

Herding leads to wrong decisions in the stock market

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One reason for extreme fluctuations in the stock market is herding.

"Provided that the herd constitutes a majority, [investors](#) have a tendency to follow it without reflecting over their decisions. It can have devastating consequences," says the researcher Maria Andersson in a new thesis at the University of Gothenburg, Sweden.

"It is therefore important to understand which psychological mechanisms induce people to behave in the same way as everyone else," says Maria Andersson, who has studied why herding occurs in her doctoral thesis in psychology.

The [stock market](#) contains various kinds of information that can provide guidance as to the future yield of shares. An important question is which information and analyses investors use when they make investment decisions. "A common strategy is to observe what others do and follow the herd," says Maria Andersson.

Influenced by a herd

The thesis presents four experimental studies that illustrate herding in the stock market. Some 450 people took part in the investigations. The primary aim was to establish whether investors are influenced by a herd when they make investment decisions, and if that is the case whether it matters if the herd constitutes a majority or a minority. The size of the

herd and the [reliability](#) of its judgements varied in the different studies.

In brief, the results show that there is a strong tendency to put trust in the majority being right and to disregard minorities. This result applies irrespective of whether the majority has performed well or not. Minorities on the other hand have no influence even if their point of view is correct.

Is there any way to avoid being drawn along with the herd?

The studies demonstrate ways of breaking the influence of the majority by getting the participants in the trials to use more premeditated thinking.

"This can be achieved by raising the participants' awareness of how reliable the information is," says Maria Andersson.

Better and clearer information would probably also increase the chance of investors disregarding the herd. Being aware that the [information](#) available concerning the stock exchange is not always reliable and critically examining what the herd is doing is consequently a good starting point for successful share dealing.

Source: University of Gothenburg ([news](#) : [web](#))

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