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Diffusion of Optimistic and Pessimistic Investor Sentiment: An Empirical Study of an Emerging Market

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Abstract

This study explores the optimistic and pessimistic investor sentiments of three major institutional investors (foreign investors, trust investors, and dealers) in the Taiwan stock market and investigates the interactions and effects of these types of sentiment. Related indices are first calculated to examine whether investor sentiments are contagious among stock investors. Next, optimistic and pessimistic sentiments are differentiated to examine how each of them diffuses in the market. Finally, an index of dynamic sentiment spillover is estimated to investigate the diffusion effect of institutional investor sentiment under varying market performance. The results of this study confirm that, under favorable market performance when institutional investors are optimistic, the diffusion effect of investor sentiment is nonsignificant. By contrast, the diffusion effect of pessimistic sentiment is significant, indicating that investor sentiment contagion is asymmetric.

Keywords: Investor sentiment; Institutional investor; Emerging market; Optimism and pessimism; Investor sentiment diffusion

JEL Classification: G02, G10

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