IOSR Journal of Business and Management (IOSR-JBM)
e-ISSN: 2278-487X, p-ISSN: 2319-7668. Volume 17, Issue 8.Ver. III (Aug. 2015), PP 28-30
www.iosrjournals.org

Adaptive Attitude of Investors: A Simplified Approach

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Abstract: *The Relevance of Behavioural Finance Principles relating to the emotional and psychological factors has been recognized in the literature of investment behaviour study. There are many such factors under the purview of this nascent discipline which are directly or indirectly related to the investment behaviour. In this paper an attempt has been made to simplify one such factor, viz. adaptive attitude of investors. Different studies have already been made both in India and also abroad on this area. However no such paper has been found which discusses about adaptive attitude in a simple manner. So an attempt has been made to elaborate and diagnose the Adaptive Behaviour concept in a very simple yet scientific manner so that we can have an insight about what actually the Adaptive Behaviour is or that to know its features or factors signifying the presence of Adaptive attitude in decision making.*
Keywords: *Adaptive Attitude, Behavioural Finance, Relevance.*

I. Introduction

Investment process or that the investment decision making is not at all considered as a quantitative analyzing process of returns. Rather from many studies done under the purview of behavioural finance many such factors has been enlightened which are not all quantifiable but are emotional and psychological.. As [Amlan J. Sharma (2014)a] mentioned "Before taking any investment decision every investor uses some technique for valuing the securities. Two mostly used techniques are fundamental and technical analysis. The former approach is based on the intrinsic or present value of future cash flows and the other is based on the past behavior of prices. However in real practice investment decision making is not guided by tool i.e. fundamental analysis or technical analysis, but other qualitative factors. These qualitative factors covered by the emerging field of behavioral finance are the cognitive (mental) factors and emotional issues that impact the decision-making process." Again it is due to the limitations of the traditional portfolio theories like Efficient Market Hypothesis (EMH), which cannot correctly judge the investment behaviour the new field of behavioural finance has emerged."There are definitely different shortcomings of EMH, as all the good theories have. The theory has been tested many times at different situations leading to conclusions sometimes favorable to it and vice versa. Those shortcomings actually are pointed out by the behavioural finance dimensions, specially the investor rationality concept." [Amlan J. Sharma (2014) b]. So to better understand the investment behaviour, study of those emotional factors are also necessary and one such factor is adaptive attitude of investors.

Meaning Of Adaptive Attitude

The term "adapt" implies to change or to adjust. Similarly adaptive means to capacity to change or adjust something so as to be suitable in the new situation. In investment behaviour perspective the term may be used to describe the capacity to change ones behaviour or attitude or belief in the light of past mistakes or the new developments or new information. Adaptive attitude is an important part of the behaviour. There are always new developments and news breaking up in the financial market which may affect the investment behaviour of the individuals. Similarly sometimes the investors make wrong investment decisions and as a result suffer losses. Such bitter experiences also have got some positive feedback for future decisions as the investors can learn a lot from such failures and may commit not to repeat such wrong decisions in future again. These all ideas and concepts can be studied under the broad heading of adaptive attitude of investors. Similarly the bad experiences in the financial market may also break the motivation of the investors sometimes and the adaptive attitude study also covers the area of how fast the investors can adjust such experiences in their decisions and start investing in a proper way. Therefore in all we can say that adaptive attitude is one of the good qualities that each investor should possess to be a successful investor in the financial market.

Need For Adaptive Behaviour Study

As stated the adaptation is a continuous requirement for being a successful investor. If the investors do not adjust to the new information, they cannot make use of such information in the best possible way. Similarly if they don't learn from their past mistakes and rectify their behaviour in future then they may suffer more losses. Again there is a time element, i.e. they should adjust in the fastest way, only then they can survive in this

competitive market of investors. Therefore the study of the adaptive attitude would definitely help to study the investment behavioural pattern of the individuals and different strengths and weaknesses present in their behaviour.

II. Objective of The Study

This study has been conducted mainly to simplify the concept of adaptive behaviour, which is one of the investment biases covered by the behavioural finance discipline with regard to study of investment behaviour of individuals. The paper first discusses the meaning of adaptive behaviour and followed by the factors implying the presence of adaptive behaviour and then also showing some limitations of adaptive behaviour study.

III. Research Methodology

The paper is mainly conceptual and descriptive in nature and it is based on the studies available over internet based sources and various other related books and journals.

IV. Review Of Past Studies

A few of the past studies related to the Adaptive Behaviour are mentioned below.

Results of An study done by Helena Chytilova (2013) indicated that when subjects have to cope with uncertain nominal environment, they tend to switch to rule-guided (backward-looking) behavior of adaptive type, which is the best option in terms of costs minimization and as well in terms of strategic complementarily, where it is optimal to follow behavior of other players, although they behave in suboptimal way, since rewards may be maximized.

Henry Ma (2014) has introduced a framework of adaptive investment, in which investors try to find the best investment opportunities by adapting constantly to changing economic and market conditions.

Uri Ben Zion et al (2010) mentioned in their paper that adaptive investors who look to the past to adjust expectations about future returns will shun diversified funds. That is, adaptive reaction to feedback implies under-diversification when the investor gets complete feedback on the performance of the diversified fund as well as its components in a given period.

Brit Grosskopf & Rosemarie Nagel (2006) observed that convergence towards equilibrium is driven by imitation and adaptation rather than self –initiated rational reasoning.

Arvid O.I. Hoffmann et al (2013) found that the adaptive evolution of return expectations during the crisis is similar to the adaptation process found in calmer market periods and further they also supported the findings of Barberis, De Bondt also on the ground that individual investor perceptions indeed exhibit adaptive behavior with respect to very recent stock-market performance.

Martin Lettau(1997) remarked that "one feature of adaptive agents is that they adjust their portfolio composition after observing the return of past investment decisions. This behavior leads to interesting deviations from rational decisions. First, the adaptive agents tend to take on too much risk compared to rational agents. The magnitude of this risk taking bias depends on the number of market observations that the agents use before they update their investment portfolio."

V. Factors Signifying Adaptive Attitude

Based on the extensive review of literature the following factors or concepts have been identified as reflective or complementary to the presence of adaptive attitude in decision making process of individual(s).

1. **Learning from past mistakes**: it is a common phenomenon that every investor sometimes makes wrong decisions for which he feels regret later on. But not all of them learn from such mistakes and sometimes even cannot decide where they have made the mistake. In other words they don't try to analyse the past decisions properly. But the adaptive investors analyse the mistakes and learn from them. They always try not to repeat such mistakes again. So learning from past mistakes signifies the quality of adaptation among investors.
2. **Effect of new information**: Every now and then new piece of information and new developments comes up in the stock market. The adaptive investors capture such new information very fast and incorporate them in their investment decisions to get the competitive advantage from such information. It implies that accepting the new information in the best possible way and making adjustments as per such information is a sign of adaptation.

3. **Forecasting ability**: To forecast the future market condition with the help of past conditions and then to make adjustments in decisions accordingly is also a sign of adaptation. For example the investor may predict that the future market would not be safe as the recent past conditions were not good and this will continue in the future too. In such a case the investor may construct his portfolio with less risky asset classes.

4. **Adjustments with friends, relatives etc**: This is an another way of adaptation as the investors try to suppress their own concepts and ideas and try to be in conformity with those of his friends, relatives or colleagues etc. They don't possess confidence in their decisions and by adapting or changing their decisions with his companions they feel secured. This is actually a maladaptation, i.e. adaptation in a wrong sense. Sometimes it may also be covered under the herd behaviour study.

5. **Change in expectations as per market conditions**: The common non adaptive investors fixes his expected risk and return level before making the investment and try to have it at any cost. But the adaptive investors regularly checks their investment decisions in the light of the current market conditions and also adjusts their risk-return expectation frequently with the changes in the market conditions. Thus the adaptive investors don't suffer heavy losses as they are in regular analysis of their investment commitments.

6. **Change of investment avenues**: The non adaptive investors invest in a certain asset and look forward to it with the hope of good returns. But the adaptive investors also expect the good return but for that they also frequently change their portfolio of investments as per the performance of different asset classes. For example, if a certain asset is not performing well then he would change his investment in such asset to a good stock.

VI. Limitations of Adaptive Behaviour Study

Although the study of adaptive behaviour of investors is very important to better judge the investment decision making process of individuals but this study also has got some limitations as mentioned below:

1. The adaptive behaviour is a psychological phenomenon and cannot be measured in absolute terms.
2. Sometimes there lies a overlapping nature between herd behaviour and adaptive bahaviour which makes it difficult to study.

VII. Conclusion

To sum up we can say that adaptive behaviour of investors is one of the important emotional and mental factors that seem very much relevant to better study the investor behaviour. And this paper would definitely help to better understand the concept of adaptive behaviour and also to identify the presence or absence of adaptive attitude among investors. Although based on the extensive review of literature but still the factors signifying adaptive attitude cannot be said to be exhaustive in nature, So many new situations may also be identified from further research.

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