

The main focus of this thesis is to comprehensively describe the area of research called Behavioral finance and to point out a theory which has existed over 30 years but it is still not further developed: the Prospect theory. It has an application in many areas including finance - the major of this work. The thesis analyses the volatility of returns on futures contracts on cotton, crude oil and S&P 500 index using ARCH type models. The analysis confirms an asymmetric leverage effect of returns on volatility of all of the three contracts which corroborates a loss aversion in the decision making of investors, one of the main features of Prospect theory. On the other hand a measure of investor sentiment defined using open interest information incorporated in the model to directly capture investors reactions proved to be a weak tool.