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BEHAVIORAL FINANCE: AN INTRODUCTION TO THE PRINCIPLES GOVERNING INVESTOR BEHAVIOR IN STOCK MARKETS

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ABSTRACT

The conventional academic finance emphasizes theories such as modern portfolio theory and the efficient market hypothesis, but the novel field of behavioral finance integrates psychology and sociology in financial decision-making process of individuals, groups, and institutions. This paper is aimed to discuss some general principles of behavioral finance including the following: the heuristic theory, the prospect theory and herding behavior among investors and provide explanation for why investors make irrational decision.

KEYWORDS: Behavioral Finance, Modern Portfolio Theory, Efficient Market Hypothesis, Heuristic Theory, Prospect Theory, Herd Behavior