Is the Stock Market Efficient?

In efficient capital markets, adjustments are quickly and correctly made. In other words, prices immediately and fully reflect all information. In this paper, tests for the random walk theory are applied to investigate whether equity markets are efficient. The equities we research are the S&P 500 index, Apple Inc. (AAPL), and Humana Inc. (HUM). Both AAPL, one of the most traded stocks, and HUM, one of stocks with lowest trading volumes, have been components of the S&P 500 for the past 35 years. The unit root test, test for a deterministic trend or a stochastic trend, and regression on random walk model are applied to inspect whether the data follow a random walk process. If stock markets follow the random walk theory, though it is not guaranteed that markets are efficient in each form of EMH, then prices already reflect historical information and returns. If this is the case, then it is impractical to forecast prices by using historical data. This paper provides methodologies for investors or researchers to test whether the movements of equity prices are random.

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An important debate among investors is whether the stock market is efficient—that is, whether it reflects all the information made available to market participants at any given time. The efficient market hypothesis (EMH) maintains that all stocks are perfectly priced according to their inherent investment properties, the knowledge of which all market participants possess equally. Financial theories are subjective. In other words, there are no proven laws in finance. Instead, ideas try to explain how the market works. Here, we take a look at where the efficient market hypothesis has fallen short.
whether the stock market is efficient is critical to inform our investment decisions. My favorite definition of what constitutes an efficient market comes from Burton G. Malkiel in his 2003 paper titled “The Efficient Market Hypothesis and Its Critics”. Malkiel defined an efficient market as a market where “prices fully reflect all known information, and even uninformed investors buying a diversified portfolio at the tableau of prices given by the market will obtain a rate of return as generous as that achieved by the experts”. To put that in more relatable terms: · If the stock... A stock market is said to be efficient if it accurately reflects all relevant information in determining security prices. Critics have asserted that share prices are far too volatile to be explained by changes in objective economic events—the October 1987 crash being a case in point. Although the evidence is not unambiguous, reports of the death of the efficient market hypothesis appear premature. Science. Vol 243, Issue 4896 10 March 1989. Variations of the Efficient Market Hypothesis propose that the stock market already contains all useful information, and therefore assumes that stock prices are all reasonable. A derived conclusion from this is that one cannot consistently “beat the market” on a risk-adjusted basis, and those that do are simply lucky outliers on the bell curve of success. There are different levels of strictness or literal-ness as to how far the logic of EMH extends. There are others that disagree with the efficient market hypothesis. Some point out that certain investing styles tend to consistently beat the m... In an efficient market the return on a security is compensating the investor for time value of money and risk. The efficient market theory relies on the fact that stock prices follow a random walk, which means that price changes are independent of one another. Thus, stock prices follow a random walk if. · The movement of stock prices from day to day do not reflect any pattern. · Statistically speaking. · The movement of stock prices is random. · Time series of stock returns has low autocorrelation. In an efficient market competition ensures that. · New information is quickly and fully assimila