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Difference between behavioral finance and traditional finance

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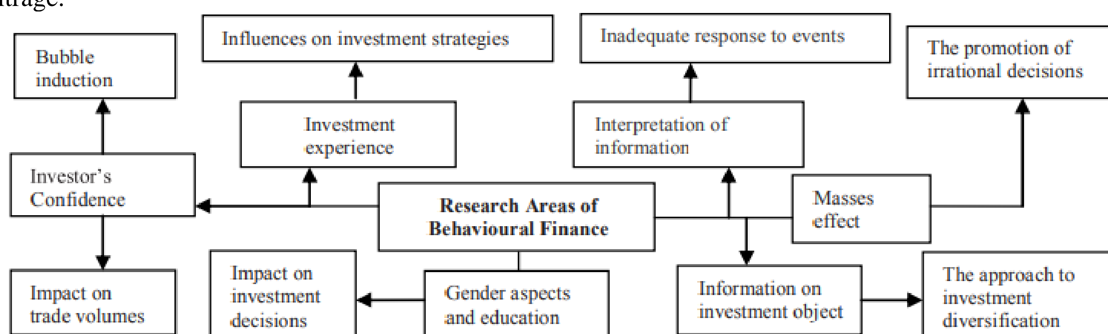
ABSTRACT

Global financial markets are leveraged by many factors: The process of economic which take place in the world, institutional and political hampering, information disperse and attainability etc. In behavioral finance people's reaction as well as perception are one of the most significant factors. Not only institutional investors but also individual investors who has been investing in financial markets in recent decades has become more popular. Short term price changes are influenced by market participants that are not always based on logic, sometimes it can be inspired by mood or instant news. That is why, Investing decision depend on the object and it's financial status in future. Whereas In traditional finance experts find out financial locus admired not by the error-prone and emotional Homo sapiens, but by the stunning Homo economicus. Behavior finance models always depend on a concept of independent investors who are susceptible to judgment and decision-making fallacy. This article issues a brief introduction on behavioral finance, which encircle research that drops the traditional premise of expected which efficient markets.

Keywords: *Economics, Global finance, Emotional homo sapiens.*

1. INTRODUCTION

Behavioral finance manifest research that traditional assumption of anticipate utility maximization with rational shareholder in efficient market. Efficient market hypothesis has dominated finance for 30 years. Three basic theoretical arguments form the basis of the EMH. The most significant is that shareholders are rational and by connection securities are valued rationally. Before taking investment, decision everyone takes information carefully, which is based on the idea. It is related to internal firmness. Each and every decision has to be made in organized way such that it connects one another, the third principle tells us that decision-maker always follow self-interest. Behavioral finance means study of market which is based on psychology. It shows us why people buy stocks or sell stock; also shows why they don't buy it. This research on investors tells us about the behavior, helps us to explain 'market anomalies' that stand against standard theory. This is because this peculiarity is persistent. Therefore, this behavior exists. Behavioral finance confine research that drops the traditional presumptions of expected utility expansion with rational shareholders in efficient market. There are two building blocks of behavioral finance. First cognitive psychology and second the limits to arbitrage.



Therefore, Subrahmanyam (2007), offers to fuse the traditional financial theories, which support the rationality with the theory of behavioral finance and predicts that investors 'behavior' is not rational. Subrahmanyam proves that the financial behavior correctly tells the traditional financial theories. There are lots of psychology literature documenting that tells about people make

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systematic errors while thinking: they make decision easier (heuristics), overconfidence, put lots of weight on recent experience (representativeness), separate decisions that should be attached together (mental accounting), wrong presenting the individual matters, incline to be slow to make the changes (conservatism), and their preferences may also create warp when they avoid acquiring paper losses and seek to acquire paper gains (disposition effect).**5** Traditional Finance comes to light with the concept of Markowitz for selecting portfolio, which concepts are used in investment Decisions till date. Traditional Finance rises with the concept of Markowitz (1952) for portfolio that theory are still used in investment Decisions. Their work goes till capital structure work of Modigliani and Miller,(1958). The rise of Modern finance theory (Sharp; 1964, Mossin; 1966 and Fama; 1970) denotes efficient market theory which leads to rise of modern finance. These systematic theory gives the almost accurate information about stock market and it's efficiency that provide clear decision-making ability about Investment for present and future profit and gains. Black, Scholes and Merton; (1973) gave the new thesis names as option pricing theory that is now used for evaluation of options. Utility expected theory characteristics are very similar as the Modern Finance theory. The struggle between modern finance and behavioral finance is the study of market efficiency that Statman, (1999) defines of meaning point of views of market efficiency gives information regarding systematic patron of risk that not sport to psychology like feelings etc. Byrne and Utkus stated in "why bother with behavioral finance". In Traditional Finance theory, investors are not baffled about the information's which are provided with investors so that a theory of traditional finance not matches with the reality.**6**The reason of publishing this article is to tell people through this debate that, fundamental assumptions on human behavior. The next part provides a general map of research and describes in detail the analogy and dissimilarity between behavioral and traditional finance.

2. MATERIAL METHODS

This article shows two aspects of finance, behavioral finance and traditional finance. It also shows various factors affecting a human's financial decisions because of emotional instability and lack of decision -making.

2.1 Portfolio on behavioral finance

Behavioral finance is the study of the effect of psychology on investors and financial markets. It stated why investors often emerge to lack-safe biases instead of reality. There are many forms of Behavioral Finance like

2.2 Negative behavior

Aggressive: physically threatening
Argumentative: always arguing with people
Bossy: always dominating people, what to do

2.3 Positive behavior

Altruistic: shows concern for others
Caring: want to help people
Compassionate: 1. feels sympathy
2. concern for others
Considerate: thinks of others

2.4 Traditional behavior

Traditional financing means a loan of credit protected through a economical institution under standard terms, generally depends on character, collateral, capital, and capacity. ... Basically, loans from large or small banks are the one of the most common source of traditional finance. Considering to traditional finances, investors receive unlimited data, knowledge and information that are perfect. The investors delicately processes this information, so there is complete rationality. Whereas in behavior finance, investors have crossed rationality so the investors doesn't process all the information. Investors are still bound to make an error in judgment.Traditional finance defines that the market is efficient and is a representation of the financial market's real value. This debate is based on the fact that traditional finance believes that investors have self-control. But behavior finance believes that the market is volatile and that's why there are market abnormality. Here investors don't have perfect self-control, so restriction exist. The volatility of the market leads to the rising and falling of stock prices, so an unpredictable market.

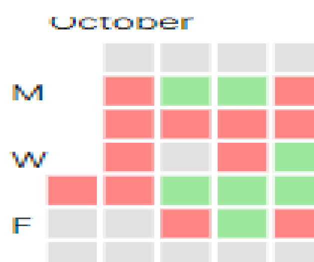
3. RESULT

3.1 Behavioral finance

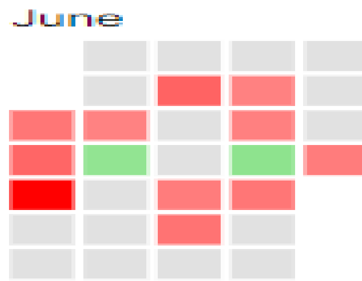
Table 1: Behavioral Finance

Sr. No.	Emotions
1	Exicitment
2	Aggressive
3	Slowdown
4	Recovery

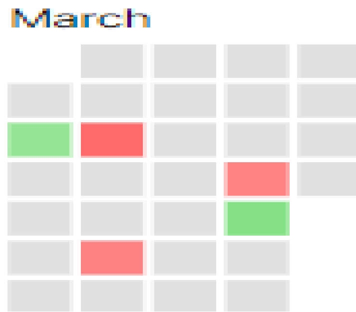
Exicitment



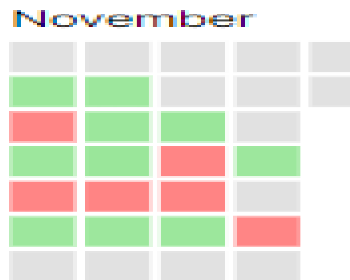
Aggressive



Slow Down



Recovery



4. CONCLUSION

In this paper we studied about the human behavior, who invested in stock market? In our research we get to know the problems that was faced by the investor while trading. How there was lack of confidence, decision making power and spirit. Here is the complete portfolio of trader. Traditional financing means a loan of credit protected through a economical institution under standard terms, generally depends on character, collateral, capital, and capacity.

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