

What is Behavioral Finance?

Worksheet

Behavioral finance studies how psychology influences financial decisions. Emotions, cognitive biases, and herd behavior often override rational thinking and create market inefficiencies.

Questions

1. Loss aversion means investors...

- A) Gain profits equally to losses
- B) Feel losses more intensely than equivalent gains
- C) Avoid all risk
- D) Only invest in safe assets

2. Herd behavior in markets occurs when...

- A) Professionals dominate trading
- B) Retail investors ignore the crowd
- C) Everyone follows the same trend
- D) Only institutions trade

3. What is FOMO in investing?

- A) Fear of Missing Out — buying due to crowd pressure
- B) Fear of Money Options
- C) Failure of Market Opportunity
- D) Fundamental Overall Momentum

4. Overconfidence bias leads to...

- A) Conservative portfolios
- B) Excessive trading and poor returns
- C) Strong diversification
- D) Low risk-taking

5. During a market crash, an investor panics and sells profitable positions. Why?

6. A trader holds a losing stock hoping to break even. What bias is at play?

7. An investor only reads positive news about their stock. What is this called?

8. Define: What is behavioral finance?

9. Define: What is loss aversion?

10. Define: Define anchoring bias.

Answer Key

1. B) Feel losses more intensely than equivalent gains — Loss aversion is the psychological tendency to avoid losses more strongly than pursuing gains.
2. C) Everyone follows the same trend — Herd behavior means investors copy others regardless of fundamental analysis.
3. A) Fear of Missing Out — buying due to crowd pressure — FOMO drives investors to chase trends and buy near peaks.
4. B) Excessive trading and poor returns — Overconfident investors overtrade and underestimate risks, often underperforming.
5. Loss aversion + fear Investor overweights recent losses Ignores long-term strategy Panic selling locks in losses during temporary dip
6. Anchoring bias Trader anchors on purchase price Ignorant of new information Keeps position despite negative fundamentals
7. Confirmation bias Seek info supporting existing belief Ignore contradictory evidence Leads to overconfidence and poor decisions
8. The study of how psychology and emotions influence financial decisions and market outcomes.
9. Tendency to feel the pain of a loss more intensely than the pleasure of an equal gain.
10. Relying too heavily on the first piece of information (e.g., purchase price) when making decisions.

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