

# A Study of the Factors Influencing Investors' Expectations in the Chinese Stock Market

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**Abstract.** With the continuous development of behavior finance, scholars have paid more and more attention to the irrational factors in the stock market, and the research on the psychological factors of investors in the stock market is also more in-depth. The decline of the irrational investment sentiment of the noise investors caused by the decline of the investment value of the stock market has weakened the adverse effects of the investor's non-rational behavior on the stock market, and thus, the negative effects of the investor's non-rational behavior on the stock market are weakened. The expectations of rational institutional investors and some rational individual investors begin to rise. The relevant government departments can use the conclusion of this paper to guide investors to regulate the stock market, and investors can adjust their investment strategies promptly according to the conclusion of this article.

**Keywords:** Investor expectations; Influencing factors.

## 1. Introduction

As one of the investment activities with the largest number of participants, the stock market is characterized by its wide coverage, a large number of participants, and a large amount of capital, and is widely influenced by psychological factors such as expectations, which are inseparably linked to the expectations of stock market investors.

As an important factor affecting stock market movements, investor expectations largely determine the future direction of stock market development. The development of China's stock market currently requires government departments to take measures to help investors restore confidence in the stock market so that investors can form positive and reasonable expectations and gradually eliminate the negative impact of negative expectations.

Research on the role of expectations at home and abroad shows that expectations have a strong influence on investor sentiment, stock market yields, monetary policy, stock prices, interest rate policy and other stock market quality factors, macroeconomics, monetary policy, and investor behavior. Expectations, as a psychological factor, are an important cause of abnormal changes in asset prices and lead to enhanced market speculation. Irrational investor expectations have caused turmoil in financial markets, and heterogeneous expectations of institutional investors have contributed to IPO pricing biases. Domestic and international research on expectations has shown that expectations have a significant impact on stock market returns, monetary policy, the stock index futures market, and IPO pricing bias.

This paper presents a theoretical analysis of the factors influencing investors' expectations by summarising the current state of research at home and abroad. This paper presents a theoretical analysis of the factors influencing investors' expectations in the stock market from several perspectives: irrational factors in the stock market, stock market quality, and macroeconomics. It also concludes with policy recommendations for government departments and stock market investors.

## 2. Literature Review

### 2.1 Expectancy theory

Keynes (1936) felt that investors make decisions based on their expectations of others' choices, Fried (1957) proposed adaptive expectations and expressed consumer choice as people forming

expectations of how things will develop in the future based on past information. Lucas (1972) argued that subjects of economic activity have full access to all available Adam, and Klaus (2017) investigated the relationship between investor sentiment and stock market expectations, finding that expectations are higher at the peak (lower) and lower at the bottom. found that expectations are overly optimistic (pessimistic) at peaks (lows), demonstrating that investor expectations are not rational expectations. Annarita Colasante, and Antonio Palestrini (2017) analyzed the behavior of experimental subjects in an experimental setting and showed that it is difficult for overall expectations to converge to rational expectations when individuals are all part of adaptive expectations.

## **2.2 Investor influences**

Jorg Bley, Mohsen Saad (2012) studied the particular volatility of seven frontier markets in six GCC countries and found that there was a significant negative correlation between stock market expectations and lagged qualitative volatility in individual stocks in Saudi Arabia, but not in the investment markets of Kuwait and Abu Dhabi, while, when using EGARCH or AR models to estimate conditional idiosyncratic volatility, the relationship becomes positive. chungpeng Yang (2013) examines the effect of sentiment on stock market expectations by building a sentiment asset pricing model and explores how stock market expectations change when parameters change under different circumstances. When overall market sentiment is low, stock market expectations fall. Omankhanlen Alex Ehimare et al. (2016) used the short-term dynamics of macroeconomic indicators and stock prices over the period 1985-2014, the study explored the relationship between stock price movements and macroeconomic activities in the Nigerian stock market The nature of the correlation that exists, concluded that the inflation rate is consistent with the movement of stock prices, in line with theoretical expectations, as a result of investors' perception that the stock market has inflation protection during the later period of structural adjustment, and that even though the exchange rate grows in the same direction as stock prices, as a country's exchange rate rises, stock prices in China will become cheaper and therefore attractive to foreign investors. It is recommended that stock market investors should pay attention to trends in the fluctuation of macroeconomic variables in order to predict stock market price movements.

## **3. Theoretical analysis of the factors influencing investors' expectations**

By combing through the literature on factors influencing expectations at home and abroad, it is found that investor irrationality factors, stock market quality factors, and macroeconomic factors all have an impact on stock market investor expectations.

### **3.1 Irrational factors in the stock market affect investor expectations**

Investor sentiment is a kind of psychological expectation of the future trend of the stock market due to the combined influence of various information from various sources, and this expectation of investors actually has a certain bias on the future price of risky assets, and this expectation of investors will have a significant impact on the behavior of investors, which will, in turn, affect the price determination of the relevant assets in the stock market. This has a significant impact on investor behavior, which in turn affects the price determination of the underlying assets in the equity markets. Investor sentiment is essentially an investor's assessment of investment returns on the basis of limited rational expectations, taking into account individual characteristics such as risk, the opportunity cost of capital, and expected returns on investment, and ultimately the results are expressed externally in the form of investor sentiment or action.

### **3.2 Macroeconomic influences on investor expectations**

The development of the stock market not only reflects the development of the macroeconomy but also contributes to the sustainable development of our macroeconomy through capital financing.

Studies at home and abroad have shown that there is a clear correlation between a country's macroeconomic development and the degree of stock market development.

The impact of macroeconomic performance on the stock market is mainly based on the following path: when the macroeconomic situation is good, it indicates that the country's economic situation tends to be good in the coming period, and the main body of investors in the stock market will have optimistic expectations and increased confidence in the investment. The macroeconomic boom will lead to an increase in the country's GDP and corporate profits, which will be reflected in the growth of stock returns on the stock market. On the other hand, as most investors have good expectations for the future of the country's economy, this may lead to investors increasing the amount and duration of their investment plans, thus further boosting the stock market. In times of macroeconomic downturn, all of the above will show the opposite trend.

### **3.3 Stock market volatility directly or indirectly affects investor expectations**

The volatility of stock market indices represents the riskiness of the stock market, which is an investment market where risk and return co-exist, and Sharp proposed the CAPM model in 1964, which showed a simple linear positive correlation between risk and return in the stock market. (1973) used the beta coefficients of all stocks in the New York Stock Exchange from January 1935 to June 1968 as the object of their study, and employed cross-sectional regression analysis on the basis of grouping, and the empirical results showed that there was a significant linear positive correlation between stock market risk and return. Wu Changfeng et al. (2002) conducted a cross-sectional comparative analysis of the risk characteristics of China's stock market and found that there is a significant positive correlation between stock market risk and its return in the long run.

An increase in stock index volatility implies an increase in risk and return, while a large number of noise traders in China's stock market investors are risk-averse investors who chase risk and dream of short-term riches, and a large number of investors will enter the stock market when the stock market volatility, i.e. risk, becomes greater in pursuit of high returns, which on the one hand will generate herding effects leading investors to form upward expectations, and on the other hand, the stock market, On the other hand, stock market volatility will expand the degree of investors' risk appetite, leading to an increase in the degree of the irrationality of investors, and eventually, the cognitive bias and behavioral bias of investors will intensify at the same time to form an impact on the stock market, making investors' expectations rise, i.e. the volatility of stock indices becomes greater leading to the rise of stock market investors' expectations.

### **3.4 Stock market returns directly or indirectly affect investor expectations**

Shiller (1984) suggests that in the stock trading market, most investors' investment decisions and behavior are not basically due to changes in stock fundamentals, but simply because of changes in stock price trends, which are used to make their investment decisions and investment behavior, a trading behavior known as feedback trading behavior. Positive feedback trading behavior is considered to exist in the stock market if there is a significant positive correlation between investor demand for a particular stock and the historical return on that stock, and negative feedback trading behavior is considered to exist in the stock market if there is a significant negative correlation between investor demand for a particular stock and the historical return on that stock.

Stock market returns, as a concentrated manifestation of the disorganized information in the stock market, are a product formed under the influence of multiple information, so stock market returns can explain and predict a lot of information. Due to the existence of significant positive feedback trading behavior in China's stock market, with the existence of a large number of noisy retail traders, as well as many rational retail investors and rational institutional investors, stock market returns continue to rise. The stock market due to the existence of positive feedback trading behavior, there will be a large number of bubbles generated, and at any time there is the possibility of bursting, the future development trend of the stock market appeared negative expectations.

#### 4. Policy recommendations

In terms of the current situation of the Chinese stock market, it is clear that all aspects are not mature enough.

For policymakers, the expectations of stock market investors will affect the development trend and direction of the stock market, so their expectations can be guided by favorable policies or the release of favorable news to enhance investor sentiment and thus influence investor expectations, but also to prevent investors from overheating investment sentiment leading to the formation of pessimistic expectations about the future trend of the stock market; in the stock market earnings rise Initially, the rise in stock market returns will lead to positive investor expectations, while a sustained rise in returns will lead to pessimistic investor expectations, so relevant government units should grasp investor expectations in a timely manner and provide guidance; government departments can also regulate stock market investor expectations by controlling the timing of capital inflows into the stock market through policies. During periods of high stock market volatility, government departments can control risk-averse investors to form positive expectations of the future development trend of the stock market through policies and press measures, so as to promote the healthy operation and development of China's stock market with good expectations.

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