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IMPACT OF FEAR AND GREED IN FINANCIAL MARKET

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ABSTRACT

Fear and Greed are mirror images of each other. Fearful investors tend to panic and sell their assets less than worth and greedy investors purchase these assets.

In this Paper we will exploret human behavior, stock market trading is just another human endeavor. Trading in stock market is controlled by human emotions, i.e., fear and greed. Both fear and greed take out extremes in human behavior, yet this is the very ammunition a trader looks for. It brings out new prospect on every day.The elements of fear and greed are lively and healthy for all Players, because large amount of money taken from banks, equity, mutual funds, pension funds and money managers drive the market. They also operate the environment. Are they immune from emotions? Does their job performance depend on their portfolio's performance? Don't they have to answer to their board of directors, their shareholders? So we can conclude that all the people in market have to suffer from fear and greed.

KEY WORDS:*Financial Decision, Emotions, Financial Market, Investor, Fear and Greed.*

Introduction:

Behavioral approach is an approach to understand the movement in financial markets which is contrary to the Efficient Market Hypothesis (EMH) which has been the key position of traditional finance. A group of academician believed that the financial markets are efficient and highly analytical but **Fama**defined efficient markets as those markets in which, "Security prices always fully reflect the available information".

The Efficient Market Hypothesis was unchallenged for about half of the century. The theoretical and empirical success of efficient Market Hypothesis strongly influenced the investors and in turn popularized "index funds" as investment option.

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But with the increased involvement of investors, having different personalities, the stock prices showed abnormal behaviors'. These abnormalities were initially termed as market anomalies, as they could not be explained in the Neo-classical framework. To answer the increased number and types of market anomalies, a new approach to financial markets had emerged-the behavioral finance. It focuses on investor's behavior and their investment decision- making process.

Contrary to the classical view, behavioral finance assumes that due to the irrational behavior of investor advisors and the combined and multiplied effect of the personalities of investors, markets will not always be efficient. This inefficiency of financial markets causes the stock prices to deviate from the predictions of traditional market models.

Financial Decision –Making and Emotions

Emotions play a very important part in our decisions. But most of rational and objective people believe that there is no room for emotions in their decision making. But it is not considered as a right statement, because while understanding the emotions it helps the businessman to make better choices and also take better decisions particularly in the uncertain world of financial market. Decision making with the help of emotions occurs throughout the boom and bust cycle of stock market. The chief driver of emotions is Fear and Greed. And these two emotions are counterproductive for most investors. Or we can say emotions lead to poor investment.

Introduction of Greed:

Greed is defined as an irresistible urge to possess more and more, than an individual actually needs.This greed may be of money, status, food or any other materialistic pleasure.

Some researchers say that greed is like love or other say that it is like an addition. If we consider greed as love, it has the power to change our minds, keep out of the way our senses, control the individual and provoke our mind and body to change. On the other hand if we consider greed like an addiction, because greed is like smoking and drinking. If person comes out of the addictions it is possible to get over from the bad effect of it but on the other hand if someone does not resist its inducement, he can easily be brushed away by it. Or in other

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words we can say that, in business world, traders are hit by emotional disturbances and are addicted to get rid off from the state of happiness, leisure, and excitement but some are prone to all these addictions. In addition, as drug creates an absurd and risky feeling, the same way human minds are naturally activate by financial awards. However, there is no established research on biochemistry of the greed.

Introduction of Fear:

Emotion is a feeling of inconvenience and stressful state in adverse conditions, whereas a feeling of pleasure in favorable conditions.

Fear is an unpleasant, often strong emotion, of anticipation or awareness of danger. As markets turn to be overwhelmed with greed in the same way it can take place with the fear. When there are huge losses for some period and they continue for sustained period, the whole market is caught in a fearful situation and it sustains further losses. As being too greedy is not good in the same way being too fearful also a costly trade.

Fear Power:

Dot- com bubble or internet boom is not only dominated by greed investors in the market but also contribute as good features for fear following bust. As a market stem their losses after the colliding internet boom, fearful investors take a decision to come out quickly from the stock market and search for the more certain, stable, valuable funds that are less risky in nature, investors want to bid their money in the money market securities and principal protected funds and all of them are low risk and return securities.

Types of Investors:

Regular investors: Regular investors are very uncommon in the market. They take decision of investment for long term as compared to short- term equity. They invest money when they have surplus with them and withdraw when are in need.

Only Savers: Most of the investors in India are of this category. They never invest in equity as they think equity is risky so why take the risk. They basically invest in FDs, RDs.PPF, etc.

Seasonal Traders: They are experienced investors who have not earned much from their investments. These are generally close to employees of trading house or investing professionals.

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Angel Investors: Angel investors are also known as informal investors. They are wealthy individuals who provide capital for business startups and also help with advice and contacts

Business Investors: These are investors who make investments either directly or via captive fund.

Risks –Taker Investors: These investors are those types of investors who never panic, are ready to take risks, and are very much confident.

Average investor: Average investor refers to ***"the universe of all mutual fund investors whose action and financial result are restated to represent a single investor".*** This universe would include small and large investors as well as professionally advised and self-advised investors.

Characteristics of Extremely Successful Investors:

Following are characteristics of extremely successfully investors:

Proactive Learners: Highly successful investors are proactive learners. They spend more time studying and analyzing than average investors.

Invest with a Designed Exit strategy: Successful investors plan exit strategy first before entering into the market. They know that there are always two sides of an investment.

Investors Should be Patient: Successful investors are very patient. When they make their decision on an investment, they are prepared to wait make sure their plan becomes visible.

Strong Emotional Control: The market is controlled by two emotions i.e. fear and greed and every true investor know that the market is driven by these two sentiments. Investments of average investors are based on these emotions but successful investors have a stronger control over these emotions.

Defined Investing Strategy: Every successful investor has over time developed a well-defined investing strategy that work and they stick to strategy.

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Investors Should be Focused: Successful investors are focused on their investment vehicle. They always take one step at a time and one investment at a time.

Flourishing Investors use Trend to their Advantage: Another characteristic of successful investors is that they know to their advantage. Average investors fear over market fluctuations but professional investors welcome these fluctuations because it's based on these fluctuations that they make their money.

Investors Should be Determined: From the above quote can conclude that, sticking to your investment policy whether you are winning or losing requires a great deal of determination.

Investor Should Prosper on Risk: Investment or investing is a risk but not knowing what you are doing is a greater risk. Every specialized investor, whether on the winning or losing side still respect the 50-50 probability of success or failure?

Investors should be Disciplined: Successful investors are much disciplined when it comes to investing.

Investors Know How to use Leverage to their advantages: Before I discuss further, one should know the major difference between a successful investor and the average investor? The answer of this question is that a successful investor knows how to make money by investing with other people's money while an average investor invests with personal funds. Investing with other people's money is a from leverage.

Investors learn Quickly from their Mistake: Successful investors learn from their mistakes, they don't get disheartened by these mistakes because they know mistakes are the part of process to become a better investor.

Investors Have a Team of Professional Advisors: If you observe successful investors closely, you will notice they have a team of specialized advisor. Average investors try to punch the market alone while specialized investors invest as part of a team.

Investors Have a Strong Financial Background: From the above quote, you can conclude that, one can only become a better investor by being on the streets; Street is referred as

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practical knowledge. Successful investors have a solid financial background: a background molded on the streets.

Successful Investors are passionate about the Game of Investing: Why are you and investor? You answer to this question will determine if you will be successful in the world of investing or not.

Emotion and Finance:

According to R.S Woodworth, *“Emotion is that state of mind where we find certain psychological changes which are known only to be individual who is experiencing an emotion. Emotion is also a stirred up state of body in the sense it bring about certain bodily changes which are external and hence can be seen by other for example striking behavior is typical of anger”.*

From past two decades research has been significantly increased on emotions in many fields such as neuroscience, medicine, finance, psychology, sociology and even in computer science also. Many theories explain the origin and experience of emotions but now a days, current research on emotion includes the development of materials.

Components of Emotion in Financial Decision:

Cognitive appraisal: To decide what to feel after interpreting or explaining what happened just after interpreting; **Bodily Symptoms:**Symptoms are the way your body alerts you to how you are out of balance. Both animals and human begins show the bodily symptoms; **Action Tendencies**:Readiness to execute an action related to the undergone feeling; **Expression:**Facial and vocal Expression and **Feeling:**They are subjective representation of emotions.

Emotional Stage of an investor in Financial Decision

Optimism: It normally characterizes the start of the cycle as investors buy their stocks, naturally with a positive outlook for the future and anticipation of potential gains.

Excitement: It is quick to follow after some initial success, as we begin looking for new ways to accomplish more based on what we already achieved.

Thrill: It comes after yet more success, as investors begins to delight in their wins and congratulate themselves for their smart decisions.

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Euphoria: It sets in as wins come quick and fast, bringing in a stream of easy profits and pushing investor's sentiment to dizzying heights.

Anxiety: It inevitability interrupts the climb, as the market surprises us by moving downwards. Faced with their first potential loss, investors reassure themselves that their well-calculated strategy will deliver in the long term.

Denial: It takes this to the next level, when markets still show no signs of a rebound. At this stage, the investor begins to deny that he made a poor choice, clinging on to the belief that things are set to improve.

Fear: It finally takes hold when the market realities set in, amidst the confusion of getting things wrong, it is easy for sentiment to drop drastically, and for doubt to set in as fears that the market will never move in our favor escalate.

Desperation: It sees a frantic attempt to salvage the situation with any idea that might have a chance of helping us break even.

Panic: It follows when all options are exhausted and the road downhill is imminent.

Capitulation: It sees the tormented investor admitting defeat and giving up hope of things turning around, shifting his focus from recovery to damage control, and existing in order to avoid making further losses.

Despondency: It is the lowest point of the emotional roller coaster. Investors cash out whatever remaining stocks they have, having given up hope of the markets ever recovering. With the wounds still raw and stinging, they vow never to buy stocks again to avoid getting burnt a second time.

Depression: It sinks in as the fallen investors ruminate on their failure and the regrettable decisions theta contributed to their predicament.

Hope: It returns slowly after investors notice that the markets are picking up realizing that movements are cyclical. This is when they cautiously begin to look out for the next opportunity.

Relief: **I**t is when faith is renewed after their next buy has turned profitable setting the stage for sentiment to turn optimistic once more.

Coping with the Emotion:

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Investors can reduce the effect of emotions and take a better decision. There are some steps which can take in to consideration as follows:

Boarded your Horizon: An investor should properly balance the portfolio which reduces the probability of large losses and convert that losses to short term and makes emotional brain in to overdrive.

Ignore the Short- Term Fluctuations: Asa human being our brain is hardwired to make projections based on past trends and some projections are those which does not exist in the market. It can be very dangerous for financial decision. An investor should focused on the long run return and ignore the short term fluctuations.

Investment Policy: An investorshould develop an investment policy statement and follow it which outlines the important goals and a strategy to achieve them. With a written policy makes it more comfortable to follow a prudent path when emotions are not able to tell us.

Rebalance: Consistently repositioning your portfolio to target allocations is a time-tested way to keep your investment portfolio at a predetermined level of risk.

Stay Disciplined: Putting too much emphasis on short-term market movements or popular, alarmist market forecasts might cause you to develop an irrational sense of fear. Turn off the investment "noise". Have faith that market work, and stay co0mmitted to your long-term objectives.

CONCLUSION:

Behavioral Finance is concerned with both individual investment behavior and aggregated price formation on financial market. There is direct and more prominent effect of feelings in case of individual investors. Emotions can be negative or positive which produced more optimistic and pessimistic expectations which are more observed in short term period.

At last the final decision is in the hand of the investor of their portfolio and they are responsible for any losses and gains in their investment. Taking a correct and sound decision of investment while controlling emotions, i.e., Fear and Greed and not following the market sentiments blindly, it is the crucial to successful investing and maintaining your long- term strategy. Think twice before resolute in to an investment strategy during a period of high emotions in the market because it can curse a disaster.

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