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MARKETS: TOWARDS AN INVESTOR  
SENTIMENT INDEX FOR INDIA AND  
ARGENTINE SOVEREIGN BONDS

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# BEHAVIORAL FINANCE IN EMERGING MARKETS: TOWARDS AN INVESTOR SENTIMENT INDEX FOR INDIA AND ARGENTINE SOVEREIGN BONDS

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**Abstract:** This paper explores the critical role of investor sentiment in understanding market behavior, with a particular focus on emerging markets, specifically India and Argentina. Drawing on the theory of behavioral finance, we examine how sentiment-driven factors—such as emotions, cognitive biases, and social influences—shape investor decision-making in these volatile markets. By analyzing both theoretical perspectives and real-world market data, we highlight how investor sentiment can lead to market inefficiencies, increased volatility, and sudden shifts in asset prices. The paper also delves into the potential of artificial intelligence (AI) to enhance sentiment analysis, offering a more accurate and timely understanding of market dynamics. Through AI techniques such as natural language processing (NLP) and machine learning, investors can better gauge sentiment trends and predict market movements, providing a competitive edge in emerging economies. The case studies of India and Argentina illustrate the complex interplay between sentiment and market behavior in environments characterized by political instability, economic uncertainty, and external shocks. Finally, the paper discusses the possibility of building an Investor Sentiment Index for India and Argentine Sovereign Bonds, and the implications for investors and policymakers in managing sentiment-induced volatility, as areas for future research in the integration of AI and behavioral finance in emerging markets.

**Key Words:** Behavioral Finance, Investor Sentiment, Artificial Intelligence, and Market Behavior

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## Introduction

Understanding the dynamics of financial markets has long been a subject of keen interest for both academics and practitioners. Among the various factors that influence market behavior, investor sentiment has emerged as a pivotal concept in behavioral finance. It highlights how psychological and emotional factors, rather than purely rational assessments, drive investment decisions and market outcomes.

In the context of emerging markets, investor sentiment becomes particularly significant. These markets, characterized by rapid growth potential and inherent volatility, are more susceptible to external influences and behavioral biases. India and Argentina provide compelling case studies: India, as an emerging economic powerhouse with a robust financial market, and Argentina, as a country marked by financial crises and macroeconomic instability. By examining these cases, we aim to understand how investor sentiment shapes their market behavior.

This paper is structured into two main sections. The first part delves into the theory of investor sentiment, exploring its foundations, measurement tools, and implications for market behavior. The second part focuses on emerging markets, with particular attention to India and Argentina, to illustrate how investor sentiment operates in real-world scenarios. By connecting theory with practice, this study seeks to provide insights into the broader implications of investor sentiment for emerging market economies.

## Theory of Investor Sentiment

### Conceptual Framework

Investor sentiment refers to the overall mood or attitude of investors toward financial markets, reflecting their willingness to take risks. This sentiment can deviate from objective fundamentals, leading to phenomena such as overvaluation, undervaluation, or excessive market volatility. Scholars such as Barberis, Shleifer, and Vishny (1998) have provided foundational models that integrate sentiment into financial market analysis, bridging gaps in traditional theories.

Key characteristics of investor sentiment include:

- **Heuristics and Biases:** Cognitive shortcuts that influence decision-making, such as overconfidence and anchoring.
- **Emotional Responses:** Fear and greed as primary drivers during downturns and booms.
- **Collective Behavior:** Herding tendencies that amplify market trends.

While traditional finance assumes rational agents, behavioral finance and investor sentiment acknowledge the role of human psychology, particularly under uncertainty.

Investor sentiment plays a crucial role in shaping market dynamics, representing the mood or general attitude of investors toward the market. It goes beyond traditional rational decision-making theories, which assume that investors act based on available information and expected returns. Instead, investor sentiment acknowledges that emotional factors, biases, and psychological influences frequently lead investors to make decisions that deviate from fundamentals.

Investor sentiment can manifest in various ways, such as:

- **Optimism:** When investors are generally confident about future economic prospects, leading to increased demand for risky assets.
- **Pessimism:** When negative news or fears about economic stability lead to widespread sell-offs and a flight to safety.
- **Excessive optimism or pessimism:** Situations where investors become overly confident or fearful, resulting in market bubbles or crashes.

Scholars in behavioral finance, such as Barberis, Shleifer, and Vishny (1998), Shiller (2000), and Baker and Wurgler (2006), have developed models to incorporate investor sentiment into financial market theory. These models often challenge the efficient market hypothesis (EMH), which assumes that all available information is fully reflected in asset prices. In contrast, the sentiment-driven view suggests that markets can be inefficient due to irrational behavior, leading to mispricing and volatility.

The key difference between sentiment-driven models and traditional financial models lies in the role of human psychology. Investor sentiment influences market prices through:

- **Overreaction and Underreaction:** Investors may overreact to new information during periods of extreme sentiment (either optimism or pessimism) or underreact during more neutral periods.
- **Herd Behavior:** The tendency for individuals to follow the actions of a larger group, particularly in moments of uncertainty, which can exacerbate market trends.

**A. Tools for Measuring Investor Sentiment**

While investor sentiment is inherently difficult to quantify, numerous methods have been developed to gauge its strength and direction. These tools rely on both qualitative and quantitative data sources to track the mood of the market.

1. **Sentiment Indices:** Several indices have been created to measure market sentiment, such as the American Association of Individual Investors (AAII) Sentiment Survey, which tracks the sentiment of retail investors. Another common index is the Volatility Index (VIX), which reflects investor fear based on options pricing.

2. **Media and News Analysis:** With the rise of digital platforms, analyzing public sentiment has become more accessible. Studies have used news articles, social media posts, and even Google search trends to track investor mood. For example, sentiment analysis of Twitter feeds or financial news can provide insights into whether investors are bullish or bearish.

3. **Market Indicators:** Some market indicators, such as the Put-Call Ratio, measure sentiment indirectly. A high ratio of put options (bets that prices will fall) to call options (bets that prices will rise) suggests bearish sentiment, while a low ratio signals optimism.

4. **Surveys and Polls:** Investor sentiment is also tracked through surveys conducted by financial institutions, such as the University of Michigan Consumer Sentiment Index. These surveys assess consumer and investor confidence and can serve as leading indicators for market movements.

Consumer Confidence Index (CCI), Volatility Index (VIX), and others index.

Indicator	Description	Data Source	Typical Use Case
Consumer Confidence Index (CCI)	Measures consumer optimism	Conference Board	Predicts consumer spending trends
Volatility Index (VIX)	Market volatility proxy	CBOE	Gauges fear in market
Emerging Market Sentiment Index	Sentiment in emerging markets	Bloomberg	Tracks risk appetite

By combining these various tools, analysts and researchers can form a more comprehensive view of market sentiment, although it is important to recognize that sentiment is highly dynamic and can change rapidly.

### Impact of Investor Sentiment on Market Behavior

Investor sentiment plays a significant role in market behavior, especially during times of heightened uncertainty or significant economic shifts. Sentiment can directly influence asset prices, volatility, and trading volumes, often more than underlying economic fundamentals.

- **Market Volatility:** Positive sentiment can lead to excessive optimism, where investors drive up asset prices beyond their fundamental value, creating speculative bubbles. Conversely, negative sentiment may lead to market crashes, where panic selling ensues, even if the fundamental economic situation is not as dire.

- **Price Swings:** Sentiment-driven price swings often defy rational explanation, as seen during periods of overvaluation or undervaluation. For instance, during the dot-com bubble in the late 1990s, excessive optimism about technology stocks led to a sharp rise in prices, followed by a massive correction when sentiment turned negative.

- **Investor Behavior:** Investor sentiment can also affect individual decision-making. For example, when sentiment is high, investors may be more likely to take risks, engage in margin trading, or follow popular trends, even without fully considering the risks involved. Conversely, during periods of low sentiment, investors may exhibit risk aversion, avoiding equities and flocking to safer assets like bonds or gold.

The connection between investor sentiment and market outcomes is particularly relevant for understanding bubbles and crashes. In these extreme scenarios, investor sentiment can detach from underlying economic fundamentals, creating opportunities for mispricing and excessive volatility.

### Investor Sentiment in Developed vs. Emerging Markets

Investor sentiment operates differently in developed and emerging markets due to varying economic structures, investor bases, and institutional frameworks.

- **Developed Markets:** In mature financial markets, sentiment is often influenced by a relatively small number of institutional investors and well-established information channels. These markets tend to have deeper liquidity and more efficient mechanisms for price discovery, which can dampen the effects of sentiment shifts. However, even in developed markets, sentiment-induced bubbles and crashes, such as the 2008 global financial crisis, demonstrate the powerful role of emotion-driven behaviors.

- **Emerging Markets:** Emerging markets, on the other hand, are often more susceptible to swings in investor sentiment due to several factors:

- **Higher Volatility:** The risk and return profile of emerging markets tends to be more volatile, amplifying the effects of sentiment.

- **External Influences:** Emerging market sentiment is also highly influenced by global economic conditions, foreign investment flows, and political instability.

- **Market Psychology:** Investors in emerging markets may be more prone to emotional decision-making due to a lack of information, a less developed regulatory environment, and a greater susceptibility to herd behavior.

For instance, in countries like Argentina and India, where economic conditions can fluctuate rapidly, shifts in investor sentiment can have immediate and dramatic effects on market performance.

### Role of Sentiment in Emerging Markets

Investor sentiment has a particularly unique and pronounced role in emerging markets, where several structural and behavioral factors amplify its effects. Understanding these nuances is crucial for analyzing how investor sentiment can influence market behavior in these contexts, especially in countries like India and Argentina.

### Increased Sensitivity to Global Events

Emerging markets are more sensitive to global economic events, such as changes in commodity prices, foreign exchange fluctuations, and geopolitical risks. This makes their financial markets highly reactive to shifts in investor sentiment. For example, an increase in global risk aversion, as seen during financial crises or geopolitical tensions, can lead to a sudden withdrawal of foreign capital, which disproportionately affects emerging markets due to their dependence on external funding.

- **Capital Flows and Sentiment:** Emerging markets tend to be heavily reliant on foreign direct investment (FDI) and portfolio inflows. These capital flows are often driven by global risk sentiment, where investors move in and out of emerging markets based on their perception of risk and return. When sentiment is negative, foreign capital tends to flee, leading to a devaluation of currencies, rising interest rates, and market volatility.

- **Commodity Prices:** Many emerging market economies, such as Argentina, are heavily dependent on exports of commodities. Investor sentiment in global commodity markets can, therefore, have an outsized impact on their financial markets. For example, a sudden shift in sentiment regarding oil prices or agricultural products can lead to sharp fluctuations in the stock prices of companies in these markets.

### Market Liquidity and Investor Behavior

Emerging markets are typically characterized by lower liquidity and fewer institutional investors than developed markets. As a result, investor sentiment tends to have a more pronounced impact on market movements in these economies.

- **Lower Liquidity:** Lower market liquidity means that sentiment shifts can lead to more significant price swings. In developed markets, large institutional investors provide a stabilizing effect by conducting more thorough analyses of assets. In contrast, in emerging markets, retail investors and smaller institutional players may be more reactive to short-term sentiment shifts, resulting in increased volatility.

- **Herd Behavior:** Investors in emerging markets are often more prone to herd behavior due to the limited availability of reliable information and fewer risk-management tools. When sentiment turns negative, a herd mentality can cause widespread panic, leading to market crashes. Conversely, excessive optimism can fuel speculative bubbles, as investors flock to the market driven by emotions rather than fundamentals.

### Political and Economic Instability

Emerging markets are often marked by political instability, policy uncertainty, and higher levels of economic volatility. Investor sentiment in these markets is heavily influenced by factors such as political elections, fiscal policies, inflation rates, and governance issues.

- **Political Sentiment:** In countries like Argentina, political sentiment can drastically influence investor confidence. For example, in times of political turmoil or uncertainty regarding government policies, investors may shift to safer assets, creating significant pressure on the local currency and financial markets. The recent economic crises in Argentina have often been linked to investor reactions to political decisions, such as changes in taxation, foreign exchange policies, and government interventions.

- **Economic Sentiment:** In emerging markets, investor sentiment is also closely tied to perceptions of the economic outlook. In countries like India, where economic growth has been strong, investor sentiment has generally been positive, driving capital inflows and stock market gains. However, economic downturns, high inflation, or fears of economic mismanagement can quickly alter sentiment, leading to market volatility.

### Psychological Factors and Cognitive Biases

Investor sentiment in emerging markets is also more susceptible to psychological factors and cognitive biases, which can lead to decision-making that deviates from rational expectations. Behavioral finance research has shown that biases such as loss aversion, overconfidence, and anchoring can have a significant impact on investor behavior, especially in volatile environments.

- **Loss Aversion:** Investors in emerging markets are particularly sensitive to losses, which can lead to abrupt sell-offs when markets show signs of decline. During economic downturns, investors may panic and sell off their holdings, fearing further losses, even if the long-term fundamentals remain strong.

- **Overconfidence:** When sentiment is high and markets are performing well, investors may become overly confident, leading them to take excessive risks. This is common in emerging markets where investors may believe that the market will continue to rise indefinitely, ignoring warning signs of potential instability.

- **Anchoring:** Investors in emerging markets may also exhibit anchoring bias, where they base their decisions on historical data or past performance that may not be relevant in the current market context. For example, they may anchor their expectations to previous periods of growth, leading to overly optimistic projections.

### Conclusion on Investor Sentiment in Emerging Markets

Investor sentiment in emerging markets is an important determinant of market dynamics and behavior. It has the power to amplify volatility, fuel speculative bubbles, or lead to sudden market crashes. The heightened sensitivity of emerging markets to global economic shifts, political instability, and psychological biases makes them especially vulnerable to sentiment-driven market movements.

In the next sections, we will explore how these factors play out in practice in two important emerging markets—India and Argentina. By understanding the mechanisms at play in these specific markets, we can gain deeper insights into how investor sentiment influences their financial markets and how investors can better navigate these environments.

### Role of Artificial Intelligence in Understanding Market Sentiment

Investor sentiment is often driven by emotions, news, and social factors that are difficult to quantify using traditional models. However, with the rise of artificial intelligence (AI) and machine learning, it has become increasingly possible to analyze large datasets and identify sentiment trends that might otherwise go unnoticed. AI-based methods, particularly in the fields of natural language processing (NLP) and big data analytics, offer promising ways to measure and predict investor sentiment with greater precision and timeliness.

**AI in Sentiment Analysis**

Artificial intelligence tools can process vast amounts of unstructured data from various sources, including news articles, social media platforms, and financial reports. **Sentiment analysis**, a subset of NLP, can be used to analyze textual data and classify it into positive, negative, or neutral sentiments. This approach helps gauge public opinion on market events, policy decisions, and political developments, all of which can heavily influence market movements.

For example, AI algorithms can analyze **tweets, financial news, or company earnings reports** to detect sentiment shifts that might precede significant market changes. This capability allows investors to act quickly on sentiment-driven market trends, gaining a competitive edge.

**Machine Learning for Market Prediction**

Machine learning, particularly **supervised learning** algorithms, has become integral in predicting market trends based on historical data. These models can incorporate sentiment data derived from news, social media, and financial reports alongside traditional financial indicators. The combination of sentiment and quantitative factors can provide a more holistic view of market conditions.

In the context of emerging markets like India and Argentina, where volatility and external shocks can heavily influence investor sentiment, AI models can help forecast potential market corrections or rallies. These models can adapt to changes in sentiment over time, improving their accuracy and usefulness.

**Machine Learning Models in Sentiment Analysis**

Model	Strengths	Limitations	Common Applications
Random Forest	High accuracy, robustness	Prone to overfitting	Financial sentiment analysis
Neural Networks	Captures complex patterns	Computationally expensive	Social media sentiment
Support Vector Machines	Effective in small datasets	Limited in large datasets	Text-based sentiment

**AI in Monitoring Social Media for Sentiment Shifts**

In the age of digital communication, social media platforms such as Twitter, Reddit, and Facebook have become important sources of market sentiment data. AI-powered tools can monitor these platforms in real-time to track shifts in investor mood or anticipate market movements. For instance, Reddit’s WallStreetBets community has proven to be a powerful driver of market sentiment, as seen in the GameStop short squeeze event.

By using AI to analyze social media posts and trends, investors can gain insights into herding behavior and other sentiment-driven phenomena that traditional methods might miss. This is particularly useful in emerging markets, where sentiment can be amplified by rumors or social movements.

**A. AI for Early Detection of Market Bubbles**

One of the most compelling applications of AI in financial markets is its ability to detect early signs of market bubbles. By continuously monitoring sentiment and comparing it with historical price trends, AI models can identify **discrepancies** between market valuations and investor sentiment, which often precede financial bubbles.

In emerging markets like India and Argentina, where economic crises can result from bubbles, AI could serve as a tool for regulators and investors to take preemptive action before sentiment-driven market distortions lead to crashes.

**B. Challenges and Limitations of Using AI in Sentiment Analysis**

Despite the potential of AI to enhance sentiment analysis, there are several challenges to consider:

- **Data Quality:** The accuracy of AI models depends on the quality of the data used. Incomplete or biased data can lead to incorrect sentiment readings.

- **Model Overfitting:** Machine learning models may be prone to overfitting, especially when trained on small datasets or overly complex features, which can reduce their predictive power.

- **Interpretability:** Many AI models, particularly deep learning algorithms, can act as “black boxes,” making it difficult to understand how they arrive at specific conclusions. This lack of transparency can be problematic for investors seeking to interpret model outputs.

### C. Role of Artificial Intelligence in Understanding Market Sentiment

Investor sentiment is often shaped by factors that are difficult to quantify using traditional financial models. Emotions, rumors, political events, and social factors frequently drive market behavior, especially in emerging markets, where economic instability and external shocks are common. However, with advancements in artificial intelligence (AI), it is now possible to analyze vast quantities of unstructured data to measure and track sentiment shifts in real time. This section explores the various applications of AI in understanding investor sentiment, focusing on how AI tools can enhance traditional methods of sentiment analysis and provide deeper insights into market behavior.

### D. AI-Powered Sentiment Analysis

One of the key contributions of AI to the understanding of investor sentiment is its ability to process and analyze large datasets from a variety of sources. Sentiment analysis, a subset of natural language processing (NLP), enables the extraction of subjective information from text-based data. AI models can analyze news articles, social media posts, financial reports, and other textual data to classify sentiment as positive, negative, or neutral.

For example, AI can be used to track how specific news events—such as political developments, economic reforms, or corporate earnings—affect market sentiment. By processing thousands of news articles or tweets in real time, AI algorithms can detect subtle shifts in sentiment that may precede significant market movements. This enables investors to act swiftly, identifying trends and making informed decisions based on real-time sentiment data.

In emerging markets like India and Argentina, where sentiment can be heavily influenced by political instability and economic uncertainties, AI-powered sentiment analysis becomes a valuable tool for predicting market reactions to events such as elections, changes in fiscal policy, or external economic shocks.

### E. Machine Learning for Predicting Market Movements

Machine learning (ML), a core branch of AI, plays a crucial role in predicting market trends by incorporating sentiment data alongside traditional financial indicators. In the context of emerging markets, machine learning models can be trained to detect patterns in historical market data, including stock prices, trading volumes, and sentiment scores. These models can then use this information to forecast future market behavior.

For instance, supervised learning algorithms, such as decision trees and support vector machines (SVM), can analyze past market data to identify which sentiment signals—whether positive or negative—are most strongly correlated with specific market movements. By learning from historical patterns, these algorithms can improve their ability to predict market shifts, providing investors with more accurate forecasts.

In addition to predicting broad market movements, machine learning can also be used to forecast sentiment-driven volatility. For example, in Argentina, where financial markets are highly susceptible to changes in investor sentiment due to economic crises and inflationary pressures, machine learning algorithms can help investors anticipate periods of heightened market risk or identify opportunities when sentiment is overly pessimistic.

### F. AI in Social Media Monitoring

Social media platforms like Twitter, Facebook, and Reddit have become critical sources of information and sentiment for investors. The rise of social trading communities, such as Reddit’s WallStreetBets, has highlighted the power of collective sentiment in influencing market movements. AI tools can monitor these platforms in real time, using NLP algorithms to track shifts in sentiment and detect emerging trends.

For example, AI can be employed to track the frequency and tone of keywords related to specific stocks, sectors, or economic events. By analyzing these social media posts, AI can identify when a particular sentiment is gaining traction, signaling potential market movements. In emerging markets like India, where social media has become a dominant platform for political discourse and financial speculation, AI’s ability to assess public sentiment on these platforms is invaluable in predicting market reactions to government policies or global economic events.

AI models can also detect herding behavior, where investors tend to follow the actions of others rather than making independent decisions. This is particularly prevalent in emerging markets, where the flow of information can be uneven, and sentiment is often driven by social influence. By monitoring social media discussions, AI can flag instances where investor sentiment is becoming excessively optimistic or pessimistic, providing early warnings of potential bubbles or crashes.

### G. AI for Early Detection of Market Bubbles

One of the most compelling applications of AI in financial markets is its ability to detect market bubbles before they burst. Bubbles often form when market prices become disconnected from underlying fundamentals, driven by irrational exuberance or collective sentiment. AI models can help identify early signs of such bubbles by comparing current sentiment levels with historical market data and price trends.

For instance, AI can use unsupervised learning techniques to identify clusters of stocks or assets that are experiencing disproportionate increases in price without corresponding improvements in their underlying financials. By analyzing sentiment data alongside price movements, AI can flag assets that are being overly hyped by market participants, alerting investors to potential risks.

In the case of Argentina, where inflation and currency devaluation are recurring risks, AI could play a crucial role in identifying when market sentiment is becoming overly optimistic about the country's economic outlook, potentially leading to a bubble in stocks, bonds, or currency markets.

### H. Challenges and Limitations of Using AI in Sentiment Analysis

While AI offers significant potential in understanding market sentiment, there are several challenges and limitations to consider:

**Data Quality:** The effectiveness of AI models depends on the quality of the data they are trained on. Incomplete, biased, or noisy data can lead to inaccurate sentiment readings, undermining the model's predictive power. In emerging markets, where data quality may be lower or harder to obtain, these challenges become more pronounced.

**Model Complexity:** Many AI models, especially deep learning algorithms, are complex and can sometimes act as "black boxes," making it difficult to interpret how they arrive at their conclusions. This lack of transparency may make it harder for investors and policymakers to trust AI-driven insights.

**Overfitting:** Machine learning models can sometimes overfit to historical data, meaning they perform well on past data but fail to predict future market movements accurately. This is particularly problematic in volatile environments like emerging markets, where market conditions can change rapidly.

### I. The Future of AI in Sentiment Analysis for Emerging Markets

Looking ahead, the integration of AI in sentiment analysis is likely to grow in importance, particularly in emerging markets where market volatility is often exacerbated by external shocks and political events. Future advancements in machine learning algorithms, particularly in areas like reinforcement learning and natural language generation, will enhance AI's ability to predict sentiment shifts and market reactions.

Furthermore, the increasing use of alternative data—such as satellite imagery, transaction data, and web traffic—combined with AI's ability to process and analyze large datasets, will allow for even more accurate assessments of investor sentiment and market conditions. As AI technologies evolve, they will likely become an indispensable tool for investors looking to understand the psychological drivers behind market movements and improve decision-making in emerging markets.

### J. Future of AI in Sentiment Analysis for Emerging Markets

As AI technologies continue to evolve, their role in understanding investor sentiment in emerging markets will likely become more prominent. Future advancements in **reinforcement learning**, **unsupervised learning**, and **real-time data processing** could enable even more accurate sentiment predictions and market insights. Furthermore, AI could help reduce human biases in investment decision-making, leading to more rational behavior in volatile markets.

## I. Investor Sentiment in Emerging Markets: Case Studies of India and Argentina

### A. India: A Rising Economic Power

India, the world's fifth-largest economy by nominal GDP, presents an interesting example of how investor sentiment can influence market behavior in an emerging market. Over the past few decades, India has experienced remarkable growth, driven by a combination of demographic factors, rapid urbanization, and economic liberalization. However, the country also faces significant challenges, such as political uncertainty, income inequality, and regulatory complexities, all of which impact investor sentiment.

**1. Economic Growth and Investor Sentiment** India's economic growth has generally been a source of positive sentiment among investors, both domestic and foreign. The country has become a hub for foreign direct investment (FDI), particularly in sectors such as technology, infrastructure, and consumer goods. Positive sentiment about India's long-term growth prospects has led to substantial capital inflows, pushing up the value of Indian stocks and bonds.

○ **Capital Markets:** The Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE) are two of the largest stock exchanges in the world by market capitalization. Investor sentiment in India has been heavily influenced by factors such as government reforms, economic growth rates, and corporate earnings.

○ **Foreign Institutional Investors (FII):** Foreign investors have historically played a significant role in India's equity markets. Positive global sentiment towards emerging markets, coupled with India's strong growth story, has resulted in sustained foreign investments. However, any downturn in investor sentiment, such as concerns over inflation or political instability, can lead to capital outflows and significant market volatility.

**2.Role of Sentiment During Crises** While investor sentiment in India has generally been positive in recent years, periods of economic and political uncertainty have highlighted the market's vulnerability to shifts in sentiment. For instance, the 2008 global financial crisis saw a sharp decline in investor confidence worldwide, and India was not immune to this shift. The sense of fear and panic among investors led to significant sell-offs in Indian equities, even though the country's economic fundamentals remained strong.

○ **Impact of Global Crises:** India's markets are deeply connected to global financial systems. During periods of global economic uncertainty, such as the U.S. subprime mortgage crisis, investor sentiment turned negative, leading to a sharp correction in Indian stock markets. These events underscore the vulnerability of emerging markets to global shifts in sentiment.

**3.Sentiment Driven by Political and Policy Changes** Investor sentiment in India is also highly influenced by political and policy developments. The Indian market is sensitive to the outcomes of general elections, changes in government leadership, and the direction of key policy reforms.

○ **Modi's Economic Reforms:** The election of Prime Minister Narendra Modi in 2014 generated significant optimism among investors, as he promised sweeping economic reforms aimed at boosting growth and improving the ease of doing business. The "Make in India" initiative, aimed at promoting manufacturing, and the Goods and Services Tax (GST) reform were viewed positively by investors and helped improve sentiment towards Indian markets.

○ **Demonetization and its Aftermath:** In 2016, Modi's sudden demonetization policy aimed at curbing black money created uncertainty in the short term, leading to negative sentiment in the markets. This incident serves as a reminder of how swiftly investor sentiment can change in response to government actions, especially in emerging markets where regulatory risks are higher.

**4.Cognitive Biases and Market Behavior in India:** Indian investors, like those in many emerging markets, are prone to cognitive biases that influence market behavior. For instance, there is evidence of overconfidence bias, where investors tend to overestimate their ability to predict market movements, leading to excessive risk-taking during bullish periods.

○ **Herding Behavior:** The Indian stock market has witnessed periods of extreme herding behavior, particularly during bull markets, when investors rush to buy stocks based on the actions of others rather than sound fundamentals. This can lead to market bubbles, as was the case during the mid-2000s when stock prices of technology and infrastructure companies skyrocketed.

○ **Overreaction to News:** News events, both domestic and global, often lead to overreactions in Indian markets. For example, announcements of policy changes, economic data releases, or even international news about global trade tensions can cause significant fluctuations in stock prices, driven more by emotional reactions than rational analysis.

## **B. Argentina: A Case Study in Sentiment-Driven Volatility**

Argentina, with its history of economic crises, inflation, and political instability, presents a stark contrast to India in terms of investor sentiment dynamics. The Argentine market is characterized by high volatility, driven by both domestic and international factors. The country's frequent economic crises have shaped investor behavior, making sentiment one of the most important determinants of market outcomes.

**1.Political Instability and Investor Sentiment** Argentina's market has been historically influenced by political instability and policy uncertainty. The frequent changes in government, coupled with economic mismanagement, have created an environment where investor sentiment swings dramatically based on political events.

○ **Kirchner Era (2003-2015):** Under the leadership of the Kirchner family, Argentina adopted populist economic policies, including heavy government intervention in markets, price controls, and high public spending. These policies led to periods of positive sentiment during the early years, as the economy grew, but eventually resulted in negative sentiment due to the mounting fiscal deficit and inflationary pressures.

○ **Macri's Election and Subsequent Reforms:** The election of Mauricio Macri in 2015 was initially met with positive sentiment, as investors hoped for market-friendly reforms and a reduction in government interference. However, Macri's inability to stabilize inflation and his eventual resorting to borrowing from the International Monetary Fund (IMF) led to a shift in sentiment, as concerns over the country's debt burden and currency devaluation grew.

**2.Inflation, Currency Devaluation, and Market Volatility** One of the key drivers of sentiment in Argentina is inflation, which has been a persistent problem for the country. High inflation erodes the value of the Argentine peso and leads to widespread uncertainty among investors.

- **2001 Financial Crisis:** During the financial crisis of 2001, Argentina defaulted on its debt, leading to a collapse in market sentiment. The devaluation of the peso, coupled with high inflation and widespread social unrest, resulted in a sharp downturn in the stock market and a flight of capital.

- **2018 Crisis:** In 2018, Argentina faced another currency crisis, with the peso losing significant value against the U.S. dollar. This led to a sharp decline in stock prices and a tightening of liquidity. Investors, driven by fear and uncertainty, moved quickly to sell off their Argentine assets, leading to further market declines. The government’s response, including seeking assistance from the IMF, further worsened sentiment.

**3. Investor Behavior and Cognitive Biases in Argentina** In Argentina, investor sentiment is influenced by a deep-seated sense of caution and distrust in financial markets, stemming from past crises. Argentine investors tend to exhibit a high degree of risk aversion, often turning to assets like U.S. dollars or real estate as safe havens during times of uncertainty.

- **Loss Aversion:** Due to the country’s history of financial crises, Argentine investors are particularly sensitive to losses. This has led to a risk-averse approach, with many investors preferring low-risk, low-return assets, even during periods of economic growth.

- **Panic Selling:** During times of economic or political instability, there is a tendency for panic selling in Argentina’s financial markets. This behavior is often fueled by a fear of currency devaluation or inflationary pressure, leading to sudden market drops that do not necessarily reflect the underlying economic conditions.

**C. Comparing India and Argentina**

India and Argentina, while **both classified as emerging markets, represent distinct investor sentiment dynamics.** India’s market is generally more optimistic, driven by strong economic growth, political reforms, and a burgeoning middle class. However, it is still vulnerable to shifts in global sentiment and internal political changes. Argentina, on the other hand, is more prone to sharp volatility, driven by political instability, inflation, and past economic crises. Investor sentiment in Argentina is often negative, reflecting deep-seated fears of financial instability.

**Investor Sentiment Indicators: India & Argentina**

Indicator	India	Argentina	Data Source	Relevance
Consumer Confidence Index	Fluctuates due to inflation and reforms	Highly volatile, influenced by devaluation	Reserve Bank of India / INDEC	Reflects economic optimism/pessimism
Stock Market Volatility	Moderate; responsive to global events	High; sensitive to political changes	NSE India / Merval	Gauges market fear levels
Social Media Sentiment	Focus on technology and startups	Focus on inflation and political turmoil	Twitter, news sentiment analysis	Measures real-time market mood

Understanding the role of investor sentiment in these two markets provides valuable insights into the broader behavior of emerging market economies. In both countries, investor sentiment has a direct impact on market outcomes, whether it is in the form of capital inflows, market crashes, or speculative bubbles.

**How to Build a Sentiment Index for Sovereign Bonds in India & Argentina**

The construction of a sentiment index for sovereign bonds is a complex but rewarding process, as it allows analysts to quantify market emotions and predict bond price movements and yields. In general, in the world there are existing sentiment indices or frameworks that evaluate sovereign bond markets, although their availability and specificity vary by country. For example, India & Argentina have not specific sentiment index for our sovereign bonds.

At a global level, indices such as the JPMorgan Emerging Market Bond Index (EMBI) and the Credit Default Swap (CDS) spreads are commonly used to assess sentiment indirectly. These indices reflect investor attitudes towards sovereign risk by measuring the spread between emerging market bonds and U.S. Treasuries. Countries included in the EMBI, benefit from this type of market sentiment assessment, which offers insights into credit risk and market perception.

Additionally, organizations like the IMF have developed methodologies for integrating sentiment proxies into sovereign debt analysis. These include mispricing measures to evaluate the impact of market sentiment on sovereign bond yields and future economic outcomes. Such tools allow for a deeper understanding of how optimism or pessimism influences borrowing costs and fiscal stability in both advanced and emerging markets

As we said, **there isn't an existing investor sentiment index specifically tailored for sovereign bonds in India and Argentina**, that aligns with our intended design. However, related measures and frameworks do exist:

✓ **CCIL All Sovereign Bonds Index (India)**: This index tracks the daily movement of government securities across different tenors in India. While it doesn't directly measure investor sentiment, it provides a foundation by monitoring market dynamics and could be integrated into a broader sentiment index.

✓ **J.P. Morgan Emerging Market Bond Index (EMBI)**: This global index includes sovereign spreads for emerging markets, including Argentina and India, and could serve as a source for spreads data. Sentiment proxies can be derived by analyzing deviations from fundamentals, as noted in IMF studies.

✓ **Sovereign Debt Mispricing as a Sentiment Proxy**: IMF research highlights that residuals from regression models explaining sovereign spreads (accounting for fundamentals) can act as sentiment measures. These methods have been applied to emerging markets, including Argentina, and could be adapted for India.

That way, to construct an investor sentiment index for sovereign bonds in emerging countries such as India & Argentina, follow to consider at least 6 steps:

**Defining Sentiment Indicators**

To build a sentiment index, the first step is selecting indicators that reflect investor mood and perceptions about sovereign bonds. For India and Argentina, these indicators might include:

- ❖ **News Sentiment Analysis**: Monitoring financial news and press releases about economic policies, political stability, and global economic trends.
- ❖ **Social Media Sentiment**: Tracking public discourse and investor opinions on platforms like Twitter, particularly during major events such as elections or fiscal policy announcements.
- ❖ **Bond-Specific Data**: Using bond yield spreads (e.g., India's government bond yields versus U.S. Treasury yields) and credit default swap (CDS) spreads to infer market risk perceptions.
- ❖ **Macro Indicators**: Economic variables like inflation rates, foreign exchange reserves, and fiscal deficits that influence bond market sentiment.

**Data Collection**

Data collection is critical and requires multiple sources:

✓ **Financial News and Reports**: Automated tools like web scraping can collect articles from major financial news outlets, such as The Economic Times (India) or La Nación (Argentina).

✓ **Social Media Platforms**: APIs like Twitter's allow real-time sentiment extraction based on relevant hashtags or keywords (e.g., #IndianBudget, #ArgentineDebt).

✓ **Bond Market Data**: Historical bond yield and CDS data from databases like Bloomberg, Reuters, or central bank archives.

**Sentiment Scoring**

Once the data is collected, it is essential to assign sentiment scores.

▪ **Textual Data Analysis**: Using Natural Language Processing (NLP) tools to analyze news articles and tweets for positive, negative, or neutral sentiments. Algorithms like VADER (Valence Aware Dictionary and sEntiment Reasoner) or BERT (Bidirectional Encoder Representations from Transformers) can be employed.

▪ **Market Data Scoring**: Yield spread increases may be assigned negative sentiment scores (indicating rising risk), while decreases signal positive sentiment.

**Weighting the Indicators**

Different indicators may have varying levels of importance based on market conditions and investor behavior. For instance:

- ❖ News sentiment might carry higher weight during political transitions in Argentina, reflecting heightened media influence.
- ❖ Bond yield spreads might dominate in India during periods of global monetary tightening, given its reliance on external markets.

**Example weighting scheme:**

Indicator	Weight (%)
News Sentiment	40

Indicator	Weight (%)
Social Media Sentiment	30
Bond Yield Spreads	20
Macro Indicators	10

### Interpreting Index

The final index will range from highly negative (e.g., -1.0, indicating extreme pessimism) to highly positive (e.g., +1.0, indicating extreme optimism). Examples:

- ❖ A steep decline in the index might signal market panic due to a sovereign downgrade in Argentina.
- ❖ A gradual increase could indicate growing investor confidence after a successful monetary policy reform in India.

### 6. Applications and Limitations

#### Applications:

- **Risk Management:** The index helps investors gauge bond market volatility and adjust their portfolios.
- **Policy Feedback:** Governments can monitor how fiscal or monetary decisions are perceived in real time.

#### Limitations:

- ❖ **Data Bias:** Sentiment derived from textual data can be skewed by media bias or limited social media reach.
- ❖ **Complex Interactions:** The interplay between macro indicators and sentiment may vary, requiring recalibration over time.

This methodology provides a robust framework for understanding investor sentiment in sovereign bond markets, offering valuable insights for policymakers, analysts, and investors in emerging economies like India and Argentina.

In conclusion, constructing a sentiment index for sovereign bonds in emerging markets like India and Argentina represents a pivotal step in understanding and forecasting investor behavior. By combining established metrics such as sovereign spreads, CDS spreads, and EMBI data with innovative approaches like AI-driven sentiment analysis and residual mispricing measures, this framework can offer nuanced insights into market dynamics.

Such an index not only enhances transparency but also empowers policymakers and investors to identify sentiment-driven misalignments and potential risks. It underscores the interplay between market psychology and fundamental economics, enabling better decision-making in complex, volatile environments typical of emerging economies. This initiative could also set the stage for similar applications across other countries, fostering a more globalized understanding of market sentiment.

### Conclusion

Investor sentiment plays a critical role in shaping the behavior of financial markets, particularly in emerging markets where volatility and uncertainty are often more pronounced. Through the exploration of both **India** and **Argentina**, we have seen how sentiment can drive market movements, affect capital flows, and influence investor decision-making in these unique economic environments.

#### A. Summary of Key Findings

**Theoretical Insights on Investor Sentiment** The theory of investor sentiment, rooted in behavioral finance, highlights the emotional and psychological factors that drive market decisions. In emerging markets, where informational asymmetries, political instability, and economic volatility are more prevalent, sentiment often outweighs rational analysis, resulting in amplified market reactions. This is particularly true in **India** and **Argentina**, where sentiment-induced market fluctuations have been observed in response to political developments, economic policies, and global events.

Model	Applications in India	Applications in Argentina
Random Forest	Analyses stock trends in IT and fintech	Focused on energy and agro-industry
Neural Networks	Predicts investor mood in tech startups	Monitors currency and debt sentiment

Model	Applications in India	Applications in Argentine
Sentiment Lexicons	Measures sentiment in regional languages	Analyzes economic news headlines

**Investor Sentiment in India:** India’s market, despite its strong growth story and optimism about long-term potential, is not immune to the effects of investor sentiment. Positive sentiment has driven significant capital inflows, while negative sentiment—prompted by factors such as political instability, global economic shifts, or economic policy missteps—has led to sharp corrections. The role of investor sentiment in India’s financial markets is amplified by the global interconnectedness of the economy and the increasing participation of foreign institutional investors.

**Investor Sentiment in Argentine** In contrast, Argentine’s financial markets are more susceptible to sentiment-driven volatility due to the country’s history of economic crises, high inflation, and political turmoil. Argentine’s markets exhibit a pronounced reaction to sentiment shifts, particularly during times of economic instability or policy uncertainty. The experience of loss aversion and panic selling is more deeply ingrained in the Argentine investor psyche, reflecting a heightened sensitivity to market risks and past financial crises.

**Practical Implications for Investors and Policymakers**

For investors in emerging markets, understanding the dynamics of investor sentiment is crucial for navigating the risks inherent in these markets. Sentiment-driven volatility can create opportunities for profit, but it also presents the risk of significant losses. Investors need to be aware of the psychological biases at play—such as **overconfidence**, **herding behavior**, and **loss aversion**—and adopt strategies to mitigate the impact of these biases on their investment decisions.

- **Long-term vs. Short-term:** In markets like India and Argentine, where sentiment can cause rapid fluctuations, investors with a long-term perspective may be better positioned to ride out periods of volatility. On the other hand, short-term traders need to closely monitor sentiment indicators and news events that could shift market psychology.

For policymakers, the ability to understand and manage investor sentiment is equally important. In **India**, where economic reforms and political stability have a direct impact on investor confidence, maintaining a favorable sentiment can be key to sustaining economic growth and attracting foreign investment. Conversely, in **Argentine**, where investor sentiment is more fragile, managing expectations and restoring confidence in economic management is critical to reducing market volatility and ensuring stability.

**Limitations and Areas for Future Research**

While this paper has provided an in-depth analysis of investor sentiment in India and Argentine, further research is needed to explore the broader implications of sentiment on emerging markets. Some key areas for future study include:

1. **Sentiment Indicators:** Developing more precise sentiment indicators, based on both qualitative and quantitative data, could help investors and policymakers better gauge market psychology and anticipate market shifts.
2. **Sentiment in Other Emerging Markets:** Expanding the analysis to include additional emerging markets in Asia, Africa, and Latin America could provide a more comprehensive understanding of the global sentiment landscape.
3. **Impact of Digital Media and Social Sentiment:** The rise of digital media and social networks has revolutionized how information and sentiment are disseminated in financial markets. Research into the role of social media in shaping sentiment in emerging markets could offer fresh insights into market dynamics.

**Conclude**

Investor sentiment is a powerful driver of market behavior, particularly in the context of emerging markets like **India** and **Argentine**. By understanding how sentiment influences investment decisions, market volatility, and economic stability, both investors and policymakers can better navigate the complexities of these markets. While investor sentiment is inherently difficult to predict, recognizing its influence on market movements provides valuable insight into the psychology of financial markets in emerging economies. As these markets continue to evolve, the role of sentiment will undoubtedly remain a critical factor in shaping their future trajectory.

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