

Accepted Manuscript

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Martin T. Bohl, Nicole Branger, Mark Trede

PII: S0378-4266(17)30193-0
DOI: [10.1016/j.jbankfin.2017.08.006](https://doi.org/10.1016/j.jbankfin.2017.08.006)
Reference: JBF 5189

To appear in: *Journal of Banking and Finance*

Received date: 13 May 2015
Revised date: 24 July 2017
Accepted date: 7 August 2017

Please cite this article as: Martin T. Bohl, Nicole Branger, Mark Trede, The Case for Herding is Stronger than You Think, *Journal of Banking and Finance* (2017), doi: [10.1016/j.jbankfin.2017.08.006](https://doi.org/10.1016/j.jbankfin.2017.08.006)



The Case for Herding is Stronger than You Think

Martin T. Bohl*

Nicole Branger[‡]Mark Trede[§]

This version: July 24, 2017

Abstract

In this paper, we challenge the often implemented herding measure by Chang, Cheng, and Khorana (2000). They regress the cross-sectional absolute deviation of returns on the absolute and squared excess market return. A coefficient on the squared excess market return significantly smaller than zero is interpreted as evidence for herding. However, we show that the true coefficient is positive under the null hypothesis of no herding. Hence, their test is biased against finding evidence in favour of herding. Empirical examinations for the S&P 500 and the EuroStoxx 50 confirm the misleading implications of Chang, Cheng and Khorana's measure, while our modified test provides clear-cut evidence for herding behaviour.

Keywords: Measuring Herding Behaviour, Cross-Sectional Deviation of Stock Returns, US Stock Market

JEL: G12

* Department of Economics, University of Münster, Am Stadtgraben 9, 48143 Münster, Germany. E-mail: martin.bohl@wiwi.uni-muenster.de

[‡] Corresponding author: Finance Center Münster, University of Münster, Universitätsstrasse 14-16, 48143 Münster, Germany. E-mail: nicole.branger@wiwi.uni-muenster.de

[§] Department of Economics, University of Münster, Am Stadtgraben 9, 48143 Münster, Germany. E-mail: mark.trede@uni-muenster.de

We thank Philipp Adämmer, Jeanne Diesteldorf, the editor and two anonymous referees for helpful comments and suggestions.

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