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Does herding behavior in Chinese markets react to global markets?

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Abstract: **T**his study examines the possibility of herding behavior among investors in stocks listed on Chinese exchanges. Results based on daily data indicate that Chinese markets display herding behavior. This holds true whether we measure stock dispersions using firm data or industry data. Using a rolling regression method to estimate the herding equation, we find that the herding coefficient is sensitive to new information, displaying a time-varying property. This study finds significant evidence that herding behavior in the A-share markets is negatively correlated with that in global markets, while herding behavior in the B-share markets is positively related to that in global markets.

JEL: G15, G14

Key Words: Herding, Chinese stock markets, Cross-sectional dispersion

1. Introduction

In the finance literature the term herding is often used to describe the correlation of investor behavior resulting from copying and/or imitating trading activity. This correlation in trades may stem from informational cascades, in that the observation of prior investors' trades can be so informative that investors are willing to ignore their own private information in trading. As a result, herding behavior leads to a group of investors moving in the same direction, pushing stock prices further away from their economic fundamentals and, in turn, causing price momentum and excess volatility (Bikhchandani et al. 1992; Nofsinger and Sias 1999). Thus, some technical analysts see the herding behavior of investors as an example of extreme market sentiment. Academic researchers of behavioral finance identify herding in the collective irrationality of investors, leading to misvaluations of economic fundamentals (Shiller 2005).