



Herding behaviour and sentiment: Evidence in a small European market

Elisabete F. Simões Vieira^{a,*}, Márcia S. Valente Pereira^b

^a GOVCOPP Unit Research, ISCA, University of Aveiro, Campus Universitário de Santiago, Aveiro, Portugal

^b DEGEI, University of Aveiro, Campus Universitário de Santiago, Aveiro, Portugal

ARTICLE INFO

Article history:

Received 30 October 2013

Accepted 17 June 2014

Available online 11 September 2014

JEL classification:

G14

G11

G02

Keywords:

Herding behaviour

Capital market

Information cascades

Behavioural finance

ABSTRACT

This work studies herding behaviour in a small European market, by analysing the stocks that constituted the Portuguese stock PSI-20 index, for the period between 2003 and 2011. The two different approaches used to measure herding intensity led to different results, suggesting that measurements of the herding phenomenon are sensitive to the method used. Consequently, there is a need for further research into the methodology used to test this phenomenon. Additionally, the study analyses the relationship between herd behaviour and investor sentiment, an area that has been little explored. In applying causality tests to the impact of sentiment on herd behaviour, only weak evidence is found that sentiment influences herding.

© 2013 ASEPUC. Published by Elsevier España, S.L.U. All rights reserved.

Comportamiento gregario y sentimiento: la evidencia sobre un pequeño mercado europeo

RESUMEN

Este trabajo estudia el efecto rebaño en un mercado europeo de dimensión reducida, analizando los valores que constituyen el índice portugués PSI-20, para el período 2003-2011. Para ello, se consideran dos aproximaciones con objeto de medir la intensidad de este tipo de comportamiento, las cuales arrojan resultados diferentes, de lo que se deduce que el fenómeno manada es sensible al método de medición utilizado. Por consiguiente, existe la necesidad de promover investigaciones relacionadas con la metodología de medición asociada a este fenómeno. Este trabajo analiza, además, la relación existente entre el comportamiento de rebaño y el sentimiento del inversor, la cual no ha sido hasta la fecha suficientemente estudiada en profundidad. Aplicando tests de causalidad para evaluar el impacto del sentimiento del inversor sobre su comportamiento gregario, solo encontramos evidencias débiles de la influencia del primero sobre el segundo.

© 2013 ASEPUC. Publicado por Elsevier España, S.L.U. Todos los derechos reservados.

Códigos JEL:

G14

G11

G02

Palabras clave:

Comportamiento imitador

Mercado de capitales

Cascadas de información

Finanzas del comportamiento

Introduction

Behavioural finance has focused on the study of the rationality of investors as well as on the cognitive processes involved in the financial decisions made by investors, specifically, in their capital market investment decisions (Fromlet, 2001).

* Corresponding author.

E-mail address: elisabete.vieira@ua.pt (E.F. Simões Vieira).

Investor behaviour can cause price changes that do not necessarily follow the arrival of new information to the market but are, rather, caused by collective phenomena (Shefrin, 2000; Thaler, 1991). This has led researchers to seek theoretical explanations and empirical evidence regarding a number of behavioural finance phenomena, one of which is herd behaviour.

Herding may be defined as a group of investors ignoring their own information and beliefs and following the decisions of other investors, imitating them.

The first theoretical studies of this subject were carried out by Banerjee (1992), Bikhchandani, Hirshleifer, and Welch (1992) and Welch (1992). According to these authors, after a significant number of investors have chosen the same type of behaviour, others begin to ignore their own information and begin imitating their predecessors, thus setting in train a sequence of similar decisions.

However, the results of empirical studies into herding are not consensual. This may be due, among other factors, to the choice of time horizon for institutional investors, which is usually quarterly. According to Radalj and McAleer (2003), long periods make the herding evidence difficult.

In this context, we analyse the herd behaviour of Portuguese investors operating in the Portuguese capital market between 2003 and 2011. First, we study herding intensity, focusing on investor behaviour. Then, we evaluate the relationship between herding intensity and investor sentiment. Portuguese investor behaviour is analysed as a whole, since we have no means to distinguish individual from institutional investors.

This paper offers several contributions to the literature on herding. First, the study is applied to a small and illiquid capital market, which might influence the herd behaviour. Second, it considers two different approaches to the measurement of herding. This allows us to compare results and discern whether different methodologies lead to dissimilar conclusions. Third, it analyses the relationship between the herd behaviour and the investor sentiment, an issue that has been little explored. Finally, it covers a sufficiently broad period of time to dilute any biases arising from one-off market fluctuations.

The results suggest that empirical measurements of herding are sensitive to the measurement method used. Moreover, we find only weak evidence that herd behaviour in the Portuguese market is influenced by sentiment.

This paper is organised as follows. Section “Literature review and hypotheses” presents the literature review and formulates the hypotheses. Section “Methodology and data” describes the methodology and the data. The following section presents the empirical results. Finally, Section “Conclusion” offers our conclusions.

Literature review and hypotheses

The field of behavioural finance arose out of criticism of classical finance by a number of authors, including Kahneman and Tversky (1979).

According to behavioural finance theory, investors are influenced by psychological factors when making their decisions. Instead of following economic models, investors allow themselves to be influenced by their beliefs and emotions, thus deviating from rational choices and causing a shift in asset prices in relation to their intrinsic value. This makes it difficult to determine the underlying value of assets.

Some authors argue that the existence of irrational investors will have no influence on prices, because they are random. In addition, irrational investors behave similarly, and rational investors take arbitrage opportunities. Shiller (1984) studied the impact of irrational investor behaviour on the capital market, concluding that

such investors can cause changes in the movement of prices in relation to their fair values.

Capital markets can be influenced by psychological and socio-psychological factors, meaning that they are not necessarily efficient. Salzman and Trifan (2005), looking mainly at competitive contexts, emphasised the relevance of investor emotions and feelings in financial decision-making and the subsequent effect on the price of financial assets.

Moreover, investors deciding on investments may engage in a process of imitation, influencing each other and wanting to sell and buy the same financial assets.

Herding behaviour

There are several definitions of herding behaviour.

Banerjee (1992) suggests that herding occurs when individuals do what everyone else does, even when their private information suggests they should take a different decision. Devenow and Welch (1996) and Scuibba (2000) refer to patterns of behaviour correlated among individuals.

Chang, Cheng, and Khorana (2000) referred to this behaviour as a process by which market participants base their investment decisions on collective actions alone, suppressing their own beliefs.

Patterson and Sharma (2007, p. 4) note that “herding occurs when a group of investors trade on the same side of the market in the same securities over the same period of time or when investors ignore their own private information and act as other investors do”.

Several authors have attempted to identify possible causes for the occurrence of the herding phenomenon.

Hirshleifer, Subrahmanyam, and Titman (1994) argue that the existence of herding is based on the tendency of investors to follow the same information sources, interpreting the signals conveyed to the market in a homogenous way and, therefore, taking similar financial decisions. Consequently, when individuals have access to the same sources of information or interpret it similarly, correlated behaviour patterns occur.

Other reasons for the herding phenomenon have been suggested. These include the fact that institutional investors negotiate excessively or analyse the same group of securities and transact in the same direction. Other potential causal factors that have been cited are the desirability of similar assets, compensation schemes, the cost of reputation, the quality of the information conveyed to the market and the degree of sophistication of the market (Black, 1986; Demirer & Kutan, 2006; Patterson & Sharma, 2006; Rajan, 1994; Scharfstein & Stein, 1990; Trueman, 1988).

There are two distinct understandings regarding the rationality of this phenomenon. Some authors suggest that herding is irrational and caused by the herding instinct, through which several groups of investors face similar decisions. This makes it difficult to identify and measure the herding effect. The second approach suggests that herding can be entirely rational and that it results from the deliberate intention of investors to mimic each other. The authors arguing this position are of the opinion that there is an important relationship between rationality and emotion in the decision-making process and that psychological factors may be compatible with the optimisation of investor behaviour. Empirically, it is difficult to distinguish one form of herding from another, given the multitude of variables that can sustain investment in a specific stock at a particular time.

Lakonishok, Shleifer, and Vishny (1992) evaluated changes in the observed proportions of buyers and sellers of certain securities, focusing on institutional investors. The authors found no solid evidence of herding in 769 tax-exempt U.S. pension funds analysed for 1985–1989.

Grinblatt, Titman, and Wermers (1995) analysed 155 U.S. mutual funds between December 1974 and December 1984. In

Download English Version:

<https://daneshyari.com/en/article/1006809>

Download Persian Version:

<https://daneshyari.com/article/1006809>

[Daneshyari.com](https://daneshyari.com)