By applying insights from psychology and other behavioral sciences, behavioral finance helps to overcome the shortcomings of the traditional finance approach, which assumes that agents and markets are rational, and improves our understanding of financial markets and its participants. This thesis extends this line of research by providing new insights into the preferences of investors, their investment decisions, and the behavior of financial markets. The results show that people dislike downside risk and employ decision-making patterns that may result in risk-taking behavior of which they are not aware, or in which they normally would not engage, and that can result in non-optimal behavior. More specific, people change their behavior in response to previous outcomes, preferences are highly sensitive to the context of outcomes, and people tend to use simplifying heuristics to construct their investment portfolios. Furthermore, this thesis shows that incorporating behavioral-based preference patterns has substantial influence on investor’s optimal behavior in financial markets.

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