Is there investor overreaction to ESG performance information? Investigation of momentum effect from ESG performance in the emerging market

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Abstract

With their increasing importance in business, the ESG: Environmental, Social, and Governance aspects have evolved from a mere clandestine investing criterion to a relatively popular and mainstream one. Retail investors for their philanthropic and institutional investors for signalling their green commitments are responding to ESG information. This study investigates whether investors overreact to ESG information and if that translates into ESG momentum effects. In this sense, the study aims to recognize and evaluate ESG momentum as an investment strategy. The study investigates whether the investors respond optimistically to positive or good news about the companies with a better ESG score and pessimistically to negative or bad news for the companies not performing as well on the ESG parameters. In line with the overreaction hypothesis, the study investigates the existence of ESG momentum and checks for other explanations for such momentum, such as the short-selling constraints, by reaffirming the presence of momentum to overreaction to ESG.

Keywords: ESG, ESG momentum, investor overreaction, trading strategy, overreaction hypothesis