Decoding Behavioural Finance: A Critical Review of Investor Psychology and Market Anomalies

Punith. [1] & Sureshramana Mayya [2]

[1] Research Scholar, The Institute of Management and Commerce, Srinivas University, Mangalore - 575001, Karnataka.

Orcid ID: 0009-0000-2938-6160, E-Mail: punith.kbp@gmail.com

[2] Research Professor, College Commerce and Management, Srinivas University, Mangalore575001, Karnataka.

Orcid ID: 0000-0003-1951-0126, E-Mail: sureshmayya@hotmail.com

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[1] Research Scholar, The Institute of Management and Commerce,

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[2] Research Professor, College Commerce and Management,

Srinivas University, Mangalore575001, Karnataka.

Orcid ID: 0000-0003-1951-0126, E-Mail: sureshmayya@hotmail.com

ABSTRACT

Purpose: This study critically examines behavioural finance better to understand investor psychology and the occurrence of market irregularities. It discusses core behavioural theories, evaluates the limitations of traditional financial frameworks, and assesses the practical relevance of these insights for investors and policymakers.

Design: This study adopts a qualitative approach, incorporating insights from a literature review and empirical findings drawn from various researchers in the field of behavioural finance. It includes qualitative studies that explore past financial crises, psychological biases, and investor decision-making patterns, offering a comprehensive understanding of investor behaviour.

Findings: The results indicate that cognitive and emotional distortions significantly affect investor decisions, contributing to market inefficiencies. The paper highlights several prominent biases—such as aversion to loss, excessive confidence, and group-driven decision patterns—that can shape market trends and individual investment behaviour.

Practical Implication: Gaining awareness of behavioural tendencies can help investors make better-informed decisions, implement structured financial strategies, and avoid falling into market traps. These insights also support regulators in forming policies that improve market stability and guard against irrational investor actions..

Value: This work adds to the behavioural finance literature by linking psychological theories with conventional financial thought. It offers useful perspectives to investors, advisors, and policymakers, aiding in the formulation of more robust and adaptive investment strategies.

Keywords: Behavioural Economics, Investor Behaviour, Mental Biases, Decision Processes in Finance, Conventional Financial Systems, Risk Strategy.

1. INTRODUCTION:

1.1. Overview of Behavioural Finance

Behavioural finance integrates insights from psychology with traditional financial concepts to understand the irrational aspects of investor decisions. While conventional financial models presume that investors behave logically and have access to complete information, behavioural finance disputes these notions by highlighting the role of cognitive and emotional influences on decision-making.

1.2. Key Aspects of Behavioral Finance:

1.2.1. Behavioural finance explores how individuals interpret information and make financial decisions. Studies suggest that investor behaviour is not always guided by logic but is often shaped by cognitive

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shortcuts, emotional influences, and inherent biases (Nagy & Obenberger, 1994) [1]. Key psychological elements like overconfidence, groupthink, and aversion to losses significantly impact market behaviour and trends (Barnea et al., 2010) [2].

*1.2.2. Market Anomalies and Inefficiencies***:** Conventional financial models, including the Efficient Market Hypothesis (EMH), suggest that asset prices fully incorporate all known information. In contrast, behavioural finance offers insight into irregular market behaviours—such as bubbles and crashes—attributing them to widespread investor irrationality (Zhang & Zheng, 2015) [3]. Research indicates that emotional and cognitive biases often cause investors to misjudge or exaggerate the importance of new information, leading to price movements that stray from intrinsic values (Boda, 2018) [4].

1.3. Cognitive Biases in Investing

Behavioural finance outlines numerous mental shortcuts and emotional influences that impact how individuals make investment decisions. Key examples include:

1.3.1. Herding Behaviour: Many investors tend to mirror the actions of others rather than conducting their own analysis, often contributing to the formation of market bubbles and crashes (Srivastava, 2012) [5].

1.3.2. Loss Aversion: People are generally more sensitive to potential losses than to gains of the same value, which can lead to overly cautious or irrational investment choices (Baker & Ricciardi, 2014) [2].

1.3.3. Overconfidence: Some investors place excessive trust in their knowledge and forecasting abilities, which can result in taking greater risks than warranted (Baltussen, 2009) [6].

1.4. Implications for Financial Markets

Understanding investor psychology helps policymakers, financial advisors, and institutional investors design better strategies to mitigate irrational behaviour. Behavioural finance insights contribute to improving investment strategies and regulatory frameworks, making financial markets more resilient (Okur & Gurbuz, 2014) [7].

Thus, behavioural finance provides valuable insights into how investor psychology contributes to market distortions, challenging the assumptions of classical financial models. It brings attention to the influence of mental biases and emotional responses on financial choices, offering guidance for both investors and policymakers in crafting strategies to address irrational behaviour. As a discipline, it continues to grow and shape future directions in investment research and financial analysis.

1.5. Significance of Understanding Investor Psychology

Investor psychology plays a vital role in shaping financial decisions, influencing market patterns, investment behavior, and overall economic health. While traditional financial models suggest that investors act rationally and base their decisions on full information, behavioural finance presents a contrasting view. It emphasizes the significant impact of psychological influences on investment behaviour (Al-Husseini et al., 2023) [8]. Gaining insight into investor psychology is therefore key to enhancing decision-making, reducing inefficiencies, and strengthening risk management practices.

1.6. The Role of Psychology in Investment Decisions

The mental state of investors, including their thoughts and emotions, plays a significant part in shaping their financial decisions. Behavioural finance explains that investors may not always behave logically due to factors like overconfidence, fear of losing money, and the tendency to act collectively (Kobiyh et al., 2023) [9]. These psychological patterns have been linked to irregularities in the market, asset bubbles, and significant downturns—situations that are not fully justified by conventional financial theories (Al-Husseini et al., 2023) [8]. For instance, during periods of strong market growth, many investors tend to imitate others' choices instead of depending on detailed fundamental evaluations (Humra, 2015) [10].

Another common psychological bias affecting investors is their tendency to prioritize preventing losses rather than achieving comparable gains. This mindset often results in retaining underperforming assets

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longer than would be considered rational due to expectations of a future recovery (Malmendier, 2018) [11]. Likewise, overconfidence can cause investors to overrate their expertise and forecasting abilities, frequently leading to excessive trading and heightened exposure to risk (Gherzi, 2015) [12].

1.7. The Impact of Investor Psychology on Market Anomalies

Investor behaviour plays a significant role in understanding unusual patterns in the market, including phenomena like asset bubbles and sudden downturns. Conventional economic theories often fall short in explaining such irrational actions, whereas behavioural finance offers a more suitable approach. Studies have indicated that investor-driven emotions, rather than the actual worth of assets, can inflate prices and contribute to forming market bubbles (Okur & Gurbuz, 2014) [7].

Conversely, panic-driven reactions to adverse information can result in sharp market declines. Investors may respond emotionally rather than relying on sound financial judgment. Evidence suggests that individuals often project recent patterns forward, anticipating that short-term movements will persist, which can intensify market instability (Roopadarshini, 2014) [13]. This demonstrates how emotional cues significantly affect investment decisions and overall market dynamics.

1.8. Practical Implications for Investors and Financial Institutions

Acknowledging how psychological influences shape financial behaviour enables individuals and institutions to make sounder decisions. Observing biases can help investors manage impulsive choices and enhance long-term outcomes (Bisen & Pandey, 2011) [14]. For example, adopting structured investment methods like Systematic Investment Plans (SIPs) can reduce the impact of emotionally driven actions by promoting regularity and self-control in investment practices (Thakur, 2017) [15].

Moreover, financial professionals can apply principles from behavioural finance to gain deeper insights into their clients' attitudes toward risk and investment patterns. By integrating behavioural assessments into financial strategies, advisors can customize recommendations to reflect better client-specific tendencies and expectations (Suresh, 2013) [16]

1.9. Traditional Finance vs. Behavioural Finance

Traditional and behavioural finance fields provide differing explanations of how individuals approach financial decision-making. Traditional theories assume that investors behave logically and utilize available data to make decisions that enhance their utility (Köseoğlu, 2019). In contrast, behavioural finance incorporates emotional and psychological dimensions, recognizing that real-world decisions are often influenced by biases, causing deviations from rational expectations (Hong, 2005) [17].

1.10. Assumptions of Traditional Finance

Traditional finance is largely based on the Efficient Market Hypothesis (EMH), which claims that financial markets incorporate all relevant information into asset prices, and that investors behave in a rational and predictable way (Bloomfield & Noyes, 2010) [18]. This model assumes logical thinking without the influence of emotions, where securities are priced fairly and consistent excess profits are unlikely. Risk evaluation is expected to be impartial, guiding investors toward sound financial choices (Ackert, 2014). Nonetheless, critics argue that traditional theories overlook real-world irregularities like asset bubbles and irrational investor behaviour, challenging the belief that markets consistently operate in a rational manner (Muhammad, 2009) [20].

1.11. Behavioural Finance: A Paradigm Shift

By incorporating elements of psychology into the study of investment decisions, behavioural finance questions the assumption that investors always act rationally (Suryawanshi & Jumle, 2016) [21]. It points out that individuals are often influenced by mental shortcuts and biases like overestimating their abilities or favouring information that supports their beliefs, which can impair judgment. Emotional responses such as fear and greed also significantly shape how markets behave, often driving unpredictable decisions and fluctuations in investment patterns (Ang, 2018) [22]. Furthermore, the tendency of investors to follow crowd behaviour rather than forming independent views can result in significant market disruptions like bubbles and crashes (Rashid et al., 2022) [23]. These insights from

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behavioural finance have provided a valuable explanation for recurring market anomalies that traditional models fail to explain (Ricciardi, 2008) [24] fully.

1.12. Practical Implications of Both Theories

The divergence between traditional and behavioural finance has significant implications for investors, policymakers, and financial institutions (Ricciardi, 2008) [24]. Traditional finance advocates for passive investment strategies, such as index funds, whereas behavioural finance supports active management that considers investor sentiment and biases. Recognizing cognitive biases enables investors to implement strategies that counteract irrational decision-making, ultimately improving risk management. Additionally, understanding behavioural biases assists policymakers in designing regulatory frameworks that protect investors from predatory practices and market manipulation (McGoun & Skubic, 2000) [25]. Integrating insights from both traditional and behavioural finance can lead to more balanced financial strategies and policies that enhance market stability and investor protection.

2. OBJECTIVES OF THE STUDY:

The research study aims to:

(1) Examine behavioural finance evolution, significance, and impact on financial markets.
(2) Analyse key investor psychology theories and behavioural biases affecting decisions.
(3) Explore market anomalies arising from psychological and emotional biases.
(4) Assess practical implications for investors, policymakers, and financial institutions.
(5) Highlighting the main obstacles and identifying areas for further exploration within the field of behavioural finance.

This set of goals seeks to establish a well-rounded foundation for examining how investor psychology interacts with irregularities in financial markets. The intention is to offer meaningful guidance for researchers, policymakers, and professionals in the field.

3. THE EVOLUTION OF BEHAVIOURAL FINANCE:

3.1. Historical Perspective and Key Milestones

Behavioural finance emerged to address limitations in traditional financial theories. While standard finance theories like the Efficient Market Hypothesis (EMH) assume rational investors, real-world financial behaviours often contradict these assumptions (Nair & Antony, 2015) [26].
The development of behavioural finance gained momentum in the 1980s and was solidified by Daniel Kahneman and Amos Tversky's Prospect Theory (1979), which demonstrated that investors systematically deviate from rational decision-making (Veni & Kandregula, 2020) [27]. As behavioural finance evolved, it provided alternative explanations for market anomalies, such as speculative bubbles and irrational investing behaviour (Rashid et al., 2022) [23].
Key milestones in the evolution of behavioural finance include:

- **1970s**: Emergence of Prospect Theory, establishing the foundation for behavioural finance (Veni & Kandregula, 2020) [27]
- **1980s**: Initial research integrating psychology into finance theories, challenging the assumptions of market efficiency (Nair & Antony, 2015) [26].
- **1990s**: Widespread acceptance of behavioural explanations for financial anomalies, leading to further development of heuristics and cognitive biases (Kanapickienė et al., 2024) [28].
- **2000s-Present**: Application of behavioural insights in investment strategies, risk assessment, and regulatory frameworks (Kasemsap, 2015) [29].

3.2. Role of Psychology in Decision-Making of Financial Aspects

Psychological factors significantly shape financial decision-making. While traditional finance assumes that investors act rationally, behavioural finance emphasizes the influence of emotions and cognitive biases on investment behaviour (Kasemsap, 2015) [29]. Investors frequently depend on mental shortcuts

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or heuristics, which can result in consistent errors in judgment (Kanapickienė et al., 2024) [28]. One such bias is overconfidence, where investors overrate their knowledge and predictive abilities, often taking on excessive risks (Kasemsap, 2015) [29]. Another common bias is loss aversion—the tendency to avoid losses more strongly than seeking equivalent gains—which can lead to investors holding onto declining assets longer than rational analysis would recommend. Herding behaviour, where investors mimic market trends rather than performing independent assessments (Veni & Kandregula, 2020) [27], has been linked to the formation of asset bubbles and market crises (Nair & Antony, 2015) [26]. Emotional responses, particularly fear and greed, further intensify market instability and contribute to irrational decision-making (Rashid et al., 2022; Lin, 2023) [23], [30]. Understanding and addressing these psychological influences has led to significant changes in investment strategies and regulatory frameworks, ultimately enhancing risk management and contributing to greater market stability (Kanapickienė et al., 2024) [28]..

4. CHALLENGES TO TRADITIONAL FINANCE THEORIES:

4.1. The Efficient Market Hypothesis (EMH) and Its Limitations

The Efficient Market Hypothesis (EMH) argues that markets are perfectly efficient, with asset prices reflecting all known information, and that investors behave rationally to achieve optimal outcomes (Lin, 2023) [30]. Despite its foundational role in traditional finance, various empirical studies have pointed out shortcomings in this theory.

1. **Market Anomalies:** Several findings have challenged the view that market prices always represent the actual worth of securities. Patterns such as momentum effects and seasonal variations often contradict EMH predictions (V. Gupta et al., 2014) [31].
2. **Information Asymmetry:** The EMH assumes that all investors have equal access to information. However, unequal information access through practices like insider trading can disrupt market balance (Lin, 2023) [30].
3. **Investor Psychology:** Behavioural finance suggests that investors often rely on mental shortcuts and are influenced by cognitive biases, which can lead to decisions that deviate from rational expectations (Szyszka, 2013) [32].
4. **Herding Behaviour:** Instead of making independent evaluations, investors may imitate others, contributing to inflated prices and market crashes (Chung, 2017) [33].

These observed limitations indicate that markets do not always function in a perfectly efficient manner. Consequently, there is a growing need to integrate behavioural perspectives into conventional financial models (Gu, 2023) [34].

4.2. Rationality vs. Irrationality in Investment Decisions

Traditional finance assumes investors are rational decision-makers who objectively assess risks and act in their best interests. However, behavioural finance research demonstrates that real-world investors frequently behave irrationally (Dhankhar & Kumari, 2013) [35].

1. **Cognitive Biases:** Investors exhibit overconfidence, loss aversion, and anchoring bias, leading to suboptimal investment choices (Kansal & Singh, 2015) [36].
2. **Emotional Reactions:** Changes in market conditions can evoke strong emotions, leading to behaviours like panic-driven selling during market declines or overly optimistic buying during upward trends (Konstantinidis et al., 2012) [37].
3. **Framing Effects:** How investment choices are presented influences decision-making. Investors react differently to perceived gains and losses based on framing rather than objective evaluations (Mamun et al., 2015) [38].
4. **Contradictions to EMH:** The persistent occurrence of irrational behaviour undermines EMH's assumption that investors always make logical, value-maximizing decisions (Lin, 2023) [30].

The growing recognition of irrational investor behaviour calls for a revised theoretical framework that integrates rational and psychological elements to understand financial markets better (E. Gupta et al., 2014) [39].

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5. KEY THEORIES IN BEHAVIOURAL FINANCE:

5.1. Prospect Theory – Understanding Risk Aversion and Loss Aversion

Prospect Theory, developed by Daniel Kahneman and Amos Tversky in 1979, explains how investors perceive gains and losses asymmetrically. Investors fear losses more than they value equivalent gains, leading to loss aversion, a key psychological bias in financial decision-making (Khan et al., 2023) [40]. Loss aversion makes investors hold onto losing stocks longer than they should and sell winning stocks too early. This contradicts traditional finance theories that assume investors always act rationally (Srinivasan & Karthikeyan, 2023) [41].

5.2. Bounded Rationality – The Limits of Rational Decision-Making

Herbert Simon's concept of Bounded Rationality explains that investors often face limitations in processing information and, therefore, may not always make the best possible decisions (Babarnnde, 2020). Instead of thoroughly analyzing all available data, they tend to rely on simplified approaches or rules of thumb to manage complex financial problems. This can result in suboptimal choices, such as overlooking key trends or failing to maintain a diversified investment strategy (Amin & Pirzada, 2014) [43].

5.3. Heuristic Biases – Mental Shortcuts and Their Impact on Investing

1. Heuristics are mental shortcuts that simplify decision-making but can introduce consistent biases (Schulmerich et al., 2015) [44]. Common heuristic-driven errors in investing include:
2. Availability Bias: Decisions are influenced by recent or easily remembered events, which may cause investors to overreact to short-term market changes.
3. Representativeness Bias: Individuals interpret new information based on past patterns, which can result in flawed assumptions.
4. Gambler's Fallacy: There is a false belief that previous random events affect the likelihood of future outcomes, even when they are statistically unrelated (Sood & Sharma, 2022) [45].

5.4. Overconfidence and Anchoring Bias – How Investors Miscalculate

Overconfidence leads investors to overrate their understanding and forecasting abilities, which can cause them to take excessive risks or trade more aggressively than necessary (Singh, 2012) [46]. Such behaviour may result in poor decision-making, including a failure to recognize early warnings of downturns.

Anchoring bias refers to the inclination to rely heavily on a starting value or reference point when making financial judgments. For instance, if an investor purchases a stock at $100, they may irrationally maintain that investment, even when analysis suggests selling at a lower price would be more appropriate (Shao, 2023) [47]. This tendency can hinder flexibility in response to shifting market scenarios.

Gaining awareness of these psychological tendencies in behavioural finance equips investors and professionals with tools to recognize irrational choices and implement methods to counteract their influence (Sudirman et al., 2023) [48].

6. MARKET ANOMALIES AND BEHAVIOURAL BIASES:

6.1. Tulip Mania, South Sea Bubble, and the Dot-com Bubble

Throughout financial history, numerous market bubbles have occurred due to prices moving far beyond their intrinsic values, influenced mainly by collective investor sentiment. For example, Tulip Mania in the 1600s is one of the earliest known bubbles where tulip bulb prices soared before collapsing (Dwivedi, 2023) [49]. Similarly, speculation during the South Sea Bubble of 1720 led to a dramatic market crash (Dale et al., 2005) [50]. In more recent times, the Dot-com Bubble of the 1990s-2000s stemmed from overly optimistic investment in internet-based companies, resulting in inflated valuations and widespread losses (Prieto & Perote, 2017) [51].

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6.2. Herding Behaviour and Speculative Bubbles

Herding occurs when individuals imitate others' investment choices instead of basing decisions on their analysis. This behaviour often fuels market bubble formation by driving demand beyond justified valuations (Szumny, 2009) [52]. A clear example is the Dot-com Bubble, where excitement about tech companies led to irrational investment surges. These dynamics are typically driven by the widespread dissemination of market sentiment, known as information cascades, which cause trends to persist even when unsupported by fundamentals (Azofra-Palenzuela et al., 2006) [53].

Behavioural finance suggests that herding behaviour is linked to psychological biases such as overconfidence and representativeness heuristics. Market participants often believe that following the crowd reduces risk, which can lead to exaggerated market cycles and crashes (Siddiqui & Narula, 2016) [54].

6.3. The Role of Emotions in Market Volatility

Investor emotions play a major role in driving fluctuations in financial markets. Emotions like fear and greed can cause individuals to act irrationally, often leading to panic during downturns or over-enthusiasm during booms (Dong, 2024). Biases such as overconfidence and loss aversion contribute to exaggerated price changes, disrupting market efficiency (Frans, 2024) [56].

A notable instance is the 2008 Financial Crisis, during which high levels of speculative activity and investor optimism led to extreme volatility. Likewise, cryptocurrency markets have experienced similar instability due to behavioural tendencies like FOMO (Fear of Missing Out) and speculative decision-making (Yang, 2019) [57].

Recognizing the impact of behavioural biases and market irregularities enables investors and policymakers to develop effective strategies to reduce risk and support the creation of more stable financial environments (Iancu et al., 2023) [58].

7. IMPLICATIONS FOR INVESTORS AND FINANCIAL PRACTITIONERS:

7.1. Behavioural Insights for Portfolio Management

Behavioural finance sheds light on how cognitive tendencies shape investment decisions. While conventional financial theories suggest that investors act logically to optimize returns, research has shown that biases often result in poorly diversified or suboptimal portfolios (Khare & Kapoor, 2023) [59]. Acknowledging these tendencies can help practitioners build stronger, more adaptive investment frameworks.

For example, loss aversion may cause individuals to retain underperforming assets longer than advisable, while overconfidence can lead to aggressive and frequent trading (Jain et al., 2015) [60]. To manage these effects, portfolio strategies can be structured around long-term discipline and avoidance of impulsive behaviour (Chhapra et al., 2018) [61].

7.2. The Importance of Recognising Cognitive Biases

Awareness of cognitive distortions is essential for improving investment decision-making. Anchoring, framing, and similar tendencies can lead investors to make flawed judgments by overemphasizing certain data points or misinterpreting information. Recognizing these biases can significantly improve the quality of financial decisions (Ahmad, 2021; Wang, 2023) [62], [63].

Recognizing these biases enables investors to take corrective actions, such as seeking multiple perspectives before making investment decisions or consulting financial advisors to challenge inherent biases (Lekovič, 2020) [64]. Financial practitioners can incorporate behavioural insights into advisory services by providing clients with decision-making frameworks that counteract irrational tendencies.

7.3. Strategies to Mitigate Irrational Decision-Making

Investors and financial professionals can adopt structured strategies based on behavioural finance principles to reduce the impact of irrational decision-making. Key strategies include:

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*7.3.1. Pre-commitment Strategies***:** Encouraging investors to set predefined investment goals and risk limits to prevent impulsive decisions (Krishnamurti, 2009) [65] .

7.3.2. Diversification and Asset Allocation: Allocating investments across multiple asset classes to minimize risk exposure and counter cognitive biases (Sathya & Gayathir, 2024) [66].

7.3.3. Education and Training: Delivering financial literacy initiatives focusing on how psychological biases influence decision-making processes and ultimately affect investment performance.

7.3.4. Adopting a Long-Term Perspective: Encouraging investors to focus on long-term financial goals rather than reacting to short-term market fluctuations (Ahmad, 2020) [67].

By integrating these behavioural strategies into investment decision-making, investors and financial practitioners can enhance portfolio performance and reduce susceptibility to irrational market behaviour (Sidhu et al., 2022) [68].

8. CRITICISMS AND FUTURE DIRECTIONS IN BEHAVIOURAL FINANCE:

8.1. Challenges in Behavioural Finance Research

Behavioural finance has gained significant traction as an alternative to traditional financial theories, but it is not without criticism. One major challenge is the lack of a unified theoretical framework, making it difficult to develop generalizable models (Okur & Gurbuz, 2014) [7]. Unlike traditional finance, which relies on well-established mathematical models, behavioural finance incorporates psychological factors that are often subjective and difficult to quantify (Yang, 2019) [57].

Another challenge is the difficulty in empirical validation. While behavioural finance offers compelling explanations for market anomalies, these theories are hard to test under controlled conditions, Bachar. (2016) [69]. Additionally, critics argue that many behavioural biases identified in the literature lack predictive power and often rely on the retrospective justification of market Hirshleifer, D. (2025) [70].

8.2. Integration with Traditional Financial Theories

The merging of behavioural finance concepts with conventional financial theories has sparked considerable discussion. Many researchers suggest that behavioural finance should enhance, rather than replace, established models (Leković, 2020) [64]. One notable approach aiming to unify both perspectives is the Adaptive Market Hypothesis (AMH), which proposes that market efficiency can change over time, influenced by investor behaviour (Hong, 2005) [17].

Despite these efforts, integrating psychological insights into mathematical finance remains challenging. Traditional finance relies on rational choice models, while behavioural finance incorporates cognitive biases and emotional influences, which are difficult to quantify. However, researchers continue exploring hybrid models that account forational and irrational investor behaviour (Garcia, M. J. R. (2013); Fu, Changfa. (2022) [71], [72].

8.3. Emerging Trends and Future Research Areas

Future research in behavioural finance will likely explore integrating technological innovations and data-centric methodologies. The growing use of artificial intelligence and machine learning offers promising tools to examine investor behaviour more comprehensively, enabling deeper insights and enhancing the accuracy of predictive financial models. Additionally, cross-cultural studies will likely gain prominence, as investor psychology varies across different economic and social (Ariany, 2024; Rokhilawati et al., 2024) [73], [74].

Another emerging area of interest is neurofinance, which investigates the neurological foundations of financial decision-making. Using brain-imaging technologies, researchers seek to uncover how emotional responses and cognitive processes shape investor behaviour (Cui, 2024) [75]. This interdisciplinary approach could lead to more precise models of investor behaviour, bridging the gap between psychology and finance.

As behavioural finance evolves, addressing its limitations and refining its theoretical foundations will be crucial in ensuring its long-term relevance and applicability (Halder & Milan, 2024) [76].

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9. CONCLUSION:

9.1. Summary of Key Insights

Behavioural finance has become an essential extension of traditional financial theory, offering explanations for market phenomena that conventional models struggle to justify. Accounting for psychological and emotional biases—such as loss aversion, herding behaviour, and overconfidence—provides insight into the non-rational factors influencing investor decisions (Krishnamurti, 2009) [65]. Integrating behavioural insights has provided a more comprehensive understanding of investment strategies, market inefficiencies, and risk perception, challenging traditional financial models (Okur & Gurbuz, 2014) [7].

9.2. Practical Takeaways for Investors and Policymakers

The findings of behavioural finance highlight the importance of recognizing and mitigating cognitive biases in financial decision-making. Investors can adopt diversified portfolios, systematic investment plans, and risk assessment strategies to reduce impulsive decisions driven by emotions. Policymakers and financial regulators can leverage these insights to design investor protection policies, behavioural-driven regulatory frameworks, and financial literacy programs to enhance market stability.

9.3. The Need for a Balanced Approach to Finance

A comprehensive approach to financial decision-making requires combining traditional finance principles with behavioural insights to create models that reflectational and irrational investment behaviours (Zhang & Zheng, 2015) [3]. Future research should focus on developing hybrid models that incorporate quantitative financial tools and behavioural analysis to improve investment outcomes. By bridging the gap between rationality and psychology, investors, financial institutions, and policymakers can foster a more stable, efficient, and investor-friendly financial environment.

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