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INDIVIDUAL INVESTOR'S SENTIMENT AND ITS IMPACT ON PAKISTANI STOCK MARKET TREADING PERFORMANCE: A QUALITATIVE STUDY DESIGN

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ABSTRACT

Purpose *– This research purpose is to examine the influence of individual investor sentiment on the trading performance of the Pakistan stock market, discovering how psychological biases, sentiments, and market insights impact the decision-making of investments and outcomes.*

Design/methodology *– This research has used a qualitative research method and the 21 participants' data has been collected through structured interviews. The thematic analysis tool has been used for data analysis.*

Findings *– The study emphasizes the significant influence of behavioral factors like overconfidence, loss aversion, and herding behavior on individual investor's trading performance at the Stock Exchange of Pakistan (PSX). The outcomes demonstrate that the confidence of investors varies with market environments, loss aversion behavior, and herding propensities arise in the uncertainty of the market, while they do not constantly improve performance. Whole, psychological factors play a vital role in determining the behavior of the investor, with their impacts on trading performance fluctuating under Pakistan's market situations.*

Research implications*–It contributes to the understanding of how these factors form investment decision-making and performance in the vibrant market situation of Pakistan.*

Originality *– This study suggests an original understanding of the behavioral biases affecting the trading performance of individual investors in the Stock market of Pakistan, especially discovering the role of psychological factors that as overconfidence, loss- -aversion, and herding behavior in a developing market environment.*

Keywords: *Behavioral factors, Trading performance, Pakistan Stock Exchange.*

INTRODUCTION

The financial markets of emerging economies like Pakistan always depend on the role of investor sentiment. The decisions of the individual investors are based on emotional and psychological factors. These habits and traditions can lead to short-term market fluctuations that do not always align with the fundamental performance of listed companies. These behavioral biases—such as overreaction to news, herd behavior, and irrational exuberance—can significantly impact stock market performance (Gao, Zhang, & He 2022). The unique socio-economic conditions, political instability, and market inefficiencies natures of the Pakistani stock market are further influenced by these factors where investor sentiment is a crucial determinant in trading behavior (Saeed, & Shahzad 2020). Further, a major portion of the investors consists of retail investors in Pakistan where investor sentiment of these investors plays a key role in determining stock market performance. Literature also shows, that the optimism or pessimism of the investors significantly affects market trading volume, stock prices, and volatility (Ali, & Shah 2023). The market behavior indicates bullish when investor confidence is positive otherwise falls sharply when investor sentiment is negative (Khan, & Ali 2022). The impact of investor sentiment is more visible in markets like the Pakistan Stock Exchange (PSX), where a high level of retail participation exists and a lower degree of institutional involvement is shown as compared to the markets in the developed world (Zahid, & Zafar 2023).

As mentioned before, the literature indicates the direct and indirect effects of individual investor sentiment on market returns, volatility, and trading volumes in emerging markets. Pakistan's stock market, characterized by high retail investor participation, shows a strong correlation between investor sentiment indicators (such as the Consumer Confidence Index and news sentiment) and market trends (Hassan, et al. 2021). The role of social media and digital platforms in shaping sentiment is becoming increasingly important, with discussions and trends often affecting individual investor decisions and, consequently, market outcomes (Javed, & Zaheer 2023).

The research has explored intensively the impact of investor sentiment regarding the global stock markets, however, there is still a huge gap in research regarding individual investor sentiment regarding the performance market. Further, no authentic research can be witnessed about the Pakistani market in this field. The current studies primarily focus on institutional investors or broader market sentiments, overlooking the psychological factors affecting individual investors' decisions (Zahid, & Zafar 2023). Furthermore, behavioral biases such as overconfidence, loss aversion, and herd behavior are underexplored about Pakistan's equity market (Ali, & Shah 2023). This research aims to fill these gaps by analyzing the impact of individual investor sentiment. In addition, the influence of digital media, on market performance and volatility in Pakistan would also be investigated. By delving into sentiment-driven market trends, this study will provide insights into how these factors influence investor behavior and contribute to market volatility and long-term trends in the Pakistani equity market.

The main objective of this research is to evaluate the role of individual investor sentiment regarding the trading performance of the Pakistani stock market. It further analyzes the psychological and behavioral factors of the investors that contribute to market trends and volatility. Many studies have been conducted to consider the investor's sentiment while evaluating the performance of the training in the markets. This study focuses on the Pakistani market where the culture, customs, and traditions are also different and influence the investor's decision regarding investment. Hence this study would be highly beneficial for the research literature in this field. It is believed that the outcome of this research would be highly beneficial to finding in-depth insights into the Pakistani stock market and supporting policymakers on how to improve investors' decisions and stock performance. Individual investors, financial advisors, businesses listed on Pakistan's stock exchanges, and the government all benefit from this research.

Literature Review

The existing literature review is given intensive analysis of the latest literature has been carried out and presented in a formal way to identify the gaps.

2.1 Theoretical framework

This research study has been grounded on the following behavioral finance theories:

2.1.1 Heuristic Theory

The heuristics theory is the rule of thumb that supports investors in decision-making regarding investment. Under heuristics theory, people track simple and effective rules in the Page 28 decision of investment and also use shortcuts in complex situations. However, it can lead to biases in situations when things change. The major concern that can be caused by this situation is the suboptimal investment decisions. Individuals have a natural propensity to make quick decisions, and when faced with a difficult situation, they make simple solutions to solve the problem (Hutchinson, & Gigerenzer 2005; Sandri 2009), explained that heuristics are basic approaches for estimating the probability that is centered on the rule of thumb. Kahneman, & Tversky (1979), heuristic techniques are the golden rules that can lead to greater relief in the process of decision-making, especially in difficult and uncertain environments. The justification behind this theory is, that the heuristics theory provides investors with solutions that improve the efficiency of decisions, especially in challenging and ambiguous conditions (Ritter 2003).

2.1.2 Prospect Theory

Kahneman, & Tversky (1979) established a theory known as Prospect Theory which criticizes the expected utility theory (EUT). The Prospect Theory is a descriptive model regarding investor decision-making in risk and develops another model which is an alternative to EUT. It further suggests that investors make decisions that are based on the potential value of losses and gains rather than the outcome. The Prospect Theory is fundamentally a behavioral economic theory that describes the decisions between different alternatives that involve risk. The Prospect Theory works on the principle of avoiding losses even if there is no gain. As generally believed investors Page 29 can feel regret in any decision which can lead to losses. This theory is highly important, due to the use of behavioral statistics in reaching an outcome, as considered by this research project (Kahneman, and Tversky 2013). Numerous academic studies have used The Prospect theory to outline certain mental states that influence a person's decision-making processes, such as Loss aversion, Regret Aversion, and Mental Accounting (Quaicoe, & Eleke-Aboagye 2021; Shukla, Rushdi, and Katiyar 2020).

2.2 Behavioral Factors Influencing Trading Performance

According to recent research, behavioral characteristics have significant effects on investing decisions, which in turn influence how well individual individuals trade. Ali, & Yousaf's (3023) study, highlighted the significance of psychological biases like loss aversion and overconfidence in influencing investor behavior and decision-making at the PSX. Comparably, Khan, & Rehman (2022) emphasized how sentiment-driven behaviors, like herd behavior, and sentiments can impact trading techniques and findings, particularly under unstable market circumstances.

Further factors impacting trading performance, such as market trends and the impact of other investors' decisions, have been investigated in studies by (Ahmed, et al. 2021). These psychologically driven biases create cognitive errors like overestimating knowledge or emphasizing preventing losses, which add to less-than-ideal trading results. In the context of the Pakistani stock market, trading performance and market dynamics are significantly influenced by investor attitude, which is influenced by local economic circumstances.

Based on these outcomes, the research considers the following behavioral components as important predictors of individual investors' trading performance at the PSX: herding behavior, loss aversion, and overconfidence. These elements offer substantial insight into how investor sentiment drives market behaviors in developing economies like Pakistan and are based on well-established psychological theories.

2.2.1 The Impact of Overconfidence Bias on Investment Decisions

Investors with overconfidence bias often underestimate their capability to foresee market movements, which often results in misunderstanding risk and overvaluing stock anticipates, producing inadequate outcomes

(Shah, & Rehman 2023). This bias is associated with self-attribution, as failures are credited to external variables and achievements to talent (Ahmed, & Iqbal 2022). Overconfident investors frequently participate in excessive trading because they disregard public information and focus on their own beliefs (Ahmad, & Shah 2020; Javed, & Khan 2021). Despite conflicting results in foreign research, overconfidence impacts the actions of retail investors in the Pakistani stock market, particularly during volatile times (Tariq, & Iqbal 2022). Assessing this bias's influence on trading performance at the Pakistan Stock Exchange (PSX) needs an understanding of it.

2.2.2 The Impact of Loss Aversion Bias on Investment Decisions

A fundamental idea in behavioral finance is that loss aversion highlights investors' propensity to protect losses before obtaining rewards (Hirshleifer 2015). This bias drives investors to adopt risk-averse methods, often averting potential losses even at the cost of losing out on greater return on investment. In the Pakistani financial sector, loss aversion is popular, with investors unwilling to take possibilities related to the worry of loss, which hinders the trading process (Ali, & Raza 2023; Farooq, & Iqbal 2022). According to some studies, loss aversion and investment performance have a good relationship (Anderson, Henker, & Owen 2005). Nevertheless, additional studies indicate that market instability and other external factors have an important impact on how investors behave (Bhowmik 2013). To evaluate this bias's influence on trading performance at the PSX, it is crucial to fully understand it.

2.2.3 The Impact of Herding Bias on Investment Decisions

The prominent bias in financial making choices is herding behavior, in which investors follow the behaviors of others instead of trusting their research (Pompian 2016). Feelings, senses, and instincts drive this behavior, which makes investors track market trends or seek colleagues, brokers, or peers for direction (Rooh, et al. 2023). Some studies claim that herding has little to no impact on investment performance, particularly in volatile markets (Azad Khan & Pakistan, 2017), while others, such as those by (Quddoos, et al. 2020), reveal that it is positively associated with successful trading. The research of (Bikhchandani, et al. 1998; Metawa, et al. 2019), herding may impede logical decision-making and result in short-term gains by following tendencies in the stock market of Pakistan, but it cannot guarantee long-term success.

3. Research Methodology

This study is exploratory and the data was collected from the individual investors, who trade on the Pakistan Stock Exchange (Walliman 2017). The research design of this study is based on qualitative techniques to pursue the study and arrive at useful results and conclusions. The philosophy used behind this study is Interpretivism. According to Saunders, Lewis, & Thornhill (2007) interpretivism philosophy is based on the critique of positivism in social sciences and where researchers are critical of positivism and discuss that rich insight, into the complex world is lost if such difficulty is reduced completely to a series of laws like generations. The data collection method used in this study is primary data, hence the instrument used for collecting data has been structured interviews which were responded by individual investors based on the Pakistan stock exchange. The sampling technique which has been used for this study is simple random sampling. The study used 21 sample size and data conducted through structured interviews. Hence, the proposed study conducted 25 qualitative interviews with the relevant respondents. After conducting 21 interviews, the current research attained the saturation point. However, this study conducted 4 further interviews to ascertain if new themes could have emerged. The outcome of these 4 interviews didn't yield any theme and similar results and themes emerged. In general, saturation is a criterion for completing data gathering and analysis in qualitative research (Glaser, Strauss 1967). Every interview had its transcript, which was categorized according to the respondents. Every interview question was answered and the results were tabulated. To complete the data interpretation process, this study used a thematic analysis method to evaluate the interviews.

4. Findings of the study

Following the methodology section, which describes how data was collected, transcribed, coded, and emerging themes were established, this describes the process of the study's analysis. Investors' experience, how investors understand the economy, investment priorities, how emotion/psychological biases are reduced, investment guidance, and problems experienced during investment decisions are themes that emerged during data analysis. Thus, these themes are discussed in turn.

4.1 Data Analysis and Interpretation of Interviews

Following are the respondent's points of view regarding investment decision-making in the PSX:

4.1.1 Behavioral Biases

Three (3) to four (4) individual investors' responses are similar regarding investment decisions in the Pakistan stock exchange as below;

4.1.1.1 Overconfidence, Trading Performance

The participants were asked to express their opinion regarding the Overconfidence of investors in investment decision-making, and trading performance in the PSX. The opinion of respondents held investors are sometimes overconfident and sometimes not overconfident due to market fluctuations, and an unstable economy. They asserted the view that:

Respondents from 1 to 13 expressed that:

"We don't believe that investors are overconfident in the stock market in Pakistan/PSX. As you may be aware, the market trend has recently been unpredictable. As a result, many investors have suffered from losses, making them less confident. We have no reason to believe that our investment opinions are more reliable than those of our family, coworkers, or friends in investment decisions" (Personal Interview: Respondents 1 to 13).

Respondents from 14 to 21 stated that:

"I believe that if investors are losing too much money, they will lose confidence, and their stock market capabilities and knowledge will not be ready to aid them to outperform the market. When market conditions are bad, I lose confidence in my investment choices and rely on the guidance of my family, coworkers, and friends" (Personal Interview: Respondents 14 to 21).

Investors are influenced by market trends and act under them; they may be pessimistic or optimistic depending on market conditions. According to market trends, sometimes they are becoming overconfident, and sometimes they are not confident regarding investment decision-making. In conclusion, they have decided to go with a neutral and moderate approach. When the market trend is upward or booms, investors get more confident and rush to participate in the stock market; on the other hand, when the market trend is downward, investors become less confident in their investment decisions. During ups and downtrends, investors take extreme positions while making investment decisions, which is why when investors become emotional, they lose all of their stock investments. There are (3) different kinds of investors in the stock market: short-term, medium-term, and long-term. Long-term have no problem when the market trend is not good but in the short and medium term, investors lose their all money.

4.1.1.2 Loss Aversion, Trading Performance

The participants were asked about their perspectives on individual investors' loss aversion, and trading performance in the PSX. Individual investors consider loss aversion while making investment decisions. However, sometimes it can be observed from the decision that it has been overlooked. There is a general perception that these kinds of behavior are natural in the Pakistani stock market. They expressed their position as follows:

Respondents 1 to 7 elucidated that:

"Yes, I consider loss aversion strategy in my decision-making pertinent to investment because I am a loss-averse investor and When my investment stocks suffer from a big loss, then I am frightened. Loss aversion is more important to me." (Personal Interview: Respondents 1 to 7).

Respondents 8 to 14 listed that:
"I consider a loss in investment decision-making, and loss aversion is crucial to me because I am a risk-averse investor." I am more concerned about losing than focusing on attaining gains. I will be more satisfied if I know that, I am protected against a loss than if I make a profit from the investment. If I have previously lost money on an investment, I will not invest in those stocks because I cannot bear losing money" (Personal Interview: Respondents 8 to 14).
In the light of interviews, the proposed research discovered that the loss aversion strategy which has been considered during decision-making is pertinent to investment. They consider the risk before investment decisions making for the sake of loss. They have been focused on losing more than focusing on attaining gains. The loss-averse investors may or may not be invested in the ESG practicing firms. Therefore, Pakistani investors are not risk-takers due to poverty, cultural effects, family & friends' influences, unemployment, inflation, unstable economy, instability political situations government restrictions and global crises, etc. They always try to minimize loss prior and then focus on profit in investment decision-making in the stock exchange of Pakistan. Sometimes loss aversion strategy influences trading performance and is sometimes not affected. According to the researcher, loss aversion bias causes investors to make irrational decisions. In comparison to male investors, female investors are more risk-averse. The originators of behavioral finance revealed that loss aversion is a very powerful issue (Tversky, 1992). It refers to investors' preference for maintaining their capital rather than emphasizing expanding their capital, they should have focused on reducing their debt. Positive and negative changes in the market value of their investments suggest various responses from investors. Which is the core premise underpinning this bias. When compared to gains, losses are twice as powerful. After a previous loss, those who suffer from this bias become risk conventional and sell shares that have gained in value.

Respondents 15 to 21 planned that:
"I am not a risk-averse investor; I am constantly looking for a high return with a high risk." I do not feel nervous when my investment stocks suffer huge losses. When the market performs poorly, I will raise my investment; therefore, I do not make decisions based on the risk of losing money. That is why loss aversion investment practice is not important to me" (Personal Interview: Respondent 15 to 21).
It has been also discovered during the interviews that investors are aggressive in mind in the Pakistan stock market regarding investment. They always focus on high risk and high return and do not feel nervous when they confront large losses in their invested stocks. As a reason, as high-risk takers, they occasionally achieve better trading performance and profit.

4.1.1.3 Herding Bias, Trading Performance
The respondents were asked about their perceptions of individual investors' herd behavior, and trading performance in the Pakistan stock exchange. Herd bias is defined as an investor's tendency to mimic the actions of a larger group without questioning whether those actions are practical or not. Sometimes the investors do not follow the other's decision-making pertinent to investment in the Pakistan stock market. They evident their position as below:

Respondents 1 to 11 detailed that:
"Herding is thought to be greater in emerging markets than in mature markets. Developed markets have been developing for a long time and have developed more mature, thus investors are more concerned with the performance of the companies than with the decisions of other investors. Hence, the more developed the market is, the fewer investors participate in herding behavior; nonetheless, in the Pakistan stock exchange" (Personal Interview: Respondent 1 to 11).

Respondents 12 to 21 quantified that:
"In the Pakistan stock exchange most investors are following other investors' decisions regarding investment, I also follow my relatives, friends, and colleagues. I believe in collective information as compared to single information. I believe other investors

are more profitable and their information is more reliable and react quickly to the change in other investors' decision-making and follow their reactions. I think when all investors are going to invest in that particular stock it means there is a smart profit for investors" (Personal Interview: Respondents 12 to 21).

Further analysis of the interviews revealed that in the PSX most investors follow other investors while making decisions regarding investment. The main reason for this fact as families and friends are highly valued in Pakistani society. They also follow family members, friends, and coworkers. In comparison to their individual information, they believe in collective information. They believe that other investors are more profitable, that their information is more accurate, and that they can react fast to changes in other investors' reactions. The respondents also suggested that, in comparison to other nations, investors in Pakistan's stock market are unable to achieve extraordinary profits due to herd mentality. As a result, the herding factor has an insignificant impact on investor decision-making and trading performance. Although previous research (Anum and Ameer 2017; Le Luong, & Thi Thu Ha 2011) establishes that herding bias is associated with investment performance positively, this proposed study originate has no significant connection between herding bias and investment performance. One reason for the result could be the country's unfavorable economic circumstances. The fluctuating market environment (Bhowmik 2013), has an impact on an asset's underlying worth, making precise forecasting hard for investors. The study is consistent with (Caparrelli, Arcangelis, and Cassuto 2004), that investors are more motivated towards herding behavior during an unpredictable market situation.

5. Conclusion, and Recommendations

The study presented suitable answers to all important questions designed during this study. The major aim of this research was to develop an understanding of the impact of behavioral factors on individual investors' trading performance. The outcome of the research favored that behavioral factors influence the trading performance at the Pakistan Stock Exchange. It is further revealed that the influence of cultural norms also influences the individual investor as the retail investor gets a lot of advice from others. It is believed that individual investors don't take risks and are hence influenced by other factors including psychological biases such as overconfidence, and loss aversion. The performance of the trading in the Pakistan market shows great influences from these factors. These factors also influence the whole market and fluctuate market conditions. The investors normally become more confident during bull markets and less when the market trends downward. The research also identifies a strong tendency toward herding behavior, where investors often mimic the actions of others, particularly in times of market uncertainty. Despite this, herd mentality does not significantly enhance trading performance, suggesting that the fluctuating economic and market conditions in Pakistan limit the effectiveness of this bias.

Finally, while psychological factors significantly shape investor decisions in the PSX, their impact on trading performance varies, and behavioral biases offer avenues for further exploration in Pakistan's emerging market context.

Based on the findings, it is recommended that investors in the Pakistan Stock Exchange focus on improving their understanding of psychological biases, such as loss aversion and overconfidence, to make more informed and rational investment decisions. Additionally, enhancing the adoption of ESG principles within the market could provide long-term benefits and improve the decision-making process, especially as retail investors continue to shape market trends. This study would provide support to professionals, investment advisors, policymakers, and regulatory authorities in understanding the importance of behavioral factors.

The major limitation of the research study is that the research has been carried out keeping in view the Pakistan stock exchange only. Further, the sample size is also limited due to limited access to investors.

Forthcoming researchers can compare the performance of the Pakistan stock exchange with any other countries like China, India, etc. To highlight differences, future research studies would include data collected from individual and institutional investors separately to demonstrate differences.

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