Financial Economics Research; Vol.3, No.2; 2026
E-ISSN: 3006-3663 P-ISSN: 3006-3655
DOI: https://doi.org/10.70267/fer.250302.277283
Published by: Zeus Press

# The Alienation of Behavioral Biases Among A-Share Investors from a Localization Perspective

**Zekai Jiang***

*School of Management Science and Engineering, Central University of Finance and Economics, Beijing 100000, China*

**Corresponding author: Zekai Jiang.*

## Abstract

Behavioral finance has established a complete theoretical system in mature Western capital markets, effectively explaining the alienation induced by Market Behavioral Biases. However, the A-share as an emerging policy-driven and retail-driven market, has a unique investor structure, trading mechanism, and indigenous sociopsychological characteristics, leading to a significant alienation of classic behavioral bias theory. This article will take the Alienation of Behavioral Biases Among A-Share Investors as the core object of study. And based on Prospect Theory and employing a literature review approach, this article will conduct a systematic analysis of such aberrant phenomena as the polarization and reversal of the Disposition Effect, the full-chain extension of the Herd Effect, and the cyclical reversal of overconfidence, also delve deeply into the roots of distortion—including trading systems, information asymmetry, the retailization of institutional investors, and local culture. Research indicates that Western behavioral finance theory is not fully adapted to the unique institutional and cultural environment of the A-share market, unable to explain its underlying causes. Promoting the localization of behavioral finance theory is a critical path for correcting A-share investor behavioral alienation and enhancing market pricing efficiency, providing a theoretical basis for regulatory policy formulation and investor strategy construction. This paper addresses the gap in traditional research that overlooks institutional and cultural differences in emerging markets, while acknowledging limitations such as the lack of empirical testing. Future research could further refine the localized behavioral finance theoretical system through empirical and quantitative studies.

### Keywords

localization, A-share market, investor behavioral biases, behavioral alienation, behavioral finance

## 1. Introduction

In recent years, behavioral finance has established a comprehensive theoretical framework in mature Western capital markets, effectively explaining anomalies stemming from behavioral biases in market conduct [1]. However, the A-share market—characterized as an emerging market driven by both policy and retail investors—exhibits a unique investor structure, distinct trading mechanisms, and specific indigenous socio-psychological traits; consequently, classic Western theories of behavioral bias undergo significant divergence when applied within this context. This alienation is not only reflected in macro-level phenomena, including the extremization and reversal of the disposition effect [2, 3], the full-chain propagation of the herd effect [4, 5], and the cyclical reversal of overconfidence [6, 7]; but also further profoundly rooted in micro-level

mechanisms and socio-psychological factors, including the T+1 trading system, price limit mechanisms, information asymmetry, the "retailization" of institutional investors, and indigenous Chinese culture [8]. In light of this, this paper aims to conduct an in-depth analysis of the phenomenon of behavioral biases among A-share investors from a localized perspective. It seeks to reveal the limitations of Western behavioral finance theories when applied to the specific market environment of China, while emphasizing both the necessity of—and the pathways toward—adapting behavioral finance theory to the local context. This study not only makes up for the deficiencies of traditional behavioral finance research—which overlooks the institutional disparities and indigenous cultural characteristics of emerging markets— but also refines the theoretical framework of behavioral finance with Chinese characteristics. It also provides theoretical foundations and practical guidance for regulatory bodies to formulate policies aligned with market realities and for institutional and individual investors to build strategies adapted to the local market. Furthermore, it offers a reference paradigm for the localization of behavioral finance research and market governance in other emerging capital markets.

## 2. Background

The fundamental objective behind the establishment of China's A-share market was to facilitate the reform of state-owned enterprises and to construct a platform for financing and investment that connects corporations with investors. As a market that is both policy-driven and retail-dominated, the A-share market is characterized by the psychological traits of its investor base and a massive number of retail investors [9]. With its continued evolution, the A-share market currently displays a landscape dominated by retail investors, marked by the rise of private equity funds, while the proportions held by general corporate entities and state-backed "national teams" remain relatively stable [10]. Within this structure, the massive population of retail investors exerts significant influence yet remains unable to effectively contend with institutional investors. The core issue underlying this is information asymmetry, primarily reflected in information disclosure, intermediation, dissemination, supervision, and the information-processing capabilities of investors [11]. Currently, the trading mechanisms of China's A-share market remain immature; the T+1 and price limit mechanisms constrain price adjustments to a certain extent [8], exacerbating volatility and lag, and making individual investors more susceptible to external influences. It is precisely due to these distinct localized characteristics of the A-share market that existing behavioral bias theories have undergone alienation within this market—a form of alienation that differs from other capital markets and necessitates more localized research for explanation.

## 3. Research Objective

Given the unique institutional and cultural context of the A-share market, investor behavioral biases exhibit idiosyncratic characteristics that diverge significantly from Western theoretical frameworks. To gain a comprehensive understanding of—and effectively address—these idiosyncratic phenomena, this study is structured around the following three core objectives:

**Research Objective 1**: To grasp the overall landscape of behavioral biases within the A-share market.

**Research Objective 2**: Building upon these macro-level characteristics, analyze the micro-level psychological and decision-making mechanisms behind behavioral biases.

**Research Objective 3**: Identify effective pathways for the connection between macro manifestations and micro mechanisms.

For the first research objective, it is essential to examine their idiosyncratic manifestations from a macro perspective, thereby elucidating the macro-level idiosyncratic features of behavioral biases in this market. Regarding to the second objective, the study will delve into the micro perspective by dissecting the psychological cognition, decision-making processes, and market interaction patterns of individual investors, thereby providing an in-depth analysis of the micro-level behavioral factors underlying these idiosyncratic phenomena. The third objective represents the ultimate purpose of understanding the connection between macro manifestations and micro mechanisms. This study will explore the necessity of correcting idiosyncratic behaviors within the A-share market and analyze the potential theoretical and practical implications of such interventions, with the aim of offering policy recommendations to foster the healthy development of the market.

## 4. Theoretical Framework

Prospect theory, proposed by Kahneman and Tversky [1], holds that individuals' decision-making under uncertainty is not based on absolute utility, but on changes in gains and losses relative to a reference point, and exhibits significant asymmetric characteristics. The core principle would present as follow. First, loss aversion, where the degree of pain caused by an equivalent loss is significantly greater than the pleasure derived from an equivalent gain, leading individuals to have extremely high negative sensitivity to risk perception. Second, risk preference reversal is manifested as a tendency toward risk aversion (settling for sure gains) when facing profits, and a tendency toward risk seeking (taking a "last-ditch" gamble) when facing losses. Finally, diminishing sensitivity, meaning that as the absolute value of gains or losses increases, the marginal psychological utility they produce gradually weakens.

## 5. Literature Review

### 5.1 Market-driven Upheavals in Prospect Theory—The Extremes of the Disposition Effect

In classical prospect theory, investors tend to overestimate low-probability events. However, under the A-share price limit system, this psychological distortion is forcibly amplified by external institutions. When the stock price is close to the price limit, the market will exhibit a significant "magnetic effect": the price limit will induce investors' "fear of missing out", causing them to subjectively overestimate the probability of the stock price continuing to rise, thus leading to irrational chasing behavior near the price limit [12]; conversely, the price limit will cut off liquidity, causing investors to have an extreme panic of "liquidity depletion", thus overestimating the probability of subsequent crashes. This institutionalized "probability induction" directly alters the probability weighting function curve in Prospect Theory, making it exhibit steeper non-linear characteristics at the boundaries compared to Western markets.

The T+1 trading system is a liquidity constraint unique to the A-share market, which directly interferes with the settlement cycle of investors' "mental accounts". Under the T+1 constraint, investors who buy on the same day cannot perform "corrective" selling. This makes the investor's reference point no longer just the purchase cost, but a dynamic anchor point superimposed with "time premium" and "immediate liquidity risk" [13]. Studies have found that this mandatory holding and waiting strengthens the investor's "loss aversion" coefficient: due to the inability to stop losses in time, the psychological pressure on investors increases exponentially when facing intraday fluctuations. Loss aversion in this institutional environment is not a static personality trait but a form of "institutional panic" constrained by trading rules, leading investors to be extremely conservative when in profit, while falling into "learned helplessness" when in loss due to the inability to take immediate action, ultimately evolving into a deep alienation of the disposition effect.

The most significant dramatic change is the "disposition effect reversal" phenomenon that occurs in extreme game scenarios in A-shares (such as new stock speculation and consecutive limit-up stocks). Traditional theory predicts that investors will "sell winners and hold losers," but in the high-frequency gaming of A-shares—characterized by high retailization and severe information asymmetry—investors generally exhibit a "lottery-like preference" [14]. Under the protection of the limit-up system, profitable positions are regarded as a scarce "entry ticket". Investors not only do not take profits, but also have a strong "gambler's fallacy" and continue to add positions. While when facing consecutive limit-downs, due to the liquidity trap under the T+1 system, investors often choose to "panic sell" rather than continue to hold when they can sell [15]. This reverse behavior of "selling losers and holding winners" is essentially a parameter alienation of Prospect Theory under the combined effect of extreme liquidity constraints and local gaming psychology, reflecting a regression of A-share investors' decision-making logic from "value judgment" to "emotional survival" under institutional pressure.

### 5.2 The Cyclical Escalation of the Herding Effect and the Cyclical Reversal of Overconfidence

The disposition effect has further spurred a more prominent full-chain herding effect in the A-share market. This is an inevitable upgrade of individual behavioral deviations to group behavioral deviations through market interaction. The classic herd effect theory distinguishes between rational herding based on information asymmetry and irrational herding based on emotional imitation [4]. However, A-share herding behavior is

highly decoupled from corporate fundamentals: while mature market investors use intrinsic corporate value as a decision reference point, A-share investors' reference points have systematically alienated into “others' holding returns” and “theme popularity” [16, 17]. At the same time, the positive feedback mechanism of “chasing highs and selling lows” brought about by the disposition effect has led to the rapid spread of the profit-making effect of theme speculation. An “institutions first - large investors follow - retail investors follow the trend” imitation trading model has emerged in the whole chain, making investors' holdings highly similar and the track extremely clustered, which has been distorted into a pure game of emotional speculation on the rise and fall limit [5, 18].

The periodic outbreak of the herding effect in the group, in turn, distorts the self-cognition of investors, forming the local alienation characteristic of overconfidence. This is the reverse shaping process of group behavior on individual psychology. Classic overconfidence theory considers investor overconfidence as a stable personality trait and cognitive bias [6]. However, A-share investors' overconfidence exhibits extreme periodic reversal characteristics. In the bull market cycle, the general short-term profits brought by the herding effect will be mistakenly attributed by investors to their own game ability. At the same time, the continuously rising stock price will continuously raise the decision reference point of investors, making them overestimate their own ability to control risks, and eventually evolve into the extreme radicalism of the whole people adding leverage to enter the market [7]. In the bear market cycle, the general losses brought by the herding effect will be simply attributed by investors to the external environment. At the same time, the rapidly falling stock price will greatly reduce their decision reference point, making them instantly underestimate their own investment ability. Overconfidence directly reverses into the extreme conservatism of panic selling [19, 20].

### 5.3 Reasons for Mechanism Alienation from an Economic Perspective

The aforementioned alienation of behavioral biases in the A-share market is essentially a parameter reconstruction and mechanism mutation of classic behavioral finance models under the specific micro-environment of A-shares. Its roots span the entire investor decision-making chain and are superimposed with multiple local factors: At the information processing stage, investors exhibit significant attention-salience bias and lottery-like information screening preferences. The echo-chamber effect of social media and viral information dissemination further solidifies the micro-foundation of the herd effect [14]. At the cognitive judgment stage, the T+1 and price limit systems distort the risk preference parameters of Prospect Theory, leading to intensified loss aversion asymmetry and the extremization of the disposition effect. Simultaneously, overconfidence and historical price anchoring effects are prevalent, with investors generally relying on intuitive systems for decision-making while suppressing rational analysis [21, 22]. At the trading execution stage, the T+1 system reinforces regret aversion and the sunk cost fallacy, while the magnet effect of price limits fosters a pattern of consecutive-limit speculation [23]. Moreover, the extremely weak short-selling mechanism creates a one-sided market structure, making it difficult to correct overvalued mispricing [24]. Institutional investors, who should serve as market stabilizers, exhibit a “retailization” tendency under the pressure of short-term performance rankings and principal-agent problems; their behavior of “clustering for warmth” (herding) and sector rotation instead amplifies market volatility [5], while trend-following strategies in quantitative trading further exacerbate the effects of “helping the rise and adding to the fall.” Additionally, China's local tradition of collectivism and the generally low financial literacy of investors provide deep socio-psychological soil for these behavioral biases, ultimately causing A-shares to exhibit systematic irrational characteristics that are more extreme in degree, longer in duration, and more unique in form.

## 6. Key Finding

This study delves into the alienation of investor behavior biases in the A-share market from a localized perspective, revealing the limitations of Western behavioral finance theory in explaining the specific market environment of China. The research finds that A-share market behavioral biases exhibit significant macro-level alienation characteristics, specifically manifested in the extremization and reversal of the disposition effect, the full-chain nature of the herd effect, and the periodic reversal of overconfidence. These alienated behaviors are rooted in the unique micro-mechanisms and local factors of the A-share market, including the distorting effect of the T+1 trading system and price limit mechanism on the risk preference parameters of prospect theory, information asymmetry and cognitive biases, as well as the social and psychological factors such as the tendency of institutional investors to become retail investors and China's collectivist tradition.

Therefore, this study emphasizes that promoting the localization and "Chinese-characterization" of behavioral finance theory is a key path for correcting the alienation of A-share investor behavior and enhancing market pricing efficiency. This not only provides a theoretical basis and practical guidance for regulatory departments and investors but also fills the gap in traditional behavioral finance research and provides a reference paradigm for localized behavioral finance research in other emerging capital markets.

## 7. Discussion

### 7.1 Applications and Significance

Localizing and adapting behavioral finance theory to Chinese characteristics to correct market anomalies has both clear practical application value and significant academic and market implications. In terms of application, this research approach directly provides adapted analytical tools for interpreting unique behavioral biases such as the reversal of the disposition effect and the full-chain herd effect in A-shares. It accurately depicts the investor decision-making logic under the combined influence of local socio-psychology and special trading rules. This can provide a theoretical basis for regulatory authorities to formulate behavior-guiding and rule-optimizing policies that align with market realities, and offer practical guidance for institutional and individual investors to build investment strategies adapted to the local market and avoid irrational alienated behaviors. In terms of significance, this approach fills the gap in traditional behavioral finance research by neglecting the institutional differences and local cultural characteristics of emerging markets. It improves the theoretical system of behavioral finance with Chinese characteristics, breaks through the limitations of Western theories in explaining real-world market anomalies in the A-share market, and lays a solid theoretical foundation for systematically correcting A-share investor behavior distortions, improving market pricing efficiency, and maintaining market stability. This further contributes to the deepening of the registration-based reform and high-quality development of the capital market, and also provides a reference paradigm for the localization of behavioral finance research and market governance in other emerging markets.

### 7.2 Research Shortcomings and Research Directions

The paper also has some shortcomings: it relies solely on literature review for theoretical analysis, without conducting empirical tests, quantitative modeling, or case studies, resulting in conclusions lacking data support. Future research could focus on conducting more empirical tests and quantitative analyses of the formation and correction mechanisms of behavioral biases, continuously improving and applying localized behavioral finance theory, and laying a solid theoretical foundation for the deepening of the registration-based reform and high-quality development of China's capital market.

## 8. Conclusion

From a localized perspective, this paper takes the alienation of A-share investor behavioral biases as its core research object. Based on Prospect Theory and Limited Arbitrage Theory [25], and combined with the unique trading systems, investor structure, and local socio-psychological characteristics of the A-share market, it systematically reviews the alienated manifestations, micro-formation mechanisms, and deep-seated causes of typical behavioral biases such as the disposition effect, herd effect, and overconfidence. The paper further finds that behavioral finance theories from mature Western markets are difficult to adapt to the emerging policy-driven and retail-dominated A-share market, as they do not fully incorporate local special trading rules and socio-cultural factors, and thus cannot effectively explain the unique behavioral bias alienation phenomena in A-shares. Promoting the localization and "Chinese-characterization" of behavioral finance theory is the core path for correcting the alienation of A-share investor behavior. This transformation can provide adapted analytical tools for interpreting the decision-making logic of local investors, offer theoretical support for regulators to optimize market mechanisms and guide rational investment, and assist institutional and individual investors in avoiding irrational behaviors and formulating investment strategies adapted to the local market. This study fills the gap in traditional behavioral finance research that neglects institutional differences and local cultural characteristics in emerging markets, refines the behavioral finance theoretical system with Chinese characteristics, and provides a reference paradigm for localized behavioral finance research and market governance in other emerging capital markets globally.

## References


[1] Kahneman, D., & Tversky, A. (1979). Prospect theory: An analysis of decision under risk. *Econometrica, 47*(2), 263–291. https://doi.org/10.2307/1914185

[2] He, J., & Wang, L. (2023). Evolution of A-share investors' disposition effect and institutional influence under registration system reform. *Securities Market Herald, 33*(9), 4–13. https://doi.org/10.19622/j.cnki.cn31-1506/f.2023.09.001

[3] Zhang, Q., Xie, C., & Cheng, T. (2024). The impact of daily-frequency investor sentiment on A-share short-term returns. *Operations Research and Fuzziology, 14*(2), 163–179.

[4] Bikhchandani, S., & Sharma, S. (2001). Herd behavior in financial markets. *IMF Staff Papers, 47*(3), 279–310.

[5] Xu, N., Yu, S., & Yi, Z. (2013). Institutional investors' herding behavior and stock price crash risk. *Management World, 29*(7), 31–43. https://doi.org/10.19744/j.cnki.11-1235/f.2013.07.004

[6] Barber, B. M., & Odean, T. (2001). Boys will be boys: Gender, overconfidence, and common stock investment. *The Quarterly Journal of Economics, 116*(1), 261–292. https://doi.org/10.1162/003355301556099

[7] Yang, C., Wu, C., & Chen, M. (2005). Investors' non-persistent overconfidence and stock market reversal effect. *Management Science, 18*(2), 40–45.

[8] Xiao, X. (2024). China's A-share price limit trading mechanism and investors' disposition effect. *Journal of Financial Research, (9)*, 123–140.

[9] Leng, S. (2016). Analysis of policy-oriented characteristics of A-share investment and countermeasures. *Journal of Yangzhou Polytechnic Institute, 20*(3), 23–26. https://doi.org/10.15954/j.cnki.cn32-1529/g4.2016.03.006

[10] Wang, R. (2018). Major changes in the investor structure of China's capital market. *Financial Economy, (8)*, 99–101. https://doi.org/10.14057/j.cnki.cn43-1156/f.2018.08.042

[11] Grossman, S. J., & Stiglitz, J. E. (1980). On the impossibility of informationally efficient markets. *American Economic Review, 70*(3), 393–408.

[12] Fudan University International Finance Institute. (2026, March 20). The "magnet effect" of the price limit system and market microstructure distortion. https://fisf.fudan.edu.cn/ffr/content/314 (Accessed April 12, 2026)

[13] Guo, M., Liu, T., & Wu, M. (2019). Should the "T+1" trading system be abolished? *Tsinghua Financial Review, (10)*, 81–83. https://doi.org/10.19409/j.cnki.thf-review.2019.10.019

[14] Wang, Y., He, J., & Zang, R. (2018). The impact of short-sale constraints on securities market mispricing. *Journal of Beijing University of Aeronautics and Astronautics (Social Sciences Edition), 31*(1), 81–88.

[15] Zhang, X. (2023). The generation mechanism of major risks in China's stock market—From the perspective of liquidity supply-demand imbalance. *Economic Management Journal, (2)*, 45–58.

[16] Song, J., & Wu, C. (2001). A study of herding behavior in financial markets based on dispersion. *Economic Research Journal, 46*(11), 21–27+93. https://doi.org/10.19744/j.cnki.11-1081/f.2001.11.003

[17] Shi, D. (2001). Trading behavior of securities investment funds and its market impact. *World Economy, 24*(10), 26–31. https://doi.org/10.19985/j.cnki.cassjwe.2001.10.004

[18] Qi, B., Huang, M., & Chen, Z. (2006). Institutional investors and stock market volatility. *Journal of Financial Research, 32*(9), 54–64. https://doi.org/10.19795/j.cnki.cn11-1262/f.2006.09.006

[19] Zhao, X., & Wang, Y. (2001). An empirical analysis of the "disposition effect" in China's stock market. *Journal of Financial Research, 27*(7), 92–97. https://doi.org/10.19795/j.cnki.cn11-1262/f.2001.07.010

[20] Li, X., Wang, J., & Fu, H. (2002). An empirical study on the trading behavior of individual securities investors in China. *Economic Research Journal, 47*(11), 54–63+94. https://doi.org/10.19744/j.cnki.11-1081/f.2002.11.006

[21] Wu, J., Wang, C., Chen, Z., et al. (2020). A study on the disposition effect of Chinese individual investors—A perspective of irrational beliefs. *Journal of Financial Research, (2)*, 147–164.

[22] Li, X., Yu, H., Lu, R., et al. (2011). An empirical study on behavioral biases of Chinese investors. *Management World, (12)*, 1–12.

[23] He, C., Chen, R., Xue, B., et al. (2021). Investor sentiment, limited arbitrage, and stock price anomalies. *Economic Research Journal, (1)*, 180–197.

[24] Li, T., Chen, H., Liu, W., et al. (2023). The role of social media sentiment in identifying irrational herding behavior in the stock market. *International Economic and Financial Review, 87*, 163–179.

[25] Shleifer, A., & Vishny, R. W. (1997). The limits of arbitrage. *The Journal of Finance, 52*(1), 35–55. https://doi.org/10.1111/j.1540-6261.1997.tb03817.x

## Funding

This research received no external funding.

## Conflicts of Interest

The authors declare no conflict of interest.

## Acknowledgment

This paper is an output of the science project.

## Copyrights