# OVERCOMING PSYCHOLOGICAL BIAS AMONG STOCK INVESTORS: SEMINAR FOR A STOCK INVESTOR COMMUNITY

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**ABSTRACT**

This community service was a webinar for stock investors conducted in collaboration with Zhuan Community, a community of Indonesian stock investors. One of the problems usually faced by stock investors is psychological bias in making investment decisions. Some papers have reported that Indonesian stock investors are prone to psychological bias. In this webinar, it was shown to participants that humans are affected by psychological factors during decision making, especially financial related decisions. Those psychological factors create behavioral bias that reduce investment performance. Several examples of behavioral biases common in stock investors are introduced, namely overconfidence bias, herding behavior, disposition bias, and sentiment bias. Steps to mitigate the biases are offered. It is expected that understanding of how psychological factors affect investors behavior will enable participants to reduce its effect and thus act more rationally in making investment decisions.

**Keywords**: stock, investment, behavioral bias.

## INTRODUCTION

Psychological bias affects stock investors negatively preventing them from making optimal decisions. For example, Daniel et. al. (2002) found that investors affected by limited attention and overconfidence are prone to resource misallocation. Joo et. al. (2018) found that various psychological biases cause irrational behavior among investors. Baker and Nofsinger (2002) shows that common investment mistakes caused by cognitive and emotional weaknesses of investors can negatively affect their financial decisions. Dassani and Manda (2022) found sub-optimal choices made by investors affected by psychological biases.

Indonesian stock investors are not immune to the effect of psychological bias. Ady (2018) shows that psychological bias experienced by Indonesian investors leads to wrong decision making and fatal losses. Candraningrat et. al. (2023) found that among Indonesian investors, those who are affected by psychological bias experienced reduction of their final wealth. Pertiwi et. al. (2019) found that Overconfident investors are negatively affected by psychological biases in stock trading, leading to irrational investment decisions. The negative effect of psychological bias to investor might explain the poor consition of Indonesian stock investors. The majority of Indonesian stock investors are experiencing losses (Ini Gejala Investor Bakal Rugi Ratusan Persen, Anda Termasuk?, n.d.; Mengatasi Gangguan Mental Akibat Investasi Saham, n.d.; Ngenes! 333.000 Investor Nyangkut Massal di GOTO, n.d.). The percentage of investors incurring losses may even reach an astonishing 90% (Sekitar 90% Investor Saham Indonesia Gagal, Simak Cara Ampuh Para Investor Ini, n.d.). This phenomenon is surprising given that the Indonesian stock market index (IHSG) generally exhibits an upward trend over time. For instance, in 2013, the IHSG closed at 4,294, whereas in 2023, it closed at 7,268. This represents a 5.4% Compound Annual Return (CAR) over the past decade, excluding dividends.

It is highly possible that psychological biases can significantly lower the performance of Indonesian stock investors, leading to suboptimal decision-making and later leads to lower returns. To address this issue, UPH Surabaya Campus, in collaboration with Zhuan community, a community of Indonesian stock investors, organized a webinar to educate participants about the impact of psychological biases on stock investing.

During the webinar, it was shown to the participants that human beings are inherently prone to various psychological biases, which can influence their decision-making processes when investing. These biases can lead to suboptimal choices, ultimately resulting in lower investment returns.

In the webinar, root causes of these biases are discussed and practical steps that investors can take to mitigate their tendency to be influenced by them are provided. By understanding and addressing these psychological factors, investors can improve their decision-making abilities and potentially enhance their investment performance.

The collaborative effort between UPH Surabaya Campus and Zhuan community aimed to equip investors with the knowledge and strategies necessary to overcome cognitive biases, enabling them to make better and optimal investment decisions, leading to higher investment return.

## LITERATURE REVIEW

The webinar was started by showing the participants that human being are prone to be affected by psychological biases in decision making. For example, the sentences "buy 1 get 1 free" and "discount 50% if buy 2" are essentially the same. However, the first has more impact to us compared to the later. The sentences "95% effective" are basically the same as "5% failure rate". But the first sentence results in more sales compared to the second sentence. Same case with "Price Rp 1,000,000 discount 20%" and "Price Rp.800,000". By using these examples, it is expected that participants appreciate the fact that human beings are more affected by psychological factors than rational factors when making decisions.

There are two schools of thought in economy regarding whether human beings are more affected by rational or irrational factors in decision making. In classical economy, humans are assumed to be rational beings. We make decisions rationally; thus, the result will always be optimal. However, in behavioral economy, humans are assumed to be affected by psychological factors in making decisions, leading to irrational behavior that can lead to sub-optimal decisions. Classical economy and behavioral economy give rise to two different hypotheses in understanding stock market. Classical economy, which assumes human beings are rational entity, believes in Efficient Market Hypothesis (EMH). In EMH, stock price always expresses its fundamental value. There are no undervalued or overvalued stocks. This is because of the rationality of all investors, that will correct any stock mispricing and return it to fundamental value. On the other hand, behavioral economics assume that human beings are not necessarily rational actors. They frequently act irrationally and thus stock investors do not always make decisions that correct stock mispricing.

Evidence from the stock market tends to support the idea that the market is not efficient. A very wide swing of stock price does not support the notion that stock price always reflects its fundamental value. No such fundamental value can have such a wide swing. The existence of certain investors that consistently beat the market return also does not support EMH. If the market was efficient, it is impossible to predict whether certain stock prices will go up or down, and thus it is impossible to make constant profit from the stock market. Thus, it is suggested to the participants that inefficiency of stock market lends support to the notion that majority of investors are affected by psychological bias, and thus act irrationally. It logically follows if an investor can reduce his/her psychological bias, then he/she can act more rationally, make more optimal decisions, and in the end earn a higher return. A set of data from Indonesian inventors in 2022 were also presented to the webinar participants that show investors with higher tendency to psychological biases also tend to have lower investment return.

The reason why human beings are prone to psychological bias was discussed in a book titled Thinking Fast and Slow. The book was written by Daniel Kahneman and Amos Tversky, pioneer of behavioral economy. According to the book, human beings have two modes of thinking, thinking fast and thinking slow. Thinking fast is fast, intuitive, emotional, using rule of thumb, and consume less energy. Thinking slow is slow, rational, deliberate, systematic, and consumes more energy. The default mode of thinking is thinking fast, as it conserves energy. We cannot afford to always think slowly. When we think about serious problems, we then switch to thinking slow. The problem arises when we try to solve serious problems by using a fast mode of thinking. Fast mode of thinking is prone to be influenced by various psychological biases.

There are four psychological biases discussed in the webinar. They are overconfidence bias, herding behavior, disposition effect, and sentiment. Overconfidence bias is a human tendency to overestimate his/her ability, knowledge, or accuracy of judgement. Overconfidence bias makes a stock investor prone to take excessive amount of risk. Overconfidence bias can be mitigated by asking feedback, journaling investment, and diversification. Herding behavior is a human tendency to follow the decision of the majority, regardless of whether that decision is correct or not. This bias is mitigated by deep research on an investment decision and pushing ourselves to be contrarian. Disposition effect is stock investor tendency to sell winning stock too early and holding to losing stocks for too long. The tendency is caused by loss aversion. Humans hate to lose something. When we lose something, it is painful. Thus, stock investors sell winning stock too early to realize the profit soon, and hold the losing stock too long, expecting it to flip to winning stock. The bias can be mitigated by basing selling decision on whether the cause of the purchase is still valid.

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## METHOD

The webinar on psychological biases in stock investing was held on Sunday, December 18, 2023, from 2:00 PM to 6:00 PM via Zoom. It was organized by Zhuan Community, an Indonesian community for stock investors. Zhuan Community's vision is to become a platform for stock investors to grow independently and relate with other members to facilitate knowledge sharing. One way the community achieves this vision is to collaborate with UPH Surabaya campus to conduct periodic webinars on various stock investment topics.

UPH Surabaya campus contributed to the events by providing expert speakers in finance and stock investment. The webinar was arranged such that the first half is presentation by UPH speaker, followed by a question-and-answer session and discussion in the second half. The event was announced few days prior on an online stock investing forum, allowing participation from individuals beyond the Zhuan Community membership. Approximately 100 people attended the webinar.

Through this event, Zhuan Community aimed to educate stock investors by addressing the problem of psychological biases among investors, thereby optimizing their investment decision-making abilities and in the end increasing investment return.

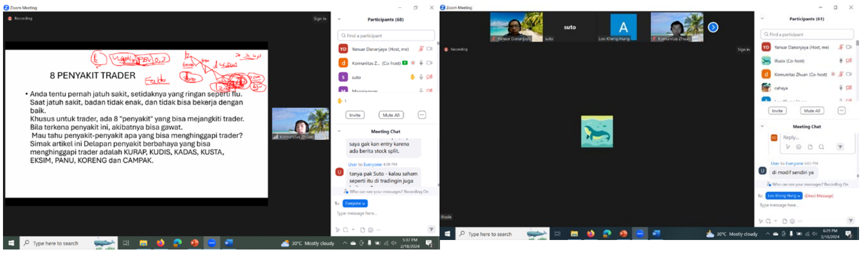


Figure 1: Screenshot of the webinar

## RESULT AND DISCUSSION

The webinar resulted in an engaging and interactive environment among participants, they actively contributing during both the explanation session and the question-and-answer session. The format of the webinar was intentionally designed to encourage active participation discussions among participants.

Several participants volunteered to share their personal experiences related to the psychological biases they experienced during stock investing.

For instance, during the discussion on herding behavior, one participant shared their experience of purchasing a stock solely based on recommendations from friends, causing huge financial losses. This provided example of the consequences of herding behavior bias in investment decisions.

Participants are encouraged to give feedback regarding the webinar, and the feedback are very good.

- @yanuard terimakasih telah berbagi ilmunya, pak. semoga lebih sering diadakan acara seperti ini
- sukses buat pak @yanuard ,, kita jadi sabun saja pak. emulsi antara air dan minyal. aman.. gak ada Foto saya . hehehe
- trims Pak atas ilmunya kemarin 🙏
- @yanuard thanks om, makin menambah conviction

## CONCLUSION

One of the root causes of poor performance among Indonesian stock investors are their vulnerability to psychological bias. Psychological bias causes investors to make sub-optimal decisions that leads to lower investment return. Simply by showing investors that they are vulnerable to behavioral bias can minimize the effect of the bias. The webinar discusses how human beings are prone to behavioral bias, the root cause, several type of common behavioral bias in stock investing, and how to overcome them. It is expected that participants can benefit from the webinar in the form of higher performance on their investment.

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