1. Noise Traders and Stock Price

<http://www.theatlantic.com/technology/archive/2011/03/does-anne-hathaway-news-drive-berkshire-hathaways-stock/72661/>

During a few years, there has been a rumor on “Hathaway Effect”, which means when the famous actress Anne Hathaway is frequently portrayed in the media, it could oddly increase the share price of the Berkshire Hathaway (BRK.A) owned by Warren Buffet. In the article, the author points out past series of evidence that shows the correlation with the stock price of the Berkshire Hathaway and the events that Anne Hathaway involved with. And, recently, after Anne Hathaway was photographed on her way out of a limo at the premiere of ‘Les Miserables’ without wearing underwear, Berkshire Hathaway’s A stock shot up 2.4% from $130.82 to $134 on the following day.

There are several efforts to explain how Anne Hathaway gives Warren Buffett a rise. Now, the most plausible suggestion from experts including the author and Buffet is that this correlation has resulted from byproduct of the robotic trading. I agree with it. And this malfunctioning is, paradoxically, a perfect example that depicts how attention through news media affects to stock price and how savvy professional traders use it. We learned about some noise traders have a tendency to make an investment decision simply based on personal emotion or others reaction to the company rather than his own evaluation of the fundamental value of the company. And, there are algorithmic trading systems that are programed to perform automated trading based on analysis of the popular sentiment in order to take advantages from it. For example, if a particular stock or company is being mentioned in the mass media, then a few of institution investors rapidly order to buy the stock, even though other conditions of the stock equal, since it is programed to realize it as hot stock to preoccupy. More interesting is that this strategy has worked at least in the short term. Because, sensitive individual investors later read the buzz and jump on the trend, pushing the price up and giving the first mover short-term momentum profits. In the case of Hathaway effect, savvy managers simply received the signal of Hathaway as investor sentiment and take the bullish stance for Berkshire Hathaway without careful analysis of the news itself. This irrational investing strategy and its consequence reflect the fact that the market is moved by human emotions. Investors are not rational; rather they are biased decision makers and sometimes copycat with no brain. And that’s why companies spend huge advertising expense to boost its stock price in short term and professional investors try to analyze popular sentiment to predict market movement.

1. Herding Behavior in Hedge Funds

<http://fortune.com/2015/10/25/valeant-bill-ackman-hedge-funds-losses/>

 “We have access to managers and data that others don’t.” This is the familiar statement from one of the major hedge funds. But in real, it’s getting harder to find any difference among them. As stock price of “Valeant Pharmaceuticals” shrunk more than 50% in the past month, many hedge funds including Lone Pine Capital and Viking Global, two of the world’s largest hedges had to share the pain together. Hedge funds introduce themselves as savvy money managers who catch out unveiled opportunity that others don’t see and justify their huge fees, saying their tons of research and analysis worth for it. However, it looks now they pile into the same stocks. As we discussed in the class, there is behavioral reason that trigger herding investments among hedge fund managers, especially young managers. Since managers are evaluated by past performance, young managers who did not have enough chance that revealed their talents before are more easily fired after underperformance. Besides, they cannot much enjoy the benefits after outperformance, and unconventional decisions could be more poisonous to them if the results are not favorable. In this incentive structure, managers are faced severe career concerns that snatch motivation to take bold actions from managers. Rather, they simply mimic actions of others who attract followers in order to benchmark the portfolio. And, if so, they may not be blamed much when whole market are failed. In this case, the article mentions that 32% of Valeant’s shares were held by hedge funds. After few of star players such as Bill Ackman took bullish stance on the company, many of top managers simply follow the trend. Followers focused more on who else are in the trend than the valuation of the stock itself. Considering the fact that Valeant earned fraudulent gains by manipulating its drug pricing, it is hard to believe that many of so-called brainy managers failed to suspect it before.