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PSYCHOLOGICAL UNDERSTANDING ABOUT MEME STOCK INVESTMENT: WHY INDIVIDUAL INVESTORS IN KOREAN AND US STOCK MARKETS MAKE COSTLY MISTAKES

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ABSTRACT

Many of the meme stocks are trending these days in the international stock market. However, there are many individual investors that experience loss. In these irrational investments there are complicated psychological biases. In this research we are trying to figure out what psychological biases occur during the changes of the meme stock prices. I researched four of the meme stocks from Korea and the United States and observed the changes in prices in trading amounts and found out the heuristic bias that can relate to this research. As a result, there are a lot of heuristic biases that relate to the change of meme stocks and it showed different results from good news and the bad news. Through this we can find out psychological biases in the trending mean stocks and understand the uncertainty of the meme stocks investment.

Keywords: Meme Stocks; Heuristic bias; Loss aversion; Individual investors; Behavioral finance; Stock market volatility

1 INTRODUCTION

Stocks are the capital of the company and the share of the profit, but in the point of view of individual investors, it has been recognized as a field of investment. The goal of the investment is to make a profit. Obviously, not all investors can make a positive return from it. One of the most controversial issues in international stock markets is the phenomenon of meme stocks. Meme stocks investment refers to the stocks that have gone viral. Particularly, their stock price increase is likely to be driven more by trends per se than by the company's actual intrinsic value. However, people follow the trend but not everyone can end up earning money. Since the surge of stock price for meme stocks is typically short-lived change, investing in them is highly risky and their price trends are difficult to predict accurately. For instance, if it reaches its peak, the expectation toward the company is too high and there are so many investors that the stocks are overpriced. If you bought the stocks earlier, then it will be profitable but meme stocks have high risk of rapid decreasing. That's why investing in meme stocks can be a lottery, but also a path to fall. After 2021, when meme stocks were very famous, 30% of individual investors stated that they invest in meme stocks, even though most of the investors had recognized the risk of investing in meme stocks (Benson, 2022). The good example of current meme stocks can be the companies that create AI technology. The big companies like Microsoft and NVIDIA are seeing the high value of the AI tech companies and they took over the companies to develop their AI so that they would not be behind in the AI field.

While meme stocks all share a common ideology to maximize profit, there are complicated factors that affect the psychological, emotional, and cognitive mechanisms that investors will experience. Regarding the most original and substantial question, “Why do many people make mistakes in choosing stocks?” is one of the major topics that is continuously discussed in the field of economics, specifically psychology. In particular, various biases that exist in the human mind were used as the evidence to prove that people cannot make rational choices when they face complicated decision making moments, like investing. According to Prospect theory, people want to maximize their profit while investing but they are also highly loss averse, called as loss aversion (Barberis, 2013). This can be related to the disposition effect. Disposition effect is a behavioral tendency of holding on to losing investments but selling profitable investments quickly. Cici (2012) shows that the disposition effect is prevalent in the mutual fund industry. The general assumption in economics is that investors are risk averse, so investors require a risk premium for holding stocks over bonds. Benartzi and Thaler (1995) shows that loss aversion and investor myopia can explain the equity premium puzzle. Myopia is decision making based on short term profits or losses rather than long term returns. Another heuristics is the gambler’s fallacy. It refers that people tend to believe that there are existing patterns in random events. Specifically, investors tend to believe the trend should be switched from surge to drop or vice versa, as the prior trend is continued sufficiently without any appropriate basis. Moreover, another heuristics is overconfidence. When some people are too confident about their decision, this bias can be called overconfident. This is also one of the biases that lead people to make inappropriate choices.

More and more investors globally started to approach meme stocks in the international stock market. However, since the common investors do not have as much information as the professionals, due to the heuristic bias of the people, they react sensitively to the news about stocks whether it is positive or negative (Nayak & Kumar, 2020). In this research, I focused on the news and events that are related to the meme stocks, focusing on the phenomenon that can be considered as the example of heuristic bias. Furthermore, through this we can understand the instability of the meme stocks and psychological behaviors that are shown.

2 METHOD

2.1 Sample cases

In this research we chose 2 types of meme stocks as the target of research. First, AI industry stocks that had significant increase of the price being considered as the meme stock. Recently, the AI industry received the most attention because it was considered that it has a high potential rate of return and one of the significant factors of economic growth. Especially investors started to focus on the companies that manufacture semi-conductors that are necessary in developing AI. Based on these AI revolution events, the stocks that have increasing price and high trading volume were considered as meme stocks. In the United States, it can be NVIDIA (NVIDIA Corporation, NVDA in NASDAQ) and in Korea it can be Samsung Electronics (Samsung Electronics Co Ltd, 005930). Second, the companies that are comparably small but highly popular were considered as stable coin related stocks. Stable coin is crypto tokens that have value that is linked to other currencies or other commodities, maintaining stable prices. Usually, most of the crypto currencies are difficult to be used as money due to the fluctuation of the price. However, since stable coins are linked to currencies, even if they are virtual currencies, they can be easily used as money for common people. Then how does stable coins affect the stock market? Stable coins do not directly affect stock prices but when a stable coin market crashes, it can lead to other cryptocurrencies to drop, causing changes in the stock market. Circle Internet Group (Circle Internet Group Inc, CRCL in NYSE) from the United States and Kakaopay (KakaoPay Corp, 377300) from Korea were selected as stable coin related stocks.

2.2 Procedure

Using the WallStreet Journal and economics news websites I found many announcements about the company's future plan, government related policies or operating profit announcements in the past three months. Then I used ([Investing.com](https://www.investing.com)) to elaborately look at the changes in the graph.

3 RESULTS AND DISCUSSION

3.1 AI-related Stocks

3.1.1 NVIDIA

July 28, Earning report, Government policy



Figure 1: NVIDIA stock trend

After US governments allowed importing the H2O chip, NVIDIA had imported 300,000 chips from TSMC. After this news was released people hoped that the AI market will grow through this event. This hope led to an increase of stock price. However, China has proposed that the H2O chip has low security issues. When this news was known to people, it caused a 1~2% increase on the first day and an additional 2% on the following days (Figure 1). Both of the two events talked about the same topic of H2O chips, but they caused two different effects to the stock market. This phenomenon can be related to loss aversion because they were afraid of loss when the news about the security issue was released. People are sensitive to information whether it contains positive context or negative context (Chen,2024).

3.1.2 SAMSUNG ELECTRICS

July 28, New contract report

One of the most known companies in Korea, Samsung, had similar events. When Samsung made a supply contract with Tesla, the price of the stock increased 6% on the first day when the news was released (Figure 2). On the other hand, when there was a 56% decrease in their net profit, 4% decrease in the profit.



Figure 2: SAMSUNG ELECTRICS stock trend

3.2 Stable coin-related Stocks

3.2.1 CIRCLE INTERNET GROUP

June 9, New law passed, Government policy

Not only the news about the country's new deal or future policies but stable coin can also relate to the stock price increase. In America, the company Circle Internet Group is the company that is related to the stable coin market. Circle Internet Group had an increase of the stock price when the Genius Act (law related to stable coin) was passed by Donald Trump creating the framework for the stable coin market. People predicted a stable coin market with high potential. That day, the price change of the Circle Internet Group stock prices was a 14% increase in the stock price (Figure 3).



Figure 3: CIRCLE INTERNET GROUP stock trend

3.2.2 KAKAOPAY CROP



Figure 4: KAKAOPAY CROP stock trend

In contrast, when professional investors stated that the stable coin market is too overrated, the price of the stock immediately dropped 2~3% (Figure 4). Then, In Korea Kakaopay is the company that uses stable coins. Just by people's anticipation, Kakaopay increased 14% of the stock price. This shows the availability bias that they are attracted to the

information that they are given (Nayak, Kumar, Asst, & Prof, 2020). The problem of this heuristic bias is that price decreasing happens rapidly because the decision of the people can easily change.

This data shows that information about the company is one of the most important factors that determines the stock prices and the decisions that investors make. Also it shows how much people are loss averse.

Why does the difference between Korean stock and American stocks occur? One of the special factors in the Korean stock market is the branching out effect also known as “Korean Discount”. This effect refers to huge companies creating affiliates and going public separately. The price of the stock is decided by founding the average of the affiliate and subsidiary that companies own. When the affiliate becomes big enough, they are considered as stock that is separate from the original company. Then the price of the original company stock will decrease because one of the huge affiliates is not considered as one part of the original company. We can clearly infer this by comparing the stock price of Apple and Samsung, the one of the leading companies in the phone industry. The price of the stock of Apple is more than three times the stock price of Samsung. Then why do people in Korea still invest in Korean stocks even though there are clear disadvantages? It is because of the home bias, which is the psychological factor which explains that people look for the stocks they are familiar with. Most of the common investors invest in the stocks of their own country, there is no complicated reason, it's just because they are more familiar with these companies.

4 CONCLUSION

In investment there are some things more than rational decision making like maximizing profit and minimizing loss. In other words the investments are done by psychological and emotional standards. This tendency is often shown when the investment is short term or meme stocks that are extra sensitive. However, this research has limitations because it is based on several other results and does not include other organization intervention that affects the stock price changes. Still, the psychological biases are important in reducing the uncertainty of changes in the stock price. To survive in an unstable “Squid Game” it is important to understand the participants' psychology.

STATEMENTS ON COMPLIANCE WITH ETHICAL STANDARDS

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