Market efficiency, long-term returns, and behavioral finance, by Eugene F. Fama

1. Key findings

The paper answers the question of whether market efficiency should be discarded. Firstly, anomalies are consistent with market efficiency as they are split randomly between underreaction and overreaction. Secondly, although long-term return anomalies seem to have nothing to do with chance, most of them are sensitive to methodology and can be attributed to chance by applying different models.

By reviewing existing studies, the author concludes that the long-term return anomalies cannot be determined either by overreaction or underreaction, and thus the random split predicted by market efficiency holds. Also, by examining the two behavioral models, the author concludes that the post-event return continuation is similarly frequent to reversal, supporting the market efficiency theory. The bad-model problems are unavoidable and more serious on long-term returns. This may be due to the faster growth with the return horizon than with the volatility of returns. Apart from the above, some anomalies may be economically or statistically marginal and do not stand up to out-of-sample replication.

2. Contribution

The paper highlights the importance of considering alternative models of price formation that can explain both overreaction and underreaction to events. While many anomalies can be attributed to methodological illusions, the author critically examined existing studies on long-term returns. In a nutshell, the paper reviewed the literature on market efficiency and emphasized the importance of robust methodology in studying market behavior.