JAIPURIA INSTITUTE OF MANAGEMENT
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JAIPURIA INSTITUTE OF MANAGEMENT, NOIDA

PGDM / PGDM (M) / PGDM (SM)

SIXTH TRIMESTER (Batch 2022-24)

ENDTERM EXAMINATION, April 2024 (SET 1)

Course Name	Behavioural Finance	Course Code	**20242**
Max. Time	**2 hours**	Max. Marks	**40 MM**

INSTRUCTIONS:

1. Answer should be precise and to the point.

2. All questions are compulsory

3. This is an open book exam (all class notes are allowed).

Q1. Suppose that Mr. Ram buys 1,000 shares in a software company at $25 / share. The company is currently attracting considerable media attention for its new accounting software, a highly touted product that is expected to become the industry standard, with considerable improvements in both efficiency and ease of use. Mr. Ram is an accountant who also has considerable expertise in evaluating accounting software options. He read all of the software company's advance information on the new package and carried out his own extensive research prior to buying the shares. Within two weeks of his purchase, the shares are up to $30, and Mr. Ram is tempted to sell them. He decides to hold on, however, as the industry excitement about the new software is increasing as the release date approaches. The shares continue to appreciate until there begin to be whispers about a serious bug in the software. In the weeks coming up to the release date, the company's share price becomes increasingly volatile, as Rumors and counter---rumors abound. The company's share price falls below $30, and then below $25. Occasionally some positive stories on social media cause brief bounces in the price, but Mr. Ram Is becoming increasingly pessimistic about the product. The shares are currently trading at $20. Although Mr. Ram now believes that the product will fail, he decides to hold onto the shares in the Hope that a new rumor will bounce the price up to $25 so that he can sell. **Analyse which prospect theory feature best explains Mr. Ram Behaviours during that time that he has owned these shares? {CLO2; BT level IV} (10 MARKS)**

Q2. John is a finance student who recently completed his undergraduate degree and landed a job at a prestigious investment firm. John's firm employs a momentum investing strategy, which involves buying assets that have shown strong performance over a certain period and selling assets that have shown poor performance. The rationale behind this strategy is to capitalize on the continuation of trends in asset prices. In his first few weeks on the job, John notices a pattern among his colleagues – they seem to be excessively enthusiastic about stocks that have recently experienced significant price increases, regardless of their underlying fundamentals. Conversely, they show little interest in stocks that have recently declined in value, even if they have strong long-term potential. One day, during a team meeting, John's colleague enthusiastically recommends investing in a tech company that has seen its stock price double in the past month. The colleague argues that the stock is likely to continue its upward trajectory and presents various technical indicators to support his claim.

However, John can't shake off his doubts. Despite the recent price surge, he notices several red flags when he conducts a fundamental analysis of the company – high debt levels, declining profitability, and increased competition in the industry. Moreover, he recalls learning in his behavioral finance course about the dangers of chasing after past performance without considering underlying fundamentals. John finds himself torn between following the momentum strategy favored by his colleagues and sticking to his principles of sound financial analysis. He knows that blindly following the momentum could lead to significant losses if the trend reverses, but he also worries about going against the consensus and potentially missing out on lucrative opportunities. As John wrestles with this dilemma, he realizes that understanding the interplay between behavioral biases and investment strategies is crucial for navigating the complexities of the financial markets. **{CLO3; BT level II, IV, V} (12 MARKS)**

A) Determine and explain two behavioral biases are at play in this scenario?

B) Explain how can investors mitigate the risks associated with momentum investing while still capitalizing on market trends? Analyse the role of fundamental analysis play in this context?

C) Assess how might John reconcile his understanding of behavioral finance and what factors should he consider in making his decision?

Q3. Alex, a recent college graduate, is eager to invest in the stock market to grow his savings. He lacks experience in financial markets but is enthusiastic about learning and earning profits. Alex decides to invest a significant portion of his savings in a company that has been hyped in social media circles. On the other hand, Emily is a seasoned financial analyst with years of experience analyzing market trends and making informed investment decisions. Emily, the seasoned analyst, conducts extensive research before making any investment decisions. However, she faces challenges in obtaining accurate and timely information due to the complexity, agency conflict, and volatility of financial markets. Despite Alex's initial excitement, the stock he invested in experiences a sharp decline in value due to unforeseen market factors. This loss significantly impacts his financial situation and leads to feelings of regret and disillusionment. On the contrary, reflecting on her experience, Emily acknowledges that even with her expertise, she cannot predict all market movements accurately. She emphasizes the importance of continuous learning, adaptability, and diversification to mitigate risks and enhance long-term investment success. **{CLO3; BT level II, IV} (8 MARKS)**

A) Explain Alex's two irrational traits using bounded rationality concept. Analyze which aspect/ (s) of bounded rationality best explains his reactions.

B) Describe which component of the bounded rationality concept impact Emily's ability to make optimal investment decisions?

Q4. Sarah has been holding onto a particular stock in her portfolio for several years. Despite fluctuating market conditions and warning signs indicating a potential downturn, she finds it difficult to sell the stock. Her attachment to the stock stems from an initial belief that it would perform well based on promising industry trends and recommendations from financial analysts. However, despite the stock's underperformance compared to her other investments, Sarah continues to hold onto it. She rationalizes her decision by recalling the initial reasons for investing in the stock and dismissing any negative news or signals that suggest selling would be prudent. She fears realizing a loss and clings to the hope that the stock will eventually rebound. **{CLO2; BT level II, IV} (10 MARKS)**

A) Explain due to the presence of which specific bias Sarah's is reluctant to sell the underperforming stock and how it can be mitigated?

B) Analyze which concept is at play in this scenario and how does it manifest in Sarah's behavior?