Why investors panic when markets fall: Understanding behaviour in a mutual fund scheme

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Market fluctuations are part and parcel of the investment journey. Yet, many investors find it difficult to deal with them and react impulsively when markets shift. Whether they're investing in stocks, mutual funds or any other investment avenue, downturns and volatility make investors jittery and lead to decisions that may not be favourable for their long-term goals.

The role investor behaviour plays in finance

This article will explain the reasons why investors panic when markets fall, why it is useful to look at behavioural patterns and psychological triggers, and how one may stay more balanced in such situations.

The role of emotions in investment decisions

Investing is believed to be about logic, but emotions may often play a role in financial decision-making. This interplay between emotions and money is at the heart of behavioural finance, a field of study that combines psychology and economics to explain how people make financial decisions. Instead of assuming investors are always rational, it looks at how emotions, biases, and social influences may affect choices about saving, spending, and investing.

Fear and anxiety are two of the most powerful emotions that may influence an investor's decision-making when markets shift. In the context of a mutual fund scheme, these emotions may lead to premature withdrawals even when the investment was meant for the long term.

This is partly because losses feel more intense than gains of the same size, a tendency known as loss aversion. For example, losing Rs. 10,000 feels far more painful than the happiness experienced from gaining Rs. 10,000. This imbalance may push investors to act in haste, especially during a market downturn.

Herd behaviour and social influence

Another reason why investors may panic is herd behaviour. When investors see others exiting a mutual fund scheme or selling their holdings during market lows, they may feel the need to do the same. Following the crowd may be seen as a more suitable option for many investors instead of standing apart, even if long-term fundamentals remain unchanged.

Such herd behaviour may result in missed opportunities for potential growth if the market recovers.

Short-term focus versus long-term goals

Many investors begin investing in a mutual fund scheme with a long-term goal in mind, such as retirement planning or funding a child's education. However, when markets turn volatile, the focus shifts from long-term goals to short-term movements. This may lead to impulsive decisions, such as redeeming units prematurely.

While market volatility may be temporary, impulsive decisions may lock in losses. When investors keep long-term objectives in mind and avoid frequent reactions, they may maintain their investment discipline.

The impact of past experiences

Sometimes, personal experiences may also shape investor behaviour. If an investor has experienced a previous downturn and faced losses, they may panic more quickly in future market declines. Similarly, if someone has seen markets recover after a downturn, they may be more comfortable about staying invested.

It is important to remember that decisions should be based on suitability, financial planning, and current circumstances rather than only on past experiences.

Past performance may or may not be sustained in future.

The role of information and news flow

Investors are often influenced by constant news updates, market headlines, and commentary from peers or social media. Negative news may magnify fear, making it harder to stay patient. For instance, during a sudden market fall, headlines may focus on short-term losses without providing a balanced view of potential long-term prospects.

Filtering information and focusing on reliable sources may help investors avoid unnecessary panic. Instead of reacting to every headline, it may be useful to stay focused on your long-term goals.

Behavioural biases in investing

Several behavioural biases contribute to panic during market falls:

- Loss aversion: As discussed, losses feel more severe than gains of equal size.
- Recency bias: Investors tend to give more weight to recent events. A sudden fall may overshadow years of steady growth in a mutual fund scheme.
- Overconfidence bias: Believing one may time the market or predict exact outcomes often leads to disappointment when events do not go as expected.

Understanding these biases may help investors make more measured decisions instead of reacting purely on impulse.

Strategies to stay calm during market falls

While no strategy may remove uncertainty, certain practices may help investors manage their reactions:

- Review goals periodically: Ensuring that investments in a mutual fund scheme align with long-term goals may provide confidence during volatility.
- Diversification: Spreading investments across asset classes may potentially reduce the impact of market swings.
- Systematic approach: Approaches like Systematic Investment Plans (SIPs) may help average out costs over time, though investors should assess if these are

suitable for their financial needs.

- Consulting advisors: Professional advice may provide perspective and help investors avoid impulsive decisions.

These strategies may not eliminate risk, but they may provide structure and reduce emotional reactions during downturns.

The InQuBe philosophy of investing

Bajaj Finserv AMC’s InQuBe philosophy represents a disciplined framework for pursuing investment opportunities. Built on three pillars, gaining an information edge, applying analytical tools, and leveraging behavioural insights, it aims to guide investment decisions by focusing on companies with solid fundamentals and potential long-term value. By navigating market inefficiencies through this structured approach, Bajaj Finserv AMC seeks to help investors maintain a consistent, long-term perspective.

Conclusion

Markets will always move through cycles of ups and downs. The challenge for investors is not only in choosing a suitable mutual fund scheme but also in managing their own reactions when markets fall. Panic is a natural response, but understanding behavioural patterns, being aware of biases, and staying focused on long-term goals may help investors make more balanced decisions. By approaching investments with patience and discipline, investors may be able to navigate market volatility more calmly.

Mutual Fund investments are subject to market risks, read all scheme related documents carefully.â¯