

SHRI VAISHNAV INSTITUTE OF MANAGEMENT INDORE(M.P.)



Session:2022-2024

Analysis of efficient market theory

**Fulfillment of the degree of
Master of Business Administration
(FULL TIME)**

Submitted To:

Dr. Chandni Keswani

Submitted By:

Anjali Chourasiya

Chetan Malviya

Chetana Chouhan

Sem - IV ‘A’



Efficient Market Theory What It Is, Forms, & Applications

What Is Efficient Market Theory (EMT)?

- Efficient market theory (EMT) is a concept in finance that asserts that financial markets are highly efficient and that prices of assets fully reflect all available information.
- EMT has been a prominent topic of debate among finance academics and practitioners since its inception.
- It has been a widely studied and researched topic for decades, and its applications have had significant implications for investment decision-making, portfolio management, and market regulation.

- The concept of EMT has its roots in the works of Eugene Fama, who introduced it in 1965.
- EMT is grounded in the notion that market participants are rational and have access to all relevant information.
- Therefore, in an efficient market, prices of securities are determined by market forces, and any new information is immediately incorporated into prices.
- This implies that it is impossible to outperform the market consistently, as prices already reflect all available information.

Efficient Market Hypothesis

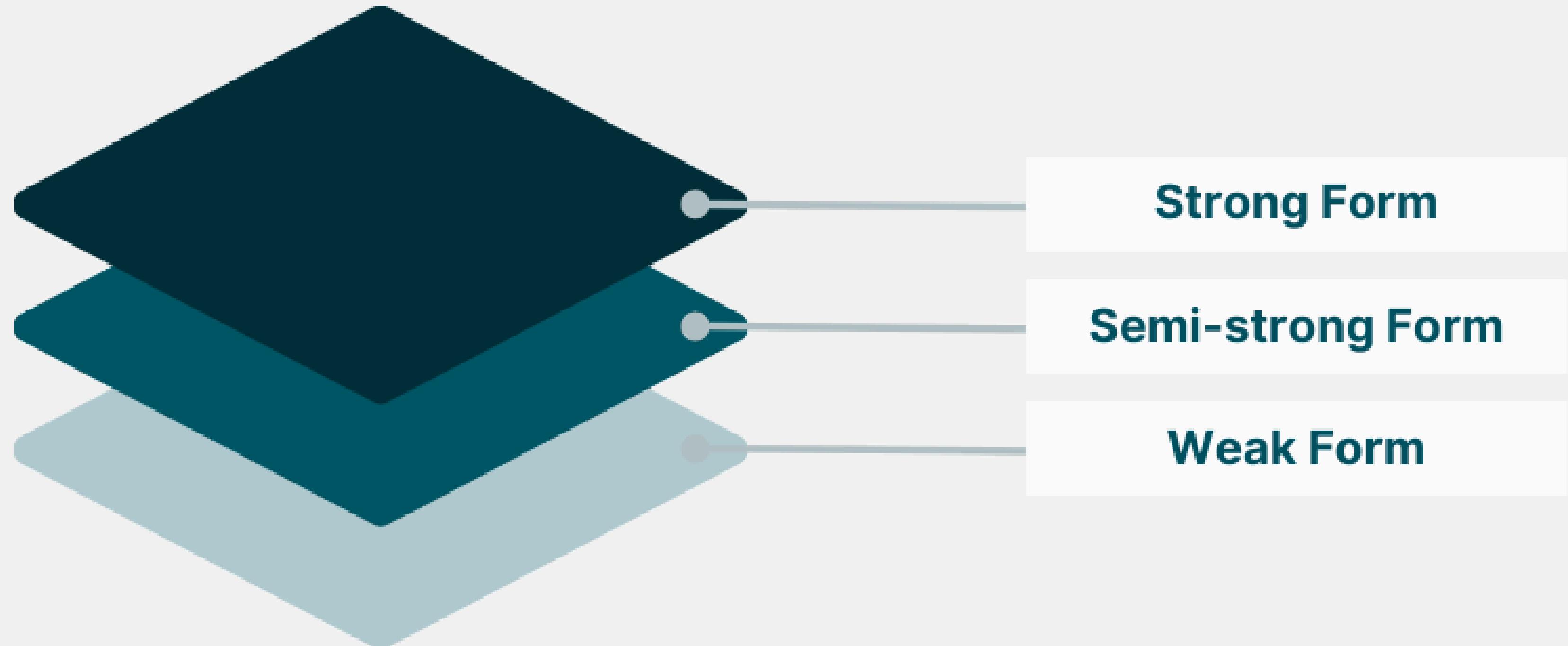
Forms of Efficient Market Theory

EMT is commonly categorized into three forms, which include the weak form, semi-strong form, and strong form.

- **Weak Form:** The weak form of EMT asserts that all past prices of securities are reflected in current prices, and it is impossible to use past prices to predict future prices.
- **Semi-strong Form:** The semi-strong form of EMT suggests that current prices reflect all publicly available information, including financial statements and other disclosures.

- **Strong Form:** The strong form of EMT suggests that current prices reflect all available information, including public and private information. In this case, insider trading would not be profitable, as prices already reflect all available information.

Forms of Efficient Market Theory



Your Empirical Evidence in Support of Efficient Market Theory

Numerous empirical studies have been conducted to test the validity of EMT.

- Stock Prices Follow Random Pattern
- Market Prices Are Unpredictable
- Actively Managed Funds Underperform

Stock Prices Follow Random Pattern

One of the earliest and most influential studies was conducted by Fama himself. In his study, he found that stock prices in the United States followed a random walk pattern and were not predictable.



Market Prices Are Unpredictable

Other studies have found similar results, suggesting that market prices are unpredictable and follow a random walk pattern.



Actively Managed Funds Underperform

In addition, some studies have found that actively managed funds, which seek to outperform the market, often underperform the market after accounting for fees and transaction costs.



Criticisms of Efficient Market Theory

Despite the empirical evidence in support of EMT, there are several criticisms of the theory.

- Investors Are Not Rational
- Reflected Market Prices Are Not Always Correct
- Prices Are Influenced by External Factors

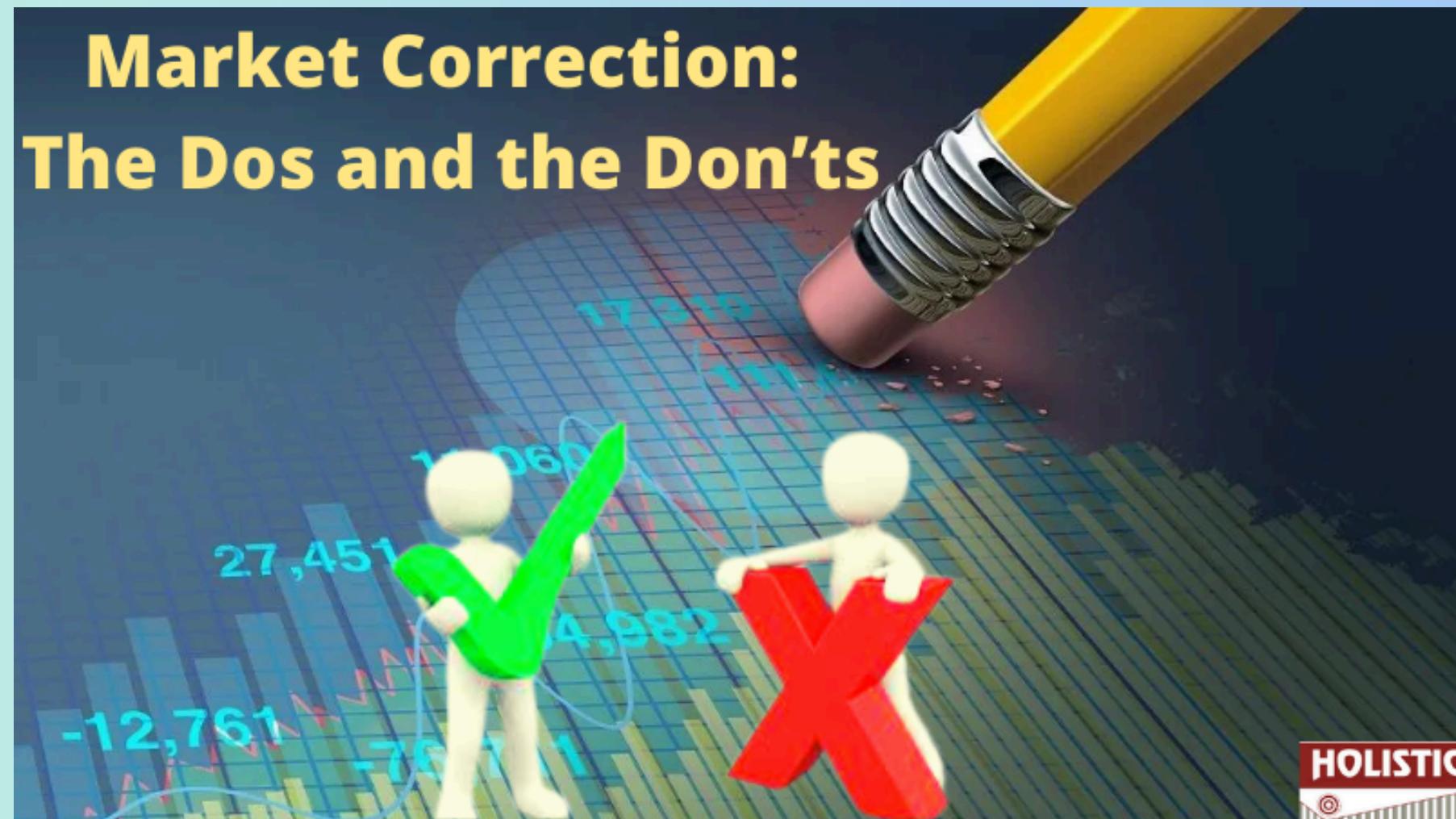
Investors Are Not Rational

Another criticism is that EMT assumes that all market participants are rational and have access to all relevant information. In reality, investors may not be rational, and access to information may be limited or biased.



Reflected Market Prices Are Not Always Correct

This assumption implies that the market always incorporates all relevant information into prices, which critics argue may not be true due to behavioral biases and other external factors that can impact market prices.



Prices Are Influenced by External Factors

Prices can be influenced by irrational market behavior or by external factors such as political events or natural disasters.



Empirical Evidence and Criticisms of Efficient Market Theory

EMPIRICAL EVIDENCE

Stock Prices Follow Random Pattern

Market Prices Are Unpredictable

Actively Managed Funds Underperform

CRITICISMS

> Investors Are Not Rational

> Reflected Market Prices Are Not Always Correct

> Prices Are Influenced by External Factors

Behavioral Finance and Efficient Market Theory

- Behavioral finance is a field of study that seeks to understand how psychological factors influence investor behavior and market outcomes.
- Behavioral finance suggests that investors are not always rational and that market prices may not always reflect all available information. Therefore, behavioral finance challenges the underlying assumptions of EMT.
- Behavioral finance has identified several cognitive biases that can influence investor behavior, such as overconfidence, herd mentality, and loss aversion. These biases can lead to market inefficiencies and opportunities for skilled investors to outperform the market.

Implications of Efficient Market Theory

The implications of EMT are far-reaching and have significant implications on the following:

- Portfolio Management
- Market Regulation

Portfolio Management

- EMT suggests that it is impossible to outperform the market consistently, and as such, active portfolio management strategies, such as stock picking and market timing are unlikely to be successful in the long run.
- Instead, EMT suggests that investors should focus on passive investment strategies such as index funds that aim to replicate market performance.



Market Regulation

- The implications of EMT for market regulation are also significant. If prices are always efficient, then it may not be necessary to regulate markets to ensure that prices are fair.
- However, some argue that regulation is still necessary to prevent fraud and market manipulation, which can lead to market inefficiencies and undermine investor confidence.



Alternatives to Efficient Market Theory

There are several alternative theories and perspectives to EMT:

- Technical Analysis
- Fundamental Analysis
- Value Investing

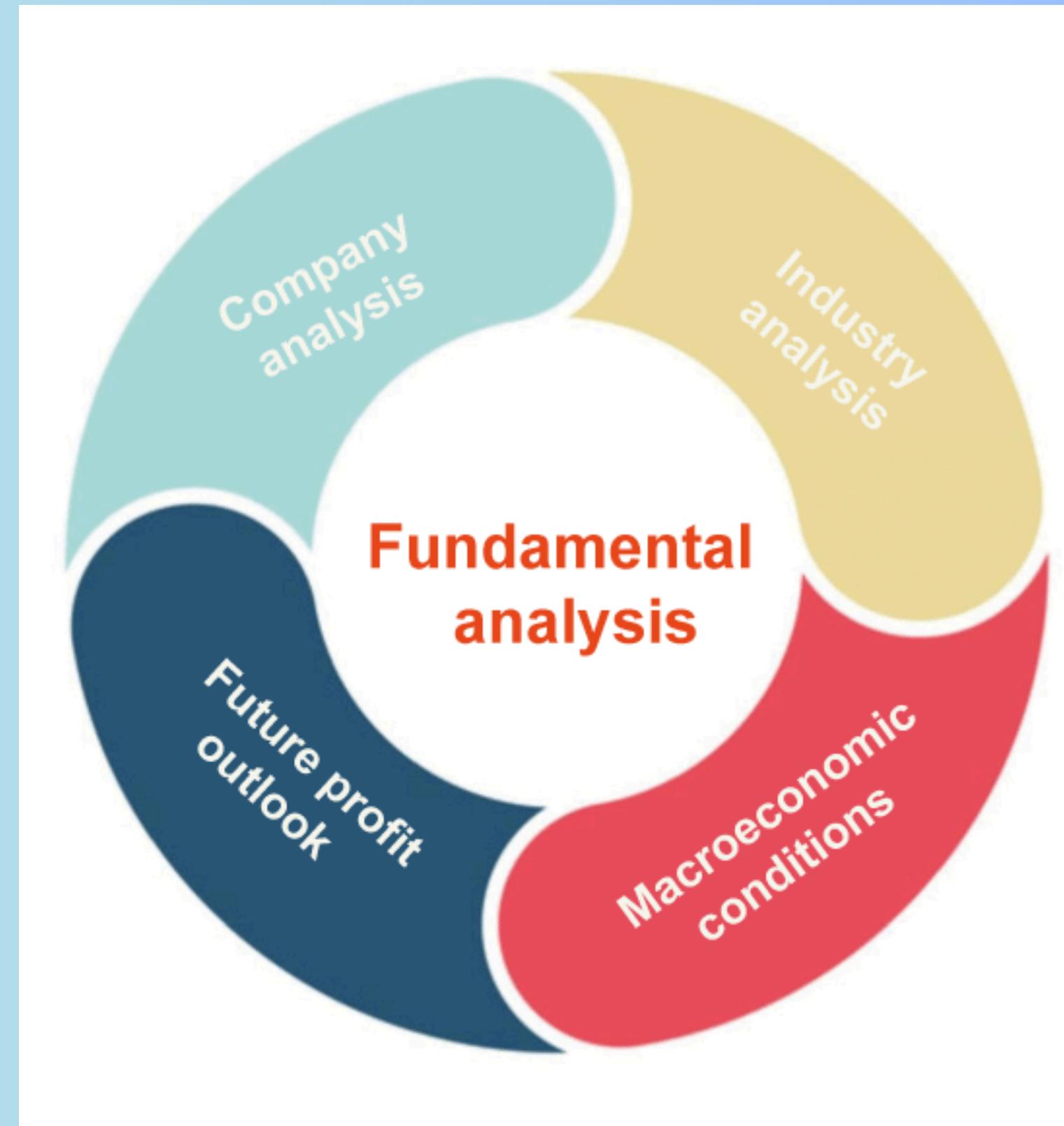
Technical Analysis

A popular approach to investing that involves analyzing past market data, such as price and volume, to predict future price movements.



Fundamental Analysis

This involves analyzing a company's financial statements, industry trends, and macroeconomic factors to determine its intrinsic value.



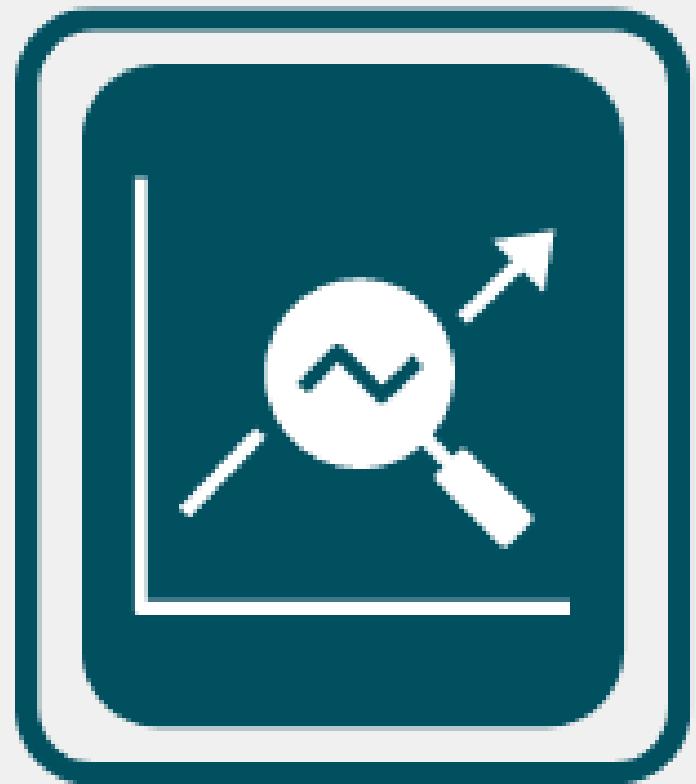
Value Investing

This strategy involves identifying undervalued securities and investing in them with the expectation that their value will increase over time.

Value Investing



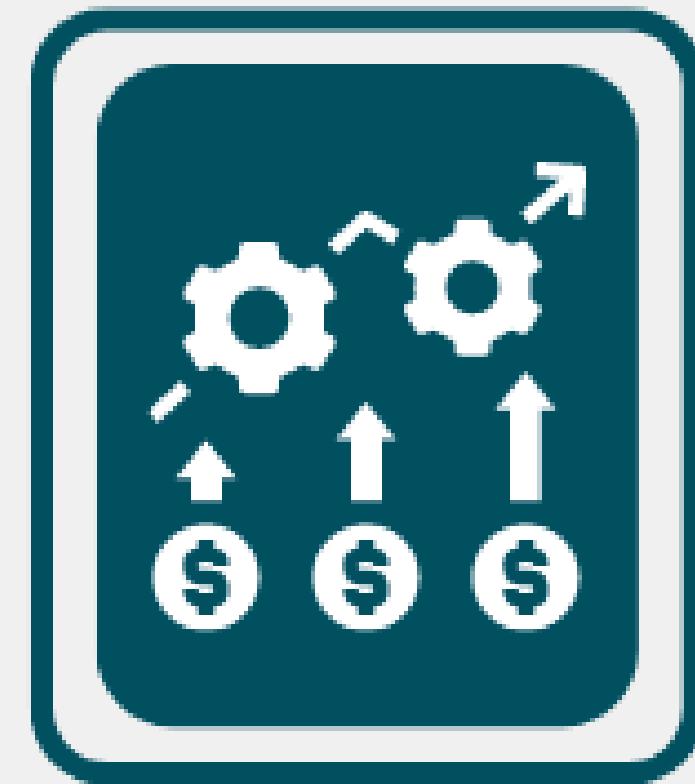
Alternatives to Efficient Market Theory



**Technical
Analysis**



**Fundamental
Analysis**



**Value
Investing**

Final Thoughts

- Efficient Market Theory is a cornerstone of financial economics, positing that financial markets are efficient and that asset prices reflect all available information.
- The concept has significant implications for investment decision-making, portfolio management, and market regulation.
- However, the debate surrounding EMT remains ongoing, with some scholars pointing to empirical evidence that supports the theory while others criticize its underlying assumptions.

- While EMT has limitations, it remains a valuable tool for understanding the behavior of financial markets and the pricing of financial assets.
- Despite the criticisms, the concept of EMT continues to be relevant in financial markets today. Investors must carefully consider the underlying assumptions of the theory and alternative approaches to investing when making investment decisions.
- Understanding the implications of EMT for investment decision-making, portfolio management, and market regulation is critical to success in today's financial markets.

Thankyou