# Term of the Week- Herd Behaviour

The term for this week is *herd behaviour*. Herd behaviour is evident in all markets and is based on following what others are doing, rather than what your own rational analysis would lead you to do.

When a stock, market or particular sector is performing strongly, other investors buy into the market based on the recent price movements, volumes and gains rather than what the underlying fundamentals of the company or market are saying. This stems from the "fear of missing out" when others are profiting.

Whether we like it or not, humans are inherently herd animals, resulting from our evolution where there was safety in numbers. This social concept is ingrained in the way we think and reflects in how we behave in markets.

Like most of these terms we will cover, herd behaviour is not just evident in markets. If we see a shop or a restaurant which is busy and a restaurant that is empty, we assume that the restaurant which is busy must be good and we choose this one, regardless of whether it actually is.

Ignoring what the rest of the market is doing and being a contrarian investor can be difficult because it can take a while for the market to correct itself, or for the market to realise the intrinsic value of a company and behave efficiently. That is not to say big profits cannot be made by following trends and many investment strategies are built on this premise.

Herd behaviour can lead to a highly valued market plummeting in value (we call this a bubble bursting). The best example of this is the dot com bubble in the late 1990s. Investors poured money into technology companies regardless of their fundamentals because the market had momentum and other investors were doing the same. Many companies had no revenues and were consistently generating losses. With the pressure building the bubble eventually burst, with valuations trending to zero and the companies with no value going out of business.

Herd behaviour is a very important concept to be aware of in markets. Take the US equity market or US technology companies – most global investors have the highest allocation in their portfolio to the US market and the belief is that US exceptionalism will always continue. Whether the market can justify its valuation is up for debate, but the important concept behind herd behaviour is to check what you are investing in and why, and to remain diversified.

Herd behaviour can be managed by doing your own research, forming your own independent opinions and questioning why things are happening or why a company is valued as it is. It may be that a popular stock can justify its valuation, but doing the research before investing can help you avoid investing in something with no intrinsic value.

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