

# Chapter 4

## Emotional Contagion and Financial Markets: The Interplay of Fear, Greed, and Herding

Ooi Kok Loang

 <https://orcid.org/0000-0003-0412-8899>

Universiti Malaya, Malaysia

### ABSTRACT

*The study investigates the complex dynamics that drive market overreaction in financial markets. This research focuses on the impact of emotional states (fear and greed), market news and rumors, peer influence, market volatility, and investor experience on market overreaction. The study employs the concepts of emotional contagion as a mediating variable and social proof as a moderating variable to understand how these factors interact and influence market behaviour. The findings highlight the significant role of emotional states and social dynamics in driving market inefficiencies. Emotional contagion is shown to amplify the impact of fear and greed, market news and rumors, peer influence, and market volatility on market overreaction. Conversely, social proof moderates these relationships, often intensifying the effect of emotions and social influences on market behaviour. The study's results underscore the importance of considering psychological and social factors in financial market analysis and regulatory frameworks.*

DOI: 10.4018/979-8-3693-7827-4.ch004

## INTRODUCTION

Recently, scientists have become more interested in studying the complex relationship between psychological and social aspects that affect investor behaviour in financial markets. Emotional contagion, which refers to the transfer of emotions from one person to another, has been identified as a prominent phenomenon among these elements. Emotional states such as fear and greed, which are frequently prompted by market news, rumours, and peer influence, have a significant impact on investment decisions. These emotions can quickly propagate throughout the market, resulting in collective behaviours such as herding, where investors imitate the actions of others instead than depending on their own analysis (Agarwal et al., 2024). This study examines the significant impact of emotional contagion on financial markets, specifically investigating how it influences the connection between several independent variables and market overreaction.

Market news and rumours operate as triggers for emotional responses among investors. Favourable news has the potential to incite avarice, leading investors to make impulsive purchases, whilst unfavourable news might instill fear, resulting in panicked selling. The market's volatility exacerbates these emotional reactions, as fluctuating prices intensify uncertainty and worry. Peer impact is a significant aspect that occurs when investors are influenced by the decisions and emotions of their peers during social interactions. This phenomenon can result in a bandwagon effect, when the behaviours of a small number of individuals can exert a significant influence on the majority, thereby amplifying market trends through a self-reinforcing cycle.

The level of investor experience, or the absence thereof, also has a substantial impact on how emotions affect market behaviour. Inexperienced investors, who may have limited understanding and self-assurance to make autonomous choices, are especially vulnerable to emotional contagion. Their proclivity to depend on external indications, such as the conduct of seasoned investors or market sentiment, can lead to illogical decision-making and excessive market reaction. On the other hand, seasoned investors are more adept at controlling their emotions and following rational analysis, although they are nevertheless influenced to some extent by the prevailing market attitude.

Market overreaction, the variable that is influenced by other factors in this research, pertains to the inclination of investors to react to market events with an exaggerated sense of optimism or pessimism, resulting in substantial variations in prices from their true values. This occurrence can lead to the formation of bubbles during periods of excessive optimism or to market crashes during periods of unwarranted pessimism. The role of emotional contagion in modulating individual emotional responses to produce collective market movements is essential to comprehend. Emotions that

20 more pages are available in the full version of this document, which may be purchased using the "Add to Cart" button on the publisher's webpage: [www.igi-global.com/chapter/emotional-contagion-and-financial-markets/363244](http://www.igi-global.com/chapter/emotional-contagion-and-financial-markets/363244)

## Related Content

---

### Nonviolent Discipline Practices Within Classrooms: Best Practices From a Trauma-Informed Perspective

Rufaro A. Chitiyo, Florence Nyembaand Elizabeth A. Ramsey (2021). *Preventing and Reducing Violence in Schools and Society* (pp. 257-282).

[www.irma-international.org/chapter/nonviolent-discipline-practices-within-classrooms/270517](http://www.irma-international.org/chapter/nonviolent-discipline-practices-within-classrooms/270517)

### Transnational Crime and the American Policing System

Starlett Michele Martin (2017). *Violence and Society: Breakthroughs in Research and Practice* (pp. 632-652).

[www.irma-international.org/chapter/transnational-crime-and-the-american-policing-system/171064](http://www.irma-international.org/chapter/transnational-crime-and-the-american-policing-system/171064)

### Professional Stress From the Implementation of Innovative Technologies: Case of Azerbaijan

Aida Guliyevaand Ulviyya Rzayeva (2022). *Handbook of Research on the Complexities and Strategies of Occupational Stress* (pp. 148-167).

[www.irma-international.org/chapter/professional-stress-from-the-implementation-of-innovative-technologies/305664](http://www.irma-international.org/chapter/professional-stress-from-the-implementation-of-innovative-technologies/305664)

### Maximizing Students' Learning Success Through Lab-on-Line: The University of Namibia Experience

Minda M. B. Marshall, Simon George Taukeni, Rheinhold Disho Muruti, Gibert Likando, Cynthy Kaliinasho Haihambo, Mathilde Shihako, Chamelle De Silvaand Marshall M. (2020). *Addressing Multicultural Needs in School Guidance and Counseling* (pp. 262-276).

[www.irma-international.org/chapter/maximizing-students-learning-success-through-lab-on-line/238644](http://www.irma-international.org/chapter/maximizing-students-learning-success-through-lab-on-line/238644)

### Entrepreneurial Psychology in the Age of AI: A Critical Review of Mindset, Behaviors, and Business Dynamics

Sovannaroth Chheangand Sovanna Huot (2026). *Exploring Entrepreneurial Psychology Through AI* (pp. 59-90).

[www.irma-international.org/chapter/entrepreneurial-psychology-in-the-age-of-ai/410120](http://www.irma-international.org/chapter/entrepreneurial-psychology-in-the-age-of-ai/410120)