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ABSTRACT

Behavioural finance (BF), a subset of behavioural economics developed during the 1990s to explain the financial market anomalies. The uniqueness of the subject is its multidisciplinary nature which combines psychology, economics, finance and even neuroscience to better understand why we make the decisions and how we can make better, more informed decisions. The influence of psychology on financial decision-making is not new to the area of economics research. Adam Smith in Theory of Moral Sentiments has put weight on the psychological aspects of human behaviour. Even during the neo-classical period, the influence of psychological factors on economic analysis is found in the writings of Irving Fisher, Francis Edgeworth, and Vilfredo Pareto, among others. The thesis contains 6 chapters including introduction and conclusion. The study has three stated objectives.

1. To examine the OB and DE in the Indian stock market at the levels of market and individual securities.
2. To explore the relation between market turnover, market return and liquidity.
3. To examine the presence of herd behaviour at the market and sectoral level at different market conditions: (a) bullish and bearish market, (b) high and low trading volume; (c) high and low volatility.

The result for first objective shows that there is positive and significant effect of lagged market return on current trading volume, which is posited as the presence of overconfidence bias in the Indian stock market. It means that the investor gives more weightage to their stock picking skills. The overconfidence behaviour of investors is visible in all the periods under study: full,

pre and post Covid-19 periods. The current study also exhibits positive relation between market turnover and market volatility in all the study periods. The reason for the presence of OB in the post Covid-19 period is attributed to government special economic packages for encouraging and attracting investment. The news of the market spectacular returns leads newbie investors to enter the market generated the FOMO (Fear of missing out) effect, attracting even more investors during the Covid-19 period.

The result of securities VAR explains the presence of OB and DE in the Indian stock market. The maximum number of stocks which shows OB is found to be in the post Covid-19 period. This is because overconfident investors are following the hot stocks in order to earn more than average return. The presence of both OB & DE is found in only one stock during full sample and pre Covid-19 period belongs to Pharma sector, and during post Covid-19 period belongs to service sector. From the results of impulse response functions, we may conclude that market and security returns are important barometers of trading activity and making financial decision among the investors in the Indian stock market.

It may be concluded from the result of second objective that the market liquidity is positively related to market return in full sample and during post Covid-19 periods and duration of liquidity is small. It means that there is presence of both optimistic and pessimistic liquidity providers in the market. The lagged market liquidity is significantly related to market return which may imply that with high market liquidity in the market underreaction happens and as a result price and market returns decline. The presence of high liquidity in the market doesn’t guarantee that trading activities will increase.

From the empirical analysis of herding behaviour (third objective) finds evidence of herding behaviour at market level in post Covid-19 periods under bullish market; low volume state and high volatility market conditions at the higher tails of the quantile distribution. The presence of herding in bullish market is due to the presence of excessive volatility and in high trading volume is due to presence of overconfident investors in the market. This behaviour is of great concern to policy makers as it can result in significant asset mispricing due to asymmetric information flowing in an imperfect information market.

In post Covid-19 period; the sectors like CD, CM, FMCG, O&G and Power exhibit herding behaviour which focus on sell side herding. The various reasons for sell side herding behaviour include supply chain disruption due to lockdown, inflated prices of the products, rising healthcare cost has led consumers to shift to saving mode as a precautionary measure. In O&G sector; during post Covid-19, see drop in oil prices due to oversupply and demand contraction owing to complete lockdown in first wave of Covid-19 which disrupted the demand. The Power sector also see reduction in demand due to financial stress owing to large debt and disruptions to the power supply chain.

In nutshell, it may be concluded that there is the presence of inefficiencies in the Indian stock market, owing to some degree of behavioural anomalies in the form of OB, DE and HB. Therefore, the regulatory authorities, like Securities Exchange Board of India (SEBI) can play an advisory role in educating investors to manage their decisions. The continuous learning about market trends, investment strategies, and behavioural biases may help investors recognize the biases while making financial decision.

The thesis work can be extended for the cross-country analysis of different biases under different market conditions which may help investors in their portfolio diversification by mitigating the risk at domestic and global level. The application of ML & AI is new domain of research which is unexplored and in nascent stage in Indian stock market using techniques, like, support vector machines, neural networks, etc. which may provide better prediction of investor behaviour.