Out of the Blue: Mood-Driven Seasonal Effects on Investors’ Reactions to News

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Abstract

Contemporary research documents various psychological aspects of economic decision-making. The main goal of our study is to analyze the role of Mood Maintenance Hypothesis (MMH, Isen (1984, 2000)) in financial markets. MMH refers to people's tendency to maintain positive mood states, and implies that positive mood is associated with less critical thinking and reduced information processing, yielding three behavioral effects: (i) out of the blue, resulting in stronger negative reactions to bad news during good mood periods (ii) sunray on a cloudy day, leading to stronger positive reactions to good news during bad mood periods, and (iii) shallow thinking, producing stronger reactions to all kinds of news during good mood periods. Employing daylight duration changes and a measure of onset and recovery from symptoms of Seasonal Affective Disorder (SAD) as proxies for contemporaneous investors' mood, we test the role of mood in investors’ reactions to analyst recommendation revisions. We find corroborative results, most notably that negative stock price reactions to recommendation downgrades are significantly stronger during daylight increasing periods, and alternatively, during the periods characterized by low rates of onset and high rates of recovery from SAD. The magnitude of the effect increases in longer event windows.

Key Words: Analyst Recommendations; Behavioral Finance; Bounded Rationality; Financial Markets; Mood Maintenance Hypothesis; ‘Out of the Blue’ effect; Seasonal Affective Disorder; ‘Shallow Thinking’ effect.

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