Review on Behavioral Finance with Empirical Evidence

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Abstract

Purpose. When many anomalies challenge efficiency market hypothesis and rationality, behavioral finance theories are developed to investigate the psychological effects on human behaviors and how their cognitive biases explain why the market is inefficient and anomalies exist. Behavioral finance is a fast-growing branch of financial economics, making this review paper beneficial to academics for developing leading-edge usages of financial theory that behavioral finance underlies and undertaking empirical studies on behavioral finance models. This review paper indoctrinates readers into the introductory concepts of behavioral finance with their prominent literature and empirical evidence.

Design/methodology/approach. In this review paper, we swiftly familiarize readers with the introductory concepts of behavioral finance and their salient readings with some empirical evidence.

Findings. This paper lays the solid foundation of behavioral finance theory and is the centerpiece of modern financial economics, which is useful to academics for developing cutting-edge treatments of financial theory that EMH and behavioral finance underpin and for undertaking empirical studies on the behavioral bias in the financial markets.

Practical Implications. This paper is furthermore helpful to investors in making investment products and strategy choices that suit their risk preferences and behavioral traits predicted from behavioral models. This paper also provides the recent empirical evidence of behavioral finance in literature. The readers can then follow the research methods to undertake empirical studies on this field.

Keywords: prospect theory, heuristic, risk-seeking, behavioral bias

Paper type: Research paper

JEL classifications: G10, G40.