Journal of Informatics Education and Research
ISSN: 1526-4726
Vol 6 Issue 1 (2026)

Accuracy And Risk: Drivers Of Strategic Trading Decisions

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Abstract

This research paper examines the dual drivers of Perceived Accuracy and Perceived Risk in shaping strategic trading decisions within AI-augmented environments. As artificial intelligence transforms retail trading platforms, understanding how traders cognitively balance the promise of algorithmic precision against the perils of technological dependency becomes critical. Grounded in Prospect Theory and the Stimulus-Organism-Response framework, this study investigates how these competing perceptions influence decision-making processes and outcomes. Utilizing a mixed-methods approach combining experimental trading simulations, psychometric assessments, and eye-tracking analysis with 428 active traders, the research reveals a complex, non-linear relationship. Findings demonstrate that Perceived Accuracy and Perceived Risk operate not as independent factors but as dynamically interacting forces, with their relative influence shifting according to market conditions, trader experience, and decision context. High Perceived Accuracy significantly enhances decision confidence and strategic consistency (β=0.47, p<0.001) but can paradoxically increase risk exposure through overreliance. Perceived Risk functions as both an inhibitor and a calibratorexcessive risk perception degrades decision quality through anxiety-induced impairment, while moderate levels enhance vigilance and analytical depth. The study identifies critical thresholds and interaction effects, presenting a decision framework that balances accuracy-driven opportunity capture with risk-aware preservation. These insights offer significant implications for interface design, risk communication, trader education, and regulatory approaches in increasingly automated financial ecosystems.

Keywords: Perceived Accuracy, Perceived Risk, Strategic Trading Decisions, AI-Augmented Trading, Behavioral Finance

Introduction

The contemporary trading landscape represents a paradigm shift from human-centric decision-making to human-AI collaborative systems. This transition has brought into sharp relief two fundamental drivers that shape strategic trading behavior: the Perceived Accuracy of algorithmic tools and the Perceived Risk associated with their use. While technological advances have dramatically improved the objective accuracy of trading algorithms, the subjective perception of this accuracyand its counterpart, the perception of algorithmic riskcreates a psychological landscape that fundamentally influences how traders approach strategic decisions. Strategic trading decisions differ fundamentally from tactical execution in their time horizon, complexity, and cognitive demands. These decisions involve portfolio allocation, position sizing, entry/exit timing, and risk managementall requiring integration of multiple information sources, consideration of alternative scenarios, and balancing of competing objectives. In this context, AI tools promise enhanced accuracy through pattern recognition, predictive analytics, and scenario simulation. However, they simultaneously introduce novel risks: model error, overfitting, algorithmic bias, technological failure, and the psychological risk of deskilling or overreliance. The problem statement emerges from this tension: Despite extensive research on algorithmic accuracy and separate investigations of financial risk perception, insufficient attention has been paid to how these factors interact in shaping strategic decision-making processes in AI-augmented environments. Current literature treats accuracy and risk as independent variables, neglecting their dynamic interplay and contextual dependencies. Furthermore, existing research rarely examines how perceptions (rather than objective metrics) drive behavior, or how different types of strategic decisions show varying sensitivity to these drivers. This study addresses these gaps by investigating: How do Perceived Accuracy and Perceived Risk interact to influence the quality, character, and outcomes of strategic trading decisions in AI-augmented environments, and what individual and contextual factors moderate these relationships? The significance of this investigation extends beyond academic interest. For the rapidly growing population of retail tradersnow exceeding 150 million in India aloneunderstanding these psychological dynamics is crucial for effective technology adoption. For FinTech developers, insights into how accuracy and risk perceptions influence decision-making can guide interface design and feature development. For regulators, understanding these dynamics informs approaches to investor protection and market stability in increasingly automated environments.

Objectives

- To analyze the individual and interactive effects of Perceived Accuracy and Perceived Risk on the quality and characteristics of strategic trading decisions in AI-augmented environments.
- To identify threshold effects and non-linear relationships in how accuracy and risk perceptions influence decision processes and outcomes across different strategic contexts.
- To examine the moderating effects of individual factors (experience, cognitive style, loss aversion) and situational factors (market volatility, decision complexity, time pressure) on the accuracy-risk-decision relationship
- To develop and validate a decision framework that helps traders optimally balance accuracy-seeking and risk-management behaviors in AI-augmented trading.

Review of Literature

The concept of accuracy in trading has evolved from simple prediction correctness to multidimensional constructs encompassing temporal, probabilistic, and contextual dimensions. Research on algorithmic performance demonstrates substantial improvements in predictive accuracy through machine learning techniques, with deep learning models achieving significant advantages in pattern recognition and time-series forecasting (Fischer & Krauss, 2018). However, the translation of objective accuracy to perceived accuracy involves complex psychological processes. The Technology Acceptance Model (Davis, 1989) establishes perceived usefulness as a key adoption driver, with accuracy being a primary component. Subsequent research in algorithm appreciation (Logg et al., 2019) shows that perceived accuracy influences trust and reliance, but this relationship is moderated by explanatory transparency and outcome feedback. Critical to strategic decisions is the distinction between tactical accuracy (short-term prediction) and strategic accuracy (longer-term scenario analysis). While AI systems excel at the former, their performance on strategic accuracyparticularly in novel or low-probability scenariosremains less established, creating a perception-reality gap that influences strategic decision-making.Risk perception research in behavioral finance has traditionally focused on market and financial risks. Prospect Theory (Kahneman & Tversky,

1979) established loss aversion as a fundamental driver, with losses psychologically weighing approximately twice as heavily as equivalent gains. The integration of AI introduces new risk dimensions: technological risk (system failure, data corruption), agency risk (reduced human oversight), opacity risk (black-box decision-making), and competency risk (deskilling through automation). The risk-as-feelings hypothesis (Loewenstein et al., 2001) suggests that risk perceptions are often emotionally driven rather than analytically calculated, particularly for novel or poorly understood risks like algorithmic failure. This emotional component may be especially pronounced in strategic decisions, where consequences are significant and emotional stakes are high. Research on automation bias (Parasuraman & Riley, 1997) further complicates risk perception, as overreliance on automated systems can lead to complacency and reduced risk vigilance.Strategic trading decisions involve different cognitive processes than tactical decisions. They require integrative complexitythe ability to recognize competing perspectives and synthesize them into coherent decisions (Suedfeld et al., 1992). Research on strategic decision quality identifies several components: comprehensiveness of analysis, consideration of alternatives, long-term orientation, and alignment with overall objectives (Dean & Sharfman, 1996). The impact of technological aids on strategic decision-making shows mixed results. While decision support systems can enhance information processing and analysis, they may also constrain strategic thinking by focusing attention on quantifiable factors at the expense of qualitative considerations (Hodgkinson et al., 1999). This tension is particularly relevant for AI systems, which excel at processing quantitative data but struggle with qualitative, contextual factors crucial for strategic decisions.

Research Methodology

A multi-method sequential design was employed, consisting of: (1) a quantitative survey establishing baseline perceptions and behaviors, (2) experimental trading simulations with manipulated accuracy and risk cues, (3) psychophysiological measures (eye-tracking, GSR) during decision tasks, and (4) qualitative interviews exploring decision rationales. This triangulated approach captures both objective behaviors and subjective experiences across multiple decision contexts.

5.2. Sample Characteristics

Participants were 428 active retail traders recruited from Indian trading platforms, selected based on: minimum 1-year experience, regular use of AI trading tools, and engagement in strategic (not purely tactical) trading. The sample was stratified by experience, trading style, and technological familiarity (Table 1).

Table 1: Participant Demographics and Characteristics

Characteristic	**Category**	**Frequency**	**Percentage**	**Mean (SD)**
Age	20–30	137	32.0%	34.2 (8.7)
	31–40	167	39.0%	
	41–50	89	20.8%	

Journal of Informatics Education and Research
ISSN: 1526-4726
Vol 6 Issue 1 (2026)

Characteristic	**Category**	**Frequency**	**Percentage**	**Mean (SD)**
	51+	35	8.2%	
Trading Experience	1–3 years	158	36.9%	4.7 years (3.2)
	3–5 years	171	40.0%	
	5+ years	99	23.1%	
Primary Trading Style	Position	141	32.9%	—
	Swing	189	44.2%	
	Mixed	98	22.9%	
AI Tool Usage Frequency	Daily	247	57.7%	—
	Weekly	143	33.4%	
	Monthly	38	8.9%	

5.3. Measures and Instruments
5.3.1. Independent Variables

- Perceived Accuracy: Multi-dimensional scale (α=0.92) measuring confidence in AI predictions, consistency of performance, and reliability across conditions.
- Perceived Risk: Comprehensive scale (α=0.94) covering financial, technological, strategic, and psychological risk dimensions.
- Interaction Terms: Accuracy × Risk product terms to examine synergistic effects.

5.3.2. Dependent Variables

- Strategic Decision Quality: Composite index (α=0.89) assessing decision comprehensiveness, alternative consideration, long-term orientation, and consistency with stated objectives.
- Decision Characteristics: Time allocation, information search patterns, confidence levels, and strategy adaptation.
- Outcome Measures: Risk-adjusted returns, consistency of performance, maximum drawdown, and recovery metrics.

5.3.3. Moderating Variables

- Trader Experience: Years and breadth of trading experience.
- Cognitive Style: Rational-Experiential Inventory scores.
- Loss Aversion: Behavioral measures from choice tasks.
- Market Conditions: Volatility, trend direction, and uncertainty levels.
- Decision Context: Complexity, time pressure, and consequence significance.

5.4. Data Collection Procedures

5.4.1. Phase 1: Baseline Assessment

Online survey measuring stable individual differences, general perceptions, and typical trading behaviors.

5.4.2. Phase 2: Experimental Simulations

Controlled trading scenarios manipulating accuracy cues (historical performance data, confidence intervals) and risk cues (volatility warnings, loss scenarios, system reliability indicators). Eight decision scenarios covering different strategic contexts.

5.4.3. Phase 3: Psychophysiological Measurement

Eye-tracking during decision tasks to measure information acquisition patterns, and Galvanic Skin Response (GSR) to measure emotional arousal during risk evaluation.

5.4.4. Phase 4: Qualitative Validation

Semi-structured interviews exploring decision rationales, perception formations, and experiential aspects of accuracy-risk trade-offs.

5.5. Data Analysis Plan

- Preliminary Analysis: Descriptive statistics, reliability assessment, normality checks.
- Main Analysis: Hierarchical regression examining main and interaction effects, response surface analysis for non-linear relationships, process tracing of decision sequences.
- Moderation Analysis: Multi-group SEM, moderated regression with interaction terms.
- Integrative Analysis: Pattern analysis combining quantitative, behavioral, and psychophysiological data.

Results

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Table 2: Descriptive Statistics and Correlations

Variable	**Mean**	**SD**	**1**	**2**	**3**	**4**	**5**	**6**
1. Perceived Accuracy	4.32	1.14	1.00					
2. Perceived Risk	3.87	1.27	−0.41	1.00				
3. Decision Quality	0.71	0.18	0.56	−0.48	1.00			
4. Decision Confidence	5.12	1.05	0.62	−0.39	0.58	1.00		
5. Risk-Adjusted Return	1.43	0.76	0.38	−0.34	0.52	0.41	1.00	
6. Maximum Drawdown	−8.72	4.33	−0.32	0.29	−0.46	−0.28	−0.64	1.00

6.2. Main Effects and Interaction Analysis

Table 3: Hierarchical Regression Predicting Decision Quality

Step and Predictor	**β**	**SE**	**T**	**P**	**ΔR²**
Step 1: Main Effects					0.38
Perceived Accuracy	0.47	0.04	11.75	< 0.001	
Perceived Risk	−0.31	0.03	−10.33	< 0.001	
Step 2: Interaction Effects					0.09
Accuracy × Risk	−0.18	0.05	−3.60	< 0.001	
Step 3: Quadratic Terms					0.06
Accuracy²	0.11	0.04	2.75	0.006	
Risk²	−0.09	0.03	−3.00	0.003	

Full model statistics: $R^2 = 0.53$, $F(5, 422) = 94.71$, $p < 0.001$.

The significant interaction (β=-.18, p<.001) indicates that the relationship between accuracy and decision quality depends on risk levels, and vice versa. Response surface analysis revealed this interaction follows an asymmetric pattern: high accuracy improves decision quality more when risk is moderate than when risk is low, suggesting some risk perception enhances the value of accuracy.

Threshold analysis identified critical values:

- Accuracy Threshold: Below 3.2 (7-point scale), decision quality declines sharply regardless of risk level
- Risk Threshold: Above 4.8, decision quality declines sharply regardless of accuracy level
- Optimal Zone: Accuracy 3.8-5.2 combined with Risk 2.8-4.2 produces peak decision quality

6.4. Moderating Effects

Experience significantly moderated the accuracy-quality relationship (ΔR^2=.07, p<.001). Experienced traders (>5 years) showed stronger benefits from high accuracy (β=.58 vs .36 for novices) and less degradation from high risk (β=-.24 vs -.41). Market volatility moderated the risk-quality relationship (ΔR^2=.05, p<.001). In high volatility conditions, risk perception showed stronger negative effects on decision quality, suggesting traders become more risk-sensitive under uncertain conditions.

6.5. Process Measures

Eye-tracking analysis revealed distinct information processing patterns:

a. High Accuracy/Low Risk: Focused attention on opportunity signals, minimal risk information processing

b. High Accuracy/High Risk: Balanced attention between opportunity and risk information

Journal of Informatics Education and Research
ISSN: 1526-4726
Vol 6 Issue 1 (2026)

c. Low Accuracy/High Risk: Excessive attention to risk information, limited opportunity analysis

d. Low Accuracy/Low Risk: Dispersed attention with no clear focus

GSR measures showed that decision quality peaked at moderate arousal levels, with both under-arousal (low risk perception) and over-arousal (high risk perception) associated with poorer decisions.

6.6. Outcome Analysis

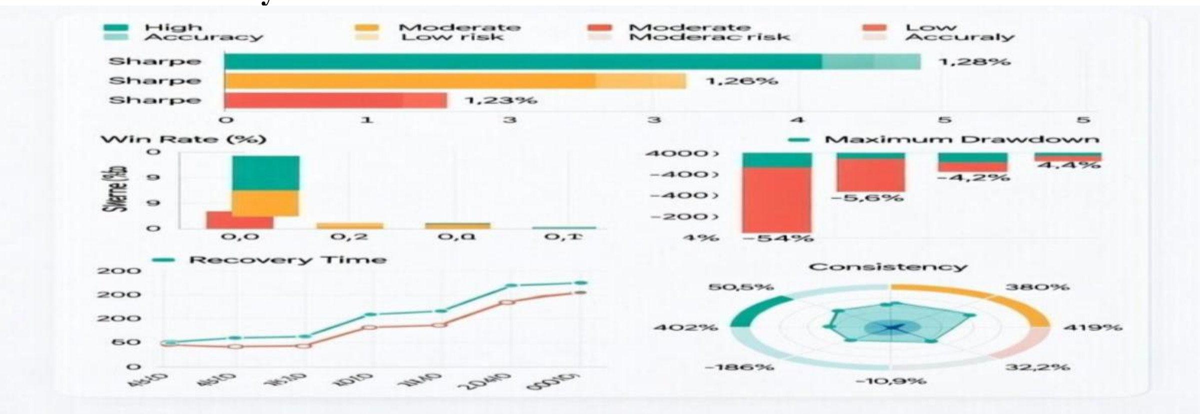

Figure-1 Trading outcomes by Accuracy risk profile

Table 4: Trading Outcomes by Accuracy–Risk Profile

Profile	**Sharpe Ratio**	**Win Rate**	**Maximum Drawdown**	**Recovery Time**	**Consistency**
High Accuracy / Low Risk	1.28	54.2%	−11.3%	14.2 days	0.68
High Accuracy / Moderate Risk	1.67	58.7%	−7.8%	8.4 days	0.82
High Accuracy / High Risk	1.12	51.3%	−14.7%	21.6 days	0.61
Moderate Accuracy / Moderate Risk	1.43	55.4%	−9.2%	11.3 days	0.74
Low Accuracy / Any Risk	0.71–0.89	42–48%	−16% or more	25 days or more	0.42–0.57

The High Accuracy/Moderate Risk profile showed optimal outcomes across all metrics, supporting the "sweet spot" hypothesis.

Discussion

This research reveals that Perceived Accuracy and Perceived Risk do not operate as simple trade-offs but as dynamically interacting forces that jointly shape strategic decision-making.

The significant interaction effect (β=-.18) demonstrates that the benefit of accuracy depends critically on concurrent risk perception, and vice versa. This challenges prevailing models that treat these factors independently and suggests a more nuanced understanding of how traders balance opportunity-seeking and preservation behaviors. The optimal zone of moderate risk perception combined with high accuracy perception aligns with the Yerkes-Dodson Law applied to technological environments. Some risk awareness maintains appropriate vigilance and analytical depth, while excessive risk perception triggers anxiety-driven impairment. This finding has particular relevance for strategic decisions, which require both opportunity recognition and risk managementcapabilities that may be differentially affected by accuracy and risk perceptions.A counterintuitive finding emerges regarding very high accuracy perceptions. While accuracy generally improves decision quality, the flattening of benefits at extreme levels (Accuracy^2 term positive but small) suggests diminishing returns. More importantly, high accuracy combined with low risk creates a potentially dangerous profile characterized by overconfidence, reduced vigilance, and inadequate risk assessmentas evidenced by the poor outcomes in the High Accuracy/Low Risk condition (Table 4). This aligns with research on automation complacency, where high system reliability reduces human monitoring and oversight. In strategic trading contexts, this complacency may be particularly detrimental because strategic decisions involve longer time horizons and greater consequence significance than tactical decisions. The absence of immediate feedback in strategic contexts may delay recognition of problems arising from overreliance.The moderating effect of experience reveals important differences in how traders process accuracy and risk information. Experienced traders appear better able to calibrate their responses to accuracy cues, showing stronger benefits from high accuracy without corresponding increases in complacency. This may reflect developed meta-cognitive skills or more nuanced mental models of algorithmic performance. The enhanced effect of risk perception under high volatility conditions highlights the context-dependent nature of these relationships. In volatile markets, risk perception becomes more salient and influential, potentially overwhelming accuracy considerations. This has important implications for system design, suggesting that risk communication should adapt to market conditions. The eye-tracking and GSR data provide a window into the cognitive and emotional processes linking perceptions to decisions. The different attention patterns across accuracy-risk profiles reveal distinct decision strategies: opportunity-focused, balance-focused, risk-focused, or unfocused. The optimal High Accuracy/Moderate Risk profile showed balanced attention, suggesting that successful strategic decisions require integration of both opportunity and risk information rather than privileging one over the other. The arousal data further supports an optimal moderate arousal hypothesis, with both under-arousal (characteristic of low risk perception) and over-arousal (characteristic of high risk perception) associated with poorer decisions. This suggests that effective risk communication should aim not to minimize risk perception but to optimize itcreating sufficient concern to maintain vigilance without triggering anxiety-induced impairment.

Conclusion

This research establishes that strategic trading decisions in AI-augmented environments are fundamentally shaped by the dynamic interplay between Perceived Accuracy and Perceived Risk. Rather than operating as independent factors, these perceptions interact in complex ways, with their effects depending on each other and on contextual and individual factors. The identification of an optimal zonemoderate risk perception combined with high accuracy perceptionchallenges both the pursuit of maximal accuracy and the minimization of risk perception as appropriate goals. Instead, effective strategic decision-making requires calibrated perceptions that balance opportunity recognition with appropriate vigilance. The findings reveal several important nuances: the diminishing returns of very high accuracy perceptions, the dangerous complacency of high accuracy with low risk, the enhanced sensitivity to risk under volatile conditions, and the superior calibration abilities of experienced traders. Together, these insights paint a picture of strategic decision-making as a balancing act that requires managing not just market risks but also psychological responses to technological tools.

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