

A Comparative Analysis of Behavioral Biases in Investment Decision-Making: Insights from Behavioral Economics and Traditional Financial Theories

Casey Green

PhD

Harvard University

Cambridge, MA 02138, USA

Drew Baker

Dr. Sc

Ludwig Maximilian University of Munich

Geschwister-Scholl-Platz 1, 80539 Munich, Germany

Oliver Thompson

Associate Professor

London School of Economics and Political Science

Houghton Street, London WC2A 2AE, United Kingdom

Abstract. This article examines the intricate interplay between behavioral biases and traditional financial theories in shaping investment decision-making processes. We employ a comparative methodology, integrating insights from behavioral economics to highlight how cognitive biases such as overconfidence, loss aversion, and anchoring influence investor behavior. Through an empirical analysis of market data and investor surveys, we reveal significant discrepancies between theoretical predictions and actual market behavior. Our findings suggest that conventional financial models often fail to encompass the complexities introduced by psychological factors, thereby necessitating a paradigm shift in investment strategy formulation. Ultimately, we propose a hybrid approach that synthesizes behavioral insights with traditional financial frameworks to enhance predictive accuracy and investment performance.

Keywords: behavioral economics, investment decision-making, cognitive biases, financial theories, market dynamics, overconfidence, loss aversion, investment strategies

Introduction

The increasing complexity of global financial markets has elicited a growing recognition of the limitations inherent in traditional financial theories, particularly in their capacity to account for irrational behaviors exhibited by investors. Behavioral economics has emerged as a pivotal field, challenging the assumptions of rationality that have long dominated economic thought. This shift is intimately linked to the phenomena of behavioral biases, which systematically affect decision-making processes under uncertainty. In recent years, these biases have gained prominence as crucial determinants of market dynamics,

particularly in the context of volatility and financial crises. For instance, the global economic disruptions experienced during the COVID-19 pandemic underscored the pervasive influence of investor psychology on market trends. As uncertainty looms large, behavioral biases such as overconfidence and loss aversion became vividly apparent, guiding individual and institutional investors alike towards suboptimal decisions. Such dynamics necessitate a rigorous examination of how these psychological factors interact with conventional financial theories. This paper aims to provide a comprehensive analysis of the integration of behavioral biases into investment decision-making frameworks. We seek to unpack the complex relationships between these biases and the predictions offered by traditional financial models. Through a structured comparative analysis of existing literature and empirical data, our research delineates the broader implications for investment strategies in a rapidly evolving financial landscape. The subsequent sections of this paper will outline the specific behavioral biases explored, provide a detailed methodological framework for our empirical analysis, and present the key findings that emerge from our research. In doing so, we aspire to illuminate the necessity of a more nuanced approach that reconciles behavioral insights with established financial theories. This work aims not only to contribute to the academic discourse but also to inform practitioners on adopting more holistic investment strategies that embrace the psychological undercurrents influencing market behavior.

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