

Behavioural Finance Factors and Investors Decision in Cross River State

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doi:10.63593/LE.2788-7049.2025.05.001

Abstract

The study empirically examined tests of behavioral finance factors and investors decision. The specific objectives were to: examine the relationship between overconfidence and investment decision, ascertain the relationship between herding and investment decision, and to investigate the relationship between Risk perception and investment decision. This study employed a survey research design in order to reproducing an extensive and exact picture of the stock market of Nigeria behavioral financing/ investment decisions. The target population of this study included all individual investors in the stock market in the year 2023, with the population of one hundred and ninety-six (196). Primary data was employed, and data were analyzed using Pearson product moment correlation. Based on the results, the major findings of the study included were: there was a significant relationship between overconfidence and investment decision, there was a significant relationship between herding and investment decision and finally, there was a significant relationship between Risk perception and investment decision. The study concluded that behavioral finance factors measured with overconfidence, Herding and Risk Perception have significant relationship on the decision of individual investors. It is recommended that behavioral financial factors should be considered which could have an impact on investor's decision.

Keywords: test of behavioral finance, investors decision, overconfidence, investment decision, herding, Risk perception

1. Introduction

In an economy, besides playing the role of a source for financing investment, stock market performs a function as a signaling mechanism to managers regarding investment decisions, and a catalyst for corporate governance. However, stock market is best known for being the most effective channel for company's capital raise. People are interested in stock because of long-term growth of capital, dividends, and a hedge against the inflationary erosion of purchasing power. The other feature that makes the stock market more attractive than other types of investment is its liquidity. Most people invest in stocks because they want to be the owners of the firm, from which they benefit when the company pay dividends or when stock price increases (Sewell, 2017).

Individual investor's behavior is extensively influenced by various biases that are highlighted in the growing discipline of behavioral finance (Jagongo & Mutswenje, 2014). Behavioral finance is a comparatively recent area that attempts to combine behavioral and psychological theory with traditional economic and financial theory

in order to provide reasons for why people make irrational financial decisions. It is a well-known term in the stock market for investment options all over the world (Sewell, 2017). Behavioral finance is the study of the impact of psychology and sociology on monetary practitioner's behavior. It is essential to examine why people buy or sell stocks without doing basic research or acting irrationally when making investment decisions. The field of behavioral finance attempts to better understand and explain how emotions and cognitive errors influence investors in their decision-making process. Behavioral finance is different in its view from the traditional belief that investment decisions are not always made on the basis of full rationality. Behavioral finance is the study of the influence of psychology on the behavior of financial practitioners and the subsequent effect on markets. Behavioral finance is of interest because it helps explain why and how markets might be inefficient. The investment behaviors of Nigerians can typically be modelled after the Nigerian Stock market (Mahmood, Ahmad., Khan & Anjum, 2021).

Financial theories have been developing since several last decades, these studies trying to understand the rationality of investors in the financial markets by using new models. The traditional financial theories have assumed that when investors take stocks investment decisions, they don't have difficulty because they are well informed, careful, and consistent. Modern portfolio theory and Capital Asset pricing Model assumes that investors are not puzzled regarding the size of information presented to them and not controlled by their behavioral finance factors. But several studies in the developed capital markets found that many phenomena regarding stock investment decisions cannot be explained. Investors in capital asset exchanges, typically taking many different and important decisions, the most common are taking investment decisions in order to maximize their wealth; others are considering seeking market timing techniques to maximize their wealth.

In contrast, some investors are more risk averter, so they are following stocks that have low risk levels, at the same time; other investors are accepting high risk stocks but applying some diversification techniques to control the unsystematic risks. As a result, studying the impact of behavioral finance of investors on stock investment decisions became very important; hence investors rarely depend on the assumptions of the financial theories when they made their decisions (Shefrin, 2019). Therefore, the main objective of this study is to explore the behavioral finance factors influencing investment decisions. The research studied the relationship of the following behavioral finance factors on investment decisions: Overconfidence, Herding, Risk Perception.

Test of hypotheses

H₀₁: There is no significant relationship between overconfidence and investment decision.

H₀₂: There is no significant relationship between herding and investment decision.

H₀₃: There is no significant relationship between risk perception and investment decision.

2. Conceptual Issues and Review

2.1 Behavioral Finance

Behavioral finance is the study of the influence of psychology on the behavior of financial practitioners and the subsequent effect on markets (Sewell, 2017). Behavioral finance argues that some financial phenomena can be understood using models in which some investors are fully rational, which mean that their investment decisions are made according to risk and return Considerations (Chitra & Jayashree, 2014). One of the famous theories was developed by Harry Markowitz about formation investment portfolios and how investors can choose portfolio assets with different risk-return combinations. Over the last years, portfolios managers began to study other concepts in this regard in addition to expected risk and return, psychological factors such as sentiment, overreaction, overconfidence etc.

Behavioral Finance is the combination of psychological and financial factors that investigates what happens in markets in which some of the investors display human limitations and complications, hence psychology systematically explores human judgment, behavior, well-being (Chan, 2021). Accordingly, investor's behavior in stocks market derives from psychological principles of decision making which explain why investors buy or sell stocks. Shefrin (2019) defined behavioral finance as a rapidly growing area that deals with the influence of psychology on the behavior of financial practitioners. Ricciardi and Simon (2020) stated that behavioral finance attempts to explain and increase understanding of the reasoning patterns of investors including the behavioral factors involved and the degree to which they influence the decision-making process.

2.1.1 Behavioral Finance and Investment Decisions

Behavioral finance seeks to find how investor's emotions and psychology affect investment decisions. It is the study of how people in general and investors in particular make common errors in their financial decision due to their emotions. It is nothing but the study of why otherwise rational people take really thumbs investment decisions. Decision making is a process of choosing best alternatives among a number of alternatives. This decision has come out after a proper evaluation of all the alternatives. Decision making is the most complex and

challenging activity of investors. Every investor differs from the others in all aspects due to various factors like demographic factor, socioeconomic background, educational level, sex, age, and race (Chaudhary, 2023).

According to Sewell (2017), decision-making is a cognitive process to choose an alternate among several possible alternative scenarios. One cannot make a decision by simply relying on his/her personal resources. The result can be a vision or an action of choice. Decision-making without certain planning can be fair but it might not end well. A manager's mental approach mediates the different problems occurring in different steps by analyzing them. Decision-making basically is a unique art to choose a certain alternative from various alternatives available. Moreover, it is a process that is being followed by the alternatives that are thoroughly inspected and evaluated. Managers who want to compete in a challenging business environment must update themselves in many fields so that they can get desired results. It is important to understand that in present competitive global perspective investors must obtain capability to get best results out of their investments.

In addition to this, investors should develop persistence and positive vision. Investors differ from one another in different aspects and demographic factors, i.e., socio-economic, education, sex, race and age. Few believe in more risk, more return which is usually risky, whereas others believe in less risk and less return which is always safe. Hence the difficult part to play while making decision is to select the particular area and field of investment. Significant consideration is given to the best investment decision. Investors while constructing their investment portfolio need to consider their risk tolerance, rate of return, market conditions and other constraints. Behavioral Finance illustrates how different investors comprehend and react to the information available in the market. It is not necessary that all the investors always behave rationally, or they predict quantitative models in same and unbiased manner. That is why Behavioral Finance gives significance to the behavior of investors, leading to several market anomalies.

In present days, Behavioral Finance has become the constitutional part of the process of decision-making because its impacts influence the performance of the investors. Behavioral Finance helps investors to choose better financial decision and to avoid same high-priced mistakes in future. According to Chaudhary (2023), upward and downward movements by securities in markets (Beta coefficient) lie in first category. On the other hand, the second category is about the non-market risk which depends on the luck of a company and its concerned industry. According to the traditional decision Theory, the decisions made by decision-makers differ from the presumptions of economists, which they proved with the help of various experiments (Abdulaziz, 2023).

2.1.2 Behavioral Finance and Its Emergence

Making money is the principal motive of an investor. During several past years, investments are usually based on forecasting, performance, market timing. That used to produce ordinary findings. Huge gap between the returns available and the return received forced the investors to look into the matter and find the reasons. So, the fundamental mistakes during the process of decision-making were identified. In other words, we can say that investors make irrational decisions during their investments and psychological impact was found during these mistakes (Chaudhary, 2023). Thus, the Subject of Behavioral Finance which got popularity in the world of investment decisions and stock markets is not new as the researchers began to work on this field several years ago. Since many years, investors have been considering psychology an important factor while determining the market behavior, but formal studies have only been conducted in recent years in this field of behavioral finance.

According to Sadiq and Ishaq (2014), behavioral Finance is the study of how humans interpret and act on information to make informed investment decisions. Behavioral finance doesn't explain the rational behavior or points out a decision faulty, rather attempts to comprehend and forecast financial markets systematically. The important point to be noted here is that no significant theory of Behavioral Finance exists.

2.2 Theoretical Foundation

According to these definitions, we will introduce the theories that explain the investor's decisions as follows:

2.2.1 Traditional Decision Theory

The classical financial theory assumes that investors are rational when they are making investment decisions. Investment rationality refers to using unbiased valid reasoning to buy or sell assets and build portfolios (Chandra & Kumar, 2018). This unbiased reasoning is viewed in the trade-off between risk and return. In general, a standard finance decision assumes that all investors are wealth maximizers (Masomi & Ghayekhloo, 2021). Classical decision theory assumes that investors have well informed systematic decisions, which are in their own self-interest, and acting in a world of complete certainty and the risk is measured by the variance of the probability distribution of possible gains and losses. The standard finance is generally considered to be publication of portfolio selection. Markowitz (1952) described how rational investors should build portfolios to maximize expected return and minimizes risk. In this way, risk and return are the main factors in investment decision. Accordingly, the portfolio will be more efficient if it offers the highest return given a specific risk or

the minimum risk given a specific return. Sharpe (1964) developed the Capital Asset Pricing Model (CAPM).

He incorporated the Markowitz mean variance-optimizer investor as well as the concept of efficient markets. The CAPM assumes that; Investors can borrow and lend at the same interest rate, the risk-free rate; all investors are rational in their decisions and create efficient portfolios; all investors' identical expectations for investment cash flow in the future and all investors are planning for one holding period. As a result, the main implications of the CAPM are; (1) The market Portfolio is mean-variance efficient; (2) The average return is an increasing function of beta (beta is a Systematic risk measure, captures the reaction of different individual securities or portfolios to changes in the market portfolio).

2.2.2 Behavioral Theory

It is argued that people are not nearly as rational as traditional finance theory makes out. For investors who are curious about how emotions and biases drive share prices, behavioral finance offers descriptions and explanations in this regard. The idea that psychology drives stock market movements flies in the face of established theories that advocate the notion that markets are efficient. Proponents of efficient market hypothesis say that any new information relevant to a company's value is quickly priced by the market. Behavioral finance psychology has explored various levels of rationality and irrationality behavior in which individuals and groups may act (Ritter, 2023).

2.3 Empirical Studies

Several studies have been made in the field of the impacts of financial behaviors on the investments decisions of individual investors in different markets around the world, in order to identify the main factors that may affect the decision making process. Barber and Odean (2019) in their study highlighted two common mistakes investors make: excessive trading and the tendency to disproportionately hold on to losing investments in Ghana. The study employed primary data using Pearson product moment correlation analysis. The population of the study was 250 employees. The study revealed that investors made excessive trading in their investment. The study recommended that investors should be overconfident. Kent and Titman (2019), in their study explains why investors are likely to be overconfident and how this behavioral bias affects investment decisions. Primary data was employed in the study using questionnaire instrument. Chi square statistical tool was used in the study. The study revealed that investors are likely to be confident in investments. The study recommended that investor overconfidence should potentially generate stock return momentum and this momentum effect is likely to be the strongest in those stocks whose valuation requires the interpretation of ambiguous information. It is added that Portfolio strategies that might be suggested by the overconfidence theory realize extremely high and persistent abnormal returns.

Dremen and Lufkin (2020) presented evidence in their study that investors under and overreaction exists and is a part of the same psychological process. The study employed primary sources of data using regression analysis. A total of 100 copies of questionnaire was distributed to investors in UK. The study revealed that investors under and overreaction exists as part of the psychological process. The study recommended that investors should be rational in their investments. Al-Tamimi (2015) studied the factors influencing the investors behavior on the UAE financial market in London between 2000-2020. The study employed primary data using questionnaire instrument of two hundred that were administered to investors. The results show that the six most influencing factors in order of importance were: expected corporate earnings, get rich quick, stock marketability, past performance of the firm's stock, government holdings and the creation of the organized financial markets and the least influencing factors to be expected losses and minimizing risks.

Zoghalmi and Matoussi (2019) in their study tried to identify the main psychological biases that influence the Tunisian investor's behaviors and that may drive a momentum effect in stock returns in Gambia between 1990 to 2020. The study employed primary source of data using questionnaire instrument. The population of the study was two hundred and fifty using Taro Yamane formula to determine the sample size of one hundred and fifty-four. The study found that the Tunisian investor's behaviors are driven by five psychological factors which are: precaution, under confidence, conservatism, under opportunism and informational inferiority complex. A study by Ton (2021) analyzed the tendency of investors to realize gains too early and the reluctance to liquidate losing positions. The study covers the period of 2010 to 2021. Primary data was in this study using questionnaire instrument. The analysis was based on the complete transaction data of the Estonian stock market. The study found the presence of the disposition effect (loss aversion) on the market as having a profound impact on the investment decision making by stock market investors thus reinforcing the position that behavioral finance plays a significant role on the stock market.

Al-Horani and Haddad (2021) try to identify the main psychological biases that may influence the investment behavior and drive a momentum effect in Jordan between the period of 2000 and 2021. Primary sources of data were used in the study using questionnaire instrument. The results showed that psychological factors that seem

to highly influence the investment behavior of Jordanian investors. Fares and Khamis (2021) investigated individual investors' stock trading behavior at the Amman Stock Exchange in Jordan between 1990 and 2021. The study employed primary sources of data using questionnaire instrument. They identified four behavioral factors (age, education, accessibility to the internet and interaction between the investor and his/her broker) that influenced investors' trading decisions. Primary sources of data were employed in the study. The study revealed that investor's age, education, and his/her accessibility to the internet had a significant and positive effect on stock trading, while the interaction between the investor and his/her broker, had a highly significant and negative effect. The study recommended that investor overconfidence should potentially generate stock return momentum that will affect the performance of the market.

Gunay and Demirel (2021) conducted a study on interaction between demographic and financial behavior factors in five of the financial behavior factors (overreaction, herding, cognitive bias, irrational thinking, and investment decisions). They found that gender has interaction with overconfidence, and the level of individual savings has an interaction with four of the financial behavior factors (overreaction, herding, cognitive bias, and irrational thinking). Hooy and Ahmad (2022), in their study tried to investigate the link between herd behavior and Monday irrationality. The study covers the period of 2010 to 2021. The study employed primary data using questionnaire. Regression analysis was used in the study. The main finding of their study is that herd behavior is the determinant of Investor's Monday irrationality in Malaysian stock market, particularly in small industries, which means that investors decisions were affected by psychological biases such as cognitive dissonance in trading during Monday.

3. Research Methodology

This study employed a survey research design in order to reproducing an extensive and exact picture of the stock market of Nigeria behavioral financing/ investment decisions. It should be noted that the behavioral and decision-making nature of stock market of Nigeria investors is vital in understating how they operate and thus the choice of research design. Therefore, the study employed a questionnaire in attempting to find the key behavioral finance factors that guide stock market investor's investment and financial decisions. The targeted population of this study includes individual investors in the stock market in the year 2022. The total number of individual investors is two hundred and fifty (250).

Taro Yamane formula was employed to select one hundred and fifty-four (154) as sample size during December 2022 in six working days of the market in Delta state. The respondents were the individual investors in the market. Primary data was collected by questionnaire which was examined by the researchers personally depending on several previous studies, the questionnaire consist of (20) questions divided into two sections. The first section contains (4) questions concerning socio-economic characteristics of the investors. The second section contains (16) questions cover the behavioral finance factors and the investment decision. Likert scale five point were used such as Strongly Agree (SA), Agree (A), Undecided(U), Disagree(D) and Strongly Disagree(SD). The data in this study were tabulated.

The data were analyzed using Pearson product moment correlation. The researcher assessed the scales content validity by using management experts in University of Calabar, upon that the researchers made the changes to the first draft in terms of eliminating, adding or rewording some of the questions included in that draft. Reliability of the measure was evaluated by using Cronbach's Alpha for the five variables, this measure allowed us to measure the reliability of the different categories and if the coefficient is greater than or equal to 0.6 is considered acceptable and a good indicator of reliability. The results indicate that the values of Cronbach's Alpha for the three variables are (Overconfidence 0.672, Herding 0.716, Risk Perception 0.693, and Investment Decision 0.755). When using the combined construct validity coefficient, a scale is deemed to be valid if the Cronbach's Alpha exceeds the value of 0.7. Since the overall Cronbach's Alpha (0.76) exceeded the minimum acceptable level, we can say the instrument was sufficient and satisfactory. The selection of the school was based on judgmental sampling.

4. Data Analysis

Test of hypotheses

Hypothesis one:

H₀: There is no significant relationship between overconfidence and investment decision.

Independent variable: Overconfidence

Dependent variable: Investment decision

Test statistic: Pearson's product moment correlation coefficient

The analysis showed a correlation coefficient of 0.872 indicating the existence of strong positive relationship between overconfidence and investment decision. The test was significant at 0.01 significant level and led to the

rejection of the null hypothesis which states that there is no significant relationship between overconfidence and investment decision. Consequently, the alternative hypothesis was accepted and the conclusion reached that there is a significant relationship between overconfidence and investment decision.

Table 1. Correlation result of relationship between overconfidence and investment decision

	OC	INVD
Pearson correlation	1	.872**
Sig. (2-tailed)		.000
Sum of squares and cross-products	138.58	171.21
Covariance	.250	.236
N	154	154
Pearson correlation	.872**	1
Sig. (2-tailed)	.000	
INVD Sum of squares and cross-products	176.41	622.44
Covariance	.336	1.51
N	154	154

**. Correlation is significant at the 0.01 level (2-tailed).

Source: SPSS analysis.

Hypothesis two:

H₀: There is no significant relationship between herding and investment decision.

Independent variable: Herding

Dependent variable: Investment decision

Test statistic: Pearson's product moment correlation coefficient

The analysis showed a correlation coefficient of 0.845 indicating the existence of strong positive relationship between herding and investment decision. The test was significant at 0.01 significant level, and led to the rejection of the null hypothesis which states that there is no significant relationship between herding and investment decision. The alternative hypothesis was consequently accepted and the conclusion reached that there is a significant relationship between herding and investment decision.

Table 2. Correlation result of relationship between herding and investment decision

	HDN	INVD
Pearson correlation	1	.845**
Sig. (2-tailed)		.000
HDN Sum of squares and cross-products	301.74	116.94
Covariance	.421	.305
N	154	154
Pearson correlation	.845**	1
Sig. (2-tailed)	.000	
INDV Sum of squares and cross-products	176.94	159.32
Covariance	.305	.201
N	154	154

**. Correlation is significant at the 0.01 level (2-tailed).

Source: SPSS analysis by Researcher, 2024.

Hypothesis three

H₀: There is no significant relationship between risk perception and investment decision.

Independent variable: Risk perception

Dependent variable: Investment decision

Test statistic: Pearson's product moment correlation coefficient

The analysis showed a correlation coefficient of 0.809 indicating the existence of strong positive relationship between Risk perception and investment decision and significant at 0.01 significant level. This led to the rejection of the null hypothesis in favor of the alternative hypothesis which states that there is a significant relationship between Risk perception and investment decision. The conclusion was that Risk perception significantly related with investment decision.

Table 3. Correlation result of relationship between Risk perception and investment decision

		RP	INVD
RP	Pearson correlation	1	.809**
	Sig. (2-tailed)		.000
	Sum of squares and cross-products	33.32	124.92
	Covariance	.517	.404
	N	154	154
INVD	Pearson correlation	.809**	1
	Sig. (2-tailed)	.000	
	Sum of squares and cross-products	127.92	318.28
	Covariance	.404	.649
	N	154	154

**. Correlation is significant at the 0.01 level (2-tailed).

Source: SPSS analysis by Researcher, 2024.

5. Discussion of Findings

The study empirically examined test of behavioral finance factors and investors decision. The result revealed that there is a significant relationship between overconfidence and investment decision. The result is in line with the works of Barber and Odean (2019) who posited that investors make: excessive trading and the tendency to disproportionately hold on to losing investments in Ghana. The study revealed that investors made excessive trading in their investment. It is added that Portfolio strategies that might be suggested by the overconfidence theory realize extremely high and persistent abnormal returns. Most people invest in stocks because they want to be the owners of the firm, from which they benefit when the company pays dividends or when stock price increases. Individual investor's behavior is extensively influenced by various biases that are highlighted in the growing discipline of behavioral finance. The investment behaviors of Nigerians can typically be modelled after the Nigerian Stock market. The hypothesis also revealed that there is a significant relationship between herding and investment decision. The result is in line with the works of Dremen and Lufkin (2020) who posited that investors under and overreaction exists and is a part of the same psychological process. The study revealed that investors under and overreaction exists as part of the psychological process. Al-Tamimi (2015) studied the factors influencing the investors behavior on the UAE financial market. In hypothesis three, it was revealed that there is a significant relationship between Risk perception and investment decision. The result is in line with the works of Ton (2021) who posited that investors to realize gains too early and the reluctance to liquidate losing positions.

6. Conclusion

This study tried to explore the influence of the behavioral finance factors on investment decisions of individual investors. To conduct the study, questionnaire has been built to measure the effect of behavioral finance factors on investment decision. (196) questionnaire has been distributed to the participants on randomly basis, in addition PPMC method was used to test the hypotheses. Results indicated that behavioral finance factors

(Overconfidence, Herding and Risk Perception) have significant relationship on the decision of individual investors.

7. Recommendations

- 1) Along with behavioral financial factors, we should consider some economic factors that could have an impact on investor's decision. Additionally, in this study, only three behavioral factors were considered which can affect investment decision making, i.e., overconfidence, herding, and Risk perception.
- 2) It is recommended that in the future more behavioral biases can be included in the study to evaluate the individual investor financial performance.
- 3) It is recommended to consider institutional investors in the future.

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