

The Conditional Dynamic Dependences between Herding and Return: Evidences from US Equity Market

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Abstract

The literature has been interested in how herding behavior affects security prices. Surprisingly, the dynamic correlation between return and herding has not been examined. This paper provides a comprehensive empirical analysis of conditional dynamic dependences among herding level, herding correlation, herding volatility, stock return, return correlation, and return volatility. This is conducted by joining the statistical herding measure developed by Lakonishok et al (1992) and the extended flexible dynamic correlation and equicorrelation techniques (Engle (2002), Engle and Kelly (2008)) in the framework of Gaussian Copula. We find that (1) while the level of herding is considerable in a volatile downside market, it is moderate in a unwavering market; (2) herding behavior is more contagious in a less stable market; (3) market herding level is positively and significantly correlated with market return, with an upward trend in a bull market and downward trend in a bear market; (4) contagions of herding and return comovement are negatively correlated. In addition, we find that the size effect is important in understanding the above dynamic dependences.

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Keywords: herding behaviour, asset pricing, dynamic conditional correlation (DCC), dynamic equicorrelation (DECO), Gaussian Copula.