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Behavioral Finance and Investment Decision-Making Among Young Investors

Keuangan Perilaku dan Pengambilan Keputusan Investasi di Kalangan Investor Muda

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Abstract

Behavioral finance combines insights from psychology and economics to explain how investors' cognitive biases, emotions, and social influences affect their financial decisions. The purpose of this study is to analyze Behavioral Finance and Investment Decision-Making Among Young Investors. This study employs a qualitative approach using the literature review method to investigate how principles of behavioral finance influence investment decision-making among young investors. A literature review is appropriate for synthesizing theoretical concepts, empirical findings, and methodological trends from previously published academic sources. This literature review concludes that behavioral finance has a significant and measurable impact on the investment decisions of young investors. Unlike traditional financial theories that assume rational behavior, behavioral finance recognizes the psychological and emotional influences that drive real-world financial decisions.
Keywords: *Behavioral; Finance; Investment*

Abstrak

Keuangan perilaku menggabungkan wawasan dari psikologi dan ekonomi untuk menjelaskan bagaimana bias kognitif, emosi, dan pengaruh sosial investor memengaruhi keputusan keuangan mereka. Tujuan dari penelitian ini adalah untuk menganalisis *Behavioral Finance* dan pengambilan keputusan investasi di kalangan investor muda. Penelitian ini menggunakan pendekatan kualitatif dengan metode tinjauan pustaka untuk menyelidiki bagaimana prinsip-prinsip keuangan perilaku memengaruhi pengambilan keputusan investasi di kalangan investor muda. Tinjauan pustaka dianggap tepat untuk mensintesis konsep teoritis, temuan empiris, dan tren metodologis dari sumber-sumber akademik yang telah diterbitkan sebelumnya. Tinjauan pustaka ini menyimpulkan bahwa keuangan perilaku memiliki dampak yang signifikan dan terukur terhadap keputusan investasi investor muda. Berbeda dengan teori keuangan tradisional yang mengasumsikan perilaku rasional, keuangan perilaku mengakui pengaruh psikologis dan emosional yang mendorong keputusan keuangan di dunia nyata.
Kata kunci: Perilaku; Keuangan; Investasi

1. Introduction

In the contemporary financial landscape, the increasing participation of young investors in financial markets has become a notable trend. With the proliferation of digital investment platforms, access to financial information, and the rising influence of social media, young individuals—typically classified as those between 18 and 35 years of age—are becoming more active in making investment decisions (Statista, 2024). Despite their growing involvement, empirical studies suggest that their investment behavior often deviates from the predictions of traditional financial theories, such as the Efficient Market Hypothesis (EMH) and Modern Portfolio Theory (MPT). These deviations are largely attributed to psychological factors, as conceptualized in the field of behavioral finance.

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Behavioral finance combines insights from psychology and economics to explain how investors' cognitive biases, emotions, and social influences affect their financial decisions (Barberis & Thaler, 2003). Unlike traditional finance, which assumes that investors are rational and markets are efficient, behavioral finance posits that investors are subject to irrationalities that can lead to systematic errors in judgment and decision-making. Among young investors, these behavioral tendencies are often more pronounced due to their limited experience, overconfidence, and susceptibility to social influences such as peer pressure and online investment trends (Nofsinger, 2022).

One of the key behavioral biases affecting young investors is overconfidence bias**,** where individuals overestimate their knowledge or predictive abilities, leading them to trade excessively or underestimate risks. Studies have shown that young investors are particularly prone to this bias, especially when engaging in high-risk investments such as cryptocurrencies and stocks recommended by social media influencers (Kumar & Goyal, 2023). Another prevalent bias is herding behavior**,** in which investors mimic the decisions of others rather than relying on their own analysis. This behavior is often amplified by digital platforms like Reddit or TikTok, where investment trends and opinions spread rapidly and influence large groups of novice investors (Kramer, 2021).

Moreover, loss aversion—the tendency to prefer avoiding losses over acquiring gains—also plays a significant role in shaping the investment strategies of young individuals. This bias can lead to suboptimal decisions, such as holding on to losing investments for too long or exiting profitable investments prematurely (Kahneman & Tversky, 1979). Additionally, mental accounting**,** where individuals categorize money based on subjective criteria, influences how young investors allocate their funds and perceive financial gains or losses (Thaler, 1999).

The implications of behavioral finance are particularly critical in understanding the investment decisions of young investors during periods of market volatility. The COVID-19 pandemic, for instance, saw a surge in retail trading among young individuals, many of whom made speculative investments without a thorough understanding of market fundamentals. The phenomenon of "meme stocks," such as GameStop and AMC, highlighted the collective influence of behavioral biases, particularly herding and overconfidence, in driving market anomalies that contradicted traditional financial models (Shao et al., 2022).

Despite the growing body of literature on behavioral finance, research specifically focusing on young investors remains limited, especially in developing economies where financial literacy is often low, and digital access is expanding rapidly. Understanding the behavioral patterns of this demographic is essential for financial educators, policymakers, and investment platform designers aiming to foster more informed and resilient investment practices.

Furthermore, the intersection of behavioral finance with technology—particularly robo-advisors, mobile trading apps, and social trading platforms—adds another layer of complexity. While these technologies democratize access to investing, they also introduce new behavioral triggers, such as push notifications and gamified interfaces, which may exacerbate impulsive or emotionally driven decision-making among young users (Lusardi & Mitchell, 2023).

Given the importance of individual investment decisions in personal wealth accumulation and broader economic stability, it is crucial to investigate how behavioral biases shape investment behavior among young investors. Such an understanding can inform the development of targeted financial education programs and regulatory frameworks that address the unique cognitive and emotional characteristics of this group.

In summary, the study of behavioral finance in the context of young investors offers valuable insights into the psychological underpinnings of financial decision-making. It highlights the need to move beyond traditional economic assumptions and adopt a more nuanced, interdisciplinary approach to understanding investor behavior. By exploring the role of cognitive biases, emotional influences, and social dynamics, this research aims to contribute to a deeper and more practical understanding of how young individuals engage with financial markets in the modern era.

2. Method

This study employs a qualitative approach using the literature review method to investigate how principles of behavioral finance influence investment decision-making among young investors. A literature review is appropriate for synthesizing theoretical concepts, empirical findings, and methodological trends from previously published academic sources. It enables researchers to identify patterns, contradictions, and gaps in knowledge without collecting primary data (Snyder, 2019).

Research Design

The study adopts a narrative literature review design, which is characterized by its flexibility in selecting and interpreting relevant sources based on the research objectives. Unlike systematic reviews that emphasize exhaustive data collection with strict inclusion criteria, narrative reviews focus on a conceptual understanding of a topic (Baumeister & Leary, 1997). This design is well-suited to behavioral finance, a field that intersects economics, psychology, and sociology.

Data Collection

Data were obtained from credible and scholarly databases, including: Scopus**,** ScienceDirect**,** Google Scholar**,** JSTOR**,** Emerald Insight**,** SpringerLink**.** The literature search was conducted using the following keywords: *behavioral finance*, *investment behavior*, *young investors*, *cognitive biases*, *financial decision-making*, *overconfidence*, *loss aversion*, *herding*, *risk tolerance*, and *financial psychology*. The inclusion was limited to publications from 2010 to 2024 to ensure relevance and contemporaneity.

Inclusion and Exclusion Criteria

To maintain relevance and quality, the following criteria were applied:

Inclusion Criteria:

a. Peer-reviewed journal articles, books, and conference papers.
b. Studies discussing behavioral finance and its influence on individual or retail investors.
c. Publications focused on young or novice investors (typically aged 18–35).
d. Sources in English published between 2010 and 2024.

Exclusion Criteria:

a. Non-academic sources (e.g., blog posts, non-peer-reviewed content).
b. Articles that do not explicitly address behavioral components in investment.
c. Publications not available in full text.

Data Analysis

The collected data were analyzed through thematic content analysis**.** Themes related to behavioral biases—such as overconfidence (Barber & Odean, 2001), herding behavior (Bikhchandani & Sharma, 2001), loss aversion (Kahneman & Tversky, 1979), and mental accounting (Thaler, 1999)—were coded and categorized. The findings were then synthesized to construct an integrated understanding of how these factors influence the investment behaviors of young individuals.

3. Result and Discussion

The analysis of the selected literature reveals that behavioral finance plays a significant role in shaping the investment decisions of young investors. This demographic—often characterized by limited financial experience, digital fluency, and susceptibility to social influence—demonstrates a unique set of cognitive and emotional biases that affect how they perceive risk, process financial information, and make investment choices. The following discussion synthesizes key behavioral factors identified in the literature and explores their implications for young investors' decision-making.

Overconfidence Bias

Overconfidence is one of the most pervasive behavioral biases among young investors. This bias leads individuals to overestimate their knowledge, skills, and ability to predict market outcomes (Barber & Odean, 2001). As a result, overconfident investors tend to trade more frequently, often ignoring diversification principles and underestimating risks. Empirical evidence suggests that younger investors, especially males, are more prone to overconfidence due to their enthusiasm for self-directed investment through online platforms (Kumar & Goyal, 2023). Platforms such as Robinhood and eToro, with their user-friendly interfaces and gamified features, may reinforce overconfidence by providing instant feedback and perceived control over outcomes (Lusardi & Mitchell, 2023).

Moreover, overconfidence can lead to excessive trading**,** which often erodes portfolio returns due to transaction costs and poor market timing (Odean, 1999). Many young investors fail to recognize the role of randomness and market volatility, attributing short-term gains to skill rather than luck.

Herding Behavior

Herding behavior refers to the tendency of individuals to follow the actions of a larger group, often without independent analysis. In the context of young investors, herding is amplified by social media platforms such as Reddit, YouTube, and TikTok, where investment trends are rapidly disseminated.

The GameStop saga in 2021 exemplifies herding behavior among retail investors, many of whom were young and influenced by viral narratives rather than fundamental analysis (Shao et al., 2022). This event showed how collective action driven by online communities could distort market prices, leading to speculative bubbles and increased volatility.

Herding can provide a false sense of security, as investors perceive consensus as a signal of correctness. However, this behavior increases systemic risk, especially when driven by misinformation or short-term hype (Bikhchandani & Sharma, 2001).

Loss Aversion and Risk Perception

Loss aversion, a concept from prospect theory (Kahneman & Tversky, 1979), describes the tendency of individuals to feel the pain of losses more acutely than the pleasure of equivalent gains. This bias affects investment behavior by leading young investors to:

a. Hold losing assets longer in the hope of a rebound (disposition effect).
b. Avoid potentially profitable but risky investments.
c. Sell winning assets too early to "lock in" gains.

Young investors may also display inconsistent risk perception, particularly during periods of market instability. For instance, during the COVID-19 pandemic, many millennials entered the stock market due to perceived opportunities but reacted emotionally to downturns, often exiting markets at inopportune moments (Nofsinger, 2022).

Loss aversion is also exacerbated by digital platforms that provide real-time tracking of portfolio performance. Frequent monitoring increases emotional reactions to short-term fluctuations, leading to impulsive decisions (Thaler, 1999).

Mental Accounting and Financial Shortcuts

Mental accounting refers to the tendency to categorize and treat money differently depending on its source or intended use (Thaler, 1999). Young investors often treat "windfall" money (e.g., bonuses, gifts, or crypto gains) as risk capital, making them more likely to engage in speculative investments.

In addition, many young individuals rely on heuristics or financial shortcuts, such as following influencer advice or basing decisions on past experiences, rather than conducting thorough financial analysis (Statman, 2019). While heuristics reduce cognitive load, they may lead to biased outcomes when investors lack proper financial education.

Influence of Digital Technology

The integration of behavioral finance and fintech is a critical emerging theme. Young investors interact with digital platforms that are designed to influence behavior through notifications, visual cues, and instant transaction capabilities. While these features democratize access, they also make impulsive trading easier and more frequent.

For example, apps with reward systems or stock trading “confetti” animations can create a false sense of achievement and contribute to addiction-like behavior (Lusardi & Mitchell, 2023). The constant accessibility to markets may lead to emotionally charged decisions, undermining long-term financial planning.

4. Conclusion

This literature review concludes that behavioral finance has a significant and measurable impact on the investment decisions of young investors. Unlike traditional financial theories that assume rational behavior, behavioral finance recognizes the psychological and emotional influences that drive real-world financial decisions. Young investors, due to their relatively limited experience, greater exposure to digital platforms, and stronger social influences, are particularly vulnerable to these biases.

Key behavioral factors such as overconfidence, herding behavior, loss aversion, mental accounting, and emotional trading influenced by fintech design consistently emerge across various studies. These biases often lead to suboptimal investment decisions, including excessive trading, lack of diversification, reactionary decisions to market volatility, and reliance on peer or influencer-based advice instead of informed analysis. Understanding these tendencies is essential for improving the financial well-being of young investors and promoting more stable and efficient financial markets.

Recommendations

Based on the findings, the following recommendations are proposed:

For Young Investors:

a. Improve self-awareness of behavioral biases through financial education that includes behavioral finance principles.
b. Focus on long-term investing and avoid reacting impulsively to market noise or social media trends.
c. Use tools such as automated investing, financial planning apps, or professional advice to mitigate emotional decision-making.

For Financial Educators and Institutions:

a. Incorporate behavioral finance topics into financial literacy programs, especially targeting high school and university students.
b. Provide practical simulations and case studies to help young investors experience and reflect on behavioral patterns.

For Investment Platforms and Fintech Companies:

a. Design digital interfaces that encourage thoughtful decision-making rather than impulsive behavior (e.g., removing gamification elements or adding cooling-off features).
b. Provide educational content and risk warnings at the point of investment decisions, especially for volatile or speculative assets.

For Policymakers and Regulators:

a. Promote nationwide behavioral-based financial literacy campaigns tailored to the habits and media consumption of the younger demographic.
b. Establish ethical guidelines for investment influencers and social trading platforms to prevent the spread of misleading or speculative advice.

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