Learner Name	
ID Number	
Organisation	

FORMATIVE ASSESSMENT: LEARNER WORK FILE VERSION 1

Unit Standard Title: **Research theories of behavioural finance to explain the influence of emotion on financial decisions**

Unit Standard No: **242557**

Unit Standard Credits: **4**

NQF Level: **6**

Mark information:

Specific Outcome/Section	**1**	**2**	**3**	**4**	**5**	**Total**	**%**	**C / NYC**
Maximum marks	30	24	6	20		80	100	

This outcomes-based learning material was developed by Masifunde Training Centre with funding from INSETA in July 2014. The material is generic in nature and is intended to serve as a minimum standard for the industry.

Formative Assessment

Section 1: 30 marks

Activity 1

Explain simply the theory of behavioral or Neo-classical economics. Then name and explain seven shortfalls in human behavior. (15)

Activity 2

Analyse with reference to Black Economic Empowerment, what are the systematic biases that may occur, that may cause investors and the markets to behave irrationally. Name and explain the two categories of behavioral bias. (7)

Activity 3

Using behavioural economics select one of the seven principles for policy makers and using an example, compare Standard (Neo-classical) Economic theory and Behavioural Economic theory. (8)

Section 2: 24 marks

Activity 4

Identify and explain the seven patterns of irrational behaviour with reference to how these patterns influence decisions. (14)

Activity 5

Below you will find the Jim Cramer case study. Using Behavioural finance theory, identify by highlighting or underlining ten of the client's possible irrational investment decisions. (10)

<u>Case Study: Jim Cramer</u>

Former hedge fund manager, columnist and author as well as host of CNBC's "Mad Money" and CBS radio's "Real Money". Cramer's claim to fame is his bombastic and 'in your face' behaviour in which he gives recommendations and analysis on featured and viewer-suggested stocks. Jim Cramer is also one of the founders of TheStreet.com, a popular financial website. Although Cramer does give his opinion on the investment value of any given stock, he prefers that his viewers go out and conduct their own research on the underlying businesses before buying stocks. However, many of Cramer's viewers do go and purchase stocks just because he recommended them. This effect is so prominent that the price of a stock can actually go up significantly for a couple of days after his recommendation, due to the increased buying pressure.

Critics often point out that Cramer can be very fickle in his investment outlook, because he appears to frequently flip-flop from a bullish position to a bearish position to reflect the market's current sentiment.

For those who aren't familiar with "Mad Money", the show's host, Jim Cramer is a former hedge fund manager. On "Mad Money", Jim Cramer gives his buy/sell recommendation on a number of featured stocks, including stocks suggested by viewers' phone calls or emails. The show has become very popular - its entertaining nature about financial matters attracted more than 300,000 viewers nightly in 2006.

In this study, researchers had gathered stock returns, daily volume data, intraday *quotes and other kinds of financial information on buy recommendations that Cramer made between July 28 and October 14, 2005. One of their key findings provides proof of the existence of the "Cramer bounce". According to the study, Cramer's buy recommendation causes a statistically significant short-term rise in the stock's price on the day directly following the day it is recommended. This rise is most apparent for small stocks, where the increase is just over 5% compared to the previous close. For the entire sample, the average rise is almost 2%.*

Does this study suggest that Cramer has a knack for finding undervalued stocks at the right time? No. Instead, the researchers in this study theorize that stocks become overpriced because a large number of "Mad Money" viewers blindly buy stocks based on Cramer's recommendation. In other words, these rises were not attributed to any new news that companies had released and, most importantly, they were not sustained for very long. In fact, the study demonstrated that these increases faded away within 12 days. The inflation in stock prices that occurs as a result of Cramer's recommendations allows clever investors to obtain higher returns and, therefore, serves as evidence against the efficiency of the market.

The study also found that trading volume on the stocks that Cramer recommended also spiked dramatically. For smaller stocks, the trading volume increased by as much as 900% on the day following the recommendation. The most interesting effect is that, in some cases, the level of turnover stayed significantly elevated for as long as 16 days after the recommendation was made. It also appears that Cramer's recommended stocks generally receive much higher buyer-initiated trades on the day following a recommendation to buy. This may reflect a flood of purchase orders from regular "Mad Money" viewers. This peak in the proportion of buyer-initiated trades ultimately drops back to pre-recommendation levels after about 12 days. This suggests that Cramer's recommendations have a direct effect on stocks' prices.

Why Is This Important?
One of the biggest assumptions (and potentially the biggest flaw) is that investors are rational. This study provides evidence that the irrational behaviours of individual participants in the financial world can create predictable, collective actions that can have at least a short-term influence on stock prices. For the most part, it can be assumed that the investors that are contributing to the Cramer bounce phenomenon are making stock purchases as a result of Jim Cramer's influence, rather than as a product of rational thought.

As a general rule, emotional investors that buy stocks without doing their homework tend to miss out on good returns. In this situation, Cramer's recommendations are expensive in the days after being featured on "Mad Money" and, all things being equal, will tend to lose value as their prices settle back to pre-Cramer bounce levels.

Social Learning Theory
Jim Cramer's recommendations can easily sway the more emotional investors into performing trades without conducting a good amount of research, because many may feel that he is an authority on stocks and that his word should be good enough.

Don't Go Mad yourself
there is an assumption that the main players in the market are rational. This study is

an example of how irrational behaviour can cause stock prices to fluctuate. Investors should not discount the role that emotion and investor psychology play in the way the market behaves. While there is no formula or indicator that can account for or assess the emotional aspects of investing, investors can save themselves from being caught up in "madness" by investing prudently, rather than just following the crowd.

Section 3: 6 marks

Activity 6

Analyse and explain market behavior with reference to volume, volatility and predictable influence on asset prices. (6)

	Volume	**Volatility**	**Asset Prices**
Market Behaviour			

Section 4: 20 marks

Activity 7

Using behaviour theories we have named 3 trends in the table below. Explain what they mean regarding the market or client behaviour. (9)

Trend	**Explanation (3 marks each)**
Sideways or horizontal trend	
Down trend	
Up trend	

Activity 8

In the table below we have shown the different markets and trends. Give an explanation of what each means with reference to an organisation's response to irrational decisions on the part of the market or trends, making reference to how an organisation can attempt to counteract the trend. (11)

Trend	Explanation
Bear market (3 marks)	
Bull market (2 marks)	
Sideways or horizontal trend (2 marks)	
Down Trend (2 marks)	
Up Trend (2 marks)	

SOUTH AFRICAN QUALIFICATIONS AUTHORITY

REGISTERED UNIT STANDARD:

Research theories of behavioural economics and behavioural finance to explain the influence of emotion on financial decisions

SAQA US ID	**UNIT STANDARD TITLE**			
242557	Research theories of behavioural economics and behavioural finance to explain the influence of emotion on financial decisions			
ORIGINATOR		**ORIGINATING PROVIDER**		
SGB Insurance and Investment				
QUALITY ASSURING BODY				
-				
FIELD			**SUBFIELD**	
Field 03 - Business, Commerce and Management Studies			Finance, Economics and Accounting	
ABET BAND	**UNIT STANDARD TYPE**	**OLD NQF LEVEL**	**NEW NQF LEVEL**	**CREDITS**
Undefined	Regular	Level 6	New Level Assignment Pend.	4
REGISTRATION STATUS		**REGISTRATION START DATE**	**REGISTRATION END DATE**	**SAQA DECISION NUMBER**
Reregistered		2009-11-03	2012-06-30	SAQA 0160/05
LAST DATE FOR ENROLMENT		**LAST DATE FOR ACHIEVEMENT**		
2013-06-30		2016-06-30		

In all of the tables in this document, both the old and the new NQF Levels are shown. In the text (purpose statements, qualification rules, etc), any reference to NQF Levels are to the old levels unless specifically stated otherwise.

This unit standard does not replace any other unit standard and is not replaced by any other unit standard.

PURPOSE OF THE UNIT STANDARD

This Unit Standard introduces behavioural finance and economics as a means to explaining the role of emotions in financial decision making. It will be useful for Intermediaries, Financial Advisors, Investment Consultants, Bankers and Financial Planners.

The qualifying learner is capable of:

- Explaining the effect of emotion on financial decisions and long term wealth accumulation.
- Applying knowledge of behavioural finance to explain investor behaviour.
- Discussing how behavioural economics can contribute to understanding market behaviour.
- Analysing how financial services organisations respond to behavioural decisions on the part of the market.

LEARNING ASSUMED TO BE IN PLACE AND RECOGNITION OF PRIOR LEARNING

It is assumed that learners are competent in Communication and Mathematical Literacy at NQF Level 4 and are working towards or have a Level 5 Financial Services Qualification or equivalent.

UNIT STANDARD RANGE

The typical scope of this Unit Standard is behavioural finance and behavioural economics as a way of explaining irrational investor behaviour.

Specific Outcomes and Assessment Criteria:

SPECIFIC OUTCOME 1

Explain the effect of emotion on financial decisions and long term wealth accumulation.

ASSESSMENT CRITERIA

ASSESSMENT CRITERION 1

Theories of behavioural finance and behavioural economics are researched to explain investment behaviour.

ASSESSMENT CRITERION 2

Systematic biases that cause investors and the markets to behave irrationally are analysed with reference to recent events.

ASSESSMENT CRITERION 3

Standard economic theory and behavioural economic theory are compared with examples.

SPECIFIC OUTCOME 2

Apply knowledge of behavioural finance to explain investor behaviour.

ASSESSMENT CRITERIA

ASSESSMENT CRITERION 1

Patterns or irrational investor behavior are analysed with reference to how these patterns influence decisions.

ASSESSMENT CRITERION 2

Behavioural finance theory is applied to identify and explain a client's irrational investment decision and to enable an intermediary to influence the client to make an informed decision.

SPECIFIC OUTCOME 3

Discuss how behavioural economics can contribute to understanding market behaviour.

ASSESSMENT CRITERIA

ASSESSMENT CRITERION 1

Market behaviour is analysed with reference to volume, volatility and predictable influence on asset prices.

SPECIFIC OUTCOME 4

Analyse how financial services organisations respond to behavioural decisions on the part of the market.

ASSESSMENT CRITERIA

ASSESSMENT CRITERION 1

Behavioural theory is applied to explain current trends in market or client behaviour.

ASSESSMENT CRITERION 2

An organisation's response to irrational decisions on the part of the market is analysed with reference to how an organisation attempted to counteract the trend.

UNIT STANDARD ACCREDITATION AND MODERATION OPTIONS

- Anyone assessing a candidate against this Unit Standard must be registered as an assessor with the relevant ETQA or ETQA where a Memorandum of Understanding (MOU) exists with the relevant ETQA.

- Any institution offering learning that will enable achievement of this Unit Standard must be accredited as a provider through the relevant ETQA or ETQA where a Memorandum of Understanding (MOU) exists with the relevant ETQA.

- Moderation of assessment will be overseen by the relevant ETQA according to the moderation guidelines and the agreed ETQA procedures.

UNIT STANDARD ESSENTIAL EMBEDDED KNOWLEDGE

N/A

UNIT STANDARD DEVELOPMENTAL OUTCOME

N/A

UNIT STANDARD LINKAGES

N/A

Critical Cross-field Outcomes (CCFO):

UNIT STANDARD CCFO COLLECTING

The learner is able to collect, organise and critically evaluate information in analysing the underlying investment options of different investment vehicles and researching behavioural finance and behavioural economics.

UNIT STANDARD CCFO COMMUNICATING

The learner is able to communicate effectively in explaining the role of emotions in financial decisions.

UNIT STANDARD CCFO DEMONSTRATING

The learner is able to see the world as a set of related systems in understanding the relationship between emotions, behaviour and economics.