The Stan Clark Financial Team's

PERSPECTIVES

An excerpt from "Perspectives" - Volume 11 - Issue 7

Behavioral finance

Don't let the investment herd trample you!

By Stan Clark - Senior Investment Advisor

Do you recall the riots in Vancouver after the final game of the 2011 Stanley Cup? Those riots were an example of a phenomenon called *herding*.

Herding causes us to follow and act with the group, instead of as individuals. Herding can result from panic after a major disaster or threat. Or, herding can be triggered – no one knows why – by the actions of just a few individuals, such as in a riot.

Herding is an odd phenomenon. Ask people if they would join a mob. Most would say, "No!" But, when the right circumstances arise, they might well join the mob. Peer pressure causes people to join herds without even knowing it – or thinking about what they are doing.

Herding, of course, also happens in the stock market. And when it does, watch out for your money! Herding is a major cause of stock market bubbles and subsequent crashes. It causes people to flock to overpriced stocks, to shy away from buying undervalued ones, and to engage in panic selling that locks in major losses.

Even canny money managers, who pride themselves on their contrarian approach to the market, can get caught up in herd behaviour. We saw this happen with the rise and then bursting of the tech bubble at the end of the 20th century – and more recently, with the one-month bear market in the first quarter of 2020.

In his 2007 book *Your Money & Your Brain*, Jason Zweig cites a study of thousands of buy-or-sell recommendations by analysts at hundreds of brokerages. The study found that "analysts tag along with the crowd… When the average recommendation is a 'strong buy,' for example, the next call from any given analyst is about 11% more likely to be a strong buy, too."

It can all begin with a few individual actions copied by a growing host of other investors. In such cases, the analysts and others have been caught up in an *information cascade*, which Zweig describes this way:

"When institutions own a hot stock in a trendy industry, they usually have heard of it by word of mouth rather than through original research – and they go on to talk it up with three times as many colleagues as the owners of less exciting stocks do. No wonder 'everybody' often seems to be talking about the same stock."

The only effective way to protect yourself from herd behaviour in the market is to adopt non-emotional, rational ways of making decisions.

The only effective way to protect yourself from herd behaviour in the market is to adopt non-emotional, rational ways of making decisions. For example: Use disciplined rules to pick stocks. Or, set an equity target and stick to it, to avoid market-timing mistakes.

Herding often results from letting others do some of your thinking for you. Following the herd may sometimes get you out of trouble – when fleeing a disaster, for example – but it more often has the opposite effect. Just think of all those bones lying at the base of the cliff at Heads-Smashed-In Buffalo Jump in Alberta's Provincial Park.

In the next issue of *Perspectives*, we will revisit herding: its main causes – and how you can avoid it. ■

Stan Clark is First Vice-President, Portfolio Manager and Senior Investment Advisor for the Stan Clark Financial Team at CIBC Wood Gundy. Stan has direct responsibility for the team and oversees all areas of financial planning, investment selection and investment management.

The Stan Clark Financial Team
Where planning, investing and behavioral finance meet

Phone: (604) 641-4361 Toll free: 1 (800) 661-9442 Fax: (604) 608-5211 Email: StanClarkFinancialTeam@cibc.ca www.stanclark.ca

Stan Clark is an Investment Advisor with CIBC Wood Gundy in Vancouver, BC. The views of Stan Clark do not necessarily reflect those of CIBC World Markets Inc. This information, including any opinion, is based on various sources believed to be reliable, but its accuracy cannot be guaranteed and is subject to change. Clients are advised to seek advice regarding their particular circumstances from their personal tax and legal advisors.
If you are currently a CIBC Wood Gundy client, please contact your Investment Advisor. CIBC Wood Gundy is a division of CIBC World Markets Inc., a subsidiary of CIBC and a Member of the Canadian Investor Protection Fund and Investment Industry Regulatory Organization of Canada.