Proceedings of the 3rd International Conference on Management Research and Economic Development
DOI: 10.54254/2754-1169/178/2025.22589

Analysis of A-share Premium Effect Based on Investor Sentiment Perspective

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Abstract: There is a premium effect in the Chinese stock market, which is affected by market sentiment and investor sentiment. This paper analyzes market sentiment and investor sentiment to explain the causes of the premium effect in Chinese stocks and discusses how sentiment affects the premium effect and proposes optimized investment strategies. After systematically combing and deeply summarizing the relevant literature, this paper applies literature analysis to deeply analyze the intrinsic connection between market sentiment, investor sentiment and stock premium effect. The results show that market sentiment and investor sentiment have a significant positive impact on the stock premium effect, the stock price fluctuates with the sentiment, and both of them have an important impact on the stock premium effect by influencing the market supply and demand relationship and investors' decision-making behavior. This paper provides certain investment strategy insights for investors and also deepens the related theory of the premium effect, which helps to improve the theory of behavioral finance and reveal the impact of irrational behavior in asset pricing.

Keywords: A-share market, Premium effect, Market sentiment, Investor sentiment

1. Introduction

A-share, as one of the largest stock markets in China, covers many aspects, including financial, green, and technology stocks dominated by the uptrend of the main. A-share stock trading liquidity, the market size of the vaster, known for its retail investors, and by the policy environment, market sentiment and other aspects of the impact of the stock premium. One of the most important issues in behavioral finance is to study the mystery of the stock premium, which is expressed as the market price of a stock is higher than its intrinsic value and was first proposed by Rajnish Mehra and Prescott. Studying the stock premium puzzle can lead to a better understanding of how emotional value drives the flow of money and create an early warning to make the right investment decisions [1].

In the investment process, investors will inevitably experience investment losses due to irrational behavior, and people are prone to loss aversion. Therefore, investors find the right investment opportunities and make rational investment in order to reduce the emotional changes caused by losses, to realize profits. This paper analyzes the stock premium from the two aspects of investor sentiment and market sentiment, expanding the scope of application of behavioral finance in the capital market,

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so that investors can better understand the impact of the two on the stock premium, to make rational decisions in the market, and to improve the operational efficiency of the market.

2. Theory and influential factors analysis of stock premium effect

2.1. Theoretical basis of stock premium

The stock premium effect, also known as the share price premium effect. In a specific market environment, due to the joint influence of many factors, the price of individual stocks will appear higher than their own intrinsic value.

The extent of the stock premium is usually characterized by the market price of the stock being higher than its net asset value. In the stock market arena, the par value is generally the nominal value of a stock, while the issue price is the actual selling price set by a company on the occasion of its initial public offering (IPO). Once the issue price exceeds the par value, it means that there is a stock premium. Specifically, in the A-share market, a premium usually refers to a stock whose market price is higher than its intrinsic or theoretical value. The premium effect occurs when such a premium is widespread in the market or reaches a certain level of significance.

2.2. Factors affecting the stock premium

In this paper, we will focus on the in-depth analysis of the impact of market sentiment and investor sentiment on stock premium. Market sentiment refers to the views and expectations of the majority of investors in the market for future market trends. It reflects the optimism or pessimism of the whole market and is affected by a variety of factors such as economic data, policy changes, market passages and so on. Investor sentiment refers to the emotional state and psychological expectations of individual investors. It is affected by personal investment experience, investment objectives, risk preferences and other factors, reflecting the investors on the financial market asset pricing error expectations or deviation from the rational expectations of the trading behavior, investor sentiment directly affects the investor's buying and selling decisions. In investment, investors' emotional state and psychological expectations will be affected by market sentiment, and their decisions and behavior will in turn affect the changes in market sentiment. Investor Sentiment Theory Lee et al. follow the model of D5SW and argue that the emotional factors of individual investors are responsible for the closed-end fund puzzle [2]. When noise traders are optimistic about returns, the trading price of the fund rises and vice versa [3]. According to Huang Tao, the accumulation of market sentiment over time drives price volatility, and if it is overly intense it can have a significant impact, generating arbitrage opportunities and attracting investors to invest [4].

2.2.1. Investor sentiment

In the investment process, investors are not completely rational and often appear some irrational behavior. Such as the lack of independent judgment and analytical ability of some investors, easy to be influenced by the surrounding environment and the behavior of others, blindly follow the wind to participate in speculation; there are also some investors in the sight of rising stock prices, blindly chasing up to buy, expecting to gain from it, but this behavior often contains a greater risk, which may result in the price of the stock premium. Most of these behaviors stem from investors' subjective assumptions and emotional impulses and are not based on an objective analysis of the company's fundamentals and the overall market environment. Moreover, due to information asymmetry and cognitive bias, not all investors get the same information, which makes investors may overestimate or underestimate the value of the stock, resulting in unreasonable changes in the stock premium [5].

According to Wen Fenghua's research, the relationship between investors' emotional state and stock returns can be obtained [6]. The average stock return is greater than the average return of the whole sample in the period of high sentiment, and investors raise the expectation of the expected stock return and participate more in the investment activities of stocks. Some irrational investors tend to overlook the risks associated with high returns, thus exacerbating high market sentiment and inducing a stock premium. High sentiment has a positive impact on stock returns (Table 1).

Table 1: Basic statistics of stock returns over time

	Mean	Std.Dev	Skew	Kurt	Sum	Sum Sq. Dev	Obs.
Whole entity	0.0053	0.0903	-0.6359	4.1764	0.5525	0.8481	105
High Mood Periods	0.0164	0.0952	-0.5682	4.3554	0.8349	0.4529	51
Low Mood Period	-0.0052	0.0850	-0.8455	3.8422	-0.2824	0.3829	54
Periods of increase	0.0148	0.0868	-0.6668	3.7345	0.6343	0.3162	43
Decreasing period	-0.0030	0.0926	-0.5813	4.4263	-0.1814	0.5150	61

The Figure 1 for periods of high sentiment are significantly greater than stock returns during periods of low sentiment. Optimism pushes up the premium, and concentrated buying by investors in the short-term triggers price increases. At the same time, the average return tends to increase as the level of sentiment gradually rises [6].

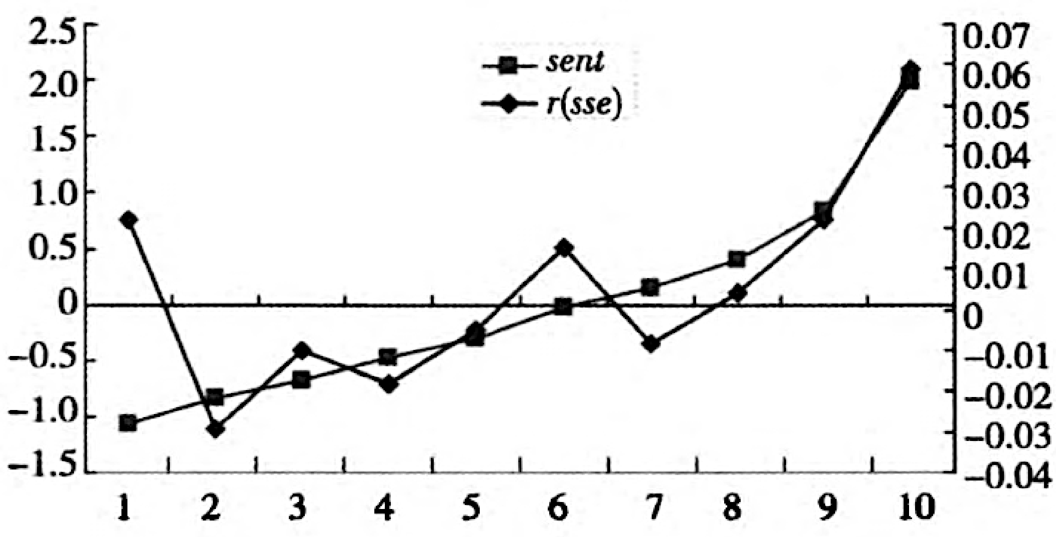

Figure 1: Average return on stocks at different levels of sentiment

2.2.2. Market sentiment

The stock market is highly susceptible to mood swings, and the ups and downs of market sentiment will have a direct effect on stock prices. When there is excessive speculation in the market and investors blindly follow the trend to participate in it, a large amount of money pours into the relevant stocks, making the demand for stocks far exceed the normal level, which may eventually lead to a premium in stock prices, deviating from its actual value.

Market sentiment refers to the general psychological state of investors on the overall trend of the market, usually expressed as optimism or pessimism. High or low market sentiment directly affects investors' risk appetite and investment decisions, which in turn affects stock prices and the premium effect. Some studies have shown that positive market sentiment tends to drive up stock prices, which in turn affects stock premiums.

According to Shen Bing's research, it was found that high market sentiment affects the movement of stock prices. And the effect of the sentiment factor will diminish as the stock market price rise area stabilizes. When sentiment is optimistic, investors are more willing to take high risks and push up stock prices. As shown in Table 2, the strategy with the highest return when choosing market sentiment indicates that market sentiment can effectively reflect the movement of stock prices, and investors can get more returns by holding the market-oriented zeitgeist strategy for a long time [7].

Table 2: Back-tested effects of sentiment timing strategy

Strategy Returns (%)	237.99	Alpha(%)	0.8585
Strategy Annualized Return (%)	9.09	Beta(%)	0.5775
Benchmark Return (%)	118.47	Sharpe Ratio(%)	0.2826
Maximum Retracement (%)	16.85	Winning Ratio(%)	61.54

3. Recommendations

3.1. Improve the market mechanism

When over-optimistic positive sentiment pervades the market, stock prices are easily inflated to unreasonably high levels, creating a premium. Regulators can use big data to analyze market trading activity, investor sentiment index, etc. If positive sentiment is found to be overheated, the stamp duty on transactions can be raised at the right time to increase transaction costs, cool down overheated market sentiment, and curb premiums caused by excessive speculation [8,9]. In the face of negative sentiment dominating the market, such as panic selling triggering share price overshooting premiums, the regulator can activate the “meltdown pause mechanism”, which suspends trading for a period of time when the share price falls sharply within a short period of time triggering the threshold, allowing investors to calm down, preventing negative sentiment from further spreading and deteriorating, and stabilizing the share price. At the same time, the continuous use of artificial intelligence to upgrade the regulatory system, maintain a high-pressure crackdown on insider trading, market manipulation and other violations, create a fair and just market environment, ensure that the share price truly reflects the value of the company, and curb premiums triggered by market malpractice from the root [10].

3.2. Strengthen investor education

During periods of high positive sentiment, investors are prone to blind optimism and chasing the wind. Currently, through the online financial knowledge popularization platform, push risk tips articles, case studies, popular stock investment failure cases to warn investors, to prevent excessive optimism to make impulsive investment decisions. The investor can also carry out online interactive live broadcasts, inviting experts to interpret the market in real time, guiding investors to rationally view the market heat. When negative emotions prevail and investors are generally pessimistic and afraid to enter the market, offline investment seminars are organized to explain the laws of the market cycle in an easy-to-understand manner and analyze historical cases of rebound after market downturns to enhance investor confidence. At the same time, for different age groups, emotional management and investment decision-making related content is integrated into the school finance curriculum to train students to establish rational investment concepts from an early age and to reduce unreasonable premium trading due to emotional fluctuations in the future.

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3.3. Cultivate the concept of long-term investment

When positive sentiment prompts investors to be keen on short-term speculation, the government can provide more policy support for long-term investment products, such as lowering the management fees of long-term investment funds to encourage investors to participate in long-term investment. Take institutional investors such as pension funds and social security funds as a model and increase their efforts to publicize long-term investment in the A-share market and show the results of long-term investment in terms of sound returns. When negative emotions cause investors to lose confidence in the market outlook and are unwilling to invest for the long term, tax incentives are introduced to reduce or waive the capital gains tax for individual investors who hold stocks for the long term, directing investors to focus on the long-term value of the company, avoiding premiums resulting from frequent transactions due to short-term emotional fluctuations, and promoting the market to form a stable and rational investment atmosphere.

In summary, the above targeted initiatives from improving the market mechanism, strengthening investor education, enhancing the transparency of information disclosure, fostering the concept of long-term investment, and stabilizing market expectations and other multi-dimensional measures are closely centered on the positive and negative factors in the market sentiment and investor sentiment. The measures are complementary and synergistic, forming an organic policy system. By effectively regulating the operation of the market under different emotional states and reducing abnormal share price premiums due to emotional fluctuations, the Chinese A-share market will be guided to develop in a more mature and rational direction. This will not only help stock prices accurately reflect the intrinsic value of companies and improve the efficiency of resource allocation in the market, but also has far-reaching theoretical and practical significance in maintaining the stability of the financial market and promoting the benign interaction between the real economy and the capital market, which will build a solid foundation for the promotion of China's capital market's long-term health and prosperity.

4. Conclusion

This paper discusses the impact of market sentiment and investor sentiment on the premium effect in China's A-share market and reveals the important role of sentiment factors in stock pricing. It is found that market sentiment and investor sentiment have a significant positive impact on the stock premium effect. Market sentiment affects stock supply and demand by reflecting the optimistic or pessimistic expectations of the market as a whole, which in turn drives stock prices away from their intrinsic value. Investor sentiment, on the other hand, exacerbates stock price volatility through irrational behaviors, such as blindly following the herd and chasing the bulls, leading to the creation of the premium phenomenon. This sentiment-driven premium effect not only affects the pricing efficiency of the stock market but also provides investors with insights into investment strategies based on sentiment analysis. The research results in this paper not only help optimize investment decisions, but also deepen the theory of behavioral finance and reveal the important impact of irrational behavior in asset pricing.

Although this paper makes a useful research exploration by analyzing the impact of investor sentiment and market sentiment on stock premiums, it still has shortcomings. Specifically, the numerical values of sentiment sources used in the study are relatively outdated and fail to adequately reflect the changes in sentiment in the current market environment, which may affect the accuracy of the assessment of today's stock premiums. Therefore, it is recommended that subsequent scholars conduct a systematic analysis based on this foundation and utilize newer data sources in order to arrive at more accurate and up-to-date judgments.

Acknowledgment

All the authors contributed equally and their names were listed in alphabetical order.

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