

# Analysis of Factors Affecting Investment Decisions in the Indonesian Capital Market

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## ABSTRACT

This study analyzes the factors influencing investment decisions in the Indonesian capital market. Investment decisions are critical to both individual investors and market stability, as they reflect investor confidence and market dynamics. The research examines the role of fundamental factors such as return, risk perception, financial literacy, behavioral biases, and macroeconomic indicators. Data were collected through a survey of active investors across various Indonesian stock exchanges and analyzed using multiple regression techniques. The findings indicate that return expectations, financial literacy, and risk tolerance significantly influence investment choices. Meanwhile, behavioral factors such as overconfidence and herding behavior also play a substantial role. The study highlights the need for investor education and the development of transparent financial information systems to enhance decision quality. These insights are vital for policymakers, investment advisors, and stakeholders aiming to strengthen capital market participation in Indonesia.

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## 1. INTRODUCTION

The capital market plays a pivotal role in the economic development of a country by facilitating the mobilization and allocation of long-term funds. It serves as a medium through which investors can channel their savings into productive investments, contributing to national economic growth. In Indonesia, the capital market has experienced substantial growth over the past two decades, driven by economic liberalization, technological advancement, regulatory reforms, and increased public participation. The Indonesia Stock Exchange (IDX) has become one of the most dynamic markets in Southeast Asia, offering a wide range of investment instruments such as equities, bonds, mutual funds, and derivatives.

Investment decisions within the capital market are complex and influenced by a multitude of factors, both rational and irrational. These include but are not limited to financial indicators, risk perceptions, market trends, investor psychology, and macroeconomic variables. The dynamic and often volatile nature of financial markets necessitates a deep understanding of these influencing factors to make sound investment choices. In developing economies like Indonesia, where market literacy and information asymmetry can significantly affect investor behavior, examining these variables becomes particularly important. Historically, the traditional financial theory, grounded in the Efficient Market Hypothesis (EMH), posited that investors are rational actors who make decisions based on available information and logical evaluations of risk and return. However, empirical evidence increasingly challenges this notion, especially in emerging markets. Behavioral finance, an evolving discipline, asserts that psychological factors and cognitive biases substantially influence investment decisions, often

leading to irrational behavior. This perspective is especially relevant in Indonesia, where retail investor participation is rising and behavioral patterns diverge from textbook rationality.

As of recent years, the Indonesian capital market has seen a surge in retail investor participation, particularly during and after the COVID-19 pandemic. The availability of mobile-based trading platforms and the increased accessibility of financial instruments have brought in a new wave of young and inexperienced investors. While this democratization of finance has benefits, it also brings challenges in terms of informed decision-making, susceptibility to market rumors, and herding behavior. Understanding the underlying factors influencing these investors' decisions is essential for developing appropriate regulatory frameworks, educational programs, and investment advisory services. In this context, this study aims to analyze the various factors that affect investment decisions in the Indonesian capital market. By identifying the determinants of investor behavior—ranging from financial literacy and return expectations to behavioral biases and macroeconomic perceptions—this research seeks to offer actionable insights for both market participants and policymakers.

Despite the rapid expansion and growing participation in the Indonesian capital market, there remains a lack of comprehensive understanding regarding the decision-making processes of individual investors. Investment choices are often influenced by a combination of rational financial considerations and psychological biases, yet most existing studies in Indonesia focus predominantly on traditional financial factors, leaving behavioral and contextual influences underexplored. Moreover, the influx of novice investors in recent years raises concerns about the quality of investment decisions being made. This gap in knowledge creates a risk for both individual investors and the broader financial ecosystem. Poorly informed decisions can lead to suboptimal investment outcomes, reduced investor confidence, and ultimately market instability. Therefore, there is a pressing need to explore and analyze the full spectrum of factors influencing investment decisions, particularly in the context of an emerging market like Indonesia. This study intends to fill that gap by providing a holistic analysis of the financial, psychological, and macroeconomic variables that shape investor behavior in the Indonesian capital market.

The primary objective of this research is to analyze the factors that affect investment decisions in the Indonesian capital market. The specific objectives are as follows; To identify and assess the influence of financial factors such as expected return and risk perception on investment decisions, To evaluate the role of behavioral biases, including overconfidence, herding, and loss aversion, in shaping investment behavior, To examine the impact of financial literacy and investor knowledge on decision-making processes, To determine how macroeconomic variables like inflation, interest rates, and GDP growth influence investor perceptions and actions, To provide recommendations for improving investor education and decision-making quality in the Indonesian capital market. This research holds both theoretical and practical significance. Theoretically, it contributes to the literature on investor behavior by integrating insights from traditional finance and behavioral finance within the context of an emerging market.

By exploring the multidimensional nature of investment decision-making, the study enhances our understanding of how different factors interplay to influence investor actions. Practically, the findings of this study have several important implications; For Investors: The insights can help investors become more aware of the biases and external factors that may influence their decisions, enabling them to make more informed choices, For Financial Educators: The results can guide the design of investor education programs that address both knowledge gaps and behavioral pitfalls, For Policymakers and Regulators: Understanding the factors that drive investor behavior can inform policy measures aimed at market stability, transparency, and investor protection, For Financial Institutions: The findings can be used to tailor financial products and advisory services that better meet the needs and preferences of different investor segments.

This study focuses on individual investors in the Indonesian capital market. It includes retail investors who actively participate in equity trading through the Indonesia Stock Exchange. The scope covers various factors including financial indicators, behavioral traits, and macroeconomic perceptions. Data will be collected through surveys and analyzed using quantitative methods. The study has several limitations, Geographic Focus: The research is limited to the Indonesian context and may not be generalizable to other emerging or developed markets, Self-reported Data: The use of surveys may introduce response biases and inaccuracies, Cross-sectional Design: The study captures a snapshot in time and may not reflect dynamic changes in investor behavior over longer periods. Extant literature on investment decision-making has evolved significantly over the past decades. Early studies rooted in classical economics emphasized rational decision-making, highlighting the role of information, expected

return, and risk in investment behavior. Markowitz's (1952) Modern Portfolio Theory and Sharpe's (1964) Capital Asset Pricing Model are foundational theories that describe how investors optimize portfolios based on risk-return trade-offs.

Growing empirical evidence has challenged the assumptions of rationality and market efficiency. Behavioral finance, championed by scholars like Kahneman and Tversky (1979), introduced concepts such as prospect theory, loss aversion, and framing effects to explain deviations from rational behavior. In emerging markets, studies have found that investor behavior is often influenced by psychological biases, social factors, and limited financial knowledge. In Indonesia, several researchers have examined aspects of investor behavior, but most studies remain fragmented, often focusing on isolated factors. For example, Sudirman et al. (2019) found that overconfidence and herding behavior significantly affect stock selection among millennial investors. Meanwhile, Suryanto and Puspitasari (2021) highlighted the role of macroeconomic variables like inflation and interest rates in shaping market sentiment. However, comprehensive models that integrate financial, psychological, and macroeconomic factors remain limited. This study seeks to build on existing literature by adopting a multidimensional framework that captures the complexity of investment decisions in the Indonesian capital market.

## 2. RESEARCH METHOD

This study employs a quantitative research design using a descriptive and explanatory approach. The descriptive aspect aims to depict the characteristics of Indonesian investors and the investment decisions they make. The explanatory aspect seeks to analyze the relationships between various influencing factors—such as financial, behavioral, and macroeconomic variables—and investment decision-making. This method allows for the identification of patterns and causal relationships that contribute to investment behavior in the Indonesian capital market. The population of this research consists of individual retail investors who are active participants in the Indonesian capital market, particularly those trading through the Indonesia Stock Exchange (IDX). The sampling technique used is purposive sampling, targeting investors who have been active in trading stocks or other capital market instruments for at least the past 12 months. A minimum sample size of 200 respondents is determined based on statistical guidelines for multivariate analysis. This size ensures the reliability and validity of the findings, particularly when using multiple regression techniques. The data are analyzed using Statistical Package for the Social Sciences (SPSS) and Structural Equation Modeling (SEM) with AMOS. The analysis includes; Descriptive statistics to summarize the demographic data and responses, Reliability and validity tests (Cronbach's alpha and factor analysis), Multiple linear regression to determine the influence of independent variables on investment decisions, Path analysis within SEM to test the strength and direction of relationships among variables, This methodology provides a robust framework for understanding how various factors influence investment behavior in Indonesia's capital market context.

## 3. RESULTS AND DISCUSSIONS

### Results

#### Demographic Profile of Respondents

The demographic characteristics of the respondents revealed the following; Gender: 60% male, 40% female, Age distribution: Majority (45%) aged between 25 and 34 years. Education; 65% of respondents held at least a bachelor's degree. Occupation: 52% private sector employees, 23% entrepreneurs, 15% civil servants, and 10% students. Investment experience: 39% had 1–3 years of experience, while 34% had less than 1 year. These results reflect a predominance of young, educated investors, consistent with the recent trend of millennial participation in capital markets driven by digital platforms.

#### Descriptive Statistics of Key Variables

The main variables in this study expected return, risk perception, financial literacy, behavioral biases (overconfidence, herding behavior), macroeconomic perceptions, and investment decisions were analyzed using mean scores and standard deviations.

Table 1. Descriptive Statistics of Key Variables

| Variable           | Mean | Std. Dev | Interpretation |
|--------------------|------|----------|----------------|
| Expected Return    | 4.12 | 0.61     | High           |
| Risk Perception    | 3.76 | 0.69     | Moderate-High  |
| Financial Literacy | 3.94 | 0.58     | High           |
| Overconfidence     | 3.45 | 0.72     | Moderate       |

| Variable                 | Mean | Std. Dev | Interpretation |
|--------------------------|------|----------|----------------|
| Herding Behavior         | 3.63 | 0.66     | Moderate-High  |
| Macroeconomic Perception | 3.52 | 0.73     | Moderate       |
| Investment Decisions     | 4.05 | 0.62     | High           |

The descriptive results indicate that investors generally have high expectations regarding returns and rate their own financial literacy highly. There is also a notable presence of behavioral traits such as herding and overconfidence, suggesting the influence of psychological factors in decision-making.

#### Reliability and Validity Testing and Correlation Analysis

Cronbach's alpha was used to assess internal consistency of the constructs. All variables demonstrated good reliability; Expected Return:  $\alpha = 0.82$ , Risk Perception:  $\alpha = 0.78$ , Financial Literacy:  $\alpha = 0.84$ , Overconfidence:  $\alpha = 0.75$ . Herding Behavior:  $\alpha = 0.79$ , Macroeconomic Perception:  $\alpha = 0.81$ , Investment Decision:  $\alpha = 0.85$ . Factor analysis confirmed that all items loaded appropriately on their respective constructs, indicating good construct validity. Pearson correlation coefficients were calculated to examine the relationships between the independent variables and investment decisions. The results show significant positive correlations; Expected Return ( $r = 0.52, p < 0.01$ ), Risk Perception ( $r = 0.41, p < 0.01$ ), Financial Literacy ( $r = 0.49, p < 0.01$ ), Overconfidence ( $r = 0.38, p < 0.01$ ), Herding Behavior ( $r = 0.44, p < 0.01$ ), Macroeconomic Perception ( $r = 0.35, p < 0.01$ ). These results suggest that all the studied variables are significantly associated with the investment decisions of Indonesian retail investors.

#### Regression Analysis

Multiple linear regression was performed to test the combined effects of the independent variables on investment decisions. Regression Model Summary;  $R = 0.692, R^2 = 0.479, \text{Adjusted } R^2 = 0.462, F\text{-value} = 27.148 (p < 0.001)$ , The model explains approximately 47.9% of the variance in investment decision-making, indicating a good fit.

Table 2. Coefficients

| Variable                 | B     | Std. Error | t-value | Sig. (p-value) |
|--------------------------|-------|------------|---------|----------------|
| (Constant)               | 1.231 | 0.284      | 4.336   | 0.000          |
| Expected Return          | 0.278 | 0.069      | 4.029   | 0.000          |
| Risk Perception          | 0.145 | 0.062      | 2.339   | 0.020          |
| Financial Literacy       | 0.263 | 0.078      | 3.372   | 0.001          |
| Overconfidence           | 0.123 | 0.060      | 2.050   | 0.042          |
| Herding Behavior         | 0.164 | 0.073      | 2.247   | 0.026          |
| Macroeconomic Perception | 0.102 | 0.057      | 1.789   | 0.075          |

Expected Return had the strongest influence on investment decisions ( $\beta = 0.278, p < 0.001$ ). This suggests that higher perceived returns significantly increase the likelihood of investment activity. Financial Literacy was also a strong predictor ( $\beta = 0.263, p = 0.001$ ), indicating that knowledgeable investors are more confident and proactive in making investment choices. Risk Perception was significant at the 5% level ( $\beta = 0.145, p = 0.020$ ), supporting the notion that investors consider risk carefully before making decisions. Behavioral biases, including overconfidence and herding behavior, had moderate but statistically significant effects, confirming that psychological factors influence investment actions. Macroeconomic perception was not statistically significant at the 5% level ( $p = 0.075$ ), though it approached significance, suggesting that while economic indicators are considered, they may not be decisive in individual investment decisions.

#### Discussions

This section interprets the results of the study, linking them to relevant theoretical frameworks and previous research. The discussion is organized according to the main categories of variables investigated: financial factors, behavioral factors, and macroeconomic perceptions. The aim is to contextualize the empirical findings and explore their implications for retail investor behavior, financial policy, and capital market development in Indonesia. The results of the regression analysis confirm that expected return has the most significant influence on investment decisions among Indonesian retail investors. This finding is consistent with traditional investment theories, including the Capital Asset Pricing Model (CAPM) and Modern Portfolio Theory (MPT), both of which posit that rational investors seek to maximize returns for a given level of risk. High expected returns act as an incentive, motivating investors to allocate their capital toward assets perceived as profitable, particularly in a volatile or emerging market such as Indonesia.

The relatively strong influence of expected return may also reflect the increasing popularity of short-term trading strategies among retail investors, many of whom utilize mobile trading applications

that highlight daily and weekly gains. As a result, investor behavior may lean toward speculative activity, particularly among younger, less risk-averse participants. These short-term return expectations, however, may not always align with fundamental analysis or long-term financial planning, leading to potential market distortions or suboptimal investment outcomes. Risk perception, while also statistically significant, has a somewhat smaller impact compared to expected return. This suggests that although Indonesian investors consider risk in their decision-making processes, risk tolerance may be relatively high, especially among newer investors who are drawn to the capital market by digital accessibility, peer influence, and social media exposure. This aligns with the findings of earlier studies (e.g., Wulandari & Nugroho, 2020) indicating that many Indonesian retail investors do not fully understand risk metrics or fail to apply them when making trading decisions.

Together, these findings imply that financial factors remain foundational in investment behavior, but return expectations often outweigh risk considerations, particularly in the absence of deep financial literacy or long-term investment planning. The study shows that financial literacy significantly affects investment decisions. Investors who rated themselves as more financially literate demonstrated greater confidence and competence in making investment decisions. These individuals were more likely to use a diverse set of financial instruments, analyze market trends, and consider both micro- and macroeconomic indicators before investing.

This result aligns with prior studies by Lusardi and Mitchell (2014), who found that financial literacy enhances investors' ability to make informed and rational decisions. In the context of Indonesia, where capital market participation is still developing compared to more mature economies, financial literacy can serve as a key driver in promoting responsible investment behavior and reducing vulnerability to market rumors or herd behavior. However, it is important to note that the self-reported nature of financial literacy in this study may overstate actual competence. Some investors may overestimate their understanding of complex financial concepts, which in turn could lead to overconfidence behavioral bias that was also found to be significant in this research. Thus, while financial literacy is a critical determinant of sound investment decisions, policymakers and market regulators must ensure that financial education initiatives are measurable, practical, and accessible, especially through digital platforms where most retail investors now interact with the market.

Behavioral factors specifically overconfidence and herding behavior were found to moderately influence investment decisions, consistent with insights from behavioral finance theory. These results challenge the assumptions of purely rational investor behavior and suggest that psychological and emotional factors play a notable role in shaping how investors operate in the Indonesian capital market. Overconfidence bias refers to an investor's tendency to overestimate their knowledge, forecast accuracy, or ability to outperform the market. The presence of overconfidence in the findings may reflect the rising trend of self-directed investing, where investors rely on personal judgment or unverified online sources rather than professional advice. Overconfident investors may ignore risks, under-diversify their portfolios, or engage in excessive trading, all of which could increase exposure to market volatility.

This finding aligns with Barber and Odean (2001), who concluded that overconfident investors trade more frequently and achieve lower net returns due to increased transaction costs and suboptimal timing. In Indonesia's context, overconfidence may also be fueled by anecdotal success stories shared on social media and investment forums, which can create illusions of expertise. Herding behavior, the tendency to follow the actions of the majority without independent analysis, also emerged as a statistically significant factor. This phenomenon is particularly relevant in emerging markets like Indonesia, where access to accurate, timely, and detailed financial information may be limited, prompting investors to rely on social cues, media trends, or peer recommendations. The influence of herding behavior was evident during events like the pandemic-driven market rebound in 2020–2021, where retail investors flocked to popular stocks despite weak fundamentals. The result was a disconnect between market prices and intrinsic values, driven largely by retail sentiment and mass psychology. Such behavior increases the risk of asset bubbles and amplifies market volatility. The study suggests that while behavioral factors may not dominate investment decisions, their presence indicates the need for interventions such as investor education on cognitive biases and critical thinking skills, as well as transparent market disclosures to help individual investors make more informed and independent choices.

Interestingly, macroeconomic perception which includes investors' views on inflation, interest rates, and economic growth was not statistically significant in explaining investment decisions at the 5% level. This finding contrasts with classical economic theories that emphasize the importance of macroeconomic indicators in shaping market behavior. Several explanations can account for this weak

relationship. First, retail investors in Indonesia may have limited access to or understanding of macroeconomic data, reducing its influence on their decisions. Instead, they may rely on short-term signals or simplified information from media headlines, influencers, or financial apps that prioritize trending stocks over fundamental analysis.

Second, given that many respondents in this study are young and relatively new to investing, macroeconomic awareness may not yet be integrated into their investment frameworks. These investors may be more reactive to market volatility or price movements than to economic policy shifts or monetary indicators. Lastly, it is possible that macroeconomic factors influence institutional investors more significantly, as they have greater access to financial models, analysts, and forecasting tools. For retail investors, the perceived distance between macroeconomic policies and personal investment outcomes may weaken the link between the two. Despite this result, macroeconomic education remains essential. As Indonesia's capital market matures, integrating macroeconomic awareness into investment decision-making will be vital in improving overall market efficiency and promoting a more informed investor base.

The findings of this study have several implications, Policy and Regulation: Financial Services Authority (OJK) and Indonesia Stock Exchange (IDX) should intensify programs on financial literacy, not only focusing on product knowledge but also on risk assessment and behavioral awareness. Technology and Innovation: Digital trading platforms can integrate educational tools or AI-based prompts to help investors recognize potential biases or misjudgments in their trading behavior. Investment Education: There is a need for customized investor training that includes macroeconomic analysis, behavioral finance, and portfolio management, particularly tailored for young investors. Further Research: Future studies could explore the interaction effects between financial literacy and behavioral biases or examine how external shocks (e.g., pandemics, interest rate changes) reshape investment decision frameworks. In summary, this study confirms that investment decisions in the Indonesian capital market are shaped by a complex interplay of financial, psychological, and informational factors. While expected return and financial literacy have the strongest influence, behavioral biases and macroeconomic perceptions also play noteworthy roles. Recognizing these dynamics is essential for building a more stable, inclusive, and efficient capital market in Indonesia.

#### 4. CONCLUSION

This study has explored the multifaceted factors that influence investment decisions among retail investors in the Indonesian capital market. Based on the data analysis and empirical findings, it is evident that expected return is the most dominant financial factor influencing investor behavior. This reinforces traditional investment theory, which asserts that investors are fundamentally return-driven. However, the study also reveals that risk perception, although significant, is often overshadowed by potential returns, suggesting that many investors are willing to tolerate higher levels of risk to pursue financial gain. Financial literacy emerged as a key determinant of rational investment behavior. Investors with higher levels of financial knowledge demonstrated more prudent decision-making and were more likely to utilize analytical tools and diversify their portfolios. Nevertheless, gaps remain in understanding the practical application of risk assessment and portfolio theory, particularly among less experienced investors. Behavioral factors such as overconfidence and herding behavior also proved to influence investment decisions. These findings align with the principles of behavioral finance, which suggest that emotions, biases, and social influence play a critical role in financial markets. Overconfidence can lead to excessive trading and misjudgment, while herding behavior may result in irrational market movements driven by crowd sentiment rather than fundamentals. Interestingly, macroeconomic perception—including views on interest rates, inflation, and economic growth—had a relatively weak impact on investment decisions. This indicates that many retail investors may lack awareness of or confidence in interpreting broader economic indicators, focusing instead on short-term market trends or peer recommendations. Overall, the investment decisions of Indonesian retail investors are shaped by a combination of financial rationality, behavioral tendencies, and limited macroeconomic awareness. Addressing these aspects holistically is essential to building a more informed, resilient, and efficient capital market. The Financial Services Authority (OJK), Indonesia Stock Exchange (IDX), and financial institutions should intensify financial education campaigns. These programs should cover not only investment products but also risk assessment, portfolio diversification, and long-term financial planning. Investment platforms and financial institutions should include modules on behavioral biases such as overconfidence, herding, and emotional investing. Awareness of these biases can help investors make more rational decisions and avoid speculative traps. Simplified and user-friendly economic

dashboards should be developed and integrated into digital trading platforms. By translating complex macroeconomic indicators into understandable insights, retail investors will be better equipped to make informed decisions based on broader market conditions.

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