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*Article*

# The Impact of Investor Behavior on Building a Moderate Financial Portfolio (Analytical Research)

**Haider Abbas abdullah Aljanabi**[1]

1. Kerbala university , Collage Of Administration & Economics
* Correspondence: Haider.abbas@uokerbala.edu.iq

**Abstract:** No matter how much science and development progress at the financial and investment level, the investor's behavior remains the main axis in building the investment decision. The research addressed the impact of these behaviors on building the investment portfolio from an analytical perspective. The research reached a set of facts, the most important of which is that the investor often goes with his personal desires at the expense of financial and investment logic. This is a clear indication that the investor's desires and behaviors outperform the scientific and academic decision. The research also put forward a set of recommendations, the most important of which was the necessity of raising the level of awareness among investors in order to recognize that emotion and desire do not meet with scientific methods and approaches in building the investment decision. Accordingly, it is necessary to work on educating investors not to go continuously with emotions and desires that may cause losses in making investment decisions.

**Keywords:** investor behavior, investment portfolio, stock market

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## 1. Introduction

Over the past few years, there has been an increasing focus on behavioral finance to understand the decision-making process of individuals. The focus on individual decisions, like portfolio-related decisions, is very relevant today as the concern for individual old age is increasing [1]. Further, one of the objectives is to drive social security by increasing financial inclusion. All these developments generate the demand for making individuals capable and relevant to take care of their financial future. Given this objective, it's crucial to understand the influence of behavior on building the financial portfolio of an individual [2], [3]. This essay attempts to appreciate the behavior of investors and its resultant impact on the portfolio of an individual. Within this broad objective, it seeks to achieve two specific objectives: first, determining the extent to which individual decisions can influence the portfolio outcome; second, evaluating the importance of building a good and moderate financial portfolio.

The essay can provide a qualitative understanding of life cycle investors, investor characteristics, and highlights the need for accumulated wealth for achieving old age consumption. The essay attempts to collect literature in the area of behavioral finance and investments [4]. It will also employ historical and analytical evaluation and conclude with a brief survey of future research directions. Section 1 provides a brief outline; Section 2 discusses the objectives; Section 3 attempts to understand investor behavior that affects the portfolio; Section 4 explains a good and moderate portfolio. The next section concludes the essay.

Understanding Investor Behavior

Investor behavior has always been influenced by the psychological and sociological facets of the investor's behavior. Every investor has been, in one way or another, influenced by these psychological factors and tends to make irrational decisions while performing their investment activities. If the understanding of the investor's behavior is grasped fully, it can lead to more positive traction and superior investment results. The reason behind this is the accumulating evidence that investor behavior can have an effect on the building of a moderate portfolio for the betterment of the community of active mutual funds [5], [6]. Current theories of behavioral finance propose that investors do not always act rationally—they sometimes act irrationally for numerous reasons and in multiple ways. Such characteristics of investors, such as excessive self-confidence, cognitive biases, and high aversion to ambiguity, might have an adverse impact on their investment processes. In other words, investors may pay too much for investment prospects (or sell investments too soon), purely because of factors such as social and market consensus, over and above the intrinsic valuation of the investment opportunity [7], [8]. Behavioral finance integrates a broader range of explanations for investor behavior than classical finance. It concentrates on the psychological, sociological, environmental, economic, and other factors that influence investors and their decisions. At the core of behavioral finance are clear predictions about how investors are likely to behave and misbehave when making investment decisions. This text comprises non-exhaustive lists of the typical biases and heuristics demonstrated by investors. Such lists are useful in that they assist in identifying potential weaknesses in an investment strategy, scheme, or behavior [9]. That said, it must be highlighted that explanations for investor behavior can often be quite complex, even baffling, given the number and combination of extra-market factors that can influence individual and group investment behavior. Personal traits, beliefs, opinions, and external influences are far more personal and unique than mere statistics and averages may suggest. Knowledge of the way investors actually behave can produce a better understanding of the nature of uncertainty. In the field of portfolio management, there is considerable potential for designing investment strategies in light of a more thorough understanding of these behaviors. Understanding and acknowledging these behaviors and the influence they have on the investment decision-making process is key for any investment or risk manager to embrace and adapt to [10]. In choosing the most appropriate guidelines and strategies, a deep comprehension of the biases and heuristics that can potentially impact investor behavior is critical.

## 2. Materials and Methods

### 2.1 Key Concepts in Behavioral Finance

Behavioral finance can be defined as the study of investors and individuals making financial decisions within portfolios or markets. A number of terminologies and concepts introduced in behavioral finance help provide a better understanding of investor behavior. These concepts include biases, which are termed errors; frames of reference, which help individuals in making financial decisions; and heuristics, which are mental operations that simplify any financial decision. When an individual decides on an investment, they are found to be influenced by a large number of decision-making processes that directly affect an investor's choice of a particular asset they can invest in. What is important is that the emotional and cognitive drivers affect the actual investment choices and the portfolio an investor is planning to maintain.

Various cognitive biases are seen to affect investors' investment choices. These biases include loss aversion, confirmation bias, representativeness or availability heuristic, overconfidence, and anchoring or framing. Confirmation bias eventually will be seen to directly affect investors by causing them to overly seek positive information about a company or its shares, making investment decisions without giving enough attention to negative news about the company. Investors eventually end up over-investing in a particular company. It is of interest to study this behavior and analyze information with bias. This section presents a number of individual and group investor behaviors that inadvertently affect the overall market functioning, based on information about availability using psychology in making financial decisions, behavior driven by risk coupled with returns involved. Understanding the above concepts, carried out both by individuals and market participants, helps enhance the understanding of irrationality leading to suboptimal investment portfolio constructions. The concepts will help in creating investment portfolio constructions of moderate financial portfolios in bankers' platforms, where the investor can make investment decisions that can help optimize the portfolio income over a long period.

Behavioral finance is described as having the capability of providing a framework through which policymakers and financial managers can develop better strategies in decision-making for portfolio management. In making financial decisions, financial deviation, when contextually drawn, does not arise as an outcome of lack of information; rather, it arises from the initially described phenomena and their combined resultant synergy.

## 3. Result and Discussion

### 3.1 Building a Moderate Financial Portfolio

Building a moderate financial portfolio that is consistent with investors' psychology can be realized by making a balanced selection of the assets used as investment instruments. Important notes in constructing a financial portfolio are asset diversification and portfolio balance. The two principles above highlight the trade-off between investment risk and return that portfolio materials entail [11], [12], [13]. Constructing a moderate investment portfolio proposes a diverse group of assets in terms of risk and return that satisfies the investor's risk profile. They belong to the rule of small risk, small return, and vice versa. The two investment characteristics of assets will also be advantageous to various investors who have different investment goals in terms of expected future demands for consumer goods and prices of goods, as well as investors who have different levels of optimism. How does a strategy or plan change into a practical portfolio? The practical portfolio is maintained in constructing a portfolio [14]. In selecting assets for a portfolio, an investor has to consider: an asset's return, which can be reflected from profit distribution and capital gain; an asset's risk, which arises from the fact that the asset's return is random. An asset's risk is divided into: systematic risk, which is equal to undiversifiable risk or market risk, and idiosyncratic risk or non-market risk. Investors can set an absolute risk parameter if the return data is normally distributed. The moderate securities for the moderate portfolio intended are investment-grade stocks and mixed bonds [15]. The moderate portfolio framework is the first step in implementing modern portfolio theory in a portfolio. The moderate portfolio framework can incorporate the implementation of an allocation strategy in assets. After selecting the investment structure, the allocation or distribution of investments will be the next step. Investment allocation can be done by distributing investments in some combination of securities and balancing it with the proportion of assets that will be used [16]. These approaches are developed in investment strategies such as growth investments and income investments.

### 3.2 Asset Allocation Strategies

Every person with an average salary and sufficient assets in bank deposits has the opportunity to invest in financial markets and accumulate the desired funds. It is also possible to improve the well-being of an experienced investor. The probability of money loss when investing depends on the selected strategy and investment portfolio. By exploring the principles of portfolio management, you can achieve the desired result in financial markets. The most important determinant of final return is the proportion of stocks, bonds, and cash equivalents an investor has in his or her portfolio. This is the conclusion reached by many experts in the field of modern portfolio management. The investor's final portfolio return depended on this correlation by about 91%. It was calculated that almost 83% of the determination of portfolio return was connected to asset allocation selection [17], [18], [19]. The remaining 7% was statistically attributed to the selection of investment instruments, excluding a significant random component. There is a small proportion of experts in financial markets that can predict trends with some degree of probability. Accordingly, the first link between the above-mentioned points shows that in such conditions, from a risk management perspective, a modern investment portfolio should include a variety of uncorrelated asset types. This means that actual returns may vary. Based on this idea, a path was paved in developing an investment management model that had not yet existed in the 1950s [20].

### 3.3 The Role of Emotions in Investment Decisions

Investors' decision-making behavior is seriously influenced by psychological factors. Fear leading to the sale of shares when the market declines or the optimism of greed leading to the purchase is a typical example of irrational investor behavior [21]. It is generally normal for a particular conduct to repeat whenever the situation provoking the specific behavior is the same. When scrutinizing historical investor behavior, it becomes obvious that the typical behavior patterns often repeat on a regular basis. Emotions and investor decision-making actually have a strong relationship, as market data suggest that behavior driven by emotions is constant. The sympathetic role between the immediate effect or the mood of the investor and the movements of the market becomes evident through the historical behavioral repetition. Many investors make investment decisions based on emotion-driven moves or 'hunches' rather than systematic planning. The severe impact of fear and greed on portfolio performance can demonstrably be shown and supports the importance of a systematic investment discipline. Emotions have been important because evidence-based investors need to have a solid strategy that mitigates the emotional irrationality of the moment. Other research in the investment behavior of individuals has shown that investors experience regret and usually act upon optimism. The investor has also been shown to be overly confident in studies of financial behavior [22]. It is vital that investors have little experience in investing, as lengthy individual research has suggested that rigorous educational programs tend to make individual investment less emotional and of high quality. Therefore, an investor can understand why they have lost money and be more likely to look to themselves if they have the motivation to know themselves better. An individual should be given financial education or personal awareness education, as good investment decisions also require emotional awareness. Understanding the internal workings of an investor will assist an individual in developing a portfolio that suits the investor's requirements.

### 3.4 Case Studies and Empirical Evidence

Behavioral finance, as an absolutely pivotal and crucial branch of the vast and expansive field of finance, is slowly and steadily infused with intricate and intricate financial portfolio theory in the practical and tangible investment arena. Behavioral finance commences its journey from the core principle of its major and paramount topics - psychological bias and investor behavior, which possess the tremendous power and potential to exert a substantial and momentous impact on financial portfolios. In terms of the ultimate achievement or disappointment in investments, the success and triumph hinge not only on fortuitous and unexpected gains and propitious and advantageous opportunities, but also on the intricate and multifaceted psychological behavior and conduct of the astute and discerning investor. However, an exceedingly limited and negligible number of comprehensive and exhaustive studies that have been undertaken and conducted by seasoned analysts employ verifiable, actual, and genuine investment data or meticulously and rigorously analyze detailed and in-depth case studies to effectively and precisely depict and portray the consequential and subsequent results of investor actions and the overall performance and achievement of diverse and eclectic investment portfolios. Many empirical studies seem to help validate the theory in this article. Behavioral decision-making is a hot topic among psychologists. Some finance scholars also study these topics from the perspective of investors. Prospect theory was first proposed by researchers who believed that investors are prone to risk aversion. Some researchers have examined the role of other psychological traits in decision-making and their effect on the implementation of the stock market. Some studies compare the results of psychological experiments in decision-making in the stock market. Some studies interview investors to inquire about their behavior. The following are the empirical studies on the role of investor behavior in the Asian stock market. Many papers have found evidence that investors are not rational to some extent. Some researchers examined trading for the accounts of professional fund managers in Taiwan and discovered that they prioritized the potential to acquire more money over the correctness of execution.

## 4. Conclusion

The financial landscape is always evolving. Since the advent of the field of behavioral finance, it has been accepted that some investors do not act rationally based on the assumptions of fundamental finance. This decision can impact their portfolio's returns. Capital markets will continue to evolve; thus, the behaviors, beliefs, and subsequent portfolios of investors are also likely to shift. The strategies revealed have held for the timeframe they were completed, but given that we exist in a volatile environment, it is to be expected that people will change their views on the market and thus how to invest in it. What we have seen is how investor behavior can affect the construction of a portfolio, showing both modern and behavioral finance principles. All of the market theories have been debunked within some aspects since they do not take into consideration the personal aspects of people and how they deal with uncertainty and thus decision-making.

Potential Future Applications of Behavioral Finance Analyses in Mainstream Behaviors: There are numerous limitations of examining behaviors in these reports, and these approaches may thus be applied in different, updated formats such as increased AI in the main markets; publications can be adjusted to include these new developments. There can also be extensions to include wider geographies or commodities. There can be an application of collaborative analysis between practical behavioral investing companies and academia. There is potential for behavioral investing companies to use the findings to better educate their clients in the space of investor behavior. It is the view that the concept of what IBP also encapsulates is beneficial for all – understanding your investor behavior strengths, weaknesses, and needs could effectively help improve your outcome as an investor.

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