International Journal on Emerging Technologies **11**(2): 154-159(2020)

ISSN No. (Print): 0975-8364
ISSN No. (Online): 2249-3255

Factors Affecting Investors Sentiments: A Review of the Literature

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(Received 05 December 2019, Revised 31 January 2020, Accepted 06 February 2020)
(Published by Research Trend, Website: www.researchtrend.net)

ABSTRACT: Investors often exhibit irrational investment decisions due to the dominance of sentiments therefore it has become essential consequently to distinguish and classify the various factors driving investor sentiments and furthermore to comprehend their implications on investment decisions. The present research work is a critical evaluation of the literature focusing on identifying the different classification of those factors which affect the sentiments of investors. The study will help in understanding factors driving investor sentiments and will leverage in exploring different investments strategies and suitable aids to avoid judgmental errors and irrational behavior with respect to the investor's decision making. More specifically, this literature review approach has helped to propose a conceptual framework which embraces Psychological and emotional factors, Market factors, Economic factors, Herd Behavior and Investors awareness that are driving the investor sentiments and their investment decisions.

Keywords: Economic factors, Herd Behavior, Investor sentiment, Investors awareness, Market factors, Psychological and emotional factors.

Abbreviations: GDP, Gross domestic product.

I. INTRODUCTION

Sentiment is a vital economy indicator as it directs the cycle of the business and volatility of market. There are various literature documented that has improved our understanding of different factors that affect the sentiment of the investors, its contribution and implications in financial markets and financial institutions. Conventional theory of finance certifies that those who invest are logical wealth maximisers as they plan investment strategies based on basic financial rules on consideration of risk and return. But in practical aspects, the investors risk level isn't equivalent and mainly depend upon personal dispositions to risk. Financial analysts generally feature that retail speculators are bound by outside imperatives i.e market related factors which make them to behave irrationally [63]. In the General Theory of Employment, Interest and Money, the Statement stated by Keynes (1936) previously depicted the criticalness of animal spirits as the human feelings that influence buyer certainty. Today, animal spirits portray the psychological and emotions that drive speculators to make a move when looked with elevated levels of unpredictability in the capital markets [41]. The term originates from the Latin spiritus animalis, which signifies "the breath that stirs the human personality. Black (1986) and Kyle (1985) presented the expression "Noise trader" which alludes to a stock trader that doesn't have inside information and settle on unreasonable speculation choices [11, 45]. Shiller & Akerlof (2009) comprehended that what is the working of economies and how to oversee and succeed them; we should focus on the thought designs that invigorate individuals' thoughts and emotions, their animal spirits [58]. We will never truly comprehend significant financial occasions except if we defy the way that their causes are to a great extent mental in nature. La Porta *et al.*, (2000) characterized "investor sentiments" as heuristic conduct conviction based or general guidelines instead of Bayesian judiciousness in settling investment decision [46]. It in this way happens when retail financial specialists' inclinations and convictions agreed to the mental proof as opposed to the standard economic model. Thus retail investor make decision not only based on economic fundamentals but most often based on their gut feeling, psychology, emotional complexities, irrational sentiments and many other factors. Barnewall (1987) insists on the characteristics of investors and discovers how emotion can affect profitable strategy into disappointment [7]. Investor sentiments reflect the attitude and irrational behavior about the stock market which leads to destructive investments. Peterson (2016) quoted that sentiments affects the investment decision at individual and collective level [54].

II. SIGNIFICANCE OF INVESTMENT SENTIMENTS

The idea of this research work is to highlight the comprehensive review of factors that have an effect on the investor sentiments in stock market. Stock market is impacted more by sentiments of investor therefore show signs of higher uncertainty and volatility than that of matured stock markets. This is an endeavor to unearth the vital economic factors, market factors, psychological and emotional factors, herd behavior and investor awareness factors affecting investor sentiment and which in turn influences investment decisions.

III. LITERATURE REVIEW

De Long *et al.,* (1990) claimed that "investor irrationality" and "limits-to-arbitrage" are fundamentals of investor's sentiments [27]. Brealey *et al.*, (2008) along with the De Long *et al.*, (1990) categorized it as important aspects of investor sentiments [14, 27]. Barberis, *et al*., (1998) proposed a parsimonious model related to investor's sentiments which are based on cognition resulting in reaction and overreaction for different parameter values [6]. Zhang (2008) defined and designed model for measuring investor sentiments in new angle [72]. Zouaoui, *et al., (*2010) analyzed that the influence of investor sentiment on global stock market and on probability of crisis in stock exchange [73]. Baker and Wurgler (2006) focused on "how to measure the investor sentiments and how to quantify its effects". Many researchers have attempted the formulation of Investor sentiment index and constructed the ISI from secondary data primarily for the USA by using the principal components analysis [3]. Bennet *et al*., (2012) used bootstrapping to test the contribution of various factors such as herd behavior, trading which is based on internet information, economic factors at macro level, risk and cost based factors, performance factor, confidence level which results in too little diversification of institutional investors and best game in town on investor sentiments [9]. The various facets or factors regarding the investors' sentiment which an impact on the decision has been delineated in the following section.

This section may each be divided by subheadings or may further divide into next heads as shown below.

A. Psychological and emotional factors

The research evidences explore that psychological and emotional factors like overconfidence, greed and fear play crucial presence in decisions of investments [23, 57, 64]. Personality attributes are amalgamation of cognitive, emotional and motivational characteristics that dominate the investment decisions [30, 62]. All human emotional complexity incorporates feeling like fear, greed, panic, anxiety, fulfillment and aspiration meddle in specific extent in financial investment decisions [68]. Investment decisions to acquire, get rid of or cling to be influenced by psychological and emotional state, and mood variations [59]. The decision time which may lead to irrational behavior bias such as overconfidence, representativeness, conservative bias and informational inadequacy of the investor also matter [35]. Investor supports the information that matches with his belief and ignore others which end up in making biased judgment [22]. Odean (1998) and Vagenas-Nanos (2010) portrayed that overconfident investors trade more therefore when there is increase in trade volume it shows that there prevails overconfidence in market [51, 67]. Kumar and Goyal (2015) emphasized over four factors mainly herding bias, disposition effect, overconfidence, and home bias or familiarity bias which affect the decisions of the investor [43]. Schmeling (2009) used "consumer confidence index" as the proxy of investor sentiments to analyze its hold on the financial market return of eighteen countries [55]. Baker and Nofsinger (2002) elaborated that when investors follow assumptions or use miniature samples to draw conclusion leading to wrongly categorizing investments as profitable investments [2]. This concept has been stated by Nilsson (2008) as Representativeness [49]. It is an inclination to be progressively hopeful about ventures that have performed well of late and increasingly cynical about speculations that have performed inadequately. This portrayal at the time of investment makes it difficult to consider them in some other manner or to investigate their latent capacity. Subsequently it leads to an excess of accentuation on past execution and insufficiency on future possibilities. Conservatism characterizes being risk averse and regret averse. Stewart and Shefrin (2000) accredited that Conservatism predisposition is when individuals utilize kept back data in their psyche to make choices and can't refresh to the latest data accessible in the financial market [56]. Such investors use old encounters in taking speculation choices. This kind of inclination is typically seen in individuals who have confronted market crash and hence are more cognizant than other investors.

B. Market factors

There are certain empirical studies which have discovered the basis of the market factors driving the investor sentiments. They are market of the investor–bull/bear market, market trend–up/down in the short/intermediate/long run, nature of market-transparent /non transparent, market returns, Market is or will face economic recession/bloom, fundamental and technicalities of the financial market. One of the most crucial market based factors include existing stocks fundamentals, stocks past trends, over-reaction and under reaction to price changes, preferences of customers and market information. Irrational sentiments of the investors impact the stock prices [26]. De Bondt and Thaler (1985) defines stock market trends into Bull and Bear market with positive and negative return respectively [28]. Pagan and Sossounov (2003) propounded that generally sentiments of investors are higher and lower in bull market and bear market respectively [52]. Many studies have probed stock market volatility in different markets and discovered that the fluctuation is high in bearish markets. Under this situation, Chordia *et al.,* (2001) additionally contend that falling markets draw minimal investments resulting in falling liquidity, more uncertainty and volatility. Investor sentiment leads to the formation of bubble and promote the movement in price of stocks [19]. When there is a bearish market, price of the stock will fall and will rise in bullish market [8]. It has been established that there is the association between return and volatility in the Chinese stock market based on investor sentiments which lacks the experience and concluded that sentiments dominate the stock return, hence higher sentiments leads to higher returns [9]. Yoshinanga and de Castro (2012) derived the connection between sentiments of the market and future stock rate of return [70]. Past investigations showed that overreaction and under reaction of investors on the stock market related news influence the decision making and result to unforeseeable outcomes [28]. Any variation in market information, price of stocks and basics of the underlying stock may result from reaction or overreaction to the price change. Zhang (2006) recommends that under state of information uncertainty, good news creates generally more strange returns while declarations of bad news produces moderately lower anomalous returns [71]. On the basis of overvaluation/undervaluation of stock prices, there exist both positive and negative relationship between sentiments of the investors and stock market return.

C. Economic factors

The factors driving the investor sentiments are real GDP, profits in corporates, inflation rate, interest rates and fluidity in the economy. Flannery and Protopapadakis (2002) established significant relationship of stock market return with inflation and money growth [31]. Pandey and Sehgal (2016) [53] coined macro-economic factors such as rate of inflation, interest rate and strength of Indian economy in determining investment decision of the investors [17]. Inflation and cash inflation have a significant influence on returns of stock market. The consequence of actual macroeconomic variables on total equity returns is difficult to determine. It is considered by economists that stock market is one of the indicator of economic growth ,Bosworth *et al.,* (1975) and many researchers have concluded that macroeconomic factors are driving the investor sentiments in stock market [13] , [12, 31, 60]. Bennet *et al*., (2012) [9] supervised a researches in Ghana on investor attitudes and the main factors affecting investor attitudes are interest rates, unemployment rates and economic strength [39]. Alam and Hasan (2003) explored quarterly data of USA (1948- 2004) to derive connection between stock market development and growth of economy [1]. Additionally, Bhar and Maliaris (2011) comprehended that the variables consist of the unemployment, inflation, dividend yield and momentum are essential elements of equity premium [10]. Wickremasinghe (2011) concluded that there is a casual relationship in both short and long run context between price of the stocks and macroeconomics variables while studying the month wise data from Srilanka stock exchange (1985-2004) [69]. Similarly, Gupta and Reid (2013) explained the relevance of monetary policy and macroeconomic factors on the stock market returns specifically to industry utilizing South African stock exchange information for the period 2002-2011 [34]. Mutuku and Ng'eny (2015) used the Nairobi Stock Exchange information data in Kenya for the period of 1997-2010 observed the relationship between behaviour stock prices in long run and certain macroeconomic variables [48].

D. Herd Behavior

Herding is defined as "Mutual imitation that leads to a convergence of action" [36]. Charles quoted "Men, it has been well said, think in herds; it will be seen that they go mad in herds, while they only recover their senses slowly and one by one". The common fault in these issues is that investors tend to follow investment decision making. Behavior is a mechanism by which market participants decide their investments and it is these mutual structures alone that undermine their own views [18]. According to Patterson and Sharma (2006), "Herding occurs when a group of investors trades on the same side of the market in the same securities over the same period of time or when investors ignore their own private information and act as other investors do" [20]. Herding is the investor's propensity to go after the same sources of information and follow the similar approach in investment decisions [37]. In herding, individual follows the herd irrespective to the decisions suggested by private information [5]. Chang *et al*., (2000) found that herd behavior of investor is only responsible for belief system of investment decisions [18]. Demirer and Kutan (2006) studied the behavior of investors on Chinese stock market [29]. Kumar and Goyal (2016) explained it that rational people imitate what everyone does, resulting in irrational behavior towards taking investment decisions [44]. There exists significant relationship between herd behavior and market sentiment in Indian stock market [40]. Messis and Zapranis (2014) established that volatility in the market is affected positively by existence of herd behavior in investors [47]. For the most part acknowledged clarification of Herd Behaviour there are two factors- firstly, the social pressure to accommodate implies that people need to be acknowledged and secondly investor believes that it is difficult to accept that huge gathering could not be right (2 heads are superior to 1).

E. Investors awareness

Investment awareness encompasses media, internet, social interaction and private information recommendations. Noctor *et al*., (1992) elucidated that financial awareness as "the ability to make informed judgments and to take effective decisions regarding the use and money management [50]." Investors generally invest by the influence of certain websites or news channels or with the advice of the friends, brokers and relatives. The main awareness variables are media, internet, magazine and friends. Awareness among investors is crucial factor influencing the behavior of the investment [24, 66]. Takeda *et al*., (2013) discussed about the investors awareness and their decision making [65]. To capture the changing small investor's sentiments and its results on equity market returns specifically is being done by the data obtained from goggle search volumes [25]. Da *et al*., (2011) highlights various reasons behind non effectiveness of classical market or survey-based investor sentiment measures in comparison with search-based to measure the investor sentiment [21]. An unexpected change in levels of pessimism among small investors, measured in terms of the popularity of the most goggled terms like that of bear market and bull market.

Internet posting is a potentially valuable source for the investors who spend most of their time on internet regarding stock prices. Campbell and Shiller (2001) illustrated that internet plays an important role in keeping financial markets better informed [16]. Investors get their information from the internet in several ways and from various suppliers. Internet posting act as source of information for security market, banks and brokerage firm [15]. Griffith *et al*., (2019) stated that the market volatility and return are directly influenced by the presence of Media and Internet [32]. Negative investment news have more influence on investor sentiments than optimistic investment news [33, 61]. Kräussl and Mirgorodskaya (2014) pointed out the influence of new media sentiments returns and price fluctuation in long term [42].

IV. IMPLICATIONS

Behavioral finance has flourished and has significant implication in momentum of stock market. Stock prices are driven by the human reaction and impact equity investments. In essence, this research work sums up the drivers of investor's sentiments which in turn influence decisions of investments in the share market and this approach can also be used in other emerging market contexts. Investor sentiment consists of both rational and irrational psychology that exists in investment decisions. Investors demonstrate blended Bayesian approach and behavioral finance on investment decision. This study come up with growing body of literature under behavioural finance paradigm and imparts valuable insights not exclusive to policy makers in structuring measures to improve financial awareness yet additionally to financial advisors and wealth managers in working with their customers. Firstly, it will encourage policy makers to construct better policy. At present, Securities and Exchange Board of India and other financial institutions are promoting financial and investment awareness programs to educate and create awareness among potential investors. Secondly, investment advisors could comprehend investor personality traits and empower disciplined investment strategy to overcome irrational decisions. They could propose investors to center around accomplishing long-term rather than short term goals. There is an earnest need of holding more awareness activities in the form of meetings, colloquium and workshops. The research work propounded a new vision on categorization of investment sentiment on rational or irrational. In an individual level, Investor sentiment on the share market can regulate speculators investment making decisions. At present, there are multiple sources of the information available on the online platform that could guide an investor to share information and views in the stock market. Therefore, a perfect blend of investment strategies using quantitative and qualitative behavioral finance tools are directing investors to choose required investment strategy.

V. CONCLUSION

This paper has explored past examinations on the different elements that impact the investor estimations. It has featured the inevitability of investor sentiments under behavioural finance and its effect on speculation choices. Owing to its broad consideration and attention, the investigation outcome may be valuable to financial specialists, financial consultants, market regulators and all other related to the market in defining speculation procedures. Many researchers including Baker *et al*., (2012) ; Bennet *et al*., (2011, 2012), Huang *et al.,* (2015) stated about investment advisor that they must realize the response of investor in advance during market fluctuation and accordingly design investment strategies for clients [4, 8, 9, 38]. The consequence of the investigation is intriguing and valuable to control portfolio allocation decisions, both by helping to comprehend the sorts of mistakes that investor will in general make in dealing with their portfolios, and furthermore by enabling us to locate better how to find the open doors for investment profits. In addition, perceiving the psychological establishment of person reaction in financial markets encourages the detailing of macroeconomics. It provides acquaintance and understandings including thinking, knowing, recollecting, deducing and critical thinking increments in the apparent risk profile of the individual investor of stock market to estimate future execution.

VI. PROPOSED CONCEPTUAL FRAMEWORK

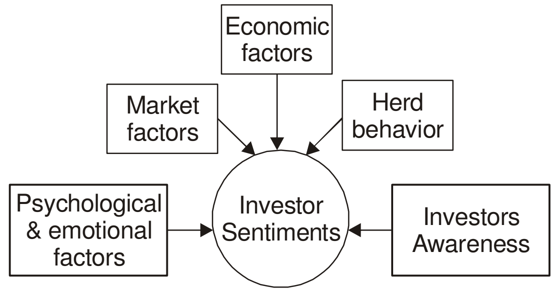

Fig. 1.

VII. FURTHER SCOPE OF RESEARCH

This study inspected the factors having great influence on the individual stock investor, and included only factors investigated by previous investigations therefore there is scope of additional factors based on behavioral attributes of investors. Later on, analysts could investigate a lot more other factors, for example, culture, family foundation and individual educational experience in light of the fact that these variables may likewise impact investor sentiment. Other directing factors can be demographic factors, for example, gender, age, conjugal status, sparing conduct, income and occupation. It can lead to empirical analysis to discover which factor has greatest impact on investor's sentiment. Considering these components could help make a progressively intensive comprehension of individual financial specialist conduct. Further research studies could either dispose of a portion of the impediments or grow the extent of examination in this investigation. The conceivable augmentation of this investigation is to consider the institutional financial specialists additionally alongside the individual speculator.

Conflict of Interest. Nil

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How to cite this article: Srivastava, Khusboo (2020). Factors Affecting Investors Sentiments: A review of the Literature. *International Journal on Emerging Technologies*, *11*(2): 154–159.