Feedback Trading in Socially Responsible Exchange Traded Funds: Does Geopolitical Risk Matter?

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Abstract

Socially responsible exchange traded funds (ETFs) have gained popularity in recent years as a result of the shift toward index investing and investors' demand for socially-conscious investments. However, trading activities in ETF markets are driven by both fundamental and non-fundamental factors, such as behavioral dynamics including feedback trading. Notably, the level of feedback trading may be intensified by investors' aversion to risk factors, such as geopolitical risk (GPR), which has been exacerbated in recent times. Against this background, this study aims to investigate whether GPR influences the degree of feedback trading in socially responsible ETFs. In line with existing literature, the feedback trading hypothesis is examined for U.S-listed socially responsible ETFs over the period of 2015–2023 using the Sentana and Wadhwani (1992) framework with asymmetrical GARCH models (GJR- and E-GARCH). The results suggest that socially responsible ETF investors exhibit positive feedback trading on average, and the level of feedback trading is positively related to GPR. Overall, this is the first study to explore feedback trading in socially responsible ETFs and its link to GPR. Therefore, the results of this study are important for ETF investors and regulators as they provide a greater understanding of the role of behavioural factors and risk exposures on investment decisions and market dynamics.

Keywords: Behavioural Finance; ESG Funds; Impact Investing; Index Investing; Investor Behaviour