ADJUSTING CLASSICAL PORTFOLIO THEORIES WITH BEHAVIORAL PRACTICES

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Abstract

This paper represents a study of the concepts and practices defined by the up-and-coming research field, namely Behavioral Finance. In addition to presenting these concepts and practices, the work incorporates behavioral issues in an attempt to build a portfolio model that is based and tailored to a particular investor profile. The paper also presents a brief description of an analysis of the investment funds on the Romanian market, and the emphasis is on the observation of the correlation between the fund allocations strategies in relation to the yields obtained. Therefore, this paper wishes to study the methods and concepts by which Behavioral Finance helps an investor make better decisions. This new direction of research helps discover those aspects that lead to irrational decisions, and by knowing them, corrective measures can be taken upon irrationality. To capture investor behavior correlated with the yields obtained, a sample of mutual funds have been analyzed for the period of Dec 2007 – Apr 2017. This part of analysis reveals the importance of risk perception, and how different perspectives upon risks, drive completely different conclusions. With this observation in mind, we then simulate a portfolio that is tailored to a specific investor profile and his goals, applying along the way portfolio optimization techniques and adjusting it with behavioral finance practices. The end result is a simulated portfolio strategy allocation that can be used as a basis for investment decision.

Keywords: behavioral finance, irrationality, diversification, portfolio optimization, margin of safety, separation property;

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