



# Behavioural Biases in Mutual Fund Investment Decisions

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## Abstract

Investor choices in collective fund requests are affected not just by logical fiscal evaluation but also by cerebral impulses that impact threat perception and investment opinions. This exploration investigates the impact of significant behavioural impulses, recency bias, performance- chasing tendency, loss aversion, safety-seeking gesture, internal account, diversification perception bias, and herding gesture on colourful types of collective finances. The study employs a qualitative approach predicated on secondary literature, behavioural finance propositions, and recorded request substantiation. The results show that recency bias and performance- chasing tendencies lead investors to allocate finances to equity collective finances after strong short- term earnings, whereas loss aversion prompts investors to move toward debt collective finances during times of request oscillations. In cold-blooded collective finances, impulses in internal accounts and diversification lead investors to view mixed portfolios as innately less parlous, affecting their allocation choices without a thorough assessment of the associated pitfalls. Also, herding gestures lead to nippy investor involvement in sectoral and thematic finances during times of robust demand trends. The exploration emphasises that behavioural impulses significantly impact collective fund investment choices, leading to skewed portfolio distribution and cyclical investment trends.

**Keywords:** Behavioural finance, mutual fund investments, investor psychology, recency bias, loss aversion, herding behaviour, diversification bias.

## 1. Introduction

### 1.1 Definition of Mutual Funds

Mutual funds are investment portfolios that collect funds from different investors and invest in financial securities. This type of investment is managed by professional asset management companies. This allows investors to invest in different financial instruments.

The Securities and Exchange Board of India (SEBI) has defined mutual funds as: “A mutual fund is a trust which collects money from investors by issuing units of its schemes, either individually or in combination, and invests the money in securities and other financial instruments.”

Mutual funds have different benefits to offer to their investors. Some of the benefits of mutual funds are professional management, diversification of risk, and accessibility to financial markets. Mutual funds collect funds from different investors, which helps individuals to invest in financial instruments.



It is observed that in recent decades, the global mutual fund market has grown significantly due to financial market development, improvement in investor protection, and financial literacy. According to Khorana, Servaes, and Tufano (2005) in their research, countries with robust regulatory systems and better investor protection measures have larger and more developed mutual fund markets.

Despite various structural advantages in investing in mutual funds, investors are unable to attain optimal results from their investments. According to empirical research, investors' behaviour does not always conform to rationality due to various psychological factors.

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## 1.2 Definition of Behavioural Biases

As the name of the term suggests, behavioural biases are deviations from rational thought caused by something psychological, emotional or cognitive. Behavioural finance is an academic field designed to use psychological and economic concepts to help us understand behavioural biases and their effects within the financial marketplace. Conventional theoretical frameworks, such as the Efficient Market Hypothesis, assume that financial investors are acting rationally based upon either the availability of financial information or a logical assessment of risk and return. Behavioural finance refutes this premise by demonstrating that investors are using heuristics for simplifying complex decision-making scenarios.

The foundations of behavioural finance were established by Kahneman and Tversky through their work with Prospect Theory. They determined that people perceive their outcomes in relation to a reference point and therefore exhibit loss aversion that is the pain of losing an amount is more severe than the pleasure of gaining an equivalent amount.

In financial markets, behavioural biases may generally be divided into two categories: cognitive bias and emotional bias.

Cognitive bias is associated with errors made when processing information including using heuristic strategies, to facilitate cognitive complexity; emotional bias, conversely, arises from the way an investor feels about a particular decision i.e., fear of loss, regret of missed opportunity, overconfidence etc., at the time he or she is making his or her decision (Pompian, 2006).

These biases affect how investors process information on the stock market, determine risk levels about each investment, and make the final decision to invest in each security, leading to irrational or non-optimal investment behaviours.

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## 1.3 Types of Behavioural Biases Affecting Mutual Fund Investors

Research in behavioural finance shows that there are many different psychological factors that impact how investors make decisions, and they often do not make rational decisions. Typically, psychological factors are either cognitive (e.g., biases in using information), emotional (e.g., biases resulting from feelings), or social (e.g., effects of other people's behaviours). Each of these types of factors will contribute to how an investor interprets financial information, assesses risks associated with investing and ultimately decides to invest in a mutual fund.

**Table 1**

**Cognitive Biases Affecting Mutual Fund Investors**

<b>Behavioural Bias</b>	<b>Description</b>	<b>Implication for Mutual Fund Investors</b>	<b>Reference</b>
<b>Overconfidence Bias</b>	Investors overestimate their knowledge and ability to predict market movements.	Leads to overtrading and frequent investment changes between mutual funds.	Barber & Odean (2001)
<b>Anchoring Bias</b>	Investors rely heavily on initial information such as purchase price or past NAV.	Prevents the ability of investors to re-evaluate the performance of their mutual funds without bias.	Tversky & Kahneman (1974)
<b>Recency Bias</b>	Investors give greater weight to recent market events or return.	Encourages chasing after and making investment returns and investing on a short-term basis.	De Bondt & Thaler (1985)
<b>Confirmation Bias</b>	Investors search for information that confirms their existing beliefs.	Investors will overlook negative performance about their mutual fund investments.	Nickerson (1998)
<b>Mental Accounting</b>	Investors divide investments into separate mental categories.	Leads to inefficient use of the capital and diversification of the portfolio.	Thaler (1999)
<b>Availability Bias</b>	Investors rely on easily available information rather than comprehensive analysis.	Popular mutual funds, or those in the media, will receive unusual amounts of investor interest.	Tversky & Kahneman (1974)

**Table 2**

**Emotional Biases Affecting Mutual Fund Investors**

<b>Behavioural Bias</b>	<b>Description</b>	<b>Implication for Mutual Fund Investors</b>	<b>Reference</b>
<b>Loss Aversion</b>	Investors feel losses more strongly than gains of the same value.	Investor avoidance of higher-risk investments or holding losing investments too long.	Kahneman & Tversky (1979)
<b>Regret Aversion</b>	Investors avoid decisions that may cause regret later.	Investor indecision to sell their poorly performing funds or to invest in other funds.	Shefrin & Statman (1985)
<b>Endowment Effect</b>	Investors value assets they already own more highly than new assets.	Investor continues to hold on to certain mutual funds despite their poor performance.	Thaler (1980)
<b>Optimism Bias</b>	Investors believe positive outcomes are more likely than negative outcomes.	Investors will tend to underestimate the amount of risk in the market during bullish conditions.	Weinstein (1980)

**Table 3**

**Social Biases Affecting Mutual Fund Investors**

<b>Behavioural Bias</b>	<b>Description</b>	<b>Implication for Mutual Fund Investors</b>	<b>Reference</b>
<b>Herding Behaviour</b>	Investors follow the actions of other market participants.	Leads to large inflows into trending mutual funds.	Bikhchandani & Sharma (2000)
<b>Bandwagon Effect</b>	Investors invest in funds that are popular or trending.	Causes rapid growth in certain fund categories.	Leibenstein (1950)
<b>Familiarity Bias</b>	Investors prefer investments they are familiar with.	Investors prefer domestic or well-known funds rather than diversified options.	Huberman (2001)

**1.4 How Behavioural Biases Affect Mutual Fund Investment Decisions**

Behavioural biases impact how individuals make decisions about which mutual funds to invest in. Although mutual funds are meant to be used for long-term investments, oftentimes investors allocate their cash based upon short-term influences, for example, the fear of loss, the confidence of knowing their money is growing, or simply following along with the crowd.

One of the best-known behavioural patterns among mutual fund investors is that they will chase performance i.e., they will invest in a mutual fund that has done well recently. Research has shown that there is a significant correlation between mutual fund inflows and past performances, meaning that investors tend to rely heavily on historical performance rather than assessing the underlying fundamentals associated with that fund's investment process (Sirri & Tufano, 1998; Barber, Odean, & Zheng, 2005).

The research has also looked at the timing behaviour of mutual fund investors – that is, the timing of both purchases and redemptions. According to this research, investors frequently purchase funds during periods of strong performance; however, they tend to redeem those same funds at times of weak performance. Such timing decisions are detrimental to overall investment returns since the returns on the involved investments have been negatively affected by the behavioural nature of the decision-making process. One study conducted by Friesen and Sapp (2007) found that these timing-related decisions were responsible for reducing investor returns by approximately 1.56% per year, illustrating how behaviour-based decision-making negatively impacts the overall performance of investments.

The selection of mutual funds is also influenced by people's biases when it comes to the style and way they behave, such as those who have psychological biases toward familiarity with a particular fund, overconfidence, or herd mentality. Evidence from countless studies in the psychology behind financial behaviour indicates that individuals who have a high level of psychological bias are much more likely to trade mutual funds more often, misread the market's signals, and poorly diversify their portfolios.

Furthermore, behavioural biases, i.e., overconfidence and herd mentality, have the potential to create greater volatility in the marketplace. As an example, there are numerous times when investors will react together to the market's trends and generally make investments in large numbers in specific mutual funds during times of rising markets; conversely, during times of falling markets, investors will redeem large amounts of their investments in specific mutual funds. The above patterns of behaviour contribute to the market being less than efficient and investors having made suboptimal investment choices.

The research in behavioural finance demonstrates that, in most cases, the choice of mutual funds by investors suggests that they are not purely rational beings; however, most of their investment decisions are influenced by behavioural characteristics. Therefore, behavioural influences create excessive trading activity, poor market timing, and inappropriate allocations of assets in a portfolio.

## 1.5 Impact of Behavioural Biases: Real-World Incidents and Case Studies

Behavioural biases are not only something that are described in theoretical models, but they have also occurred in many large financial market occurrences. Some examples of behaviour within the market that have been affected by mass psychology are the crises in the real economy and speculative bubbles. The way that mass investor psychology can lead to irrational acts in the marketplace, excessive risk-taking in investments and severe financial repercussions has been discussed extensively (Shiller, 2000). The following case studies show examples of how behavioural biases have impacted investors' decision-making processes in the global financial markets.

### Case Study 1: Global Financial Crisis (2008)

A notable illustration of how behavioural biases affect financial markets is the Global Financial Crisis of 2008. Investors and financial institutions made large volumes of investments in mortgage-backed securities and other similar housing-related products before the crash.

Biases that play a role in this case include:

- Overconfidence
- Herd behaviour
- Confirmation Bias
- Optimism

Many investors assumed that housing prices would continue to rise indefinitely. Therefore, due to confirmation bias, the many warning signs associated with lending for mortgages and the existence of a housing price bubble were largely overlooked.

When the housing bubble burst, there were very drastic declines across all major world financial markets resulting in losses in equity, mutual fund, and pension portfolios world-wide (Akerlof & Shiller, 2009).

### Case Study 2: GameStop Short Squeeze (2021)

The retail investors leveraging GameStop during the GameStop event in 2021 leveraged behavioural biases and social networking (i.e., social media). Specifically, many of the behavioural biases being leveraged using social networking were:

- Herding
- Bandwagon
- Overconfidence

As many co-investors on Reddit and WallStreetBets purchased shares of GameStop stock collectively, the related share price increased from around \$20 to over \$400 in a very short period. Most of these new co-investors were purchasing shares based on social media influences, rather than making investment decisions based on traditional, fundamental analysis. Some of these co-investors were fortunate enough to make money in the short term; however, most of the later co-investors lost a substantial amount of money when the share price of GameStop fell significantly (Eaton, Green, Roseman, & Wu, 2022).

### Case Study 3: Cryptocurrency Boom and Crash (2017 & 2022)

Cryptocurrency markets provide a modern example of how behavioural biases influence speculative investment activity.

During periods of rapid price increases, investors often purchase cryptocurrencies due to **Fear of Missing Out (FOMO)** and strong herd behaviour.

### Behavioural Biases Involved

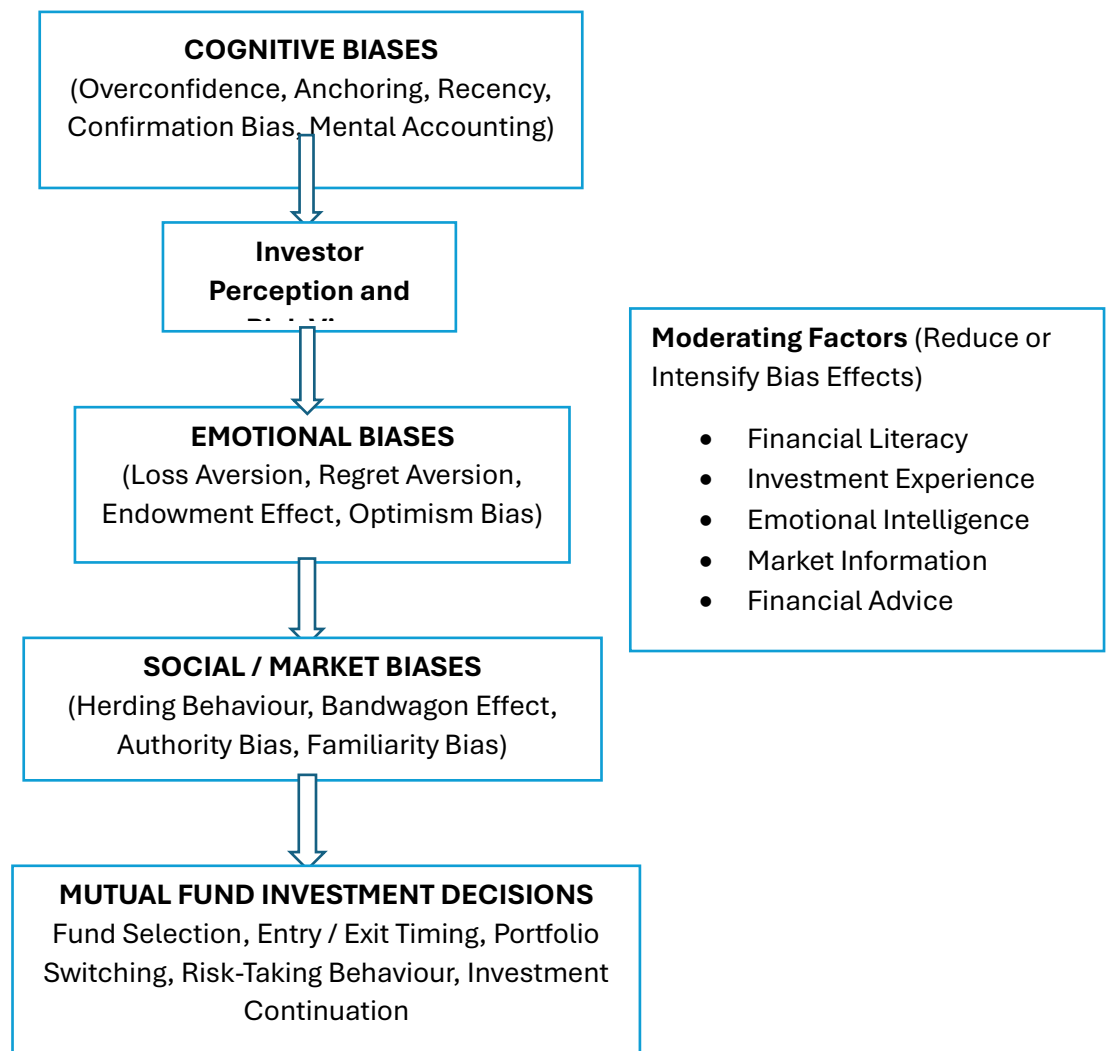
- Fear of Missing Out (FOMO)
- Herd behaviour
- Recency bias

Impact was Rapid inflows of speculative capital led to dramatic price increases in cryptocurrencies such as Bitcoin and Ethereum during 2017 and again in 2021. However, market corrections in subsequent years resulted in substantial declines, leading to large investor losses.

These events demonstrate how behavioural biases and speculative enthusiasm can contribute to financial market bubbles (Corbet, Lucey, Urquhart, & Yarovaya, 2019).

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### Conceptual Framework: Behavioural Biases Influencing Mutual Fund Investment Decisions



The conceptual framework provides a visual depiction of the way that behavioural biases have an impact on mutual fund investment choices. The framework contains a list of independent variables (Behavioural Biases) and a list of moderating variables (Financial Literacy, Emotional Intelligence, and Market Information), which ultimately contribute to the dependent variable of their mutual fund investment decisions (Portfolio Behaviour).

The conceptual framework demonstrates the relationship between investment decisions and behavioural bias. Results from the literature identified three different groups of biases – Cognitive bias, Emotional bias, and social bias.

–Cognitive Bias is a result of limited information processing capabilities. Investors will often use heuristics when interpreting financial data because of cognitive biases.

–Emotional Bias is the result of psychological responses like fear, regret, and optimism and will play an important role in risk perception.

–Social bias relates to the influence a stock market analysis has on an individual's investment choices.

Behavioural Bias collectively shapes the way that individual investor sees an investment opportunity and assesses the risk of that investment, which will subsequently influence how they will select a mutual fund, how they will time their entry/exit into that fund, whether they will switch between funds and whether they will stay in the same mutual fund long term or not.

Moderating variables are included in the model. Examples of these variables include: the financial literacy of the investor, investment know-how of the investor, the emotional intelligence of the investor and the type of access to financial advice the investor may have. All these variables have the capacity to either mitigate or exacerbate the influence of behavioural investor biases on investors making their investment decisions.

Therefore, when investigating behavioural investor biases in conjunction with the investment decision outcomes of investors, the theoretical underpinning of the model provides an understanding of how and why so many mutual fund investors make non-rational financial decisions.

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## 2. Research Objectives

The objectives of this study are:

- To examine the influence of recency bias and performance-chasing behaviour on equity mutual fund investments.
- To analyse the impact of loss aversion and safety-seeking behaviour on investor preference for debt mutual funds.
- To investigate how mental accounting and diversification perception bias affect investment decisions in hybrid mutual funds.
- To evaluate the role of herding behaviour and bandwagon effect in investor participation in sectoral or thematic mutual funds.

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## 3. Literature Review

### 3.1 Behavioural Finance and Investor Decision-Making

The assumptions made by traditional theories on financial behaviour are that all investors act according to rational behaviour and make decisions based on comprehensive information and usage of objective criteria when assessing risk vs. return. However, people often make financial decisions that are affected by behavioural finance principles. Daniel Kahneman and Amos Tversky developed Prospect Theory (1979), which shows that an investor evaluates financial performance based on relative increase or decrease in value and not based solely on absolute increase or decrease of value (Kahneman & Tversky, 1979).

Ph.D. Professor Richard H. Thaler provided further evidence for behavioural finance by explaining that investors often use mental shortcuts and heuristic rules to help make decisions. Cognitive bias can affect investments, especially in complex financial environments such as mutual funds, increasing the likelihood of investing irrationally.

### 3.2 Recency Bias and Performance-Chasing Behaviour

Recency bias refers to a complete disregard for information that has been received before a current event when evaluating whether an event will happen or not, therefore distorting the evaluation. The research of Werner F. M. De Bondt & Richard H. Thaler was able to demonstrate that investors do tend to overvalue recent events, as well as create a "wave" effect from those valuations (De Bondt & Thaler, 1985).

In mutual funds, a pattern of behaviour of "performance chasers" is created by the recency bias. Research conducted by Erik R. Sirri and Peter Tufano illustrates that investors frequently make investments into mutual funds that have recently had strong performance, while ignoring long-term consistency in performance (Sirri & Tufano, 1998). This ultimately leads to cyclical flows of investments: the flow of investments into mutual funds that are experiencing strong performance will create a positive cycle, while the flow of investments out of mutual funds that are experiencing poor performance will create a negative cycle.

### 3.3 Loss Aversion and Safety-Seeking Behaviour

Loss aversion is a common bias that influences people's decisions when investing. Prospect Theory states that people feel much more negative emotion from losing money than they do from making an equivalent amount of money. Therefore, investors tend to make very conservative investments to avoid losing money.

Myopic loss aversion, as introduced by researchers Shlomo Benartzi and Richard H. Thaler, refers to the greater likelihood of individuals who continuously check their portfolios to respond negatively to short-term drops in the market (Benartzi & Thaler, 1995). Such individuals are likely to move their investments away from long-term investments during times of high volatility, moving towards safer investments such as government securities or mortgage-backed securities.

Additionally, studies show that wealthier risk-averse individuals favour fixed income instruments because they generally provide more stable returns with less volatility than equity investments (Pant & Srivastava, 2021).

### 3.4 Mental Accounting and Diversification Perception Bias

Mental accounting is the way people perceive their different monetary choices as belonging to separate 'mental accounts,' rather than viewing the totality of their financial situation. According to Thaler (1999), many investors separate their investments into different accounts depending on the purpose of the account (i.e., asset class), i.e. for saving for retirement, for providing security in retirement, or for growth. While viewing decisions through the lens of separate purposes may simplify the decision-making process, it often results in improper allocation of the investor's overall asset portfolio.

Another example of a behavioural bias is the belief that investors have a proper understanding of diversification by thinking that by simply having multiple different types of assets creating investments in their portfolios will reduce the risk of the portfolio. Statman argued that most investors do not have a realistic understanding of what diversification means and incorrectly believe that simply combining a set of assets is sufficient to achieve a reduction in the risk of the portfolio, without consideration of the correlation of the assets that they combined (Statman, 1985). In hybrid mutual funds, the misunderstanding of diversification leads to investors thinking that a diversified portfolio is always safer than other forms of portfolios, even if there are major differences in the actual risk profile of the underlying securities.

### 3.5 Herding Behaviour and the Bandwagon Effect

Herding behaviour refers to investors following what other people are doing with their investments instead of making independent decisions using their own analysis. Theoretical literature (Banerjee, 1992) suggests that individuals will mimic the behaviour of most investors because they either do not know which way the market is going or think that the people around them have better information than they do.

Bikhchandani, Hirshleifer and Welch (1992) have written about informational cascades and how individuals will dismiss their own private information and instead follow the prevailing trend, in this case, the trend of the market.

An example of this type of behaviour is evident in the allocation of funds to sectoral and thematic mutual funds because of investors moving rapidly into sectors where recent strong performance has been experienced.

The bandwagon effect, as first described by Leibenstein (1950), suggests that because of others investing in an investment product, there will be an increase in the demand for that investment product. This type of behaviour can extend the length of economic cycles and create speculative investment patterns.

### 3.6 Research Gap

While behavioural biases and investor behaviour have been widely documented in the literature, most studies have focused on traders' behaviours in the stock market rather than on individual investors' decisions to invest in mutual funds, similarly throughout the range of mutual fund types. In addition, many studies analyse individual biases independently rather than collective behavioural factors affecting investor decisions.

Hence, the objective of this study is to address this gap in the literature via analyses of Behavioural Biases impact on investors' decisions across Equity Mutual Funds, Debt Mutual Funds, Hybrid Mutual Funds and Sectoral Mutual Funds, hence offering a more comprehensive insight into Investor Behaviour about their decision to invest in Mutual Funds.

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## 4. Research Methodology

### 4.1 Research Design

This research employs a qualitative and an exploratory approach to investigate how behavioural biases impact mutual fund investment decisions through human behaviour. No primary data will be collected, and no statistics will be conducted in this study; all data will be secondary, being academic literature and/or evidence of the markets from publicly available sources, for analysis of investor behavioural patterns. The focus of this approach is on interpreting theories related to behavioural finance and/or previous research to explain how behavioural/psychosocial factors impact the decision-making process of an investor.

### 4.2 Research Approach

This research uses an analytical modelling framework based on theories and concepts from behavioral finance theory literature. The authors reviewed previously published studies on investor psychology, behavioral biases, and investor behavior in mutual funds for patterns of behavior—those that would impact how investors make decisions and what kind of behaviors they exhibit as a result. Authors included behavioral economics theory-based insights into previous empirical evidence available in other studies.

### 4.3 Data Sources

The analysis used solely secondary data through reputable, reliable sources of information from academic and governmental sources. All literature used in this analysis includes:

- Peer-reviewed journal articles on behavioral finance and investor behavior.
- Textbooks and theoretical books related to behavioral economics.
- Quantitative and qualitative research papers about investment behaviour in mutual funds.
- Studies related to financial market analysis and case studies.

The academic databases used to identify relevant literature include, but were not limited to, Google Scholar, ResearchGate, ScienceDirect, and SpringerLink.

### 4.4 Literature Selection Criteria

The research conducted for the analysis was selected based on the connections between behavioural biases and investment decision-making. Most of the articles selected for the analysis are published articles that were peer-reviewed and are considered classic works in behavioural finance that provide evidence of psychological biases that can impact financial

decisions regarding investment markets. Any research that could not be considered academically credible, and that was not related to how investors behave, was removed from the review.

#### 4.5 Analytical Method

In the current study, the authors used qualitative content analysis to conclude from the literature reviewed and/or that was relevant to the study. Based on their psychological characteristics, behavioural biases that were present in the literature were categorised into three categories: cognitive, emotional and social. In addition, based on the type of mutual funds (equity, debt, hybrid and sectoral), the authors assessed how these behavioural biases affected investors' perceptions of the investments, their assessments of risk and their actual purchases of mutual funds.

#### 4.6 Development of the Conceptual Framework

The results of the literature review were used to create a conceptual model that describes how behavioural biases affect mutual fund investment decisions. The model has behavioural biases as independent variables, investor perceptions and evaluations of risk as the mediating mechanism, and mutual fund investment decisions as the dependent variable. Additionally, the model has moderating variables, including financial literacy, experience with investment products, emotional intelligence, and market knowledge, as potential moderating variables to explain variability in investor behaviour.

#### 4.7 Limitations of the Study

Findings and conclusions from this study are based on prior published research and theory rather than an empirical investigation using actual data; therefore, they should not be viewed as empirical data but rather as conceptual research based on historical evidence of the behaviours of investors across various markets and periods of time. However, the research has provided an ordered and theoretical explanation of the potential behaviour influences that may affect the decision-making process related to mutual fund investments.

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### 5. Findings

#### 5.1 Influence of Recency Bias and Performance-Chasing Behaviour on Equity Mutual Fund Investments

Recency bias is when investors tend to focus more on recent market events than long-term trends, which leads them to have high hopes based solely on recent performance in mutual fund equity schemes rather than considering risk factors, for example, long-term consistency, risk exposure and fundamental drivers of performance before investing.

In the case of mutual funds, short-term indicators, e.g. recent net asset value (NAV), historical quarterly fund rankings, and financial press highlighting 'performers' are widely available, easily understood, and often seen as indicators of future success. Because of the above factors, it's likely that many investors will subconsciously evaluate the above indicators as indicative of their future potential.

Investment decisions often rely on recent return performance and market momentum, rather than on a thorough evaluation of the fund's long-term investment strategy, risk exposure, and portfolio diversification.

This behaviour leads to a cyclic pattern of capital flows within equity mutual funds, whereby those that report the greatest recent returns tend to receive significant inflows from investors, while those that are temporarily underperforming face considerable redemption pressure. Thus, many investors believe that short-term performance trends will continue even though mutual fund performance has been shown to exhibit some variation over time periods.

Recency bias does not typically operate in isolation; it interacts with other behavioural influences such as herding behaviour, optimism bias, and overconfidence. A collective response may emerge from this phenomenon when many investors observe identical high-performing funds ranked highly or appearing in financial news. This collective behaviour causes those investors to move their capital toward similar funds/sectors. This collective behaviour reinforces market momentum, creating stronger short-term investment trends.

Recency bias is almost always coupled with a behavioural model or something else that is an influence to behave a certain way; specifically, the behaviours of investors are perpetuated by social norms in the market and other forces, such as herding behaviour and optimism bias. When investors see that many other people have put their cash into high-quality funds that perform well on the rankings or in the financial media, it may cause collective behaviour, where investors will move their cash to other similar funds or sectors to create additional momentum surrounding the market, which in turn creates further collective behaviour and adds to the extent of the continued trends of short-term investing.

Investors will often invest in equity mutual funds because of the overall market performance, and when markets fall or go down, investors will withdraw their money. As a result, investors who are affected by recency bias usually are pro-cyclical with respect to their investments and, by doing so, typically miss out on long-term growth opportunities because they are often trying to keep up with or are overreacting to short-term performance signals.

## Examples of Equity Mutual Fund Investments Influenced by Recency Bias and Performance-Chasing

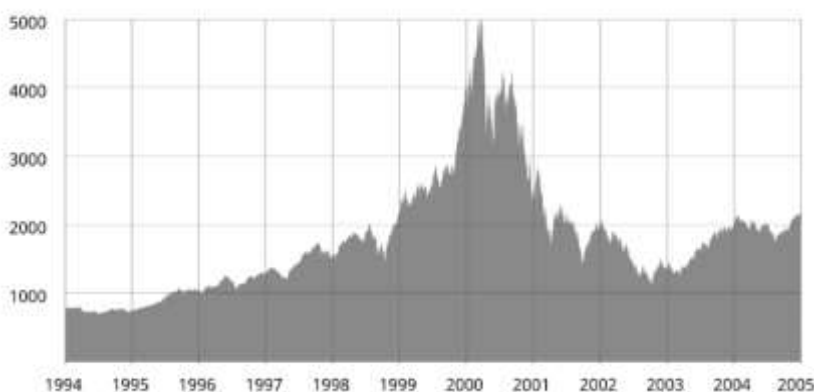
### 5.1.1. Technology-Focused Equity Funds During the Dot-Com Boom

In the late 1990s, as the Dot-Com Bubble grew, there was an influx of investments in mutual funds that focused on technology stocks due to their amazing returns over a short time. People who were investing considered the returns produced by technology stocks as being indicative of future growth and therefore quickly began to move large amounts of money into technology-focused mutual funds.

Some of the mutual funds that were impacted greatly included:

- Fidelity Select Technology Fund
- Janus Global Technology Fund
- Putnam Global Technology Fund

During the period of 1998 to 2000, these investment vehicles experienced tremendous inflows as the NASDAQ index soared because investors were chasing after past performance. As a result, there was very little to no capital left in these mutual funds after the collapse of the Technology Bubble in 2000, because investors had made so much money investing in them. Therefore, because of recency bias, the behaviour that emerged from it was that investors continued to rely on recent past performance and believe that future performance would be similar, indefinitely.



### Dot-Com Bubble (NASDAQ Chart)

The image is of the NASDAQ Composite index, which spiked in 2000 and then fell sharply because of the dot-com bubble.

### 5.1.2. ESG and Thematic Equity Funds (2019–2021)

The amount of Global Sustainable Funds has risen dramatically since 2019 through 2021, as investors have increasingly shifted towards investing in ways that help climate change. As a result of this rapid increase in demand for ESG equity

funds and value investment strategies, several different managers such as Parnassus, Vanguard and BlackRock have established dedicated ESG equity funds.

In 2021, according to Morningstar, over \$500 billion of inflows were attracted into ESG and sustainable funds globally due to strong performance over the previous short-term period, and the increasing popularity of investing through the media.

Many investors entered ESG equity funds, due to the earlier performance of these funds and the fact that they had received strong media attention; thus demonstrating the presence of recency bias and bandwagon investing behaviour on the part of investors.

Investors who have bought into ESG equity funds have done so by purchasing fund returns and following current trends, as opposed to assessing whether the funds were sustainable in the long-term or how the funds were valued.



### Annual Global ESG Fund Assets (USD Billion)



### Annual Global ESG Fund Flows (USD Billion)

## 5.2 Impact of Loss Aversion and Safety-Seeking Behaviour on Investor Preference for Debt Mutual Funds

According to the theory of Prospect Theory, loss aversion is an inherent part of investors' decision-making process, as investors view the effects of losing money to be greater than the effect of equivalent positive returns (Kahneman & Tversky, 1979). As a result of this bias, loss aversion has an impact on investor behaviour such as in the case of risk-averse or safety-seeking investors. For instance, in a mutual fund market, debt mutual funds are often selected over other types of funds by loss-averse investors due to their perception of lower risk and therefore allow for more stable capital preservation and return characteristics (Radha, Priya, & Srividya, 2026).

Debt Mutual Funds typically invest in government treasuries, corporate bonds, and other short-term interest-bearing securities and therefore pay out a relatively predictable stream of income with very little price volatility. Due to their inherent behaviour tendencies, Loss Averse Investors tend to allocate a greater share of their total portfolio to Debt Mutual

Funds versus other types of mutual funds, especially during times of economic instability or increasing levels of volatility in the market (Pant & Srivastava, 2021). This allocation behaviour reflects a greater behavioural tendency toward the preservation of capital rather than maximizing returns.

According to behavioural finance studies, decision making for investors that tend to avoid losses (loss aversion) is influenced by a number of psychological factors, such as their perception of risk relative to their previous experiences with losing money and what they see in the news about falling stock prices. One way in which loss-averse investors have been shown to demonstrate this (and make defensive investments) is by investing more in debt mutual funds when the equity market goes down (Artavanis & Eksib 2024).

## Real-World Examples of Debt Mutual Funds Influenced by Loss Aversion

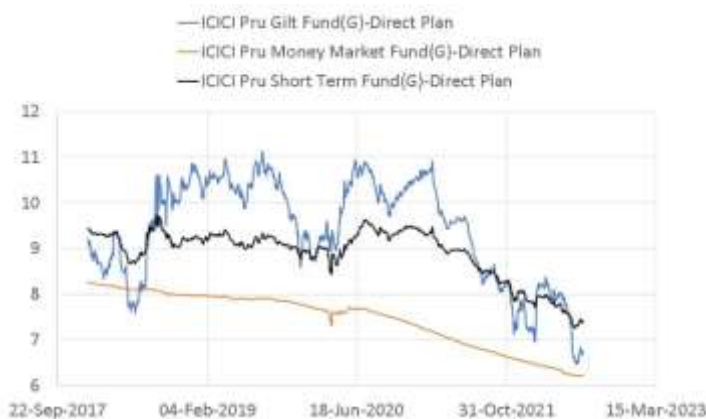
### 5.2.1 Government Bond / Gilt Funds During Market Volatility

During episodes of stock-market volatility, many investors move to mutual funds that principally invest in government bonds referred to as gilt funds due to the safe nature of the bonds; they pose little risk of default by the issuer of the bonds. Examples of these funds include the:

- ICICI Prudential Gilt Fund
- SBI Magnum Gilt Fund
- Nippon India Gilt Securities Fund

During periods of economic uncertainty, many investors will seek to redeploy their investments to these funds that tend to provide more stable returns while having a lesser relative risk profile. This movement by investors is evidenced by what has been referred to as the flight-to-safety phenomenon, in which risk-averse investors seek investments that will preserve their capital in times of extreme market volatility.

Insights into these behaviours from a behavioural perspective indicate that risk-averse investors place greater emphasis on maintaining capital and reducing their exposure to more volatile investments during times of extreme market volatility (Radha, 2026).



### 5-year rolling returns comparison of ICICI Prudential Short Term Fund vs ICICI Prudential Gilt Fund vs ICICI Prudential Money Market Fund

This was a comparison of 5 Year Rolling Returns for ICICI Prudential Short-Term Fund, ICICI Prudential Gilt Fund and ICICI Prudential Money Market Fund. Gilt and Money Market funds had much lower volatility than Short-Term funds during a time of market stress due to the risk seeking nature of an investor that is completely averse to losses.

### 5.2.2 Corporate Bond Funds During Equity Market Corrections

Investors who exhibit a safety-seeking personality often choose to invest in the corporate bond mutual fund category as a safe investment option. Corporate bond mutual funds invest in high-quality corporate bonds of financially strong

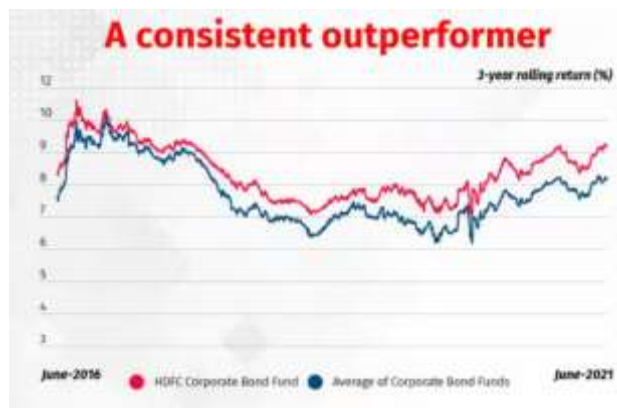
companies. In addition, they are generally considered to have lower volatility and more predictable incomes than equity investments.

Some examples of corporate bond mutual funds are:

- HDFC Corporate Bond Fund
- Aditya Birla Sun Life Corporate Bond Fund
- Axis Corporate Debt Fund

When the equity markets experience turbulence, many investors reallocate their capital to corporate bond mutual funds because they can be viewed as providing stable income and relatively low downside risk. This type of behaviour can be attributed to loss aversion as some investors will avoid making an investment that could result in a significant loss of capital.

From a behavioural perspective, there is support for the theory that people who are risk averse will buy investment grade bonds to protect their downside risk and to provide a more predictable return (Pant & Srivastava, 2021).



### Rolling Returns of HDFC Corporate Bond Fund vs Category Average

This graph shows how the 3-year rolling returns of HDFC Corporate Bond Fund (HCBF) stack up against the average return of other corporate bond funds. HCBF's 9.1% return has been better than the average return of 7.6% for This group of funds. This demonstrates that HCBF provides investors with a sound and reliable source of income for their money, which is what many of those looking for security will want during these times when equity markets are experiencing some type of correction.

### 5.3 Influence of Mental Accounting and Diversification Perception Bias on Hybrid Mutual Fund Investment Decisions

Mental accounting is an example of a cognitive bias identified by behavioural finance researchers (Thaler, 1999). Investors will have different mental accounts for different pieces of their wealth rather than treating their entire investment portfolio as one. In the case of hybrid mutual fund investing, this results in investors focusing on the different components of a hybrid fund, namely the equity component and the debt component rather than including the hybrid fund in their overall portfolio analysis. For example, instead of asking themselves how the hybrid fund fits into their overall risk profile, investors will often compartmentalise their thinking about the hybrid fund into the belief that because there is equity and debt in the hybrid fund, it is therefore safe and well-diversified. Compartmentalised thinking can lead to suboptimal allocation decisions.

Similarly, diversification perception bias is a cognitive bias where individuals think that simply having multiple asset classes (i.e. equity + debt) will achieve diversification. They assume that because both equity and debt exist together in a single product, there is an automatic reduction to investment risk. The fact that true diversification occurs when you assess how the asset classes correlate to each other in different market conditions is not considered by investors. Therefore,

hybrid mutual funds can be selected as a result of diversification perception bias rather than through an analysis of the hybrid mutual funds' risk–return characteristics (Benartzi & Thaler, 1995).

Investors tend to gravitate toward hybrid investment vehicles because they appear to provide the combined advantages of both equity and fixed-income type investments. They tend to do this even when markets are experiencing high volatility and therefore creating a search for investments that provide an overall feeling of stability and reduced investment risk, without having fully researched whether or not the financial instruments offered through hybrid funds are appropriate for their investment strategy, financial objectives, or strategic asset allocation (Statman, 1985).

In general, investors look at hybrid funds using mental accounting methods; as a result, hybrids are generally perceived to be a balanced ‘bucket’ of investments, leading them to ignore some of the possible negative features of their investment, such as: large equity overweight during down markets; credit risk associated with the fixed income portion of the hybrid fund; or lack of benefit from holding a hybrid fund that is partially an overlap with their other investments.

## Real-World Examples of Hybrid Mutual Funds Affected by These Biases

### 5.3.1 Multi-Asset Allocation Funds

The multi-asset allocation funds are another type of hybrid subcategory. The following are examples of multi-asset allocation funds:

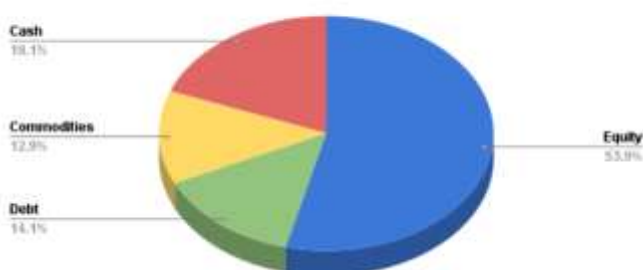
- ICICI Prudential Multi Asset Fund
- SBI Multi Asset Allocation Fund
- Nippon India Multi Asset Allocation Fund

In these funds, by law, there must be an investment in three different asset classes (equities, fixed income/debt type and gold/commodities)—something many investors see as greater numbers of different asset classes = increased diversification. Multi asset allocation funds have had net inflows of Rs. 22,000+ crores over the last two years (fiscal periods), far exceeding other funds in only equity or debt categories.

#### Behavioural Insight

Investors frequently feel that having a greater number of asset classes means more diversified—this is classified as diversification perception bias. The degree to which diversification works depends on how individual asset classes perform during market volatility, not simply having different asset classes in a portfolio.

**ICICI Prudential Multi Asset Fund Asset Allocation**



The fund has half of its investments allocated to investing in equities and continues to pursue a diversified manner with its other asset classes. Investors frequently invest based upon the assumption that these multi-asset allocation funds meet their need to diversify based on their perception of what it means to be diversified.

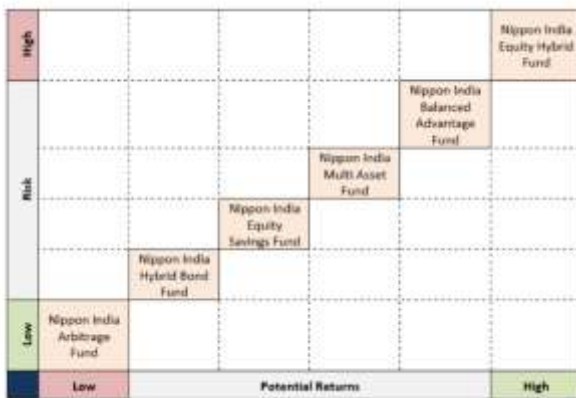
### 5.3.2 Balanced Advantage Funds (BAFs)

The dynamic nature of how Balanced Advantage Funds (BAFs) invest in equities and debt together based on market valuations is one of the unique characteristics of BAFs. HDFC Balanced Advantage Fund, ICICI Prudential Balanced

Advantage Fund, and SBI Balanced Advantage Fund are some of the leading BAFs in India that have received large amounts of investment from retail investors. BAFs attracted net inflows more than ₹45,000 crores during FY2024; therefore, it is evident that investors continue to prefer BAFs, regardless of the inconsistent performance experienced by equity markets.

**Behavioural Insight:**

Most retail investors invest in BAFs because they perceive BAFs as being diversified and less risky without performing a valuation analysis of BAFs' dynamic framework or the way equities and debt behave during a stress event - they develop a mental account for the equities, with a potential upward price movement potential, versus the debt, which has a potential for downward price movement.



**Risk–Return Positioning of Hybrid Funds (Nippon India MF)**

Nippon India's Hybrid Products, such as BAFs and multi-asset funds, can be illustrated on a Risk-Return Matrix to show how investors may think of them as diversified and low-risk investments.

The chart displayed provides an illustration of the trends within multi-asset allocations and hybrid category flows to aid in reinforcing that investors' perspectives on the advantages of hybrid diversification can change rapidly based on changes in sentiment regarding markets. Additionally, investment flows have exhibited some level of abrupt change, indicating that investors' perceptions concerning the benefits of hybrid diversification will not remain static over time.

**5.4 Influence of Herding Behaviour and Bandwagon Effect on Sectoral and Thematic Mutual Fund Investments**

The tendency of investors to conform to the group behaviour, meaning to do what the majority of other investors have done (rather than coming to that conclusion through their own independent analysis) is known as herding behaviour. In the case of financial markets, herding occurs when investors all put their money into the same stocks or the same sector(s) (or similar investments) because they see that other investors have done so, as well. Herding behaviour typically occurs for various social reasons for example; media attention given to a sector by financial analysts is another possible reason for herding behaviour, etc., rather than for objective reasons based on the underlying economic fundamentals of the sector itself (Banerjee, 1992).

Herding behaviour, through mutual funds and ETFs, is very evident in the case of sectoral and thematic mutual funds, where the fund focuses specifically on one or a group of industries such as Technology, Banking, Infrastructure, or Energy. If a particular sector is doing very well over a short period or has received a lot of attention from the media, then all of the investors will race into the sector fund(s) in order to be part of that growth as well. Herding behaviour through mutual funds, ETFs, etc., is very closely related to a bandwagon effect in that investors make their decision to invest primarily based on what they see other investors doing rather than any independent fundamental analysis.

Investors tend to invest very heavily in sectoral mutual funds when there is significant momentum in the marketplace, thus creating what has become virtually a cyclical pattern of very large inflows into these funds during periods of market

upswings and fairly significant outflows during periods of decline. This behaviour can be partly attributed to the way in which investors respond to market sentiment, rather than making real strategic long-term investment decisions.

Herding behaviour is one area of behavioural finance which can foster this cyclical behaviour across the entire market. When investors shift massive amounts of capital into a specific sector (e.g., technology) based on a collective belief, the price movement of that company's stock may be inflated far above its actual value and create a distortion in the market that is only temporary (Bikhchandani, Hirshleifer & Welch, 1992). Furthermore, in mutual fund markets where thematic investing is actively pursued, this herding behaviour often leads to significant capital inflows into thematic investing during periods of high sector performance and very rapid capital outflows when sector performance declines.

## Real-World Examples of Sectoral Mutual Funds Influenced by Herding Behaviour

### 5.4.1 Technology Sector Funds During the Global Digital Boom

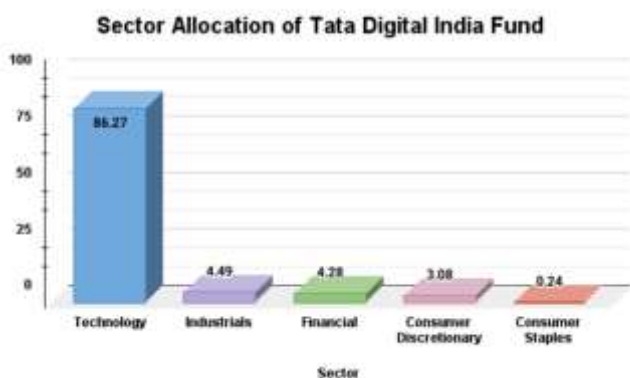
Many technology-based mutual funds received an influx of investors' money during the period of rapid growth for the digital economy, especially between 2020 and 2021, when we saw a surge in technology stocks due to increased digital adoption and the rise of remote work, as well as the strong performance of global technology companies.

- SBI Technology Opportunities Fund
- Tata Digital India Fund
- Aditya Birla Sun Life Digital India Fund

According to the AMFI (Association of Mutual Funds in India), technology funds saw many inflows due to their attractiveness to investors looking to capitalize on the momentum currently taking place in the industry.

Behavioural insight:

The large influx of money was largely due to the herding effect in which investors as a group purchased shares of technology funds as a result of having seen the strong performance of these types of funds over that time period, thereby providing greater visibility into the possibility for growth in the foreseeable future. The behaviour was compounded by the belief that many people were optimistic about the market; therefore, as they observed the market performance of other technology companies, they assumed that all technology companies would continue to grow at a similar rate going forward.



Most of the portfolio consists of just Technology companies (86.27%), thus investment risks are high; therefore, the portfolio should hold only quality companies.

### Example 2: Banking and Financial Services Sector Funds

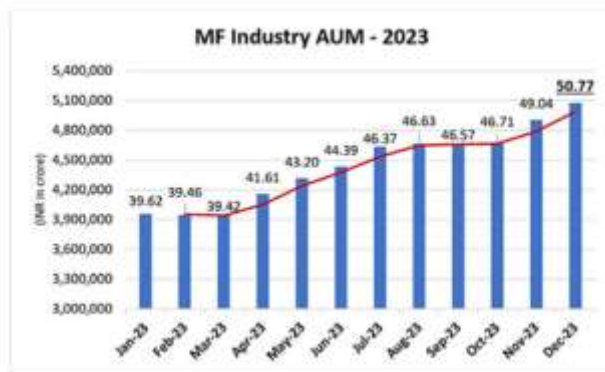
Mutual fund markets are also subject to herd behaviour with respect to the banking and financial services sector, with several well-known mutual funds focusing on this industry, such as:

- ICICI Prudential Banking & Financial Services Fund

- SBI Banking & Financial Services Fund
- Nippon India Banking & Financial Services Fund

In a time of great profitability and growth within the banking industry, large amounts of capital are typically moved into the banking industry funds by investors. Industry data has confirmed that there was a significant quantity of new money invested in banking industry funds in 2023-2024, which has coincided with a very positive economic outlook and improved profitability for many banks.

From a behavioural perspective, investors often mimic the behaviour of other market participants when making investment decisions; therefore, more investors taking part in the investment often provides an indication that it is likely to be a profitable investment. The bandwagon effect seen in the market creates additional flows into the investment regardless of whether investors have sufficient understanding of the underlying fundamentals for the banking sector.



## Mutual Funds Growth in India – 2023

### Investor inflows and performance trends in banking sector mutual funds.

## 6. Discussion

### 6.1 Behavioural Biases and Mutual Fund Investment Behaviour

Through the research presented in this article, it's clear that investor behaviour is impacted greatly by behavioural traits that physically affect investment decision-making processes made by individuals toward mutual funds; although designed as an investment vehicle with professional management & diversification built-in; numerous investors demonstrate irrational behaviour driven by psychological factors leading to significant deviations from what would otherwise be considered sound investment practice from a professional standpoint.

Data analysis supports the theoretical foundation for behavioural finance, as different types/categories of mutual funds are deemed appropriate for different groups depending on their individual behavioural biases.

The findings also reinforce the work of both Daniel Kahneman & Amos Tversky regarding their Prospect Theory in understanding how people make decisions regarding monetary investments & evaluating financial returns based upon the perceived outcome of such investments (i.e., gain or loss) rather than indeed being calculated based upon objective probabilities.

This framework gives credence to the emotional nature of an individual when responding to the most recently experienced performance of mutual funds, their own perceived risk level associated therewith & how other individuals (i.e., "peers") influence their final investment decision.

The remainder of this section will provide an overview of how four (i.e., recency bias, loss aversion, mental accounting & herding) behavioural biases were identified within this research and how they impact upon various groups/investor classes making investments in mutual funds today.

## 6.2 Recency Bias and Performance Chasing in Equity Mutual Funds

According to the results of our study, decision-making in equity mutual funds is heavily influenced by recency bias. That is, many investors make their capital allocation decisions based on funds they believe to have had positive performance recently, and assuming that they will have positive performance in the future. This creates performance-chasing behaviour in which performance history over short periods is used by investors to perform the transaction despite no consideration being given to either long-term performance or performance adjusted for risk.

This conclusion is supported by numerous studies. Sirri and Tufano found that mutual fund inflows are very responsive to prior performance, particularly in top-performing funds; Barber and Odean also found that investors tend to chase after short-term winners rather than factor in a fund's long-term track record.

Two real-life examples that demonstrate how recency bias leads to inflows into trending investments are i) Technology stocks and technology funds during the Dot-Com boom and ii) ESG equity funds between 2019 and 2021. In both examples, capital inflows were created by investors interpreting the returns from the last period as evidence of future growth prospects therefore creating significant capital inflows during periods of market expansion. When the conditions of the market changed dramatically, so too did investor sentiments, and a large exodus from these funds occurred due to investor losses.

## 6.3 Loss Aversion and Investor Preference for Debt Mutual Funds

Loss aversion is a major behavioural influence on investors' choices for debt mutual funds. Losses are experienced by investors as larger than gains of the same dollar value, which causes them to pursue conservative investing tactics in the face of uncertainty, according to Prospect Theory.

The analysis reveals that loss-averse investors tend to allocate money to debt mutual funds, such as government bond and corporate bond funds, in order to preserve their capital because they view these types of investments as safer since they are less volatile and provide more predictability regarding income. Because of this, investors tend to transfer capital from equity markets to debt funds during periods of uncertainty in the market and when there is economic instability.

This type of behaviour follows the principle of "flight to safety," whereby capital preservation is prioritized over potential returns. Similar occurrences occur during periods of stock market fluctuation, where investor flows into fixed-income funds will rise significantly.

The findings provide some examples of how to reallocate capital to safer investment vehicles when perceived risk is high, for example, government gilts and corporate bonds.

## 6.4 Mental Accounting and Diversification Perception in Hybrid Mutual Funds

The results of this study emphasise the impact of the mental accounting process and the biased perception of diversification on hybrid mutual fund investments. Mental accounting describes the psychological tendency of the investor to compartmentalise different sources of funds instead of assessing their overall investment portfolio.

When investing in a hybrid mutual fund, many investors show a false assumption that their underlying balance between equity and debt will automatically lead them to believe that hybrid funds inherently offer complete diversification. This perception leads many investors to incorrectly assume that hybrid funds will provide them with diversified investments without taking into consideration the appropriate asset allocation or level of risk required to meet their overall investing objectives.

Thaler's research into behavioural finance demonstrates that mental accounting can bias investment decision-making because individuals tend to evaluate their financial options independently from the overall context of their investment portfolios.

Those who use multi-asset allocation and balanced advantage funds show how people behave towards investing. Most investors seem to think that these types of funds will provide them with growth and protection without having to complete

significant research regarding how the fund's portfolio is allocated across various asset classes or the potential risk correlation between any investments in the portfolio.

This behaviour is indicative of diversification perception bias, whereby an investor rates their decision very low because they believe that adding various asset classes to their investment automatically lessen the risk associated with the investment, when in fact the degree of diversification is effectively dependent on the degree of performance of all asset classes, the correlation between asset classes and performance during different market situations.

### **6.5 Herding Behaviour and the Bandwagon Effect in Sectoral Mutual Funds**

Ultimately, the studies demonstrated that a herding mentality, in conjunction with the bandwagon effect, plays a significant role in increasing the likelihood of investing in sector-based and thematic mutual funds. A herding mentality occurs when an investor behaves like most other investors in the marketplace, rather than conducting their own independent analysis and making their own investment decisions.

Sector-based mutual funds typically run greater risks/returns of behavioural influences due to their concentration in specific industries. Investors typically note that specific industries have a high rate of return and, in some cases, are frequently topics in the media.

When one industry or sector begins to exhibit a higher return than the broader markets, investors will often "rush" to invest in mutual funds within that particular industry or sector.

The examples of technology sector funds and banking sector funds, provided in the findings, demonstrate how herding mentality can create significant inflows into thematic funds during sectoral growth periods and how media coverage, financial advisors and market sentiment can exacerbate this herding mentality to influence investors' perceptions that highly performing industries will continue to perform well.

Behavioural Finance helps to understand how behaviour can add to the market cycles. In many instances, when enough investors move capital to trending sectors, the price of the asset exceeds its current value. As the market shifts, you may begin to see significant outflows, resulting in increased volatility.

An example of this effect is the "bandwagon" effect. This means that many investors are jumping on to "popular" investments because many others are doing so too. This means, normally, investors will form an opinion about an investment based on social proof or what many do instead of performing a fundamental analysis to determine if the investment will be successful.

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### **6.6 Role of Moderating Factors in Reducing Behavioural Biases**

Behavioral biases greatly affect and shape how investors will make decisions; however, the model of behavior bias in this study establishes that certain moderating factors can buffer or mitigate behavioral bias. In particular, the moderating influences (financial literacy, experience in investments, emotional intelligence, and access to reliable market and financial information) can help investors make more rational financial decisions.

Specifically, as an investor's financial literacy increases, so does their ability to evaluate risk-return trade-offs and to evaluate a fund's performance based on appropriate performance metrics; to avoid emotional traps such as performance chasing; and to make decisions with respect to how much risk they take.

As such, experienced investors become more knowledgeable about market cycles and therefore are less influenced by short-term market sentiment.

Moreover, independent sources of professional financial advice and increased access to transparent information about financial markets provide additional means of reducing or mitigating behavioral bias by providing opportunities for the investor to invest based on long-term investment strategies rather than reacting to short-term market changes.

## 7. Conclusion

This study looked at how behaviour-based biases affect how investors decide to invest in different categories of mutual funds. The study reveals that mutual fund investment behaviours cannot only be explained with rational evaluations of risk and reward; a significant portion of the way investors acquire and interpret market data, their risk perceptions and how they allocate their funds across multiple categories of mutual funds is driven by psychological factors.

The study provides evidence that recency bias influences equity mutual fund investors to chase recent performance. That is, equity mutual fund investors will tend to enter the market shortly after strong returns and exit shortly after weak returns. Additionally, the fact that many equity mutual fund investors tend to incur the effect of loss aversion encourages many equity mutual fund investors to choose debt mutual funds as the perceived safety of these investment vehicles as well as preservation of capital is attractive during times of high uncertainty in the market. In the case of investing in hybrid mutual funds, mental accounting as well as diversification perception bias causes investors to view hybrid mutual funds as inherently balanced investments regardless of whether they meet their overall portfolio allocation parameters. Also, herding behaviour and bandwagon effects are significant factors that influence investor participation in sectoral and thematic mutual funds — investors are often strongly influenced by market trends as well as other investors' actions when making investment decisions for both sectoral and thematic mutual funds.

To summarise, the behavioural bias of individuals can lead to irrational investment decisions, which often results in investors trading their performance, avoiding risks and chasing the trends. When behaviours like this occur among investors, they are reducing the long-term viability of mutual funds as a way for investors to grow their wealth.

Increasing the financial literacy of investors, their level of awareness and providing them with suitable resources and guidance will help them to understand their own behavioural biases and therefore make more educated and rational investment choices. Understanding the psychology of investors further aids financial services firms and governments in designing investor education programs, which will ultimately lead to more stable and sustainable investment patterns within mutual funds.

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## 8. Recommendations

The results from this research highlighted how behavioural biases can have a huge effect on the decisions that investors make when selecting mutual funds. Although traditional recommendations tend to focus on financial education and literacy of investors, future solutions should extend beyond these conventional approaches to also include the psychological roots of behavioural decision-making when it comes to investing. The following recommendations include forward-thinking ideas that will aid in reducing behavioural biases associated with investing in mutual funds.

### 8.1 Behavioural Cooling Off Mechanisms Related to Investment Decision Making

Investment platforms that are available today could implement mandatory “cooling-off” periods before certain investment actions are taken such as switching funds after having just experienced a very positive return for a short period or redeeming funds during periods of poor market performance. This period would give the investor time (a few minutes) to access historical returns of the fund or any other relevant market cycle/period data before making their final decision to switch funds or to redeem their investment. Therefore, the implementation of this type of mechanism should reduce behavioural biases that are associated with changing one's investment behaviour based on recent performance (recency bias) and/or making rash decisions based on fear or panic due to the lack of clarity surrounding market volatility.

### 8.2 Financial Risk Score and Behavioural Risk Score

Disclosures of risks in Mutual Funds typically show the amount of risk in financial terms (e.g. Volatility or Credit Risk); it is possible to include a behavioural risk score which highlights how likely it is for any given category of fund to trigger a number of behavioural biases. For example: Sector or Thematic funds will have a higher behavioural risk score because these funds tend to lead to more significant Herding Behaviours than Diversified Funds.

### **8.3 Incentives for Long-Term Commitments in Mutual Funds**

Mutual fund companies could create behaviourally designed incentives that reward long-term investors rather than short-term traders – for instance: Investors who maintain ownership of a fund for a certain length of time (e.g. 5 years) could be eligible for a lower Expense Ratio or loyalty benefits. These types of incentives will deter performance chasing and encourage disciplined investing.

### **8.4 Investor Education using Narratives**

Investor education typically focuses on technical financial terms; therefore, many of the material presented may not help investors overcome their behavioural biases. Financial institutions could provide a narrative form of education using actual investor examples, and behavioural case studies to illustrate how the psychological biases lead to poor investment decisions. Story-based learning can create a greater influence on investor behaviour compared with analytical information.

### **8.5 Behavioural Transparency Regarding Mutual Fund Marketing**

Mutual fund marketing materials can sometimes encourage recency bias by focusing on recent returns and ranking short-term. To be more behaviourally responsible in its marketing, asset managers should provide longer-term performance data, risk adjusted returns, and performance across various market cycles rather than focusing on short-term gains.

### **8.6 Reflection Tools in Digital Investment Platforms**

Digital investment platforms might incorporate reflection prompts to help investors reflect on their investments before executing transactions. For example, if an investor attempts to invest in a fund only based on its recent performance, the platform can provide prompts or questions such as:

- “Are you investing for a long-term strategy or a short-term result?”
- “Have you thought about diversifying by having multiple types of assets?”

By using these types of reflection prompts, investors could make more conscious and thoughtful investment decisions.

### **8.7 Monitoring Behavioural Data by Financial Regulators**

Behavioural analysis can be used by regulators to detect unusual patterns in investing caused by the behaviour of the masses. If regulators see large amounts of money flowing in to a specific sector's fund over a short time period, they can provide an advisory to investors about potential speculative trends.

### **8.8 Integrating Behavioural Finance into Financial Planning Processes**

Behavioural finance frameworks should be part of the guidance given by financial advisors to their clients in creating an investment plan. Advisors need to understand not only what the best portfolio would be based on return and risk, but also the psychological characteristics of their clients such as their perception of risk; how they make decisions; and how they will react to volatility in the market. By taking a holistic approach in creating an investment plan, financial advisors can create plans that meet both a client's financial goals and a client's behavioural characteristics.

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## **9. Future Scope for Research**

Although this research has established the conceptual framework for how behavioural biases impact mutual fund investing, there are still many areas that can be explored through academic research. Future research can build upon the findings of this study and conduct empirical research; use interdisciplinary methods; and apply technology/innovation to better understand investor behaviour in mutual fund markets.

One way that future research could expand upon this research is to use quantitative empirical methods and collect primary data (i.e., from investor surveys, behaviour/decision making experiments or transaction level data) to measure statistically how behavioural biases impact the investment decisions of investors in mutual funds. This would help validate the



conceptual relationships identified in this paper and would provide statistical evidence of how specific behavioural biases impact investor behaviour.

Another way future research can expand on this area of research is to further investigate how demographic and socio-economic factors influence the impact of behavioural biases on investors' decision-making processes. Several variables, such as age, income, education, financial literacy, and investment experience, may influence the strength of the impact of behavioural biases on investors' decision-making processes. Comparative studies of different investor demographic groups would provide valuable information to identify differences in behavioural investment patterns.

Behavioral biases are important to our understanding of how mutual fund investors behave in different geographic locations. Because behavioral biases can manifest differently in different countries, the nature of mutual fund investors' behavior in developed versus developing countries warrants additional research at a cross-national level. Future research could explore the relationship between behavioral biases and the use of digital investment platforms and financial technology (FinTech). As robo-advisors, algorithmically based portfolio management, and mobile trade applications become more common, the fields of finance and behavioral finance may evolve as well. Researchers may find that behavioral biases are reduced through a less human, more technologically based, method of making decisions, or conversely that behavioral biases are exacerbated because of more frequent trades. Another avenue of research lies in the study of social media and online communities of investors and how they influence behavioral finance and decision-making in relation to mutual fund investing. Whether through online forums, website postings, or purely digital interactions, a growing number of individuals exchange opinions and insights about the direction or condition of the market, and they do so in a manner that fosters herding behavior. Understanding how digital socializing influences mutual fund investment behavior may help advance the goals of both regulators and financial institutions.

There is an opportunity for future experimental studies to assess the effectiveness of strategies like nudge theory, financial education initiatives, and decision support tools, in helping investors to develop more rational long-term approaches to their investments.

Expanded research may also help to develop predictive models of investor behaviour through the combination of behavioural finance and the use of AI/behavioural analytics; designers of these models could then use such insight to assist financial institutions in forecasting investor behaviours, enhancing the level of investment advisory service provided to customers, and developing investment products that are more appropriate for investors from a psychological perspective.

Overall, advancing research in these areas matters as they help to enhance the level of understanding of behavioural influences within the context of the financial markets and lay the groundwork for enhancing strategies to facilitate better investor decision-making related to investing in mutual funds.

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