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# The Impact of Crowd Psychology on Stock Market Cycle Case of Vietnam Stock Market

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**ABSTRACT**

The stock market plays an increasingly important role in the economy, it is a place to raise capital for businesses, increase liquidity and provide many profit-seeking opportunities for individual investors. However, investing in the stock market is not easy, most investors are influenced by the crowd psychology, they have similar actions when influenced by the crowd, this creates cycles of the stock market. The article studies the influence of crowd psychology on Vietnamese investors by surveying 120 individual investors and analyzing investor psychology in phases of the Vietnamese stock market cycle. The results show that the majority of Vietnamese investors decide to choose stocks chosen by many other investors and they easily react when the crowd reacts. The Vietnamese stock market also goes through the same psychological cycles as the stock markets in other countries. Currently, the Vietnamese stock market is expected to be in a period of thrill or euphoria. Investors should be cautious and carefully consider their investment decisions so as not to fall into a state of panic and sell-off.

**KEYWORDS:** Crowd Psychology, Stock Market Cycle, Herd Effect, Individual Investors, Behavious Finance, Psychological Mistakes

## 1. INTRODUCTION

At present, the stock market is growing and playing an increasingly important role in the growth and stability of the economies of countries. It reflects the health of the economy, through stock prices and the growth of indicators that can assess macroeconomic growth, helping the government better control the performance of listed companies through the periodic production and business reports. The stock market helps businesses to raise investment capital through the issuance of securities in addition to borrowing from banks. Besides, the stock market makes it easy for investors to carry out potential investment plans and earn profits no matter how much invested capital, so it is suitable for many types of investors.

In fact, stock markets in all countries around the world are cyclical, and stock price fluctuations always repeat a similar pattern after a certain period of time. This is also the reason why many technical analysis indicators can be accurate again and again. The price is formed by the interaction between supply and demand in the market, the price will change according to the expectations of the crowd of investors in the market, the price will increase when the majority of investors buy and will decrease when many of investors sell. In essence, prices reflect the behavior of the crowd which makes herding effect, and this behavior is driven by the fear and greed of the crowd.

Due to the herd effect, many investors bought and sold stocks in a frenzy, creating economic bubbles and crashing the stock market. Notably, this behavior repeats itself after a period of time that makes up the stock market cycle. The herd effect is present in most markets even in the markets of developed countries, the world economic history has witnessed many bubble bursts and crises like the tulip bubble (1634). -1637), South Sea -England bubble (1711-1720), Florida-American real estate crisis (1920-1922), world recession 1929, crisis 1987, Asian financial crisis 1997, crisis dotcom panic, all caused by the herd effect. Therefore, the study of crowd psychology and herd effect has a positive effect, in order to identify and limit risks in economic activities in general and securities in particular.

This article uses descriptive statistics and analytic-synthetic methods to study how crowd psychology creates the cycle of the stock market and analyze the impact of crowd psychology on Vietnamese investors and the Vietnamese stock market, from which, investors can better understand how the market works and can use it to earn stable profits.

## 2. THEORITICAL FRAMEWORKS

### 2.1. Theory of crowd psychology

Crowd psychology is a branch of Social Psychology that studies the psychology and behavior of ordinary people in collective activities. Social psychologists have developed a number of theories to explain how crowd psychology differs from and interacts with the psychology of individuals within it. Crowd behavior is heavily influenced by the loss of individual responsibility and the impression of the behavior's popularity, both of which increase with the size of the crowd. When influenced by the crowd, individuals will behave like primitive people, without the ability to think and reason, but only feel by images, by the association of ideas, they are unstable, erratic. , and go from the most hysterical fervor to the most absurdly stupid. Moreover, because of their physical condition, such crowds needed a leader who could guide them and give meaning to their instincts. The reason for forming crowd psychology is that each individual often carries the fear of going against the crowd, fear of being laughed at for failing to grasp new trends. Moreover, crowd selection is always a safe choice because there are many people to choose from, or simply the concept of "the majority always prevails over the minority" makes the individual blindly follow the flashy but empty crowds.

Crowd psychology will create a herd effect, the word "herd" means a "group of animals", normally when together, animals often jostle and push, but when the leader of the herd acts, others immediately followed without thinking even though there might be wolves or sharks in front of them. Therefore, the herd effect refers to people's thoughts or behaviors that are frequently influenced by others. People often run after what the majority thinks is good, right and wise, but they themselves do not think about the meaning of things.

The stock market is characterized by a market of the crowd, but there is a paradox in the market that the crowd usually never wins. According to unofficial statistics, 95% of investors participating in the market lose, and only about 5% succeed. The herd effect always appears in all stock markets in the world, not just in any country. In the market, the herd effect refers to the fact that in a group of investors, individual investors often rely on the actions of other investors to act. When people buy, they also buy, when people sell, they also sell. Crowd psychology also rushes in one direction and appears in two cases: first, investors are too excited; Second, investors are too scared. Both of the above cases are equally dangerous, being too excited will easily create a bubble price, and being too scared will sell everything to cut losses, sometimes even cutting losses on good stocks, with chance of future recovery.

### 2.2. Stock market cycle

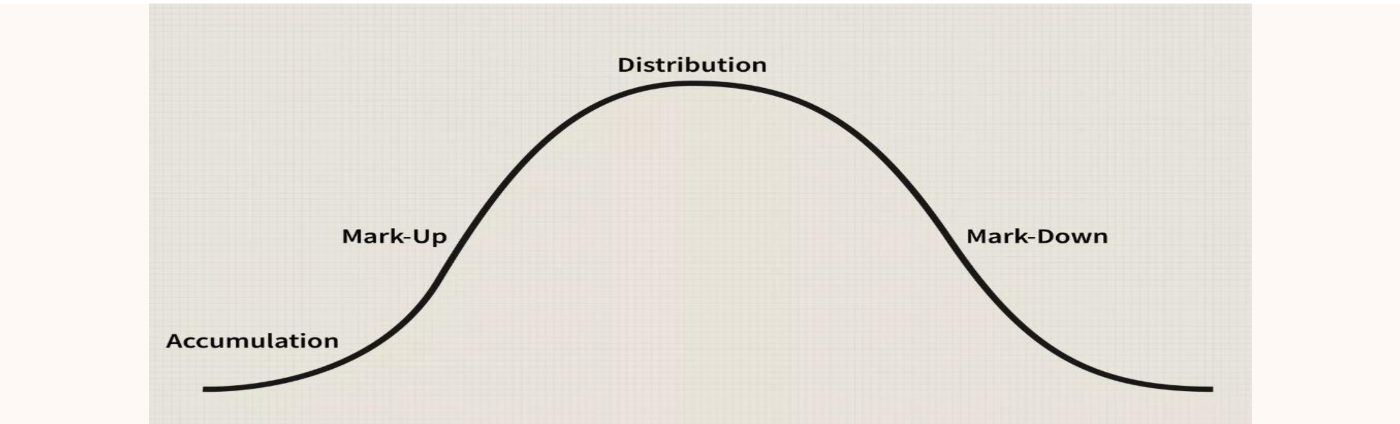
Cycle represents one or a series of phenomena that repeat over a certain period of time. A cycle is defined from bottom to bottom in an appropriate amount of time. The end of one cycle is the beginning of another

Stock market cycle is a term that refers to the trends or patterns that emerge in different markets or business environments. During a cycle, some securities or assets outperform others because their business models are suited to evolving conditions

Market cycles are often difficult to pinpoint until they occur and rarely have a specific beginning or ending point. A market cycle can range from a few minutes to many years, depending on the time frame of the analysis. A daily trader might look at five-minute time frames, while a long-term investor might look at a cycle of up to 20 years. At different stages of a complete market cycle, different securities will react differently to market forces. For example, during a bull market, luxury goods tend to outperform. In contrast, during a bear market,essential goods tends to perform better.

Market cycles have 4 stages: (1) accumulation: occurs after the market bottoms and early investors start buying, they find that the worst is over, (2) uptrend or markup: occurs when the market has stabilized for a period of time and rises to a higher price level, (3) distribution: at that time, sellers dominate when the stock peaks, (4) downtrend or markdown: occurs when the stock price crashes.

**Figure 1:** Stages of the stock market cycle



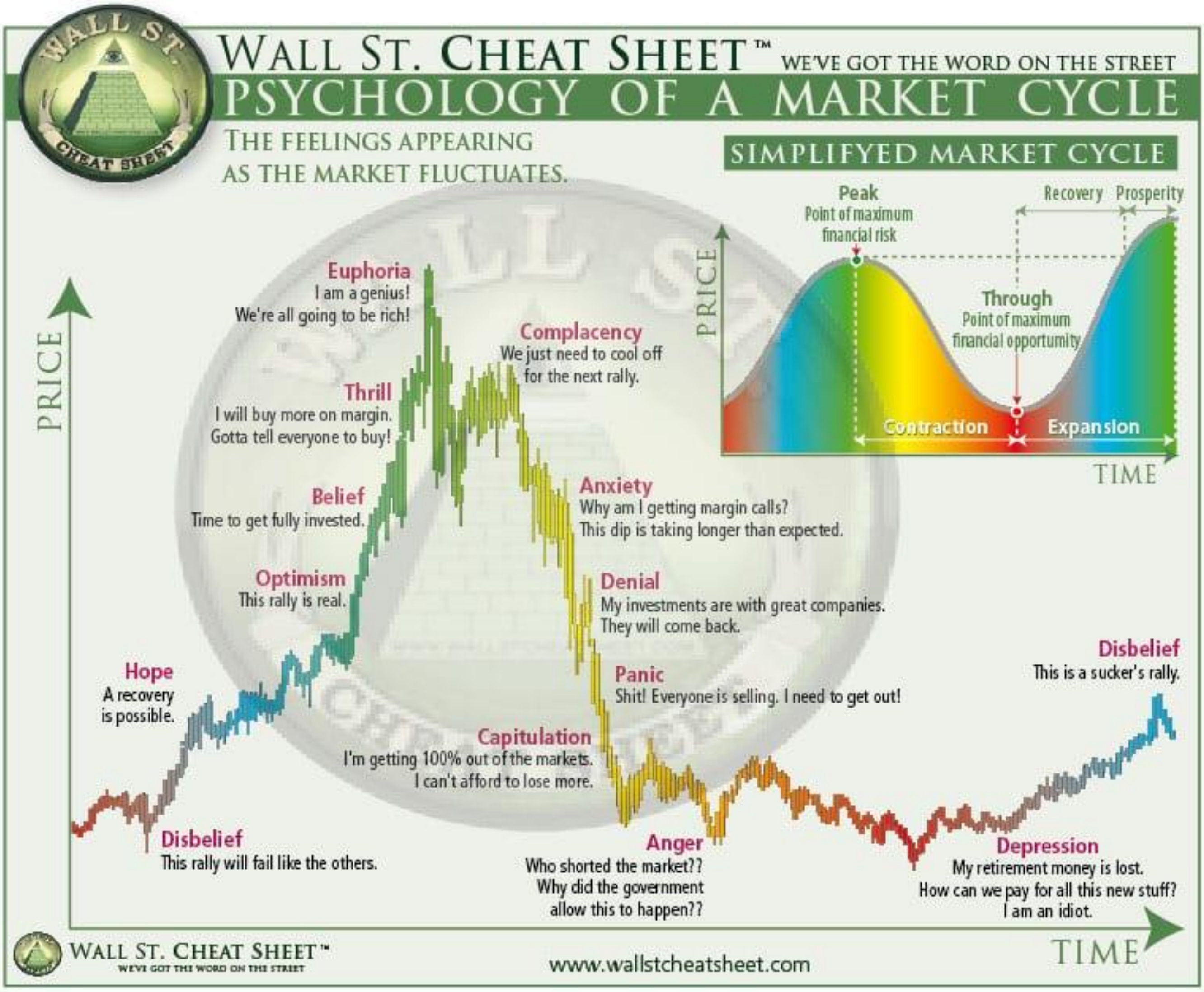

**Source:** Investopedia

**2.3. The impact of crowd psychology on market cycles**

Market cycles are formed by the influence of the psychology of the crowd. The psychology of the market cycle is a concept that refers to market movements that reflect (or are affected by) the emotional state of the participants, when the crowd is optimistic, the market is positive, the price increases continuously to form a uptrend (commonly known as bull market), whereas when the crowd panics, the market is negative, the price drops continuously, that is called downtrend. The herd effect will make the uptrend hotter by increasing the excitement in the bull market and the downtrend faster by increasing the panic when the price is down.

When participating in the market, most investor psychology is only summarized in two extremes of greed and fear. The chart below shows investor sentiment changes in the market including phases such as: disbefief, hope, optimism, belief, thrill, euphoria, complacency, anxiety, denial, panic, capitulation, anger, depression, and then repeat from the beginning.

**Figure 2:** Stages of psychology of a market cycle.




**Source:** The Cheat Sheet

The first stage is disbelief, at this stage investors do not really believe in the signs of market growth after a long period of bear market. The market has a slight growth but most think this is fake growth and do not believe the market can rise again.

Hope: After a slight recovery and growth, investors began to hope, expect, and cherish the belief that the market will grow again, but this belief is uncertain. During this period, the market price started to have stronger growth times, as well as price adjustment, but in the end the market continued to grow.

Optimism: After adjustment, the market continues to grow for a longer time. People are starting to be optimistic with positive thoughts about the next bull market but are still little afraid of the price to be adjusted.

Belief: Price continues to grow after breaking the old top, doubts about the decline disappear, investors have confidence that the market is definitely on an uptrend. Those who are already in the market will focus on investing more money in the market

Thrill: When the price continues to rise, the investor has made a lot of profit from his previous investment, the investor becomes excited, stimulating the desire to invest, not only investing alone but also introduced to relatives, friends and business relationships, etc. This is the stage when herd psychology begins to affect investor behavior and market prices.

Euphoria: New investors rush into the market because they see others buying and making profits, leading to the price going up too high, they are confident all investments are profitable. This phase is the peak of the growth wave.

Complacency: The market started to adjust down but investors are still believe that the market will rise again after the adjustment, therefore, investors continue to buy more.

Anxiety: The price continued to go down and did not rise again after the adjustment as investors initially expected. At this time, many margin accounts were liquidated due to a deeper drop of price than expected. Prices continue to go down despite many market's good news.

Denial: At this stage, investors still deny the market's downtrend because they believe that they have invested in potential projects, so there is no reason for the price to go down again.

Panic: Prices continue to go down deep and those who still hold their portfolios at high prices start to panic and sell their investments to cut loss. When seeing other investors sell, the panic increased, leading to the rest of investors selling to cut loss.

Capitulation: Investors who are still holding on after the panic see prices still going down, so will sell all their investments and don't want to hold any more.

Anger: Those who continue to hold will become extreme anger when they see market continuously decline due to various subjective and objective factors; they often ask questions such as: Why are there still sellers letting the price go down? Good news but why are prise still down? Why doesn't the government stop market manipulation?

Depression: When the market has bottomed and sideways continuously, it will make the remaining investors in the market feel sad, depressed and give up hope of the market's growth again. Depression is the final phase of a market cycle, after that a new cycle will begin by disbelief.

In the period of disbelief and hope, most of the crowd is still hesitant to participate in the market, the price tends to fluctuate sideways or increase slightly, the trading volume is low, creating the accumulation process. At the optimism, some investors started to participate in the market, most of the investors at this stage were professional investors who analyzed and recognized the trend of the market soon. When the bull market confidence is strengthened, seeing many profitable investors, the crowd starts to get interested and try to enter the market, the price continues to increase, the herd effect begins to take shape. The herd effect has a strong influence during periods of thrill and euphoria, the crowd rushes to buy shares even though they have no knowledge of the market, the price rises sharply and suddenly with large trading volume. During the period of complacency, anxiety, denial, the crowd has not accepted that the uptrend is over, they still hold stocks, only professional investors have exited the market, so the trading volume is still low, the price decreases gradually, creating the distribution process. In the panic and capitulation stage, the herd effect emerges when a lot of investors sell off, leading to a selling wave of crowd, causing the panic level of the market to reach the extreme, the price falls without stopping with high trading volume. The last stages are anger, degression will eliminate all amateur investors when they start to get bored and sell stocks at bottom. The new cycle repeats in the same way as the old pattern, even though investors know the market cycle, the reason is that a large number of investors have permanently left the market after experiencing pain and loss, they did not dare to return to the stock market, which is now being replaced by a new group of investors who have not yet experienced the different emotions of the market cycle. Their psychology and actions will repeat what happened before creating the cycles of the market.

## 3. RESERCH METHODOLOGY

The stusy uses qualitative research methods including logical and historical methods, synthetic analysis methods to understand the theoretical basis and application of crowd psychology analysis in the Vietnamese stock market cycle and quantitative analysis including descriptive statistical methods, data analysis to study the herd effect in Vietnamese investors.

Secondary data is collected from statistics of statistical organizations, reputable stock exchanges, data from articles, research articles published in reputable journals, primary data is collected through surveys. Survey subjects are investors who are directly trading on stock exchanges in Ho Chi Minh City. Due to the limited resources, the survey sample was 120 investors, using convenient sampling method. The survey scope was in Ho Chi Minh City because it is the largest financial and economic center of Vietnam. Surveys are sent to the investors via emails, Zalo or Messenger through the brokers of exchanges and trading groups.

To measure the influence of the herd effect on investors' decisions, the author uses the criteria outlined in Table 1 below.

**Table 1:** Criteria to measure the influence of herd effect on investors' decisions

| Variable | Measurement criteria | Reference |
|---|---|---|
| Herd effect (HE) | HE1: Influenced by other investors' stock selection decisions (usually buying stocks which many investors bought)<br>HE2: Influenced by other investors' trading volume decisions<br>HE3: Influenced by other investors' buying and selling decisions<br>HE4: Often monitor the reactions of other investors and react quickly to such changes | Muhammad Rehan (2021), Sarika Keswani (2019), Swati Prasad (2021) |

**Source:** Authors

From the above measurement criteria, the author built a survey questionnaire to assess the impact of each criterion on investment decisions as shown in Table 2 below.

**Table 2:** Questionnaire

| **Các nhận xét** | Absolutely disagree | Disagree | Slightly disagree | Slightly agree | Agree | Absolutely agree |
|---|---|---|---|---|---|---|
| **1.** You often trade stocks that many people around are trading (Anh/chị thường giao dịch những đối tượng mà nhiều người xung quanh đang giao dịch) | 1☐ | 2☐ | 3☐ | 4☐ | 5☐ | 6☐ |
| **2.** You usually decide the trading volume according to the trading volume of other investors (Anh/chị thường quyết định khối lượng giao dịch theo khối lượng giao dịch của những nhà đầu tư khác) | 1☐ | 2☐ | 3☐ | 4☐ | 5☐ | 6☐ |
| **3.** You often decide to trade according to the trading of other people around you (or trade according to the orders of the consultants) (Anh/chị thường quyết định thực hiện giao dịch theo các giao dịch của những người xung quanh hay giao dịch theo lệnh của các chuyên gia tư vấn) | 1☐ | 2☐ | 3☐ | 4☐ | 5☐ | 6☐ |
| **4.** You often monitor the reactions of other investors and react to those changes (Anh/chị thường theo dõi phản ứng của những nhà đầu tư khác và phản ứng theo những thay đổi đó) | 1☐ | 2☐ | 3☐ | 4☐ | 5☐ | 6☐ |

**Source:** Authors

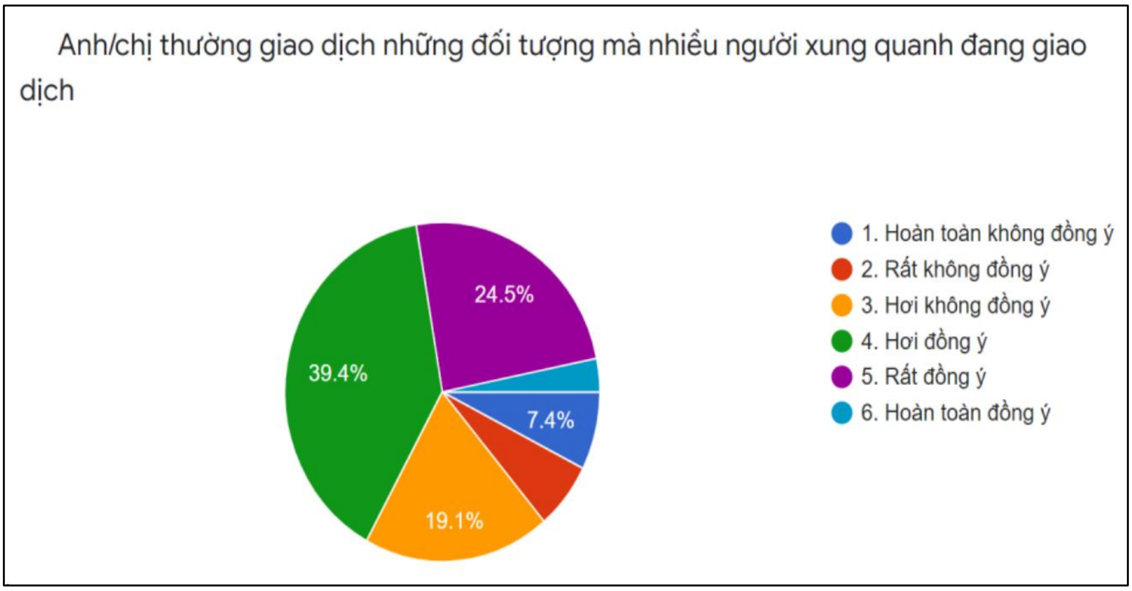
## 4. RESULTS AND DISCUSSION

### 4.1. Influence of crowd psychology on Vietnamese investors

The number of votes collected is 120, the number of valid votes is 120. The percentage of female investors is 55%, the rate of male investors is 45%, in which 0,8% of investors have high school education, 2,5% have college degrees, 87,5% have university degrees, 9,2% have master degrees. Regarding investor age: 50,8% of investors are between the ages of 18 and 25, 39,2% are between the ages of 26 and 35, and 12% are older than 36 year old. The majority of investors working in the financial industry accounted for 70,8% of investors surveyed.

One of the most common signal of the herd effect in Vietnamese investors is that they often choose stocks that many people choose even though they do not know the operating status of that company. When surveyed, 67,1% of traders agree that they are influenced by the stock choices of people around them with a quarter of investors choosing strongly agree.

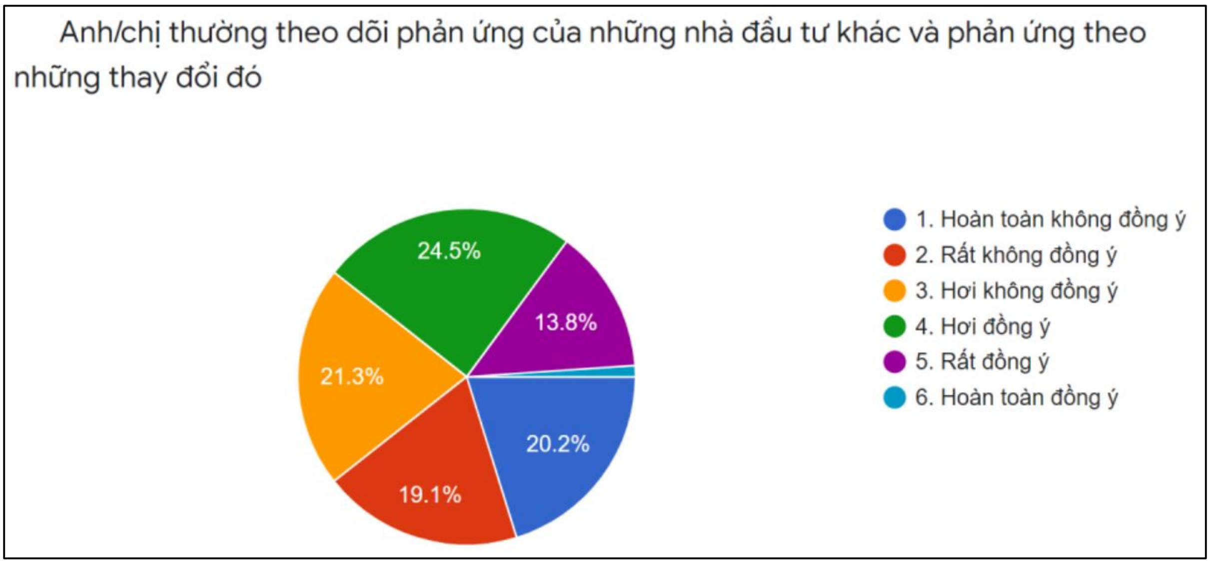
**Figure 3:** Survey results of the question: “You often trade stocks that many people around are trading”




**Source**: Authors survey results

Next, investors are also often affected by the decisions and reactions of other investors, when they see other investors massively buying, they also feel hungover, afraid of missing out, so they will react by participating in buying. When they see the crowd selling, they feel fear, panic and will also react by selling to cut their losses. When surveyed, 39,4% of investors agreed that they are easily swayed by the decisions of others.

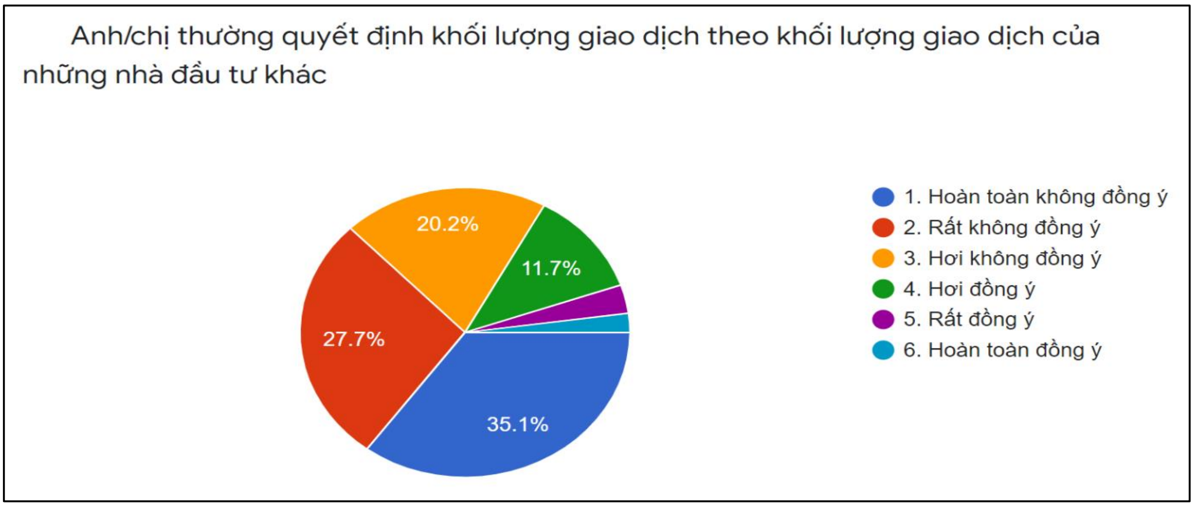
**Figure 4:** Survey results of the question: “You often monitor the reactions of other investors and react to those changes”




**Source:** Authors survey results

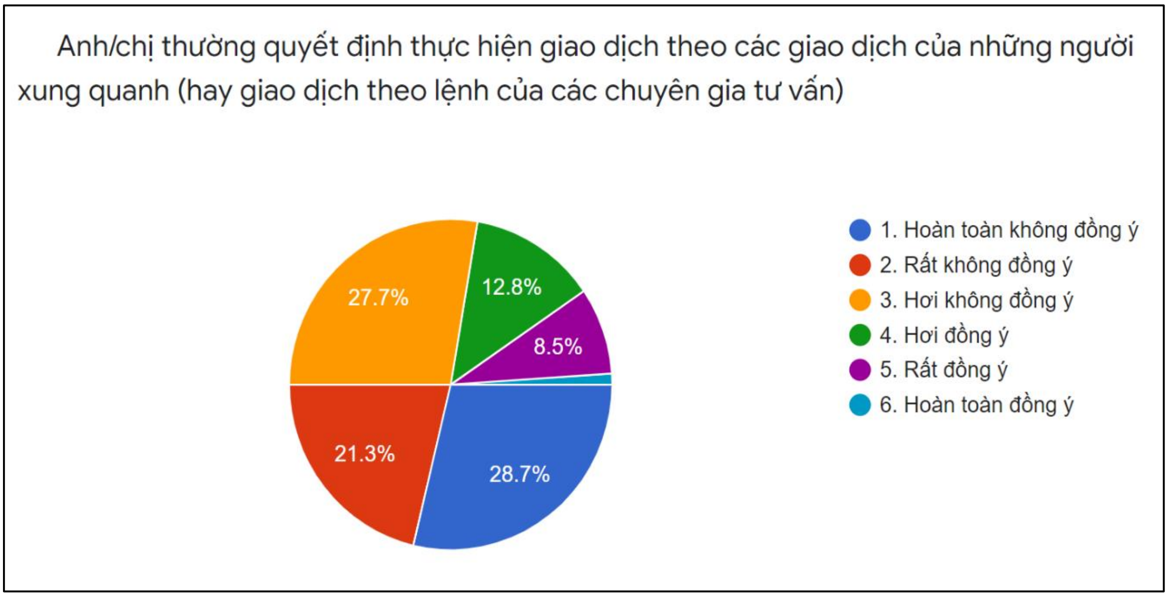
However, the trading volume of investors is less influenced by other investors and they also do not often trade on the orders of the advisor, 83% of investors choose to disagree with the question. “You usually decide the trading volume according to the trading volume of other investors”, this can be explained by the financial ability of each investor is different, and they will decide the trading volume suitable for their account size, so they are also less affected by the crowd, 77,7% of investors say that they are less affected and less follow orders of people around as well as advisor's recommendation.

**Figure 5:** Survey results of the question: “You usually decide the trading volume according to the trading volume of other investors”




**Source:** Authors survey results

**Figure 6:** Survey results of the question: “You often decide to trade according to the trading of other people around you (or trade according to the orders of the consultants)”



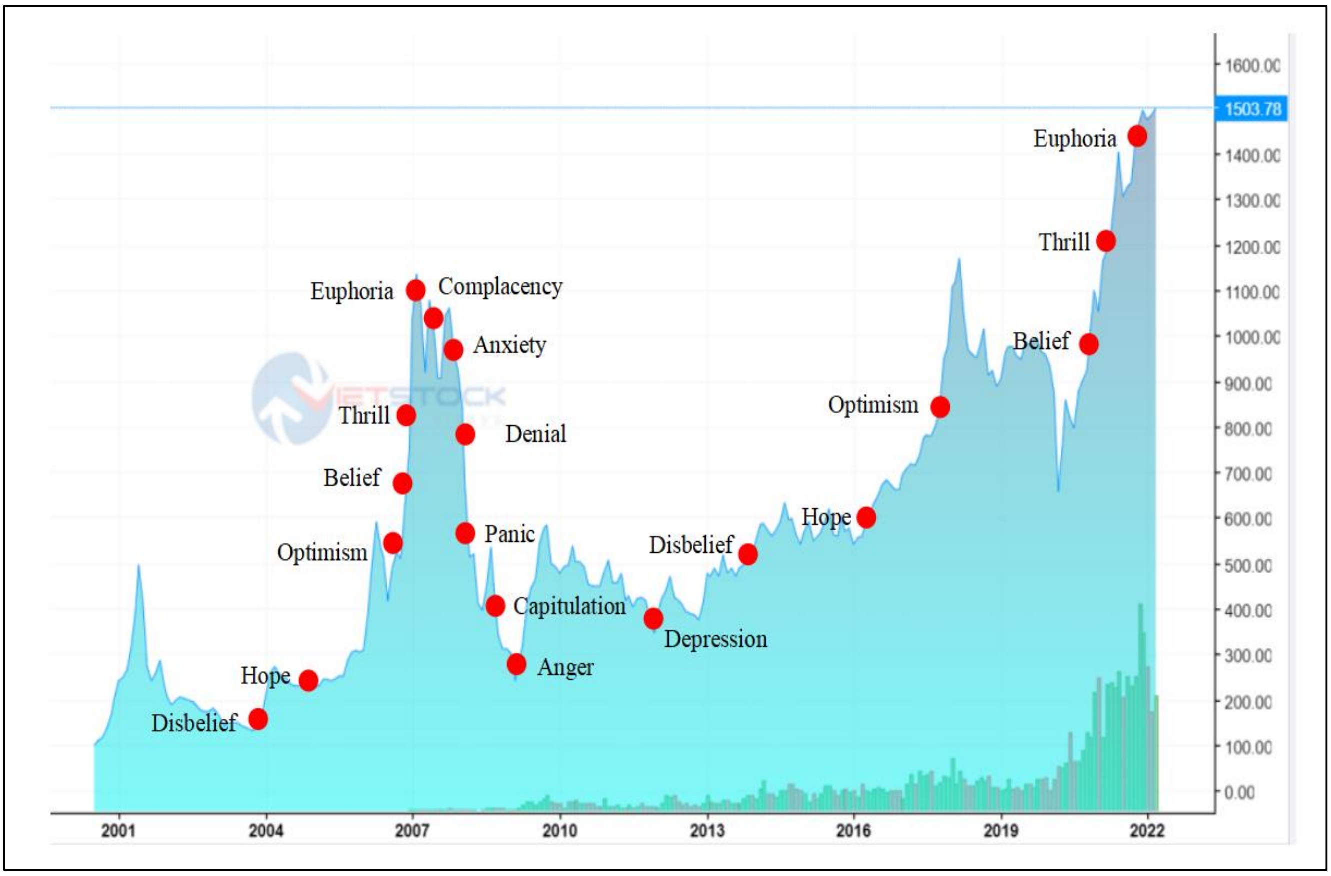

**Source:** Authors survey results

Thus, in general, Vietnamese investors are still affected by the herd effect, the actions of other investors can affect their mood and behavior, the degree of influence of the herd effect may be different for each specific action, but it shows most in the decision to choose stocks and monitor the actions of people around to make their decisions. This can have a negative impact on investors because stocks are not always bought by many people with high trading volume is a good quality stock, investors need to spend more time researching the companies to make a reasonable choice. Besides, always paying attention to other people's reactions can make your decisions become unbiased, lose confidence, don't dare to trade for fear of going against the crowd even though your analysis is correct.

**4.2. Analysis of crowd psychology and Vietnam stock market cycle**

Vietnam's stock market also faces market cycles like stock markets in other countries, which can describe the evolution of investor psychology at different stages of the Vietnamese stock market cycle in figure 7 below.

**Figure 7:** Vietnam stock market cycle (updated to 24/3/2022)




**Source**: Authors

Figure 7 has described the psychological state of Vietnamese investors since the establishment of the Vietnamese stock market, the period 2005 - 2007 witnessed the rapid growth of the market, investors were very optimistical, everyone participates in the stock market, even those who do not know anything about business and investment also participate in the stock market when they see many people becoming rich thanks to the stock market. That herd effect led to excessive bubble growth and the inevitable result is crisis of the market in 2008, panic investors sell their stock to cut losses leading to a rapid market crash close to the starting level and sideway at the low point for long time before gradually increasing again.

The current period is witnessing a rapid increase of the market, the VN-Index rises steeply with high trading volume, the "stock market, stock investment" has become the interested topic of many different classes in society, including those who have never known investing before, this is a sign of a hot growth situation, it can predict that investor psychology is in the stage of thrill or euphoria, so investors need to be very careful and keep calm to avoid being influenced by the crowd to be able to make wise and reasonable investment decisions, avoid causing heartbreaking losses that negatively affect your financial situation as well as your psychological health in the future.

The impact of crowd psychology on the formation of the market cycle is similar when analyzing specific stock, here is a example of the FLC stock cycle.

**Figure 8:** Daily chart of FLC Group Joint Stock Company in period of 2020 - 2022 (updated to April 1, 2022)


**Source:** Authors

When people expect the growth of FLC, the psychology of hope, optimism, and belief encourages the crowd to buy, creating pirce increase with high volume, which attracts more and more investors joined buying, the FLC price continued to rise leading to thrill and euphoria of the crowd. But when there is negative news for this stock, the crowd became anxious and panic and sold out to stop loss, a sign that can be recognized the panic is a sharp drop in price (continuously hitting the floor price for many days) with the high volume. The traders who only follow crowd have a high probability of entering the market when prices are near the top and panic selling to cut losses when the crowd sells, which will result in losses for these investors, so we must be very careful in controlling our psychology and limiting the influence of the crowd.

## 5. CONCLUSION

The stock market is a place where many people become rich, but it is also a place where many investors have to bitterly leave with huge losses and severe emotional trauma. Price changes in the market reflect the crowd psychology and it repeats itself in the stock market cycles, so understanding the crowd psychology can help traders looking for profit. Vietnamese investors are no exception, they are also affected by crowd psychology therefore the Vietnamese stock market also moves in cycles. The past two years have witnessed the rapid growth of the Vietnamese stock market, which is a good thing, but we must also be alert to recognize signs of euphoria to avoid enter the market at peak. Understanding the psychology of the crowd will help investors realize and avoid many market traps, keep investors survive and have stable profits. Then there will be no euphorical buying at the top or panic selling at the bottom, investors will become more disciplined, the market is still there as the way its cycles work, will repeat, will provide new opportunities for traders who have patience, know how to manage their capital and ultimately know when beginning and endind of the endless cyclical waves of the market!

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