# Behavioural Perspective of Economic Slowdown & Market Upheavals

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***Abstract-* This paper is an effort to understand the behaviour of securities markets and their implications for the economy within the wider perspective of behavioural finance.**

***Behavioural finance is a pragmatic, practical and positivist approach to study financial decision-making. It attempts to explain the aspects of finance and investing, from a human perspective.***

***Behaviourism is intended to observation and understanding of the realities in every field of decision-making in a deeper manner than the oversimplified and overgeneralized conventional mathematical modeling with limited and even fallacious assumptions which are many times inadequately representative of the real life scenario. Conventional economists recommend superficial reforms that only postpone the malady, which in the end returns with greater horror. In other words, short-run fluctuations are curtailed, but cumulative long run fluctuations increase. These policies, rather than stabilize the economy, add to its problems in the long run. But now superficial measures aren't producing even the short-run results.***

***The economists started speculating a few days earlier that the years 2019-21 are going to initiate depression worldwide with the US-China trade tensions, global warming, changed weather patterns and due to actions of the governments of advanced economies promoting distributive inequity the world is now having. There started strong indications from the automobile and financial sectors in the late 2019. This is taken as part of the 30 year cycle by Sarkar and Batra as detailed in the paper with reference to the position if crashing economies, stagflation, decreasing economic activities and decreasing employment and due to Corona pandemic. Assessment upto 2036 has been made further.***

***The systemic linkages in a progressive economy can be better understood and utilized in a highly fruitful and effective way for betterment, of all under the tenets of behavioural finance. Behavioural measures based on law of social cycle and collective psychology can reduce the amplitude of violent fluctuations of the economy significantly for a very long time and ensure its smooth & harmonious movement. But they would not eliminate these fluctuations. Nor is it desirable because straight-line evolution is not possible for any entity no matter what. For smooth functioning of the production structure the smooth flow of money requires to be ensured.***

***Indexed Terms-* Behaviourism, Bounded Rationality perspective, Law of Social Cycle, Systaltic Motion, Collective psychology, Socionomics.**

## I. INTRODUCTION

Finance as a discipline has passed through a long journey earlier from the days when the efficient markets theory was widely considered to be proved beyond doubt and simultaneously reinforced by the rational expectations approach in the early 1960s. opines that behavioral finance—that is, finance from a broader social science perspective including psychology and sociology—is now one of the most vital research programs, and it stands in sharp contradiction to much of efficient markets theory. [1]

In the 1990s, a lot of the focus of academic discussion shifted away from these econometric analyses of time series on prices, dividends and earnings toward developing models of human psychology as it relates to financial markets. The field of behavioral finance developed. Researchers had seen too many anomalies, too little inspiration that our theoretical models captured important fluctuations in the economy in general and in the stock markets in particular. An

extensive body of empirical work, summarized in Campbell, Lo and MacKinlay's 1996 book *The Econometrics of Financial Markets*, laid the foundation for a revolution in finance. [2]

The blending of finance with other social sciences that has become known as behavioral finance has led to a profound deepening of our knowledge of financial markets. Behaviourism is intended to observation and understanding of the realities in every field of decision-making in a deeper manner than the oversimplified and overgeneralized conventional mathematical modeling with limited and even faulty and fallacious assumptions which are many times inadequately representative of the real life scenario.

This paper (divided further in seven parts) is an effort to understand the behavior of securities markets (the core discussion in part V) and their implications for the larger system within the wider perspective of behavioral finance.

## II. BEHAVIORAL FINANCE—THE CONCEPT

Behavioral finance is a pragmatic, practical and positivist approach to study financial decision-making. In a way it can be compared with the intervention in the field of management and economics by Herbert A. Simon (1957) with his Bounded Rationality perspective in his *Models of Man* which brought the economic thinking flying high to the utopian world of perfect/pure competition as well as the maximizing and optimizing behavior of economic entities to the much more simple, fine, realistically useful and relevant paradigm of satisficing behavior of a decision maker at the ground level. I think this discipline of behavioral finance is also playing similar role in financial decision-making.[3]

Further Gigerenzer and Selten (2001) edited Bounded Rationality: The Adaptive Toolbox, a collection of workshop papers which promote bounded rationality as the key to understanding how real people make decisions.[4]

Ricciardi and Simon (2000) mention, "Behavioral finance attempts to explain and increase understanding of the reasoning patterns of investors, including the emotional processes involved and the degree to which they influence the decision-making process. Essentially, behavioral finance attempts to explain the what, why, and how of finance and investing, from a human perspective. Lastly, behavioral finance studies the psychological and sociological factors that influence the financial decision making process of individuals, groups, and entities."[5]

If we go to the earlier background, Selden's 1912 book *Psychology of the Stock Market* was one of the first to apply the field of psychology directly to the stock market. This classic discusses the emotional and psychological forces at work on investors and traders in the financial markets.[6]

Shefrin(2000) describes behavioral finance as the interaction of psychology with the financial actions and performance of "practitioners" (all types/categories of investors). He recommends that these investors should be aware of their own "investment mistakes" as well the "errors of judgment" of their counterparts. Shefrin states, "One investor's mistakes can become another investor's profits" [7].

Furthermore, Barber and Odean (1999) stated that "people systemically depart from optimal judgment and decision making. Behavioral finance enriches economic understanding by incorporating these aspects of human nature into financial models." [8]

Commenting on the rationalist and efficient market perspectives Wood (1995) remarked that our apprehensions and aspirations are acted out every day in the marketplace…. So, perhaps prices are not always rational and efficiency may be a textbook hoax. [9]

Selden (1912) based his book 'Psychology of the Stock Market' upon the belief that the movements of prices on the exchanges are dependent to a very considerable degree on the mental attitude of the investing and trading public'. [6]

Thaler (1985) effectively forming the start of behavioural finance discovered that people systematically overreacting to unexpected and

dramatic news events resulting in substantial weak-form inefficiencies in the stock market. This was both surprising and profound. [10]

Tversky and Kahneman (1986) argue that, due to framing and prospect theory, the rational theory of choice does not provide an adequate foundation for a descriptive theory of decision making. [11]

Plous (1993) wrote The Psychology of Judgment and Decision Making which gives a comprehensive introduction to the field with a strong focus on the social aspects of decision making processes. [12]

Lakonishok, Shleifer and Vishny (1994) conjecture that value strategies yield higher returns because these strategies exploit the suboptimal behaviour of the typical investor. A value strategy involves buying stocks that have low prices relative to earnings, dividends, book assets, or other measures of fundamental value. [13]

In the accounting literature, Basu (1997) finds evidence for the conservatism principle, which he interprets as earnings reflecting `bad news' more quickly than `good news'. [14]

Odean (1998) tested and found evidence for the disposition effect, the tendency of investors to sell winning investments too soon and hold losing investments for too long. [15]

## III. BEHAVIORAL FINANCE VS STANDARD FINANCE

Comparing the emerging discipline of behavioral finance with the old school thoughts of "standard finance" Statman (1995) mentioned that behavior and psychology influence individual investors and portfolio managers regarding the financial decision making process in terms of risk assessment (i.e. the process of establishing information regarding suitable levels of a risk) and the issues of framing (i.e. the way investors process information and make decisions depending how its presented). [16]

In their note on 'Understanding how the mind can help or hinder investment success' for investment professionals. Byrne and Utkus (2013) observed, "Behavioural finance has been growing over the last twenty years specifically because investors rarely behave according to the assumptions made in traditional financial and economic theories. Most people know that emotions affect investment decisions. People in the industry commonly talk about the role greed and fear play in driving stock markets. Behavioural finance extends this analysis to the role of biases in decision making, such as the use of simple rules of thumb for making complex investment decisions. In other words, behavioural finance takes the insights of psychological research and applies them to financial decision making." [17]

Over the past fifty years the established finance theory has assumed that investors have little difficulty in making financial decisions and are well-informed, careful and consistent. This traditional theory holds that investors are not confused by how information is presented to them and not swayed by their emotions. But clearly reality does not match these assumptions. Behavioural researchers have taken the view [18] that finance theory should take account of observed human behaviour.

## IV. A CRITIQUE ON BEHAVIORISM

Here are some remarks for better application of behavioural paradigm:

1) Behaviorism is intended to observation and understanding of the realities in every field of decision-making in a deeper manner than the oversimplified and overgeneralized conventional mathematical modeling with limited and even faulty and fallacious assumptions which are many times inadequately representative of the real life scenario.

2) Simon (1957) and other behaviorists are in agreement that man is a "social and rational animal", with their argument that, due to our limited powers of comprehension, humans can only process a small amount of information at once. The idea of omniscience and unlimited intellectual capacities is hence unrealistic and will lead to improbable outcomes when the situation becomes too complex or the individual factors are uncertain. [3]

The concept of behaviorists about man is, no doubt, broader than those of the classical rationalists, the neo-

classical optimalists and also the proponents of efficient markets theory simultaneously reinforced by the rational expectations approach as well as the new classical economics of the modern times. But it is also inadequate as to treat man as an 'animal' or just as 'social' or 'rational' is to belittle the identity and potentialities of man. The human mind has unlimited & diverse potentialities though the human physique is limited in its capabilities as compared to animals.

The classical literature whether it be of Sanskrit or Latin or Old Icelandic or other European languages treats man in a much more reasonable manner. As Singh [19] opines, "The root word 'man' (mun) in vedic/samskrit with its variations—manan, manu, manushya, maanav, etc. emphasizes man—the human being as mind-dominated or mental being as different from other creatures or even the hi-tech intelligent machines. The same vedic/samskrit root 'man' with its variations in many European languages as man, mann, manner, manly and so forth also emphasizes the mental potentialities."

(https://www.amazon.ae/Managing-Creativity-Knowledge-Economy-Contemplative/dp/8183293808) hence, behaviorism also needs to suitably modify its assumptions about man in analyses.

## V. BEHAVIOURIST PERSPECTIVE OF STOCK MARKETS AND TRADE CYCLES

Behavioral finance studies financial markets as well as provides explanations to many stock market anomalies (such as the January effect), speculative market bubbles (the recent retail Internet stock craze of 1999), and crashes (crash of 1929 and 1987). [5]

Treating speculation in land primarily responsible for trade cycles as George [20] alongwith Drake (p. 143) [21] say, 'But with rapid advancement, the swift and steady increase of rent gives confidence to calculations of further increase. It leads to land being withheld from use, as higher prices are expected. Thus, the margin of production is forced out farther than required by the necessities of production. As landowners confidently expect rents to increase further, they demand more rent than the land would provide under current conditions.' This reminds us of the American housing bubble & sub-prime lending crisis of 2008, the Greece and European crisis, Dubai property crisis and earlier property crises of Japan, East Asian economies, Argentina, the current Chinese property crisis and slowdown & so on. (all orienting with land speculation) In the same vein they further feel, 'Speculation is the force, arising from material progress that constantly tends to increase rent in a greater ratio than progress increases production. As material progress goes on and productive power increases, speculation thus constantly tends to reduce wages—not merely relatively, but absolutely…… Nonetheless, it is clear that land speculation is the primary cause producing recessions.'

It is production that gives the producer the right to exclusive possession and enjoyment. If so, there can be no right to exclusive possession of anything that is not the product of labor. (p.184) [21]

On the question of why was the original idea of equal rights supplanted by the idea of exclusive and unequal rights, George mentions that the causes are the same ones that led to the establishment of privileged classes as: (1) The concentration of power in the hands of chieftains and the military. (2) Conquest that reduces the conquered to slavery and divides their lands, with a disproportionate share going to the chiefs. (3) The differentiation and influence of a priestly class. (4) The differentiation and influence of a class of professional lawyers. The interests of priests and lawyers were served by the substitution of exclusive property in place of common land. In Europe lawyers have been especially effective in destroying all vestiges of the ancient tenure by substituting Roman law—exclusive ownership. Unfortunately, inequality, once produced, always tends toward greater inequality. (p. 205) [21]

This description is similar to Sarkar's law of social cycle based on systaltic principle, characteristics of the human mind & collective psychology and Kolbe's four fold typology of human competencies [22]. Sarkar thinks that each and every moment in this universe is systaltic or pulsative. Nothing ever moves in a straight line. Due to this systaltic motion, internal clash and cohesion take place. The ups and downs of socio economic life in different phases of the social order are sure to take place due to this systaltic principle.

Sarkar suggests that appropriate measures can reduce the amplitude of violent fluctuations of the economy significantly for a very long time and ensure its smooth movement. But they cannot eliminate these fluctuations. Nor is it desirable because straight-line evolution is not possible for any entity no matter what. These fluctuations are just as all living being cannot survive without breathing in and out in order, the overall system also cannot. Sarkar further defines collective psychology as "the average psychic momentum derived from the unit (individual) psychic momenta." It refers to the actual personality, mental color, or spirit of the times which a collective mind projects. This collective psychology is dominated by any one of the above for psychic spirits and affects the overall character of the system. These cycles usually occur and move smoothly. But, selfish, negative and self-destructive human actions make these cycles violent and devastating. [23]

Depressions occur every three years but have little impact. Every thirty years they occur to a much greater extent and every 360 years they are felt acutely. These 3; 30; 60; and 360 yearly economic cycles are in perfect coordination with earthly astronomical cycles of 2,160 years; and 25,920 years [24] as well as cosmic cycle of 3500 or 3600 years. The earthly astronomical cycles are connected with shifting of poles as a cumulative effect of wobbling of the earth in its axis. [25] [26] Here, Sarkar has discovered a new regular or rhythmical cycle quite different from all the other cycles discovered thus for displaying varying and irregular periodicity.

Prof. Ravi Batra [27] elaborated Sarkar's approach in more detail with particular reference to the U.S. economy on the basis of a diagnosis of American history and economics. He finds an unmistakable conclusion from an in-depth study of four economic variables, namely money supply, inflation, regulation and depressions. Going as far back as the l750s he has discovered that all the variables have followed an amazing rhythmical pattern. Every third decade in the U.S. economy has been the peak decade of inflation for more than two centuries except during the trauma following the American Civil War of 1860sThe high inflation of the 1970s, 1940s, 1910s, and so on was no fluke, it was part of an inflationary cycle that has crested every third decade. Furthermore, every peak decade of inflation was also the peak decade of money growth and regulation. All these variables last crested during the 1970s. . (p.6, 117)

As regards economic contractions, the three decade pattern described above still holds, but with a modification. A steep depression has occurred every decade since the 1780s. Moreover, a depression, which is far worse than a recession, occurred every third or sixth decade in the sense that if the third decade managed to avoid the crisis, then the next third decade suffered a cumulative effect, an all-time economic disaster. Thus, a depression occurred in the 1780s but not in the 1810s. Hence, the next third decade, the 1840s, witnessed an unprecedented economic calamity. But the 1870s, thirty years later, also suffered the great depression instead of a mild one due to the disturbed cycle of inflation and again of deflation as a fallout of the American Civil War as mentioned in the last para. Then, the decade of 1900s had a mild depression and again a great depression in the 1930s. Hence, the American Civil War has changed heavily the course of inflation and depression in its own way. There was no such disaster in the 1960s. If the two century long pattern continues, then the 1990s were to experience the worst depression in history and as this depression has prolonged and continues with even increasing deceptive intensity with accumulative effects of many non-economic factors like clash of civilizations, clutching dogmas, terrorism, violent natural changes, cultural perversion and so on, this estimation has proved true.

It has also been observed that a high inflation usually occurs at a gap of ten years from the starting period of a depression as is clear from the facts given above. Further, both a high inflation and depression have a usual duration of six years each. For example, the depression of 1930s covered the period 1929-36 while the high inflation of 1940s covered 1939-45. To this I may add that the recent depression since 1990 with its further implications and complications is quite different and much more deceptive as it is the fag end of the 360 yearly cycle which had started with the Christian Inquisition since 1630s; rejection of Christianity and adoption of Buddhism by Japan as well as with the building of Taj Mahal in India by Shah Jahan and gradual ascendance of Aurangzeb leading to inevitable downfall of the Mughal Empire. This is also

the culminating point of cosmic cycle of 3500 years and earthly cycle of 2160 years as already detailed.

According to Batra, a recession occurs when GNP begins to fall or its growth fails to keep pace with the growth in labor force, so that the rate of unemployment begins to rise. A depression occurs when a recession is accompanied by a collapse of the financial system. U.S. history reveals that in a recession, unemployment is no higher than 12%, whereas in a depression it may go as high as 25%.

On the forthcoming situation Batra [28] mentioned: 'Oil price will break new record until 2010 in spite of a slowing economy, but collapse in the next decade. (and the oil prices tanked then.)

The single most worrisome economic problem today is that productivity is outpacing wages all over the world. Since productivity creates supply and wages create demand, supply outpaces demand; to maintain economic balance, the world is busy creating debt, which artificially raises demand.'

Batra [28] explores a variety of economic reforms aimed at maintaining the demand-supply balance without increased debt. He offers an export-exchange rate plan to eliminate the U.S. trade deficit within the rules of free trade.

The world economy later entered into in the phase of recovery. But, Dominique Strauss-Kahn, the IMF head, felt, "The recovery is coming sooner than expected. But-we are not out of the woods and we have to be cautious. You see growth resuming almost everywhere but that almost everywhere these growth figures are related to public support and private demand remaining rather weak and not strong enough. Until private demand is sustainable to provide growth it will be difficult to say the crisis is over." [29]

Let us come back to the 30 year cycle by Sarkar and Batra. The economists started speculating a few days earlier that the years 2019-21 are going to initiate depression worldwide. There started strong indications from the automobile and financial sectors in the late 2019. This is taken as part of the above mentioned 30 year cycle. 30 years after 1989, the year 2019-20 was bound to be caught by severe depression.

Now with slowdown in late 2019s mainly with the US-China trade tensions, global warming, changed weather patterns and due to actions of the governments of advanced economies promoting distributive inequity the world is now having crashing economies, stagflation, decreasing economic activities and decreasing employment and due to Corona pandemic (Covid-19). This phenomenon is likely to continue upto 2026 and then to enter into inflationary disturbances again for six years starting from 2029-30 if the above-mentioned 30 year cycle goes on.

Another interesting attempt on this line has been made by the technical analysts of the socioeconomic (socionomics) school like Ralph Nelson Elliott in the 1930s in his book—The Wave Principle(1938) and in full detail in his final major work, Nature's Laws – The Secret of the Universe (1946). [30] It has been followed by Robert R. Prechter [31] with mathematical simplification (particularly Fibonacci series). Here, socionomics is the study of the relationship between social mood and social behavior. Pioneered by Robert R. Prechter, Jr. this theory proposes that social mood influences the aggregate character of social actions, such as those found in the economy, financial markets and politics.

## VI. A POLICY PERSPECTIVE—SMOOTHENING THE VIOLENT FLUCTUATIONS

Certain measures can reduce the amplitude of violent fluctuations of the economy significantly for a very long time and ensure its smooth & harmonious movement. But they cannot eliminate these fluctuations. Nor is it desirable because straight-line evolution is not possible for any entity no matter what. These fluctuations are just as all living being cannot survive without breathing in and out in order, the overall system also cannot. Sarkar has derived the above mentioned economic cycle from his own law of social cycle [32] and real-life experience. This law begins with general characteristics of the human mind. He argues that even though most people have common goals and ambitions, their methods of achieving their objectives may differ from person to person, depending on inner qualities of the individual.

This law of social cycle is based on collective psychology. Collective psychology is defined as "the average psychic momentum derived from the unit (individual) psychic momenta." It refers to the actual personality, mental color, or spirit of the times which a collective mind projects. This collective psychology is dominated by any one of the above for psychic spirits and affects the overall character of the system. These cycles usually occur and move smoothly. But, selfish, negative and self-destructive human actions make these cycles violent and devastating.

Here, I can propose two hypothetical assumptions. One is that there are many kinds of regular and non-regular (arising out disturbing human interference) cycles at the various levels of consciousness in the nature. They are basically responsible for formation of social cycles in direct combination with social factors. Similarly, the social cycles in direct combination with economic factors are responsible for formation of economic cycles. The social and economic cycles in direct combination with the political factors become responsible for changes and upheavals in the system of governance. The other one which is inherent in the first assumption is that the major part of the political system is a part of the economic system and the remaining part is non-economic in nature; the political and economic systems are part of the much wider social system and the social system is a part of the vast natural system. Thus the position of these systems may be just like the hands of clock. A slight movement in the hour hand results in manifold movement in the minute hand and same is the case with movement of the second hand in comparison to minute hand. Slight movement in the natural cycles may bring vast movement in social cycle and system. Sight movement in the social cycle may be responsible for vast movement in the economic system and slight changes in the socio-economic system may generate many changes in the political system. This phenomenon is shown in Figure1.The size of each system in comparison to lower systems/sub-systems may be taken in logarithmic proportions.

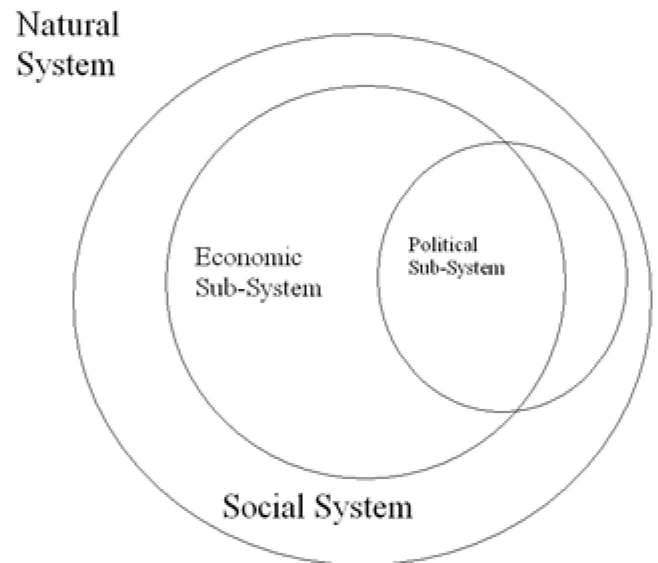


Figure 1

## CONCLUSION - A NEW FREE MARKET PERSPECTIVE

Policies advocated by Keynesians, Monetarists and proponents of standard finance strike only at the symptoms of economic ills, not at their cause, which lies in the concentration of income and wealth. These policies, rather than stabilize the economy, add to its problems in the long run. Conventional economists recommend superficial reforms that only postpone the malady, which in the end returns with greater horror. In other words, short-run fluctuations are curtailed, but cumulative long run fluctuations increase. But now the superficial measures aren't producing even the short-run results. The systemic linkages in a progressive economy can be better understood and utilized in a highly fruitful and effective way for betterment, prosperity, harmony and peace for all under the tenets of behavioural finance.

By way of caution, Robert Olsen [33] describes this "new paradigm" as an attempt to comprehend and forecast systematic behavior in order for investors to make more accurate and correct investment decisions. Shiller [1] writes in the same vein 'In judging the impact of behavioral finance to date, it is important to apply the right standards. Of course, we do not expect such research to provide a method to make a lot of money off of financial market inefficiency very fast

and reliably. We should not expect market efficiency to be so egregiously wrong that immediate prospects should be continually available.' (p. 10)

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