

# **ANALYSING THE IMPACT OF EMOTIONS: FEAR AND GREED ON FINANCIAL MARKETS**

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## **ABSTRACT**

In this research, a brief study on human emotions is conducted, focusing on fear and greed, which impact financial markets. In humans, emotions are considered a crucial aspect in shaping human behavior. Human behavior is interconnected with investing activities in financial markets. This study mainly focuses on these aspects of things like fear and greed that have an impact on the thinking and behavior of all investors, which impacts financial markets. In this research, we have collected qualitative data and information in order to get a clear view of the human physiological aspects of the investing mindset of all investors and to assess recent market trends in the money market. This study looks at what generates fear and how it manifests itself, as well as what inspires greed and how it manifests itself. We've also discussed the two indexes that aid with fear and greed in financial markets. This paper provides an overview of the function of fear and greed in market psychology, how Fear and greed have an impact on markets, the traders profit from the market's fear and greed and also the impact of fear and greed on market investor behavior.

This research paper's findings give an overview of how the fear and greed patterns of investors have an impact on financial markets. This can be a good help for all individuals who are ready to invest their money and helps them make more informed and helpful decisions.

## **KEY WORDS**

Financial markets, human behavior, human emotions, greed, fear

## INTRODUCTION

On Wall Street, there is a well-known saying suggesting market activity is governed by just a couple of emotions: "fear and greed". Even though this issue represents an oversimplification, it is often precise. Responding to these emotions, on the other hand, can have serious consequences for investor portfolios as well as the market's financial strength, and perhaps the economy as a whole. Understanding market psychology is the subject of a wide academic discipline known as behavioral finance.

Most individuals aspire the opportunity to become rich as soon as attainable, and rising stock markets encourage us to do so. The late-1990s internet boom is an outstanding instance. The gathering of internet-related stocks, several of which were still in their early stages, reached a fever peak. Investors became exceedingly greedy, driving up purchase and bidding prices to unsustainable levels. At the time, it investigated that all a financial advisor had to do was propose any investment with the word "dotcom" at the end, and investors jumped at the chance. It eventually burst, as have several other financial bubbles in history, reducing the price of shares from 2000 to 2002.

Investing in the stock market as a whole may be a roller coaster of emotions. The market's ups and downs may trigger a wide range of emotions, from optimism and elation to dread and anxiety. Understanding and controlling these emotions is essential for making sound decisions regarding investments. Investor conduct is important in stock market investing. Emotions can greatly impact investment decisions, leading to decisions that are irrational. Fear and greed being the two most powerful emotions that influence investor conduct. Fear of more losses can cause investors to dispose of their holdings during downturns in the market. During bull markets, on the other hand, greed might drive speculators to chase after trendy stocks without undertaking thorough research. Addressing such feelings and how they affect one is the first approach towards good management.

In the film Wall Street, fictitious investor Gordon Gekko famously stated, "Greed is good." However, this get-rich-quick approach makes it difficult to maintain a commitment to a regulated, long-term finance strategy, especially in an environment of what Federal Reserve Board Chair Alan Greenspan distinctly referred to as "irrational exuberance."

"The Federal Reserve's Semiannual Monetary Policy Committee Report, February 26, 1997."

It's critical to be quiet and keep sticking to the principles of making investments such as having a long-term view, averaging costs by dollar, and overlooking the herd, whether it's buying or selling.

The marketplace might be dominated by greed, however it can also be governed by fear. When equities have experienced significant losses over a prolonged amount of time, shareholders may get concerned about more declines and start thinking about sell. Naturally, this has resulted in the unintended effect of driving prices downwards even further. Herd behavior is a term economists use to describe what takes place when investors purchase or sell merely because everyone else is carrying out it. Just as greed rules the stock exchange during an upturn, fear prevails after a downturn. To limit losses, investors sell stocks fast and replace them with safer assets such as money-market investments, stable-value money, and principal-protected securities—all of which are classified as low-risk but low-return investments.

All of this argumentation on fear and greed is connected to the volatility of the stock market. When investors are forced to leave their comfort zones after experiencing losses or market volatility, they get subjected to these emotions, which can lead to costly decisions. Commit to the fundamentals rather than being seduced

up with the dominating market attitude of that moment, which may have been influenced by excessive fear or greed. Select an appropriate asset allocation. If you are particularly risk-averse, you become more vulnerable to worry, so your chances of encountering stocks should be lower than that of persons with a large tolerance for risk. "Unless you can observe your stock holding decrease by 50% without trembling you ought to avoid investing in the stock market," Buffett once stated.

Forbes. "Top 40 Buffet-isms: Insights to Help You Become a Better Investor. "This is not as simple as it appears. There's an extremely fine line between managing how you feel and being stubborn. Recall to re-evaluate your plan on an ongoing schedule. To a certain extent, you must be adaptable and rational while making decisions that will change your course of action.

## REVIEW OF LITERATURE

**Robert Shiller** : Shareholders' emotional state, according to Robert Shiller, "is without a doubt one of the most important factors causing the bull market" that has recently occurred in the United States (2000, 57). Emotion is defined as "the felt tendency towards anything intuitively appraised as good (beneficial), or away from anything intuitively appraised as bad (harmful)" (182). Emotion covers intellectual, physiological in nature, cultural and psychological elements, making an easily understood explanation of the term difficult.

**Elster (1998)**: "rage, hatred, guilt, regret, fear, pride, exaltation, pleasure, and love" are all clearly emotional states. Elster continues on to say that these types of emotions can be separated from different mental states using six long-proposed features. These traits do not provide a complete explanation of feeling considering not all features are present in all emotions.

**Damasio 1994**: Unlike past financial expert studies, the present research demonstrates how feeling really increases one's capacity to make sensible judgments'. Emotion encourages people look beyond minute details and concerns in order to concentrate on the task at hand. Emotions have a tendency to influence behavior that is in keeping with predictions for the economy. A huge corpus of behavioral literature demonstrates how the way someone feels has an enormous effect on decision making. Emotion improves Kirk's ability to focus and render critical opinions.

**LeDoux 1996; Zajonc 1980**: It is difficult and perhaps deceptive to examine cognitive components that influence financial action in separately. Emotional reaction or appraisals happen more rapidly than cognitive judgment's. Emotional variables influence perception and choice-making in perspectives. Furthermore, scientists recognize that thoughts and feelings are linked as opposed to competing.

**Shiller 2000; Haugen 1995**; recent deviations from the EMH's predictions have recently been stated that and many now contend that economies do not efficiently integrate knowledge. They present a model in which a few investors trade using noise rather than knowledge about resulting in inefficient market prices. The behavior of black's noise traders cannot be explained by news about an asset's underlying worth and might not appear totally logical. Traders with noise may trade due to the fact that they wrongly believe that they are making money on knowledge, or they may trade just because they enjoy trading.

## RESEARCH METHODOLOGY

In the present research, secondary data references have been obtained from numerous articles, journals, case studies. This evaluation relies on optional data.

Mainstream media constantly claims that psychology impacts financial decisions and asset prices. Traditional applications of financial models of economics, on the other hand, commonly presume that humans absorb information into their decision-making processes through combining probability and statistics rules with calculating, unemotional logic. This premise provides little space for impact on emotions. Moreover, when economists have utilized emotion to characterize financial market conduct, but it also emotion has frequently been described as creating unnecessary and unwanted price fluctuations.

### The study's aims at:

- \*The financial market's fear and greed

- \*Both greed and fear play important roles in market psychology.

- \*The impact of both greed and fear on market investor behavior.

- \*Which consequences do greed as well as fear have on markets? Traders profit from the market's fear and greed.

### What causes fear, and how does it exhibit itself?

Look out your window: sentiment in the market is currently very negative. The movements are substantial, indicating increased fear and volatility. The market participants are purposefully looking for reasons to panic, whether it is the financial crisis or something else the Fed is doing.

Fear is typically caused by a resistance to loss. Investors are unwilling to allow their investments to lose their value. As a result, they sell, sell, and sell. Several prudent investors take full advantage of this panic and "short" stocks, producing further downward pressure. As consequently, you see these large, outsized changes on a daily basis, as well as exceptionally significant volatility.

### What motivates greed, and how does it reveal itself?

Greed is a bit harder to combat; investors acquire confident (and then overconfident) and continues to buy as markets advance. Those who suffer from FOMO (fear of missing out) override the fears of "buying high" and jump towards the market as well. The market keeps on expanding, and valuations become too costly.

As stated earlier, greed is brought on by excessive trust, a terribly human tendency to do so. Greedy investors are further at risk of bias towards confirmation, which occurs in which individuals give a higher value to information that verifies a pre-existing opinion as opposed to fewer weight towards "red flags" or evidence that contradicts their investment's concept. FOMO can be connected with herd mentality bias, which involves simply mimicking what various other investors are currently doing while not acting based their own research that they have conducted independently. During a bull market, investors might benefit

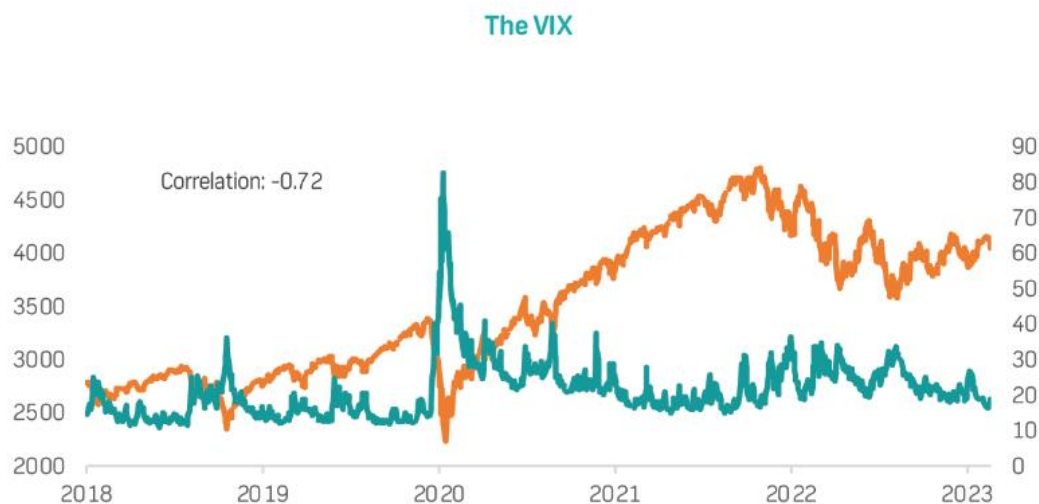
from exceptional returns and grow to feel that they have demonstrated their higher-level intellect and skilled labor that brought about in strong portfolio profitability.

## FEAR AND GREED INDEX

Fear and greed in financial markets can be measured by following ways below index:

### Cboe Volatility Index (VIX)

The Cboe Volatility Index (VIX) demonstrates the market's present outlook for the relative stability of the S&P 500 Index's short-term fluctuations in prices. It produces a 30-day forward forecast of volatility because it is calculated from the pricing of SPX index option contracts with near-term expiration periods. Volatility is frequently used to measure market mood, particularly the extent of fear between market players. Increased volatility (indeed a higher Vix value) indicates that fear is growing. Low volatility (and a low Vix index) shows that markets are quiet and may imply that greed has begun to penetrate into the market.



SOURCE BLOOMBERG, FNB WEALTH AND INVESTMENTS

**CNN Business established the Fear & Greed Index** in order to measure investor a certain atmosphere. It highlights how emotions affect when investors pay for equities. The index delivers a glimpse into whether stocks have been priced reasonably at any one point in time. The Fear & Greed index is computed on a daily, weekly, monthly and annual basis and is based on the concept that excessive fear is going to cause share prices to fall and insatiable desire will cause prices to rise in the future.

In the below study will know how Fear and greed index works,

Investing can sometimes be an emotional and reactionary exercise. An investor's choice of purchasing or trading opens up may have been influenced by fear and greed signs. The index of fear & Greed is able to forecast market movements. The index is recognized as either a reputable making investments research

instrument or an indicators for the timing of markets due to the fact that it is based on the assumption that dissent leads stock markets to trade below their inherent worth and greed produce upward trends. Usually paired with analytical tools, the index of greed and fear can help determine market mood.

Above index indicators are:

In the index, seven indicators are determined on a scale of 0 to 100. The study equal-weighted aggregate of every single one is used to generate the index. A number in the range of 50 is considered balanced, whereas higher values indicate greed. Lower percentages are found in those with fear categories.

#### Fear & Greed Index Scores and Sentiments

Score	Sentiment
0 to 24	Extreme Fear
25 to 44	Fear
45 to 55	Neutral
56 to 75	Greed
76 to 100	Extreme Greed

SOURCE: CNN BUSINESS

The Fear & Greed Index is utilized to assess market sentiment. Fear and greed emotion indicators may alert individuals to their own unique emotions plus biases that may influence their actions. When used in conjunction with fundamental and other methods of analysis, the index can be a useful tool for assessing market sentiment.

CNN Money developed the CNN Fear and Greed Index to identify if market participants are frightened or greed. CNN explores seven key fear and greed factors and assigns a rating to investor sentiment.

**\*Stock Price Momentum:** A comparison of the S&P 500 Index (S&P 500) compared to its 125-day moving average (MA).

**\*Stock Price Strength:** The proportion of stock markets those have reached 52-week highs versus those that have reached 52-week lows on the trading floor of the New York Stock Exchange (NYSE).

**\*Share Price Breadth:** an examination of trade volumes in advancing and sinking stocks.

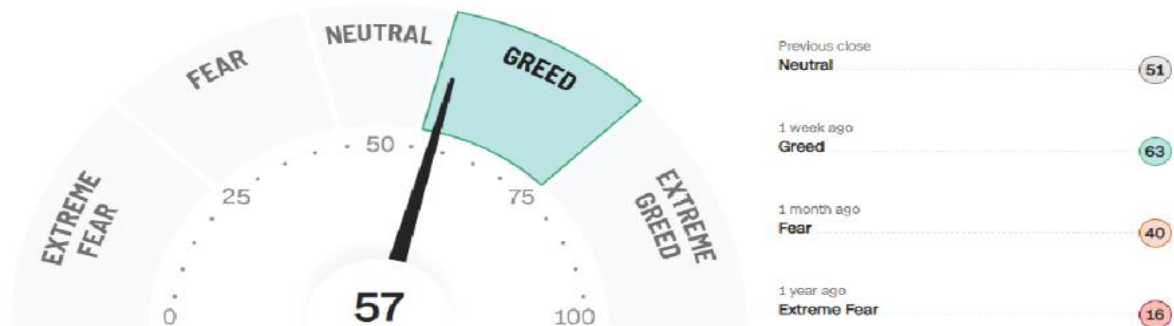
**\*Put and Call Options:** The amount of time put options lag behind options for calls, suggesting greed, or outpace them, indicating fear.

**\*Junk Bond Demand:** Determining appetite for greater risk procedures through comparing the rates on investment-grade bonds to junk bonds.

**\*Market Volatility:** CNN calculates the VIX by focusing on the 50-day moving average.

**\*Protected Haven Demand:** The differential in returns comparing equities and bonds.

### The CNN Fear and Greed Index as of 27 April 2023



Both of these measures are evaluating fear and greed in the US stock market; nevertheless, stock market mood typically transmits globally, which means that there will be a significant degree of connection between greed and fear beyond global exchanges.

#### The role of fear and greed in market the field of psychology.

Several investors are passionate and reacting, with fear and greed having major players. According to certain experts, greed and fear having the ability to influence our mental faculties in such a way that they force us to give up common sense and self-control, which causes transformation. Fear and greed may constitute potent motivators particularly when it relates to humans and money.

#### The effect do fear and greed impact on markets:

When people are dominated by the power of greed or fear in a market environment, overreactions may occur that cause price distortions. Asset bubbles, on the other hand, can rise far exceeding fundamentals. On the fear side, sell-offs can last for quite a while and drive values considerably lower than where they should be.

#### The traders profit on the marketplace's fear and greed:

Because fear and greed cause overreactions, skilled traders may acquire oversold assets along with sell excessive ones. Adopting a **contrarian strategy**, wherein you purchase when everyone else is frightened - buying up assets once they are still "on sale," and selling when anticipation leads to bubbles, can be an excellent decision. At the end of the day, though, it is human behavior to want to fit in, therefore resisting the impulse to depart from what you have planned can be challenging.

**Contrarian Investing strategy:** The more negatively the market performs, the bigger the opportunity to profit. That tends to be the motto for contrarian investing. In the words of Nathan Rothschild, a nineteenth-

century British investor and member of the Rothschild banking family, "the time to buy is when there's blood in the streets."

Whether Rothschild actually said the famous statement or not, it exposes a substantial truth about trading against psychological markets. When commodities fall and markets quiver, a daring contrarian investment could pay off generously.

### **Importance of fear and greed on investor's behavior in markets**

When it comes to stock market investment, those who are new are more probable to stumble upon buying and selling faults. When trading or purchasing shares at the incorrect time, it is believed to be a mistake. Investors pick up shares in the hope that the price of the stock will rise, and they sell whenever it appears that economic conditions or corporate choices will reduce the value of the money they've invested. "Financial markets are driven by two powerful emotions - Greed and Fear," says an old Wall Street ad. Among his 1986 letter to Berkshire Hathaway shareholders, legendary investor Warren Buffet stated, "Occasional outbreak of these two super-contagious conditions, Fear and Greed, will continue to occur in the investment community."

Investors need to make money rapidly, and bull markets existing an outstanding chance to do so. Whenever stock prices continue to rise, a greater percentage of people invest in stocks. Stock prices are dictated by the law underlying demand and supply. With a higher demand (more wealth), prices remain to rise and profits increase. Growing earnings feed more greed, and more money is invested, driving up values to ridiculous levels. Asset bubbles develop when prices are significantly higher than the underlying or inherent value of assets. Asset bubbles, like all bubbles, rupture over time and prices plummet. When the equity market corrects, investors who purchased securities at excessive costs will suffer serious losses.

When asset values get exploded, they will eventually correct. Markets that are bearish are frequently caused by a variety of factors, the most prevalent of which is a declining or sluggish economy. The values of stocks have historically fallen quicker than they've recently risen. During bear markets, a period of two to three years of stock price gains can be cancelled away in just a few weeks or months. Severe comes in in bear markets can be attributed to an assortment of variables such as heavy leverage through derivatives surrounding bull market tops, calls for margin being triggered, and others, but the main factor is fear. When markets fall significantly, investors fear more drops and sell in panic. As stated before, stock prices are determined by the law of supply as well as demand. Stock supply is high during an adverse outcome market because investors overwhelmingly want to sell their stocks in a panic. The shares collapse as a result of fear selling. Eventually, prices collapse to such minimal levels that the company's valuations become appealing (cheap), and the financial markets bottom out.

Stock market prices symbolizes all investors' together investment behaviors. Greed and fear are fundamental impulses that drive investment behavior, though they are extremely harmful to your financial interests. It is difficult to be calm in extremely unstable markets. But assuming that you avoid allowing greed and fair affect how you invest behaviors that you may be in a far stronger position to reach your financial goals.

## CONCLUSION

Handling emotions before investing in the stock market is important when making sensible and well-informed decisions. Investors could navigate the financial markets with more assurance and discipline if they identify the impact underlying emotions, grasp typical biases, and implement emotional management approaches. Investing is a long-term task, and emotional control is crucial for achieving financial fulfilment. According to the article, while emotion has an important influence on financial choices, but does not affect judgment. Some have advocated for a new paradigm that considers behavioral aspects and thus better portrays actual behavior. Understanding the damaging elements of fear and greed, especially on an educational level, is absolutely beneficial when incorporating these notions into appropriate branding. Realizing how to elicit genuine corporate fear in those who buy through your site in a polite manner is able to boost conversions, particularly where you're in an industry wherein users have a particular amount of instinctual internal fear in those you service (security systems).

However, there are several use cases which are not so kind. Fear and greed are typically irrational emotions that interfere with rational decision making, and they are frequently employed in confidence scams or getting rich quick schemes. Still, knowing their power is important, if only for preventing similar attempts.

Despite the fact that current approaches explain aspects of the financial decision-making process that seem to conflict with efficient market theory, financial analysts lack a superior framework. This means not to argue that emotional behavior should be overlooked. While some argue the fact that feelings might "get in the way" and leads to incorrect decision making in some cases, we believe that emotion is an important part of human interactions that may actually assist in decision making.

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