Stock Trading and Equity Investing with Python A-Z

Market Efficiency (Price vs. Value)

Price vs. Value

Stock Price

A stock's **Price** is the price that **can be observed** in the market.

Apple Inc. (AAPL)
NasdaqGS - NasdaqGS Real Time Price. Currency in USD

150.76 -1.58 (-1.04%)
As of 10:41AM EDT. Market open.

Stock Value

A stock's **Intrinsic Value** is a measure of what the stock is **worth**. This measure can be derived by various **valuation methods**.
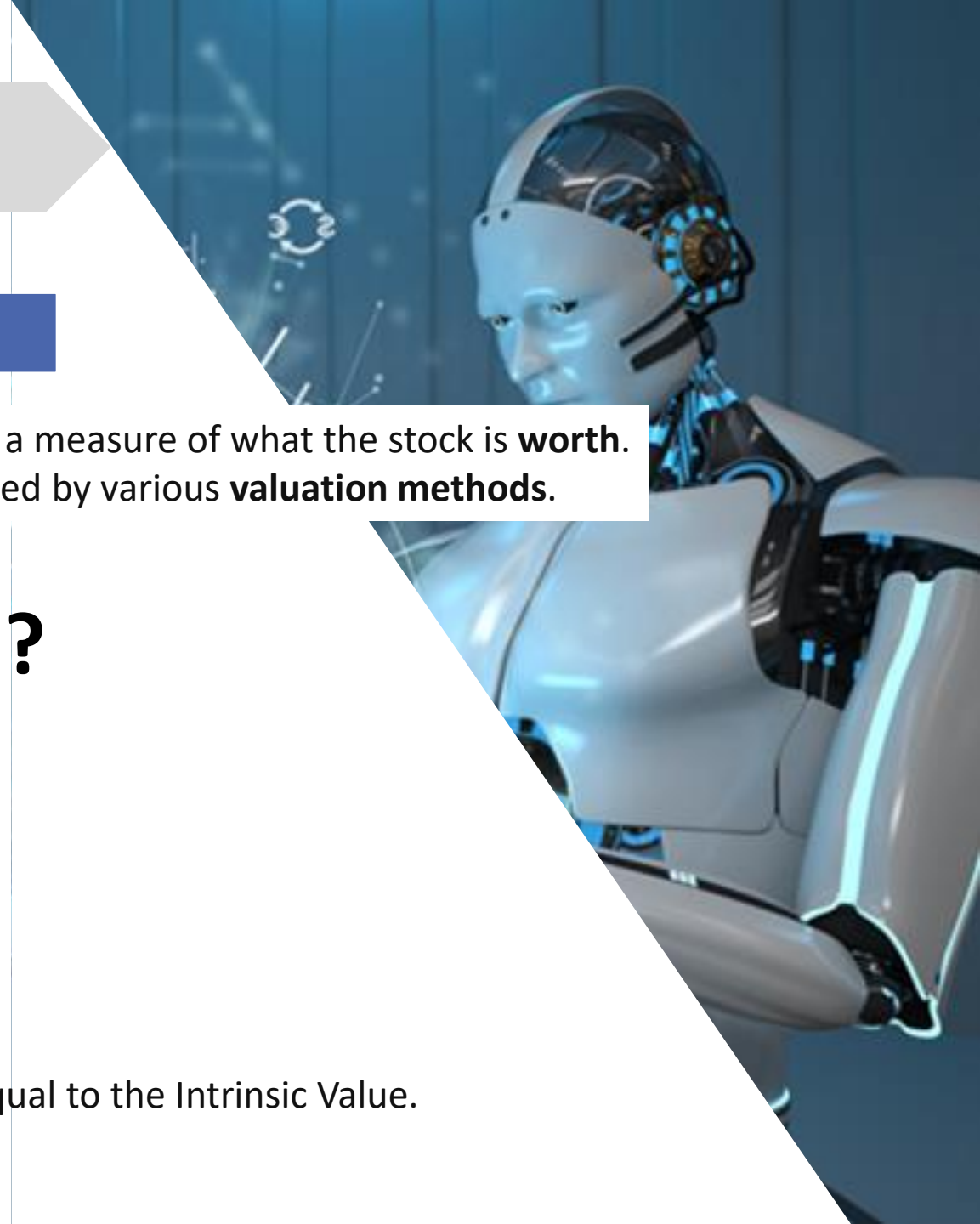
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- If Price > Value: Stock is **overvalued** → signal to **sell**
- If Price < Value: Stock is **undervalued** → signal to **buy**
- If Price ≈ Value: Hold / do nothing

In **efficient markets**, the Price is (should be) very close/equal to the Intrinsic Value.

Market Efficiency

Efficient Market Hypothesis (EMH)

Financial Markets are **information efficient**. Current Prices fully, quickly and rationally **reflect all publicly available information**.

- ✅ • **Weak form of EMH**: Historical Price and Volume Data
- ✅ • **Semi-strong form of EMH**: Financial Statements, Macro Economics, Business News, Analyst reports, etc.
- ❌ • **Strong form of EMH**: private/insider information (Insider Trading is strictly prohibited!)

- Investors / Traders (typically) **can´t make abnormal profits** with publicly available information.
- Stocks are fairly priced. "You can´t beat the market"
- Developed markets are more efficient than emerging markets
- Large Cap stocks are more efficient than Small Cap stocks (higher analysist coverage)

Do Investors/Traders always act rationally?

Markets are **not perfectly efficient** because the underlying **assumptions** of EMH **do not hold**:

- not all market participants have **full access** to all available information
- many market participants don´t have **skills/capacity** to process and analyze information
- market participants do **not act 100% rationally** (Behavioral Finance)

GameStop (GME)