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The Role of Weather on Investors' Monday Irrationality: Insights from Malaysia

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ABSTRACT

Evidence supporting the weekend effect, also known as Monday Irrationality, has shown that conventional finance is unable to follow a rational behavior assumption. Many scholars have proposed a behavioral approach to explain this phenomenon; however, few studies have investigated this effect empirically. Interestingly, literature on weather patterns and the preliminary results of our study have identified a particular weather cycle that occurs on Mondays, when the temperature in Malaysia is higher compared with other days. Therefore, this paper aims to investigate the role of weather on investors' Monday irrationality. By analyzing the market index and size-based portfolio formation model from 1999 to 2010, this research study found that the weather influenced investors' mood, causing anomalous conditions in the market. Our findings conclude that the mood of investors plays an important role on investment decisions and the resulting Monday irrationality of investors.

KEY WORDS:

weather; monday irrationality; psychological finance; malaysian stock market

JEL Classification: D03; G12; G14

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1. Introduction

To elucidate the mechanisms behind investor irrationality Monday irrationality phenomenon, one of several market anomalies, many scholars have proposed a behavioral approach (i.e., Brahmana, Hooy, & Ahmad, 2012a; Chin & Abdullah, 2013; Goetzmann & Zhu, 2005; Kudryavtsev, Cohen, & Hon-Sir, 2013; Ritter, 1988). However, it is rare to find research studies that empirically test the association between these anomalies and human behavior. Monday irrationality, popularly referred to as the Monday effect, is a phenomenon that has been largely unsolved. There is

much speculation on this topic and few studies that demonstrate any real results. The lack of empirical data indicates that this violation of the rational behavior assumption in finance has not yet been explained.

To confront this problem, this paper examines this anomaly from a psychological perspective by investigating mood sources, such as weather conditions, and analyzing them as drivers of investor irrationality as it pertains to the weekend effect. It is worthwhile to note that the weekend effect is a calendar anomaly that recurs on a particular day (usually Monday) and is negatively and significantly different from other days. The weekend effect demonstrates the irrationality of investors every Monday, when investors tend to be more aggressive or violate their utility function more frequently. Hence, this paper aims to examine the drivers behind Monday irrationality by hypothesizing that weather-induced mood is the source of this irrationality.

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