real meaning and soundness of behavioral finance since the field itself is still developing and refining itself. This evolution continues to occur because several scholars have such a varied and extensive range of intellectual and expert specialties.

Methodology and Limitation of the study

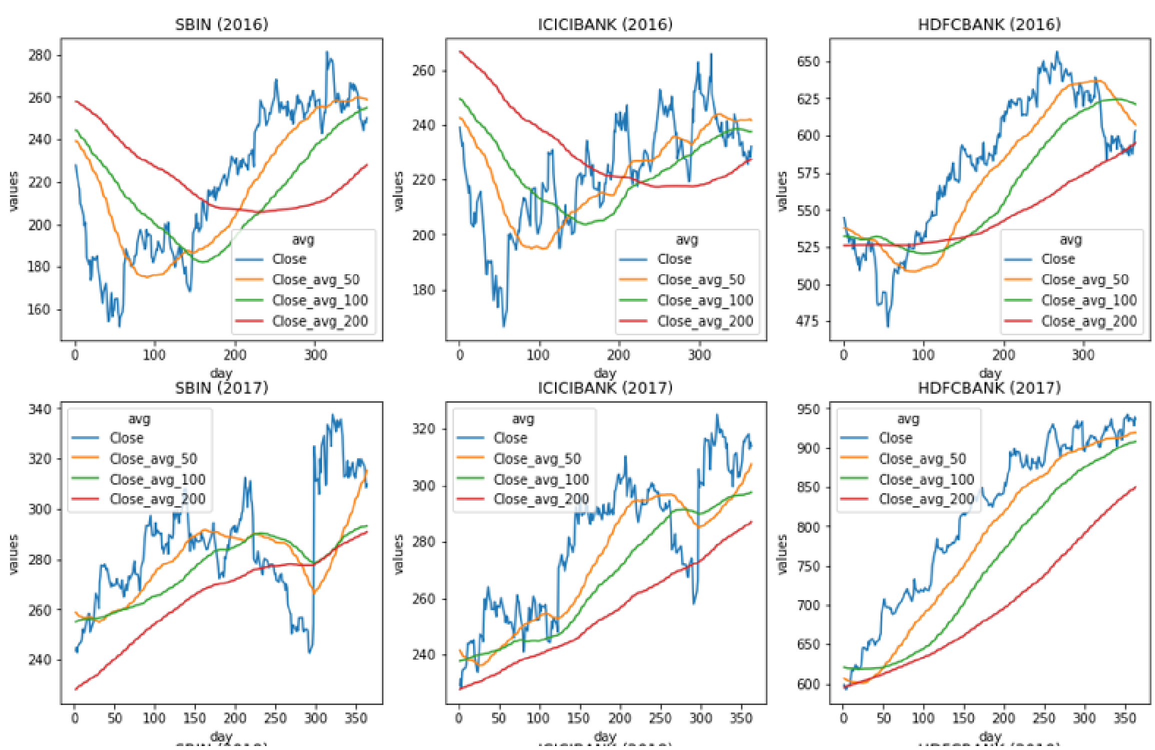
This study used both quantitative and qualitative methods of analysis. The analysis was purely based on secondary data available with respect to each bank. The data collected were analyzed using moving average method and connected with behavioral finance to find out any possible relationship exist with the stock price movements and investors behaviors. As the study is not focusing on stock price fluctuation, this would be considered as the limitation of the study. And this would lead to further scope for future research.

Analysis- Results and Discussions

For investors, finding a stock which would be feasible and lucrative to purchase can be amusing as well as rewarding activity. The purchase would be profitable provided the stock price tend to increase over a period. But which is the right time to buy the share? When we buy share for investment purposes, then knowing appropriate time to sell the stock would be easier. But sometimes selling the stock may be because of some other reasons like when the buy was mistake, the price had unimaginably risen, or the current price is not favorable. Emotion and human psychology can get in way of making a smart decision. This research paper's focus is also the same. Shefrin (2001) describes acceleration bias, which grounds investors to put more money into a failure that they feel responsible for rather than into a success. This leads to the comparatively well-liked investor's practice of averaging down on an investment that has rejected in value since the initial buy rather than regard as selling the stock if it was a blunder.

Analysis on Stock Price Movement on SBI, ICICI, HDFC

Based on the moving average method the price movement of stocks are plotted as graph. X axis represents the number of days, while Y axis denotes the stock price. Blue line indicates the movement of closing price for each day. Orange line indicates the moving average price for 50 days, similarly green line for 100 days average and red for 200 days average.



Analysis I: YEAR 2016

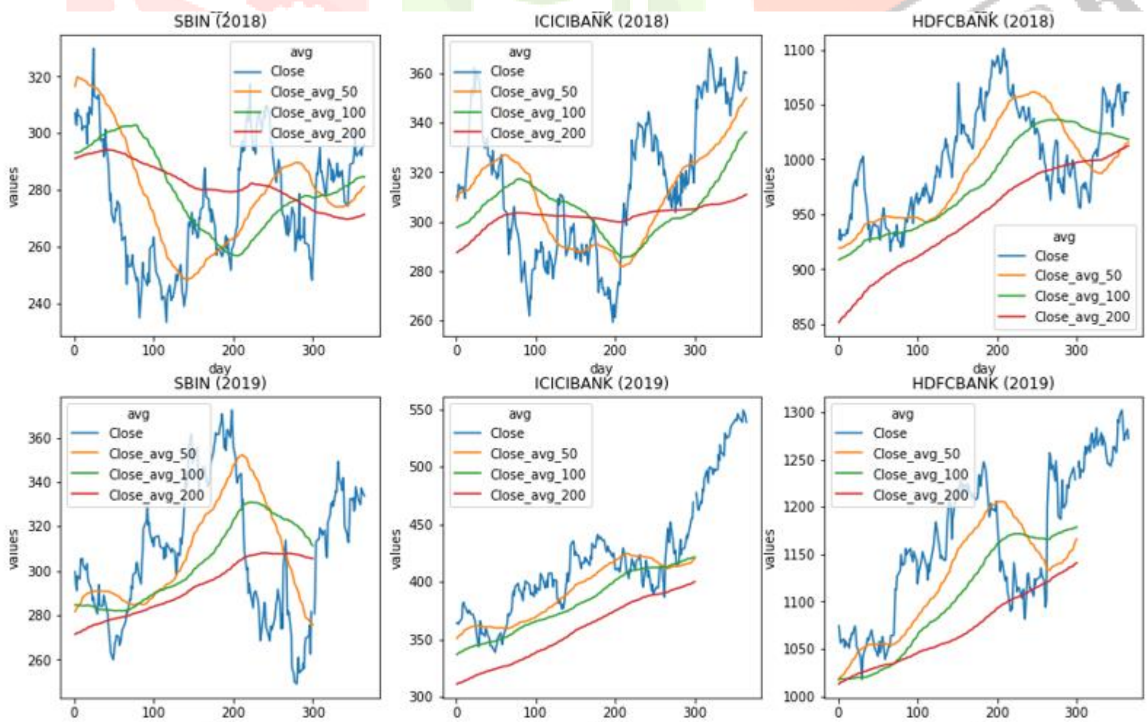
When we closely observe the charts for 2016, we can clearly understand that around 60th day the share price of SBI has gone down. It went below Rs 160. And gradually it was increasing. The highest price hits on 300th day. The chart of ICICI also depicts similar effect. The price of stock went exceptionally low, i.e., below Rs 180 around 60th day and the peak price reached after 300th day. While looking into the chart of HDFC, we can learn the similar effect around February end, decrease in price below 475 and peak rate of the stock can be pointed out with slight variation compared to other two banks. HDFC had reached its peak rate before 300th day itself. 50th day, 100th day and 200th day moving average of SBI and ICICI shows similar change regarding stock price movements. Same variation can be spotted with HDFC, although there is huge difference in their stock price.

Analysis II: YEAR 2017

The entire three banks stock price was least at the beginning of the year and steadily it was rising. We can spot sudden fall in stock price around 300th day for both SBI and ICICI and immediately after the downfall, it was increasing with some fluctuation. Though there was no noticeable downfall in stock price of HDFC Bank in 2017, the 200th day moving average curve shows the similar effect as the other two banks. If we observe closely, a noticeable downfall on 300th day of the stock price of HDFC can be seen just like other banks.

Analysis II: YEAR 2018

In the year 2018, we can note that a steep increase in stock price even before 50th day for all the three banks and slowly it will be decreasing. A downfall in stock price while nearing 100th day also is visible seen for all the three banks. Although the stock price was increasing from 200th day, again a downfall in stocks around 300th day is also noticeable. After 300th day, moving average shows increase in stock price. The price of the stocks of different banks may be different in different days but the stock price variations observed will be similar. We can see noticeable similarity will ICICI and SBI as the price of these banks are quite same like with starting price RS 240 and Rs 260, respectively. Whereas the price of HDFC is RS 850 and thus the moving average chart looks slight difference but when we observe the variations closely it will also be commensurate with other two banks.

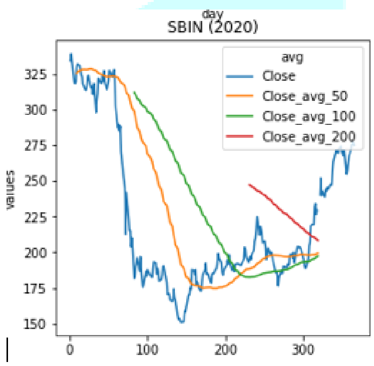


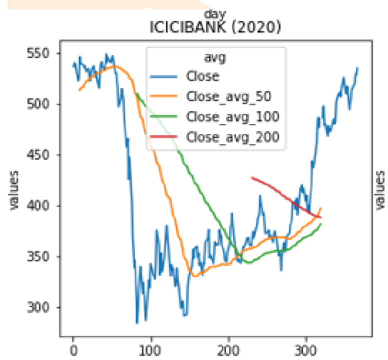
Analysis II: YEAR 2019

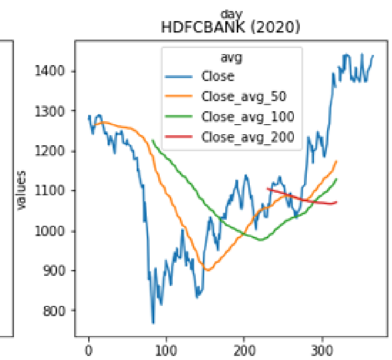
In 2019, the stock price of SBI and ICICI has started above Rs 300. HDFC s price was above 1050 in the beginning of the year. Though there are variations in the middle of the year, like any other years, in 2019 also the stock price was less around 60th day and hits the maximum over 300th day. 50th and 100th day moving average would give us clear picture of similarity in the movement of price among all the banks than daily variations. Even the 200th day moving average line also shows how the price was less at the beginning of the year and moving high towards the end.

Analysis II: YEAR 2020

In 2020 also, the stock price of all the three banks was high in the beginning and we could notice a steep fall before 100th day. And the price was going up and down in the later part of the year. The price of the stocks was also not so high as the other years prices that have been analyzed. This the year in which, the entire world economy was down because of the massive hit of COVID 19 and consecutive lockdowns. Hence, we can evidently interpret the downfall in stock prices. According to our previous inference and interpretations after 300th day the stock prices will start rising. In the same way, if we investigate the charts after 300th the stock prices were lifting. The 50th and 100th day moving average also will show the similar effect in all the three banks.







Discussions

Does Emotions and human psychology play a vital role in investor's decision-making process? Prospect theory believes that investment judgment must be based on the likely gain not merely on the efficiency of decision. It also states that numerous psychological factors have influence on the investor's decisions.

While analyzing the five years stock data of all the domestic- systemically important banks, we could observe the similar pattern of stock price fluctuations. Especially, when it decreases before 100th day and increases while hitting 300th day. Is this because of behavioral finance? When the move of the investors is likely to be same in one year, it may be because of market reasons. But this research could observe continuously same behavior in stock prices. We all know the increase and decrease in stock price is influenced by the buying and selling pattern of the stocks. Obviously, investors tend to buy more when stock price is low and sells when stock price is high. If we infer the same results in the other way, When the stock reaches highest value around 300th day, immediately the selling pattern of investors gradually reduces the value of stock and thus we could notice steep down price in the next 100th day, that is the next year.

Stock Prices change every day because of market forces. Share prices can change because of supply and demand. If more people want to purchase more stock, then demand will increase and while selling, supply will increase which causes price moves. If selling is more than the demand for it, the price would fall and vice versa. Understanding supply and demand is easy. But comprehending which factor reasons for people to like and dislike another stock is difficult. Then we analyze the recent positive and negative news about the company.

Understanding supply and demand is easy. What is difficult to comprehend is what makes people like a particular stock and dislike another stock. This comes down to figuring out what news is positive for a company and what news is negative. There are many answers to this problem and about any investor you ask has their own ideas and strategies.

Conclusion

Behavioral finance views investors as "normal" but being subject to decision making biases and errors. Decision making biases can be categorized into four buckets. Self-trickery happens when the investors believe he knows more than do. In such case they tend to miss in sequence significant for decision making. Heuristic simplification is another bucket which refers to information processing errors. Many people seek for short cut method of calculating the risk and income which leads to information processing errors.

Many investors have difficulty selling a stock and sometimes the reason is rooted in the instinctive human tendency toward voracity. There are many strategies that can identify right time to sell the stock. The most significant fact is that these strategies attempt to take human emotions out of the decision-making process. The ability to make money on stocks involves two key decisions: Buying stock at right time and selling at right time. The objective is to make profit (return on investment) which is determined by the purchase price.

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