

UNIVERSITY OF MACAU

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HERDING AND TRADING VOLUME



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Abstract

In behavioral finance, the incentive of investors to become informed is vital to the market efficiency. In this study, investment behavior of the tendency to exhibit herding behavior is tested in the Hong Kong stock market. The study modifies the cross-sectional absolute deviation of returns (CSAD) of Chang, Cheng and Khorana's (2000) measure of herding by adding trading volume variable and documents significant evidence of herding by using daily data in order to show that herding is also long-lived phenomenon. Specifically, comparing return dispersions for upside and downside movements of the market, it is observed that return dispersions during downside movements of the market are much lower than those for upside movements, indicating that stock returns behave more similarly during down markets. The findings alert investors of how a market with frequent herding investors, such as that of Hong Kong, will react to the asymmetric up and down-market returns. This study uses trading volume to explain herding behavior and observe the negative relationship between return dispersions and trading volume. Moreover, this study also proves that herding cannot generate positive market returns. On the other hand, positive market returns are the basis of herding. In addition, there is no evidence supporting the notion the dispersions decrease as investors receive cross-market herding information between the Hong Kong stock market and the Chinese stock market. However, the return information from one market will influence the herding behavior on another market. Finally, the study find that herding behavior appears to be more profound by examining trading volume during the extreme economic environment, especially financial tsunami.

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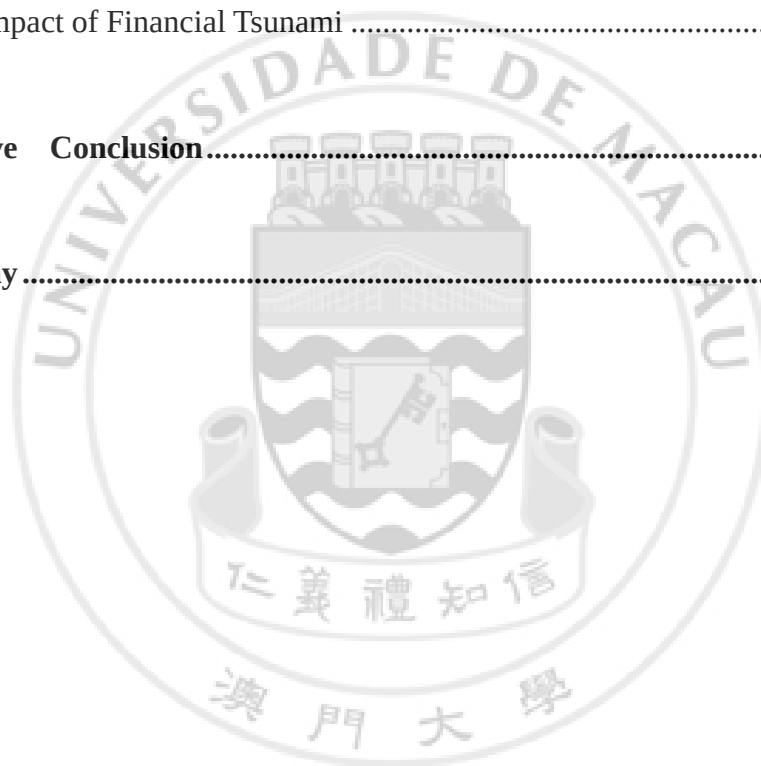
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