Efficient market hypothesis

Finance

Efficient Market Hypothesis The efficient market hypothesis asserts that the prices of securities in the market reflect the past, present and future information. All investors in the market therefore have all the information pertaining the securities and that no single investor is in a position to make above average returns without incurring above average risks. Investors will therefore make normal profits. According to this hypothesis, any new information that can influence the prices of securities will spread randomly to all investors. The weak form hypothesis argue that the prices of securities only reflect past information and therefore investors can make above average return in such market. For the case of semi-strong form, the prices of securities depend on the present and past information and not on the future expected information. Finally, the strong form contend that the prices of securities in the market reflect all the information i. e. past, present and future and that this information is in the domain of all the investors (Schwert 21). There is no opportunity to make abnormal returns in a strong market. The strong market supports the efficient market hypothesis, as it is this form where investors are never in a position to make abnormal profits without incurring higher risk. The other two forms: weak and semi-strong form fails to support the EMH because not all investors are privy to all the information about the market and therefore some investors are in a position to make above average rate of return without taking above average risks (Schwert 23). I however believe that there is no efficient market. This is because the assumption in which the EMH is hinged are ideal i. e. that there are no transaction costs, that all investors have all past, present and future information and that the stock markets are efficient. These assumptions are idyllic and unattainable. Markets can therefore be in either the weak or semi-

strong form in which case some investors have more information than others can. This can be shown from the many cases in which those in management positions have used insider information.

Economists and psychologists in the behavioral finance sector however argue that in the short run, efficient markets are unattainable. This is because the prices of securities are influenced by other psychological factors like those that the expectation in future prices. They further assert that security prices cannot be disseminated equally because of the bandwagon effect. Investors will therefore consider other factors in the determination of the investment decision on securities depending on their behavior and other expectations. For instance argue that investors react slowly to new market information as opposed to the way in which such information are much valued in the long run (Schwert 26). Social factors therefore affect the financial decisions of investors.

Individuals can thus make important decision by gathering as much information as can be in their possession to help them make viable and informed decisions. Speculative factors should be taken into account when making investment decision on securities as they affect the performance of the stock markets and can lead to contagion. In summary, it is difficult to attain a perfect market and without full rational information by a constituency of investors will automatically lead too imperfect markets. Investment decisions requires comprehensive analysis that involves many factors.

Work Cited

Schwert, G. William. 2001. “ Anomalies and Market Efficiency,” in Handbook

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