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## ABSTRACT

The present study focuses on an emerging area of research in behavioural finance, which extrapolates its concepts from applied economics, finance, experimental psychology, and sociology, and so on. It involves the examination of the impact of psychological factors on individual investor trading behaviour, and how these factors affect stock market returns in the S&P CNX Nifty index of the National Stock Exchange (NSE). A comprehensive review of existing literature reveals that investor behaviour plays a significant role in asset pricing, and it also affects stock market returns. Identifying behavioural factors that seem to affect investor behaviour will help in revisiting asset pricing theories in a new perspective. Another prominent issue that was to be addressed in the present research study is that there exists a bidirectional relationship between stock returns and trading behaviour, but the direction of this relationship has been little explored. The present research attempted to examine this relationship with special reference to Indian individual investors (INDINV).

Major findings of the present study include:

(i) Psychological factors such as *prudence and precautious attitude, under confidence, conservatism, information processing abilities,* and *financial unawareness* have a big say in determining individual investor financial behaviour in general, and trading behaviour in particular. They need to be taught about controlling their emotions while taking financial decisions; else they are bound to commit fatal mistakes.

(ii) Individual investor trading is positively related to near-future returns; prices moves up following the days of heavy trading by individuals and vice versa.

Though more elaborated study consisting of large datasets is required to establish this observation empirically approved.

(iii) Individual trading volume can be a good predictor of immediate future returns. Though this is not the case with all the stocks that individual investor trading forecast returns perfectly, but when combined with other fundamental factors, net individual trading volume reflects a good predictive ability in Indian stock market. This result supports the study by Kumar and Lee (2006) and Kaniel *et al.* (2008), but contradicts with Brown and Cliff (2002) and Subrahmanyam (2005) who cited that individual and retail trades do not predict returns.

(iv) The Indian stock markets, after so many recent developments during last decade, have reached the age where it can stand tall among any of the stock markets of developed nations. In order to give it more competitive edges, the findings of this study may be taken into account and more and more policy framework suitable to the retail and individual investors be crystallized. Retail and individual investor group is still under-exploited, more small investor-friendly market environment is supposed to encourage them participate in the stock market, and bring more market efficiency to their existing counterparts.

The findings and observations captured in the present study add to the growing evidence that certain phenomena observed in financial markets are better understood when relaxing some of the assumptions underlying the traditional finance paradigm. Further, the evidence is provided on which considering the retail/individual investors a significant part of the financial system seems the most relevant in changed scenario. It can be emphasized that policy making, development of financial products, and market microstructure should be pursued with concentration on small individual investors.