Behavioural Finance affecting Investors' Decision-Making

Nevise Demicoli | K. Hautala-Hili | Institute of Business and Commerce

Malta College of Arts, Science & Technology

Current Issue

This research study investigates the implications of behavioural finance on investors' decisions.

Hypothesis

According to the research studies made abroad, most investors are subject to behavioural biases. Therefore, this is highly considerable that such biases would also be found amongst Maltese investors. Additionally, these studies have shown that relatively small number of investors are aware of these behavioural biases, leading to irrational decisions. On the other hand, if investors are financially literate, they are may possess knowledge on investments which may provide a better return on investment.

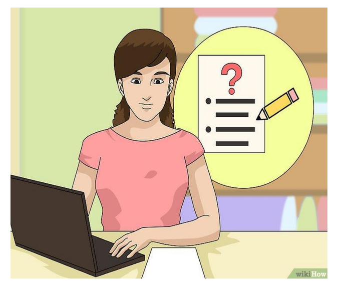
Project Overview

This study will consist of:

- Introduction; which gives a brief explanation of what is behavioral finance and the theories applied.
- Literature Review; which provides research materials and existing literature related to the study.
- Methodology; which will consist of how data will be collected and any limitations will be found.
- Findings and Analysis; where data collected will be analysed and results will be outlined.
- Conclusion; which will give a summary of the study and recommendations for further research.

Methodology

Step 1



Create questions for the survey instruments and interviews.

Step 2

Verify with the tutor that the questions are correct.

Step 3

Distribute survey instruments.

Step 4

Collect the survey instruments.

Research Variables

Dependant Variable
Investors' Behaviour

- The behaviour of individual investors, such as over-confidence, may affect decisions.

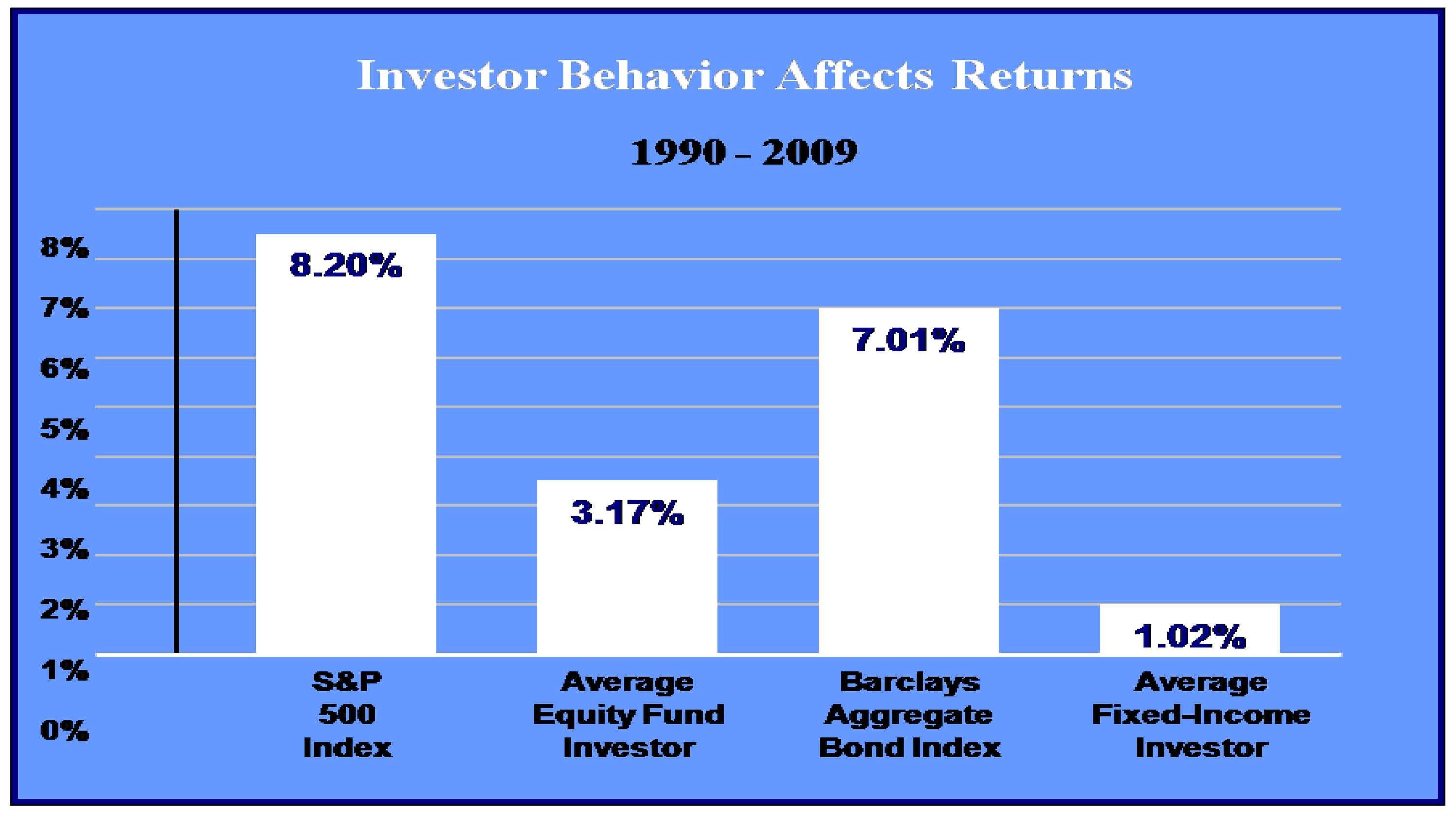
Independant Variable
Investment Decisions

- The investment decisions depend on the investors' behaviour.

Research Objectives

- To identify the main issues of a Maltese individual investor when making decisions on investments.
- To investigate the effects of irrational investor's behaviour on money markets and illogical decisions effects on the respective individual.
- To examine whether there are any correlations between the main investment strategies and the behavioural finance theories.

Findings



Source: DALBAR, Inc. Quantitative Analysis of Investor Behaviour (QAIB) 2010.

This chart displays the average annual returns for market indexes and the Average Equity and Fixed-Income Fund Investor which illustrates the negative effects of a poor investor's behaviour.

The problem is that even with all information, the evidence has proven that the average investor drastically underperforms the market averages. From 1990-2009, during arguably one of the best market periods in history, the average investor, in equity funds under-performed the S&P 500 Index by a 5.03% per year.

Next Steps

- From the literature review, the author discovered that in traditional finance, it was thought that an efficient market had existed, where investors are all rational. However, recent studies have concluded that this was wrong. In reality, there are various behavioural biases which affect the investment decisions. The data obtained supports the author's hypothesis; as there is a correlation between investment strategies and the behavioural finance theories.

References

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