Behavioural Finance

Conventional finance theory says that the market participants are highly rational and acts in a manner, which will help them, maximize their profits. However, there are many instances where emotion and psychology influence their decisions, causing participants to behave in irrational ways.

We all know that there are important psychological and behavioural variables involved in investing that provide opportunities for investors to profit. A field of finance that explain such market follies, which is now popularly known as **Behavioural Finance.**

Within behavioural finance, it is assumed that the information structure and the characteristics of market participants systematically influence individuals' investment decisions as well as market outcomes.
There are many concepts in behavioural finance like Anchoring, Mental Accounting, Confirmation bias and **Gambler's Fallacy.**

Let us understand **Gambler's Fallacy in detail today.**

We all know success in gambling is based on luck rather than rational thinking. Gamblers many times believe that some random events is behind their success and does not want to change that. If they are wearing red shirt and gambler wins then he is likely to believe that red shirt is lucky and he is likely to wear red shirt more often than not.
This kind of thinking is incorrect because past events do not change the probability that certain events will occur in the future. For example, take the flip of the coin. We all know, the probability of the any of the two possible outcomes in a fair throw is exactly half.

If we toss the coin 15 times, and all have been heads, then gambler fallacy is to think that next time it will throw up heads only. This line of thinking represents an inaccurate understanding of probability because the likelihood of a fair coin turning up heads is always 50%. Each coin flip is an independent event, which means that any and all previous flips have no bearing on future flips.

This can be extended to investing as some investors believe that they should not sell a stock after it has gone up in a series of subsequent trading session because they don't believe that the position is likely to continue going up.

As investors we should avoid falling in the trap of fallacy of gamblers.