

Intuition of Efficiency

- Reuter's pigeons and the telegraph
- Beepers & the internet
- Must be hard to get rich

Charles A. Conant “Wall Street and the Country” 1904

III

THE FUNCTION OF THE STOCK AND PRODUCE EXCHANGES

ONE of the most persistent of the hallucinations which prevail among people otherwise apparently lucid and well informed is the conception that operations on stock and produce exchanges are pure gambling. A moment's reflection, (it would seem,) might convince such persons that a function which occupies so important a place in the mechanism of modern business must be a useful and necessary part of

tion afforded by public quotations on the stock and produce exchanges were wiped from the slate of human knowledge. How would the average man, how even would a man with the intelligence and foresight of a Pierpont Morgan, determine how new capital should be invested? He would have no guide except the most isolated facts gathered here and there at great trouble and expense. A greater misdirection of capital and energy would result

Textbook Version, Fabozzi et al 2002

- “Publicly available, relevant information about the issuers will lead to correct pricing of freely traded securities in properly functioning markets.” p. 32.
- (For Fabozzi et al., it is a *hypothesis*, and they invoke it as a motivation that is behind much regulation.)

Textbook Version Today, Another Example

As one of the “seven most important ideas in finance”:

“Security prices accurately reflect available information, and respond rapidly to new information as soon as it becomes available” Richard Brealey, Stewart Myers, and Franklin Allen, *Principles of Corporate Finance*, 1984, second edition

Brealey & Myers continued

- “Don’t misunderstand the efficient-market idea. It doesn’t say that there are no taxes or costs; it doesn’t say that there aren’t some clever people and some stupid ones. It merely implies that competition in capital markets is very tough—there are no money machines, and security prices reflect the true underlying value of assets.” 1984, p. 784

2008 Edition of Brealey, Myers and Franklin Allen

- Much more research is needed before we have a full understanding of why asset prices sometimes get so out of line with what appears to be their discounted future payoffs.

Harry Roberts, 1967

- Weak form efficiency: prices incorporate information about past prices
- Semi-strong form: incorporate all publicly available information
- Strong form: all information, including inside information