AVAILABILITY HEURISTICS AND SPECULATIVE ACTIVITIES OF RETAIL INVESTORS IN OPTIONS AND FUTURES

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ABSTRACT

This study investigates the role of availability heuristics in retail investors' trading decisions. Results suggest momentum in trading activities as these seem to take increased positions in call and put options over time. Retail investors employ these heuristics as contrarian indicators while speculating in the options market. There is weak evidence of speculation and availability heuristics in the futures trading probably due to its unlimited potential losses and marked to market features. The simplicity provided by trendy trading, video apps and social media forums has converted investing into a game nudging small investors to take a bigger risk.

Keywords: *Heuristics, Behavioral Finance, Options, Futures*

1. INTRODUCTION

Heuristics are simple, efficient rules that people frequently use to help increase the speed of making decisions and forming judgments (Tversky and Kahneman, 1974; Baker et al., 2019). These are mental shortcuts that enable individuals to focus on one aspect of a complex problem and ignore others. People employ heuristics in decision-making because their brains have a natural need for closure. Within behavioral finance, heuristics relate to making financial decisions in a fast and frugal manner. Behavioral finance recognizes that although heuristics are helpful in many situations they can lead to systematic and predictable errors (Statman, 2019; 2017; Shefrin, 2002; Baker and Nofsinger, 2002; Gigerenzer et al., 1999). Heuristic framework serves as a counterpart to standard asset pricing models which assumes that people make perfectly rational *decisions*, apply unlimited processing power to any available information, and can assign probabilities to each potential outcome.

One of the important cognitive heuristics which can lead to systematic errors is *availability* heuristics (Baker et al., 2019). The availability heuristics or availability bias is a mental shortcut that facilitates decision-making based on information that is easy to recall, widely available, and highly publicized (Kahneman, 2011; Ricciardi, 2008). It stems from the belief that “what you see is all there is.” For example, while evaluating stocks, investors may overrate the importance of recent news and discount older information.

Existing studies provide compelling rationale on the role of availability bias in various financial decision-making behaviors (Han et al., 2021; Bali et al., 2021; Ricciardi, 2008; Barber and Odean, 2007; Hvide and Ostberg, 2014; Kuo et al., 2015; Jacobs and Hillert, 2016; Solomon et al., 2014; Koehler and Mercer, 2009). However, little empirical tests are conducted to analyze the direct impact of availability heuristics on retail investors’ speculative activities. How small investors employ readily available information (for example, news, investment advisory opinions, popular technical indicators, social media interactions, digital communities, video apps, etc.), and avoid diligent research while trading options and futures is not empirically tested. Such investigation is the main contribution of this study. Given a recent surge in options and index futures trading by retail investors during the pandemic, it is worth examining the extent to which such speculators are employing readily available information.

This study attempts to shed light on retail investors’ irrationality by analyzing whether availability bias plays a systematic role in influencing their speculations in the derivative market. It contributes to the existing literature in the following ways: (i) it examines the impact of availability heuristics on speculations in the options and index futures which is not investigated in the existing studies; (ii) it employs unique datasets to