Efficient market hypothesis persuasive essay

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- Technical analysis of the market trends

On which does technical analysis of the stock market focus

Efficient Market Hypothesis is among o the most debated theories in the world of business due to its contradictory nature. According to Yen and Lee (2008), the theory that has attracted many theorists, some of whom argue in its support and others argue against it. Market efficiency causes existing share prices always to incorporate and reflect all relevant information (Brooks, 2006, p. 2). Stock always is purchased for a fair value of stock exchange that makes the investor make a decision on whether to buy underpriced stock and see if they will sell during inflation. Technical analysis involves the analysis of market prices according to the previous history of the market by using primarily price and volume. The technical analysis is disputed by efficient market hypothesis which states that stock market prices are not predictable (Lo and Hasanhodzic, 2013, p. 45). Thomsett (2003) discuss the support and resistance chart of technical analysis.

chart I

In the chart, one shows the price level through which a stock seldom decline (illuminated by the blue arrows). Resistance, on the other hand, is the return level that a stock scarcely surpasses (shown by the red arrows).

Trend lines join two or more price points and are extend to the future so that it may act as a line of support and resistance (Stevens, 2002. p. 28).

The strong form market efficiency

Harder (2010) depicted that changes in the prices of assets are highly dependent on the information that is available in the market as well as the changes in discount rates. Some investors attempt to find loopholes in the market so that they can make higher profits. EMH is financial economics that shows asset prices fully reflected according to the information. Rupper, (2004, p. 9) states that efficiency can be high, semi-strong and weak. Strong efficiency means the market is reflecting all the information from the public, private and addition though weak and semistrong efficiency. Semistrong efficiency means the market is reflecting all the available public information. Weak efficiency reflects all the information and believes that all market prices should be independent.

Chan, Benton, and Ming-Shiun, (2003), argued that investors would attempt to buy stocks at an undervalued price or sell them at an overvalued price to make abnormally high profits. However, the fact that stocks are always dependent on the information available in the market and that they will always trade at their fair prices makes it difficult for investors to beat the market. According to the efficient market hypothesis, the return of stocks is a reflection of the information that is available in the market and the discount rates at given times (Chan, Benton, and Ming-Shiun, 2003, p. 39). Eugene (1970) developed the market efficiency hypothesis which states that it is not possible for an investor to outperform the market because all the information concerning the market has already been built into the stock market.

The efficient market hypothesis contradicts the technical analysis

As mentioned by Chan, Benton, and Ming-Shiun, (2003), in their research, efficient market hypothesis contradicts the technical analysis since it states that past prices cannot be used to predict the profitability of the future costs. Eugene tries to explain the EMH is quite extensive. EMH does not consider the past prices rather the investors should consider the previous profits. Being able to predict this kind of trend for any stocks can lead to an investor making high profits. This is the trick that most investors who have been able to make high profits apply. These investors can carry out comprehensive market analysis of the stock prices and then make the right decision regarding when to buy and when to sell stocks (Murphy, 1999, p. 70). From the graphs given, an investor who buys shares in January and sells in April is likely to make high profits. If the investor sells the stocks in September or October, the profitability will be lower. Therefore, it is usually not about which stocks one buys. It is about the ability to predict price movements. This is made possible by observing past prices and using moving averages to predict their future behavior.

According to Murphy (1999), the analysis of how the securities behave may take two approaches. These are technical analysis or the fundamental analysis. On the fundamental analysis studies everything from the economy, management of companies, financial conditions and company conditions (Lorenzo, 2013, p. 92). The fundamental analysis is concerned with earnings, assets, liabilities and the expenses of the business (Schlichting, 2013, p 40). Normally, when a company is performing well financially, there are high

chances that its value will be great and so will be the value of its stocks. An investor will, in turn, be more likely to invest in such a company since the worth of its stock is likely to increase. As a matter of fact, the first impression any investor will get is about the business behavior, even before they carry out any other form of analysis. However, there are cases where the behavior of a company is not always a reflection of its value. It is for this reason that the technical analysis is employed (Murphy, 1999, p. 65). This analysis only focuses on the movement of prices in the market and most cases it is accurate or nearly accurate.

Technical analysis of the market trends

As stated by Osler and Chang (1995), the head and shoulder technique is arguably the most reliable form of technical analysis in predicting the market trends. It is a representation of a natural point of origin for any empirical research, and hence it provides the basis for all predictions. In other words, the final prediction will always be influenced by this technique regardless of the method that the researcher uses. This technique may not always give an accurate reflection of the future market prices of a given stock. There are situations when the market may be unpredictable due to unforeseen events. In such cases, the head and shoulder technique cannot provide and accurate value of the stock process (Chan, Benton, and Ming-Shiu, 2003, p. 102). Different investors value stock differently. This means that the value that one investor assigns to an individual stock is distinct from the value that another investor will assign. Therefore, even with the head to shoulder technique, it is still not easy to predict the market movements, and hence it is difficult to take advantage of the markets. Technical analysis tends to use

the past information of the market to make the conclusion on the possible stock exchange prices. For the technical analysis to be able to predict it should reverse the existing trends to determine the stock prices.

Conclusion

Technical analysis indicates that market trends can be predicted and this gives the investors anticipation on what is likely to occur over time because it forecast on the future financial price movements. It uses a wide variety of charts to show the anticipated prices. Technical analysis is reliable seen it focuses much on the price which is what all investors are interested in the price. It has consideration for us-ply and demand and also support and resistance.

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