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How Emotions will Induce Financial Market

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Abstract: ***The financial markets are of pure logic and more a living playhouse where fear and greed take center part of every decision often freezing traders, whispers warnings of loss, luring into risk of financial gain and overconfidence. Every trade lies a story of hopes, dreams and fears but not just the numbers and charts. Mastering emotions is true art of trading; whenever there is volatility in the financial market and the investor should be wise enough not to travel by the emotions but synchronize the investment plan already made in line with market volatility and control emotions that may over run in that situation. The objective and principle of this article is how the emotions in addition to greed will play a role in financial market investment. Understanding market psychology enables better navigation of cycles, prioritizing risk-reward ratios over greed or fear. Investors should study company fundamentals and avoid hearsay-driven decisions, and this framework supports resilient strategies amid volatility. The aim is to identify nexus between greed and emotions that plays an important role in financial market investments. It examines historical events such as the Dot-Com Bubble, 2008 crisis, and COVID-19 market crash, as evidence of emotional influence. Recommendations emphasize emotional discipline for long-term wealth growth. Overconfidence leads investors to overestimate abilities, increases risks. Drawing on behavioral finance principles, the subject matter analyzes psychological biases like overconfidence, loss aversion that amplify market volatility. Study of fundamentals and technical analysis may start emotional pitfalls.***

Keywords: Fear, Greed, Overconfidence, Risk vs Reward, Animal Spirits, Market cycles, Confirmation bias, Loss aversion, irrational investor behavior.

1. Aim and Objective

Aim:
The aim is to identify nexus between greed and emotions that plays an important role in financial market investments.

Objective:
The objective of the article is how the emotions in addition to greed will play a role in financial market investment.

2. Introduction

The subject matter revolves around investment of surplus/available income that can be judiciously if invested yield some good results; in a sense investment is act of allocating surplus resources that can be converted into assets like stocks, bonds, real estate, business or any such other instruments or marketable products that can be converted into liquid cash where ever and whenever it is necessary for profit. This is nothing but a wealth grow in a different form in a faster way other than future savings, retirement benefits etc. so as to make the position of investor more comfortable and leads an happy life. Investment is having the following key aspects,

1) **Goal**: For everyone's goal in investment is to create passive income like dividends, interest, rent on property or such other long term financial securities that are available in the market.
2) **Process**: The process of converting surplus investment into capital gains to increase the generating value of a person with the available resources.
   For example: Equities in the Stock Market, Mutual Bonds, Mutual funds, investing in real estate, investing in commodities exchange, not but not the least investing in saving certificates like coastal savings, bank savings etc.
3) **Risk vs Reward**: People wants higher returns on their investments that cannot be termed as greed but an aspiration for which one has to take some risks if they want higher returns on their investment with higher risk, on the other hand they want to satisfy with lower returns such people can invest on low risk investments like saving certificates in Post Office and Banks where risk is low or zero.

As already mentioned above the distinction between savings and investment is in the case of savings it is a low risk for short term needs and for high profit and growth long term investment is likely will reward.

Having said about the investment in short let us examine the types of common investment that are available in the financial market one can think of,

a) Stocks (Equity Market)
As of now the financial market is rapidly expanding and the industrialization of the country needs more funds for the growth of industry that is why all industrialists to expand their

business activities goes to the financial market for obtaining long and short term credits or offering equities either in the grey market or offering IPOs at a premium that carries good amount of returns and if a judicious selection of the industry is made as the industry grows their securities/equities will also grow abnormally at times that is why people opt for long term investments in equities in companies of their choice and they can expect a future windfall.

b) Bonds

The other way of investment is purchasing government bonds or corporations for an interest payment in this type of investment your principal amount will be guaranteed by the government as the centre or state or corporations. Hence, the principal amount invested will always be returned in a way it is having minimum risk because in hard times we may lose the interest but not the principal amount.

c) Real estate

The other way of increasing the surplus amount by investing in purchase of properties which is nothing but putting the money in real estate where the land property will increase at times abnormally due to scarcity of lands for housing and industrial development will definitely yield more profits than expected.

Finally, to define investment is commitment of current financial resources/surplus investment in order to achieve higher gains in the future. However, there is no guarantee that the above hypothesis will always come true but depends upon the nature of investment, time of investment and the period of investment or the valuable things that are to be kept in mind before taking a decision. Hence it is obligatory on the part of everyone while going into investment market by putting their resources either in stocks, bonds or real estate with an expectation of generating substantial income or profit in future through value increase or through dividends and interest if it is in the equity market the final goal of a person going for investment market is to grow wealth and save as much as possible and lead a happy life. On the other hand the traditional definition of investment is,

"Commitment of resources in to something expected to gain value overtime."

The four main fundamental types of investments that are classified are,

1) *Asset classes or equities (stocks) for growth*
2) *Bonds (fixed income growth) for a stable income*
3) *Real estate (property): Investing on land or built areas to generate income or to get meaningful gains when they are disposed off.*
4) *Mutual funds and ETFs that are purely linked with financial market are the other source of generating income on the investment but here also risk and reward is more. Hence a judicious selection is more important than investing blindly.*

If all the above narrations are limited to the population who have a basic knowledge on the financial market but for those who have no such knowledge can invest in a fixed deposit in a bank or financial institutions, a small amount monthly that can yield slow but steady income. In this article, an in depth analysis made about the risk and reward ratio and the ability of a person to select judiciously without burning his or her fingers is more important. Hence, it is obligatory on the part of a person who wants to invest in financial market to study the subject matter in depth but not influenced by other's opinion, influence or greed can successfully gain profits.

3. Literature Review

There is lot of literature available on the financial market written by experts, how to deal with one's hard earned money for a future gain but all are only guidance but cannot be taken into confidence by simply observing and putting their principles in practice. Especially in equity market one is lured by others gains and tries to follow the suite.

Especially equity market/financial market so volatile and depends upon,

1) Government principles
2) The exim policy announced by the government of India from time to time
3) Budget allocations to particular sectors
4) The government relaxation of rules and regulations with respect to joint ventures, inviting overseas industrialists to start their operations in India for which not only relaxing the rules but government gives some incentives.
5) Change of rules and regulations time to time in import and export of goods especially crude oil, gold and pulses, defence equipment etc.

There are so many luminaries and economists who have written based on their experience, number of books on ***Investment Psychology vs Human Tendency*** and how to balance fear and greed, dynamics of stock market development financial behavior and emotions and understanding market psychology and the impact of the market on the unexpected events like wars and pandemics are some of the things whether to kept in mind while investing. Sometimes, fear and greed will overtake one's own decisions especially in trading decisions. If one has to invest in the equity market he/she should be very cautious about their investments, instruments and where and how they are investing; in a sense if the history of such organizations and their functional variations, administrative skills, their capital investment and marketability of the products are all important and should be taken into consideration while deciding whether to invest or not.

In the article titled "***Understanding Investor Psychology: How Emotions share market behavior***", the author expressed about understanding Investor Psychology: How Emotions share market behavior has brought out two relevant points that are mentioned below,

1) **<u>The foundations of Investor Psychology</u>**: As already mentioned above the investor psychology is one of the principal elements that change the emotions of an investor for investment decisions which influence our behavior. However in equity market, markets are driven by number of conditions such as economic indicators, corporate earnings, investor sentiments, will cause volatility. Hence it is the responsibility on the part of the investor not to be carried out by those factors influencing the investments but one should avoid emotional pitfalls in throwing the money but resilient investment strategy.
2) **<u>The other important aspect as mentioned by the author over confidence and bias</u>**: meaning sometimes investors, influenced by their overconfidence of their ability will lose investment instead of gaining due to wrong investment decisions instead of wait and watch situations. A study revealed that many of the investors overconfidence of an investor likely to take unnecessary risks and they always think that they can outsmart market movements is a dangerous game that may backfire at times.
3) **<u>The other important point containing the loses/loss aversion</u>**: The author clearly mentions in the article that one should be careful enough on, "***<u>the disproportionate impact of loses over gains</u>***".
Sometimes the investors in their anxiety, they put more investment on the same area to recover the losses already incurred. This principle may not come true but many a times trigger panic selling during down turns; meaning the investors will think the stock may go down further and the losses may accrue which may not be a proper proposition because the market players like big broking firms, intermediaries and at times even the promoters will indulge in such activities so that when they rates fall they starts accumulating the assets.
4) **<u>In the same article the author mentioned about "Confirmation bias"</u>**. It is but quite natural that investors tend to seek out information that supports their views and ignores the contradictory evidence available putting the investor into loss. This happens in the financial market especially the analysts and the representatives of the broking firms for their own ulterior motives will/for/or/against buying or selling the equities of such companies from whom they are benefited. This kind of messages if they are received and followed by an investor without analyzing it and coming to his/her own understanding may become a doomsday.
5) **<u>The other important aspect is "the Cycle of market emotions; a psychological perspective"</u>**. So far we have discussed the psychology of the investors, markets and the emotions of the investors etc. but there is another important aspect that always plays an important role is, "***<u>Market Cycles</u>***". It is important for an investor to understand the market cycle like the optimum stage, the declining stage and also the promoter's percentage of investment whether it is above fifty or not, investments by the financial institutions, percentage of individual investors plays more important role. It is the natural phenomena of an investor when the market is in rise to invest in such stocks where the stocks are rising in line with market rise. However the one point that has to be kept in mind is the length of rise and the length of fall is so important that can be seen with the Exchange Index of BSE, NSE etc. while making a decision. The normal trend of an investor is to buy such shares that are rising because they think the above trend started in the market. Evenly they sell the stocks when they are coming down, thinking that it may go down further and the losses may be more but the investor should know the optimum level of both the indications low or high and should invest accordingly for gains. This is where the emotions and greed of an investor will play an important because while the stocks are increasing they want to put more money for gains. However, this may not be the idea of the promoters through their intermediaries creates an artificial gain, so that they want to liquidate their own stocks for gains. Once the saturation point is over the stocks starts falling and when they reach the lowest ebb their promoters starts accumulating their stocks. Hence, the important point in this situation in one way it is the volume that rates, makes an important aspect whether to purchase or sell.

As an example, the Dot-Com Bubble and the 2008 financial crisis are the two different situations where one has seen peak fall and peak gain. Again in 2020 during Covid-19 pandemic shaked the entire stock market worldwide in a free fall. The situation is so alarming that certain stocks fell beyond 50% of their rate during that period even in advanced countries. While going through all the above three situations one can understand how emotions can distort the real market value. As somebody said, "***Overconfidence leads to bubbles, fear drives panic selling, heard mentally amplifies irrational behavior. Investors who understand these historical patterns are better equipped to resist the crowd's emotional pull and make decisions based on logic rather than fear or greed***".

In another article titled "***How emotions influence behavior in financial markets: a conceptual analysis and emotion-based account of buy-sell preferences***" written by Darren Duxbury, Tommy Garling, Amelie Gamble & Vian Klass published in Taylor & Francis Online publisher in The European Journal of Finance Journal on 19th March 2020, the authors have given exemplary explanation regarding conceptual analysis and emotion based account of buy-sell preferences with respect to emotions influence behavior in financial markets, they stressed the need for research while investing by going through the available literature on the subject matter keeping aside the emotions so that they may not influence investors investment in financial market. In this regard, they have identified number of issues from the available literature on financial market and found that none could explain clearly in defining different emotion constructs, in addition they also noticed that there is a lack of general emotion based account of financial behavior. While submitting their report on the subject they classified "***emotion-related phenomena and an emotion-based account of how anticipatory and anticipated emotions interact to determine investors buy and sell preferences***." They also noticed that it is important that "***one should distinguish***

between mood and emotion, a distinction commonly buried in the finance literature (Duxbury 2015) Scherer's (Citation1984) typology of affective states provides the following distinction; emotions are affective reactions that are felt intensely, but briefly, and that are triggered by an internal or external event (examples include; elation, fear), while, in contrast, moods are felt less intensely, but are of longer lasting duration, and often without apparent cause (examples include; cheerful, gloomy). In providing a definition of emotion, Elster (Citation1998) notes that emotions have an intentional object, that is, 'they are about something' (p.49), thus supporting Scherer's (Citation1984) distinction. In a similar vein, Rick and Loewenstein (Citation2008) distinguish integral from incidental emotions, with the latter arising 'from dispositional or situational sources objectively unrelated to the task at hand' (p.138); that is, moods, following Scherer's (Citation1984) typology. Throughout, we maintain the distinction between mood and emotion along these lines."

A faculty publications of ***Kennesaw State University (Digital Common @ Kennesaw State University)*** on the subject matter of Emotion and Financial Markets (2003), the faculty members Lucy F. Ackert, Kennesaw State University and Federal Reserve Bank of Atlanta, Lackert@Kennesaw.edu, Bryan K. Church, Georgia Institute of Technology – Main Campus, Richard Deaves, McMaster University, they have identified number of factors with respect to emotions and financial markets such as,

> **"*Individual psychology plays a limited role in finance theory, which assumes that individuals maximize expected utility, with expectations derived using the rules of probability and statistics.***
>
> ***A large body of literature supports the theory that positive mood allows individuals to better organize and assimilate information and facilitates creative problem solving.***
>
> ***This article argues that emotion is an important aspect of the human condition that can enhance decision making*."**

Summarizing them it is proved beyond doubt that, "***Although emotion has important influences on financial market it does not contaminate judgment. In all probability a decision taken in a positive emotion will yield better results than a decision taken in a mixed moods. According to the authors they believe that emotion is an important aspect of the human condition that can actually enhance decision making and appears to be an equally good proposition at large.***

A review of all the literature available on the subject matter everyone is on the opinion that emotions will play a significant role on the financial market; however the degree of difference between one's own emotion with that of others differs on the attitude of the person, his understanding of the financial market and how he gauges the different situations that suddenly peep into the market due to external or internal changes and sometimes government policies. It is one of the difficult task to understand the market psychology because it refers to, "collective sentiments and behavior market participants that drives price movements, often influenced by emotions such as fear and greed but not just fundamentals".

4. Discussions and Analysis

Market psychology is the mood and sentiment of investors that influences financial markets whether it is in the equity or lending. Depends upon the overall earnings and the economic data of that country, coming to the point of emotions including that of fear and greed and euphoria will altogether can drive financial markets to move irrationally causing the unexpected price variation that what is called swing market trade in equity, an economist by name John Maynard Keynes, prescribed this phenomena as animal spirits, showing how human behavior shapes markets. However, in a financial market fundamental analysis that focuses on companies value, technical analysis, market psychology to that sector and also by examining patterns and trends of investor's behavior. It is quite interesting to note while exploring the impact of market psychology on investors behavior, market psychology plays an important role and a force does not always align with the fundamentals. How if the investors lose confidence in the economy in those circumstances, they hesitant to invest in the market or buy stocks that causes drop of market index (BSE, NSE India). This unexplained situation at times cause financial loses to the investors even if the stocks are potentially good and capable of giving earnings.

As already mentioned above the greed, fear and expectations and euphoria are all the factors that contribute to markets, overall market psychology, this kind of situations that arise in the market should be kept in mind before investment taking exact queues; such emotions can be further fueled financial markets if the emotions are not controlled not affecting with constant available trends, experts news on the market and volatility, this kind of shift in the market's behavior are often referred to as animal spirits, whatever may be situation and the emotions of an investor one should not discard the two views namely fundamental analysis and the other one technical analysis.

Fundamental analysis seeks to choose winning stocks by analyzing the company's financial status in the context of that particular industry on the other hand,

Technical analysis focuses on the trends, patterns and other indicators that drive the stock prices high or low. Hence it is obligatory on the part of any investor while investing the financial market to go through the fundamental analysis and also the technical analysis and bring a balance between them for decision making.

The foremost important aspect of successful investment in a stock market for gains is do not carried away by the emotions but the investor has to pay attention to the risk reward ratio but not the reward alone. In a financial market especially in the equity behavior/emotional finance in stock market will a comprehensive understanding of how emotions, bias and such other relevant factors impact one's own financial investment decisions with respect to stocks. In all these above discussions, the two things that plays an important role in emotions, are fear and greed that will influence and investors mood while investing. It is always important not to take decisions by overconfidence or hearsay or advise of analysts but by judicious planning and implementation of the same on investments will yield better results.

The other important aspect in financial market is to distinguish between emotion and belief; though they look alike but are very different because emotions will shorter span of time in thinking whereas belief will depends on certain factors. The main aim of any investor in the finance market/equity is to increase the value of its surplus funds for future purposes and enhance the gains with investments. Unlike other investments in real estate's/properties in a growing markets may have better results but in financial market a judicious non emotional decisions will bring wind fall of fortunes.

Many of the luminaries on the subject who have dwelt with the subject threadbare found that,

"***Emotional Psychology and decision making theories and processes are brought together with a single framework, the model is intended to both explain observed behavior in financial market and support efforts to develop a robust understanding of the determinants of decision making in increasingly complex investment scenarios***", according to the article titled "***Interconnectedness of Emotions with Investment Decision-Making: A Conceptual Framework***" written by Shubhangi Verma, Purnima Rao, Bruce Burton, Satish Kumar published in Journal of Economic Surveys by John Wiley & Sons Ltd.

Finally to conclude, with the golden words of Warren Buffet in how to balance fear and greed published by Trustnet Learn publisher, "***Warren Buffett has built his investing philosophy around mastering emotions – particularly fear and greed, the two dominant forces that drive market behaviour. His famous quote "Be fearful when others are greedy and greedy when others are fearful" encapsulates one of his core investment principles: success in the stock market is not just about financial analysis but also about emotional discipline.***

Fear and greed cause investors to make irrational decisions. Fear leads to panic selling during downturns, often at the worst possible moment. Greed drives speculative behaviour, encouraging investors to chase overvalued stocks in euphoric markets. Buffett has demonstrated time and again that controlling emotions and maintaining a rational, long-term perspective is key to achieving sustained investment success.

By understanding how Buffett navigates fear and greed, investors can learn to stay level-headed during volatile markets, make more rational decisions and seize opportunities when others panic."

5. Conclusion

Emotional Investing in financial market is stumbling block in achieving long term investment goals. It is obligatory on the part of the investor to take control of the emotions and greed and should develop a strategy of sound planning investment decisions based on the available data and facts. Emotions always keep a person alive and anxiety. It is always important and necessary to an investor to focus on long term goals and at times whenever there is a need of an advice it must be taken from a professional analyst who have better experience and knowledge in that particular field like the Golden words of Warren Buffet,

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Fear and greed cause investors to make irrational decisions. Fear leads to panic selling during downturns, often at the worst possible moment. Greed drives speculative behaviour, encouraging investors to chase overvalued stocks in euphoric markets. Buffett has demonstrated time and again that controlling emotions and maintaining a rational, long-term perspective is key to achieving sustained investment success.

By understanding how Buffett navigates fear and greed, investors can learn to stay level-headed during volatile markets, make more rational decisions and seize opportunities when others panic."

Because fear and greed often make investors to take irrational decisions which leads to panic selling and buying. By staying rational, during market volatility and focusing on fundamentals and making a long term approach can help investor consistent rewards irrespective of market fluctuations.

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