# The Impact of Investor Expectation on the Financial Decision-Making

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**Abstract.** This paper delves into a fundamental analysis of two significant standards in budgetary financial matters: efficient market hypothesis and behavioral finance. The efficient market hypothesis posits that financial markets efficiently process all available information, leading market participants to make rational decisions. This theory underscores the accuracy of market predictions and the efficiency of information processing. In contrast, behavioral finance challenges the efficient markets theory by revealing various cognitive biases and irrational behaviors that influence financial decisions, casting doubt on the accuracy of market predictions and the rationality of market behavior. Through a comprehensive investigation, this article aims to compare these two hypotheses and evaluate their impact on understanding financial markets and decision-making processes. By providing insights into how market efficiency and behavioral inconsistencies coexist and influence financial practice, this article aims to contribute to the ongoing discourse in monetary economics. By delving into these contrasting theories, this paper aims to provide valuable insights into how market efficiency and behavioral factors interact and shape financial outcomes.

**Keywords:** Investor Expectation, Financial Decision-Making, Behavirol Finance.

## 1. Introduction

Proficient Advertise Theory, proposed by Fama in 1970, declares that monetary markets effectively prepare all accessible data, with members making sound choices [1]. This hypothesis emphasizes the exactness of showcase forecasts and data preparing. In any case, Behavioral Back, impacted by Tversky & Kahneman, and Shiller, challenges EMH by uncovering cognitive inclinations and nonsensical behaviors in budgetary decision-making [2, 3]. Tversky and Kahneman's inquire about appeared that representativeness and accessibility heuristics lead to silly choices, indeed with clear advertise data [2]. Kahneman and Tversky's prospect hypothesis highlighted more grounded hazard revolution to potential misfortunes, differentiating the judicious financial specialist show in EMH [4]. Shiller found stock costs vacillate past what data overhauls legitimize, showing feelings and mental desires essentially impact showcase elements [3].

These experiences uncover that markets are not continuously proficient, and financial specialist behavior can lead to showcase overreactions. Behavioral Back ponders marvels such as surrounding impacts, overconfidence, and gift impacts, underscoring the effect of mental components on monetary choices [5]. Combining the Proficient Advertise Speculation with Behavioral Fund gives a comprehensive system for understanding the complexities of monetary markets, emphasizing the part of mental and enthusiastic components in monetary decision-making.

## 2. Loss Aversion

Fundamentally to this system is the concept of misfortune revolution, a foundation of behavioral financial matters. This rule, to begin with proposed by Tversky and Kahneman, sets that people's abhorrence to misfortunes exceeds their inclination for proportionate picks up. Tversky and Kahneman's investigate illustrated that the distress caused by misfortunes is roughly twice as powerful as the delight determined from proportionate picks up [5]. In pith, the negative utility experienced from a misfortune essentially surpasses the positive utility picked up from a break even

with sum of benefit. This dissimilarity in enthusiastic reaction to picks up and misfortunes encourage illustrates the perplexing elements of speculator behavior in budgetary markets.

A classic case is the “Mugabe experiment” of Tversky and Kahneman. In this experiment, participants were faced with two choices: winning $900 with certainty or winning $1,000 with a 90% probability. Most people choose certainty to gain $900, demonstrating aversion to loss. However, when the choice becomes a certain loss of $900 or a 90% probability of losing $1,000, most people choose to take 90% of the risk, which once again proves the existence of loss aversion [5].

This finding challenges the rational behavior model in traditional economics, because according to rational expected utility theory, people should have the same attitude towards losses and gains. The concept of loss aversion reveals people's irrational behavior in the face of potential losses, and is of great significance to understanding investor behavior, market fluctuations, and decision-making processes in financial markets.

In the study of Benartzi and Thaler, the "own way of doing things in the stock market" theory they proposed not only revealed the role of loss aversion in personal investment decisions, but also hinted at people's psychological conflicts in the face of long-term and short-term gains. This short-sighted loss aversion can cause investors to miss out on high returns on long-term investments, affecting their financial security and retirement planning. This reminds us that when formulating investment strategies, it should pay more attention to educating investors about the importance of risk and time perspective [6].

Odean's "disposition effect" study revealed the psychological dilemma of investors when facing losses. This behavior can cause investors to miss opportunities to recover during a stock market downturn because they are unwilling to admit their mistakes and cut their losses. This phenomenon is very common in investment psychology, but it is often overlooked. Investors and financial advisors should be aware of this psychological bias and consider how to overcome or mitigate its effects in their investment strategies [7].

The research of Barberis, Huang and Santos shows the impact of loss aversion on market volatility from a macro perspective. Their model shows that the psychological state of market participants has a profound impact on the overall performance of the market. This theory has important implications for risk management and investment strategies in financial markets, especially under extreme market conditions. This also shows that the stability of financial markets is not only affected by economic factors, but also by the psychological state of market participants [8].

Through these studies, it can see the broad effects of loss aversion at both the individual and market levels. Loss aversion among individual investors can lead to irrational investment decisions, such as being overly conservative or overly risky, while at the market level, this psychological state can lead to increased market volatility, especially during market downturns. These findings are critical to understanding the behavioral dynamics of financial markets and provide important insights for financial advisors and policymakers. For example, financial advisors can use this knowledge to help clients better understand and manage their investment portfolios, particularly when educating clients on how to balance risk and reward. At the same time, policymakers and regulators can consider these psychological factors to develop more effective market supervision strategies and reduce the risk of excessive market volatility. Research on loss aversion not only provides an in-depth understanding of individual investment behavior, but also reveals the psychological mechanisms behind market behavior. These insights are critical to building more robust and efficient financial markets and provide investors with better financial management strategies and decision-making tools.

## 3. Market Anomalies

The Energy impact in budgetary markets may be a noteworthy wonder demonstrating that the past execution slant of stocks or other assets tends to continue into the long run. This concept has advanced essentially since its early recognizable proof, with later ponders advertising more profound experiences into its instruments and suggestions.

Luo, Subrahmanyam, and Titman have contributed to this understanding by analyzing how force techniques can abdicate positive returns. They found that stocks performing well over a 6 to 12-month period regularly proceed to perform well in ensuing months, whereas underperformers proceed to decay [9]. This design negates the productive showcase theory, which sets that past execution ought to not reliably advise future costs.

Tai amplified this investigation through observational investigate, affirming the strength of the energy impact. Their discoveries recommend that indeed when bookkeeping for components like market size and the book-to-market proportion, energy procedures can create critical positive returns [10]. This shows that the energy impact can be more profoundly established in financial specialist behavior and advertise brain research than in chance recompense alone.

Encourage growing the geological scope, McBrayer illustrated that the energy impact isn't limited to a single showcase but is a global phenomenon. This consider highlights that whereas the impact is predominant around the world, its appearances can change over distinctive nations and regions due to nearby advertise structures, data dispersal effectiveness, and financial specialist behavior [11]. Such varieties recommend that the force impact is impacted by a complex transaction of worldwide and neighborhood advertise variables.

The inversion impact in monetary markets, as a concept, challenges conventional speculations of advertise behavior, especially the proficient showcase speculation. It proposes that stocks with a history of destitute execution may involvement an upturn within the future, and alternately, past best entertainers may underperform. This concept has been investigated and approved through different ponders over the a long time.

Modi in their inquire about digs into advertise wasteful aspects, especially centering on the dismissed stock irregularity and inversion inconsistency [12]. This consider affirms the nearness of the inversion impact, showing that short-term best entertainers tend to underperform subsequently, adjusting with the initial discoveries of De Bondt and Thaler [13]. This suggests that investors' beginning responses to stock execution may be over-exaggerated, leading to a remedial inversion over time.

Jiang and Lao investigated this marvel within the setting of the Chinese stock showcase, distinguishing irregularities between past returns and productivity development as a key driver of short-term inversion. Their discoveries show that stocks with past returns conflicting with productivity development are more inclined to inversion, proposing a mispricing clarification for this wonder [14].

Abiprayu looks at showcase overcompensation and cost inversion within the Indonesian stock showcase, contributing to the understanding of how financial specialist behavior, especially mien impacts, can lead to cost inversions. This think about illustrates that overreaction to showcase data can result in unexpected cost inversions, reflecting the complex elements between financial specialist opinion and advertise execution [15].

## 4. Framing Effect

Framing Effect is an important concept in behavioral economics, which describes how people may make different decisions when faced with different ways of presenting information. This concept was first proposed by Tversky and Kahneman in their research. They demonstrated the influence of the framing effect through the "Asian disease experiment": when faced with the problem of saving 600 lives, people tend to choose deterministic options (such as saving 300 people for sure) and avoid risky options (such as 1/A probability of 3 to save 600 people, a probability of 2/3 to save no one); but when the problem is reframed as "choosing the number of deaths," people tend to choose the risky option [16]. This experiment shows that even when faced with the same actual choice, different ways of presenting information can lead to significant differences in decision-making.

In another study, Levin, Schneider, and Gaeth found that consumers rated meat products higher when they were labeled as “containing 75% lean meat” than when the same product was labeled as

"containing 75% lean meat." 25% fat", consumers rated it lower, even though the two labels were de facto equivalent [17]. This further demonstrates the ubiquity and importance of framing effects in everyday decision-making.

These studies show that the framing effect plays a key role in the decision-making process and reveals people's irrational characteristics in information processing and decision-making. This has important implications for understanding consumer behavior, marketing strategies, and broader economic decision-making. By understanding the framing effect, it can better understand and predict people's decision-making behavior in different situations and provide guidance for formulating effective communication strategies and decision-making frameworks.

In terms of empirical analysis, Druckman's study provides an empirical example of framing effects in political communication. He found that in political debates, different information frames significantly affect people's attitudes and choices about policies. People are more likely to support a policy when it is framed as involving personal freedoms; support decreases when the same policy is framed as a public safety issue [18]. This suggests that framing effects play an important role in political communication and public opinion formation.

Another study was conducted by LeBoeuf and Shafir, who explored how framing effects influence individuals' financial decisions. Research has found that when savings goals are framed as "avoiding losses" rather than "achieving gains," people are more likely to take actions to achieve these goals [19]. This finding has important implications for understanding personal financial planning and consumer behavior.

It can see the wide application and influence of framing effect in different fields. These findings highlight the important influence of how information is presented on people's decision-making. From a personal perspective, these studies suggest that it needs to be aware that it may be affected by framing effects when making decisions. Understanding this can help us evaluate information more objectively and avoid making irrational decisions based on how it is framed. For marketing professionals, policymakers and financial advisors, these studies provide important insights into how to effectively communicate and influence decision-making. For example, when designing advertising and marketing strategies, a reasonable message framework can more effectively attract consumers and influence their purchasing decisions. Similarly, in the fields of public policy and financial services, a reasonable information framework can help people make decisions that are more beneficial to long-term interests. These studies also remind us that as information recipients, it should critically evaluate the way information is presented and seek sources of information from multiple perspectives to reduce the potential impact of framing effects on our decision-making. Overall, research on framing effects not only reveals the complexity of the human decision-making process, but also provides us with strategies for more effective communication and decision-making in various situations.

## 5. Endowment Effect

The endowment effect refers to the phenomenon that people place a higher value on the items they own than the market value of the same items. This concept was first proposed by Thaler in his research. Thaler found that when people own an item, their valuation of the item is generally often higher than the price they would otherwise be willing to pay for it [20]. This suggests that simply owning something is enough to give people a higher subjective assessment of its value. A classic example is the "coffee cup experiment" conducted by Kahneman, Knetsch, and Thaler [21]. In this experiment, half of the participants were randomly given a coffee cup, while the other half were not. They were then asked how much they would like to sell or buy the coffee mug. Results showed that participants who owned a coffee mug demanded approximately twice the selling price that participants without a coffee mug were willing to pay for the purchase. This experiment visually demonstrates the endowment effect: people place a higher value on the items they own. The endowment effect is a powerful and ubiquitous psychological phenomenon that affects people's value judgments and

decision-making processes. From a personal perspective, these findings serve as a reminder to remain objective when evaluating the items, it own and avoid overestimating their value due to excessive emotional attachment. For marketing and business negotiations, understanding the endowment effect can help develop more effective strategies, such as increasing consumers' perceptions of a product's value by letting them experience it. The existence of the endowment effect also challenges the assumptions about rational choice and market efficiency in economic theory, reminding us that it needs to take into account the complexity of human psychology and behavior when analyzing market behavior.

In terms of empirical analysis, a study conducted by List explored the performance of the endowment effect in different market environments. List found that the endowment effect was weaker among professional traders but more significant among ordinary consumers [22]. This suggests that market experience and expertise may moderate the impact of the endowment effect.

Another study was conducted by Ericson and Fuster who explored how the endowment effect affects individuals' health insurance choices. Research has found that even when offered the same insurance plan, people tend to stay with their current plan rather than switch to a plan that costs less or offers greater coverage [23]. These finding sheds light on the role of the endowment effect in important economic decisions.

It can see the broad impact of the endowment effect in different fields and environments. List's research reminds us that in a more professional or familiar market environment, people may be more able to objectively assess the value of the items or assets they own. This is an important implication for financial market participants, suggesting that through education and experience people may be able to reduce the impact of the endowment effect on decision-making. Ericson and Fuster's research revealed the role of the endowment effect in important personal decisions, such as health insurance choices. This suggests that people tend to stick with the status quo even when faced with potentially more advantageous options, possibly due to overreliance on existing options and resistance to change. This has important implications for the design and promotion of new insurance products or financial instruments, that is, consumers' attachment to the status quo needs to be taken into account when guiding them to make better choices. Research not only enhances our understanding of the endowment effect, but also provides insights into how to consider and respond to the endowment effect in practical applications. Whether it is trading in financial markets, choosing insurance products, or making daily consumption decisions, understanding, and dealing with the endowment effect is the key to improving the quality of decisions. These findings highlight the need to take into account people's psychological dependence on existing assets or states and how this dependence affects their choices and behavior when formulating economic policy and business strategies.

## 6. Conclusion

This paper explores the impact of several key concepts in behavioral finance (such as loss aversion, market anomalies, framing effects and endowment effects) on financial market decisions. These concepts reveal the psychological mechanisms behind market dynamics, challenge the assumptions of rational behavior in traditional financial theory, and are of great significance to understanding market fluctuations and investor behavior. Behavioral finance research has limitations, particularly in terms of differences between laboratory settings and real market environments, the generalizability of the theory, and quantitative challenges.

Future research should focus on developing quantitative models, combining big data and machine learning techniques, and conducting cross-cultural studies. This will help to better integrate behavioral finance insights and traditional financial theory, improve the ability to predict market behavior, and find applications in actual financial market operations. Behavioral finance provides new perspectives for understanding financial markets, but also points to areas for future research to explore, especially in terms of integrating theory and practice.

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