Title of the Study:

A Study on Factors Affecting Individual Investor’s Sentiment Towards Equity Market

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Abstract

The Efficient Markets Hypothesis (EMH) has been a dominating theory among Economics and financial theories, which suggests that market prices fully reflect all relevant information (Fama, 1970). It has been used widely to theoretical models but empirical studies of equity shares prices show disagreement on fundamental of the price-discovery process (Lo, 2007) as per efficient market hypothesis. The EMH subsequently faced both theoretical and empirical challenges and gradually loses its importance just as other once-fully supported economic theories must encounter at some stage. The assumptions of EMH about the individual investor’s behaviour are often called into questions like rationality of individual investors, irrelevance of irrational investors and perfectly working arbitrage.

There is growing body of both theoretical and empirical literature focuses now on testing the role of investor’s sentiment and its implication for financial market and organizations. This literature provides evidences of market anomaly like excessive trading volatility, predictability in returns of stock and investor’s over or under reaction to corporate announcements. Consequently, contemporary research shifted its focus on exploring drivers of their behaviours and its implication for market efficiency.
The traditional models analyze stock price formation by quantitative and performance-related factors but do not consider the impact of human behavior. Hence, the traditional models are not able to explain fully the movement in share prices. It is advocated that the transition in investor’s sentiment may offer better justification of short-term movements in equity share prices, than any other set of fundamental factors. It is therefore suggested that understanding investor’s sentiment would provide a superior explanation of stock price performance. Technical analysis considers that human behavior has an impact on stock prices but it does not incorporate a clear explanation on factors affecting investor’s sentiment. Against this backdrop, it becomes important to identify the factors affecting investor’s sentiment.

Investor’s sentiment means investor’s attitude and opinion towards investment in the stocks. Investor’s sentiment is measured through three aspects (1) Investor’s Optimism (2) Investor’s Participation and (3) Investor’s Stock Market Outlook. The researcher investigated the impact of Market Specific Factors and Stock Specific Factors on investor’s sentiment.

This thesis consists of six chapters and bibliography. Chapter 1 deals with the introduction of the topic under study, research rationale, objectives of research, significance and the potential value of the study. This chapter also gives the outline of the whole thesis.

Chapter 2 describes the theory of traditional financial analysis techniques like fundamental analysis used by investors for the determination of intrinsic value of equity share and technical analysis techniques used by investors to predict the price of share based on understanding of the trend in price change through charting.

Chapter 3 contains the review of literature related to the research area. Literature review covers the studies undertaken on financial behavior of individual investors and more specifically on investor’s sentiment towards equity market. It also provides the theoretical definition of key variables under discussion like investor’s sentiment. It contains different models for the measurement of investor’s sentiment and the model of individual investor’s sentiment selected for the present study. It deals with market specific factors and stock specific factors that influence individual investor’s sentiment. Market specific factors are Herd Behaviour, Macroeconomic Factors, Internet led access to Information, Best Game in Town, Performance Factors and Confidence of Institutional Investors and Risk and Cost Factor; whereas the stock specific
factors are Expected Events Surrounding the Stock and Book Value, Financial Characteristics, Psychological Factors and Quality of Management, Past Price Performance and Sector Attractiveness, Who else is Buying and Recommendations of the Financial Community.

Chapter 4 describes research methodology which contains introduction to research, the statement of problem, research objectives, hypothesis and research design. Research design includes the population under study followed by the sampling element, sampling frame, sampling technique, sample size, method of data collection, description of research instrument, type of research approach used for the present study, pilot testing of questionnaire, coding of questionnaire, time dimension of the study, research environment, sources of data, data analysis method, software used for data analysis and procedure of research.

Chapter 5 shows data analysis and interpretation, following the objectives under study. Different statistical tools are used based on requirement like descriptive statistics, factor analysis, multiple regression and Variance Inflation Factor (VIF) value. First of all factor analysis is conducted for market specific variables and stock specific variables to extract the factors which affect the investor’s optimism, investor’s participation and investor’s stock market outlook. Multiple regression is conducted to test the factors significantly affecting the dependent variables under study and Variance Inflation Factor value (VIF) was considered to assess the multi collinearity issue. To assess the irrational behaviour of individual investor, frequency analysis is conducted to confirm existence of mental accounting and regret.

Chapter 6 contains findings, conclusion, implications and limitations of the study. Finally, chapter concludes with providing scope for further research.

**Key words:** Investor’s sentiment; under reaction; market specific factors; stock specific factors.