5.2: Market Efficiency

Markets are said to be efficient when prices of stocks accurately represent all currently available information. This means that we cannot determine which stocks are "good" and which are "bad". All stocks are properly valued given what is known today. If they turn out to be "good" or "bad" in the future, it is due to information that has yet to be revealed. There are three types of market efficiency that are based on what is considered "current" information.

Weak Form Efficiency – Markets are efficient based on past price data

Semi-Strong Form Efficiency – Markets are efficient based on all publicly available information

Strong Form Efficiency – Markets are efficient based on all public and private information

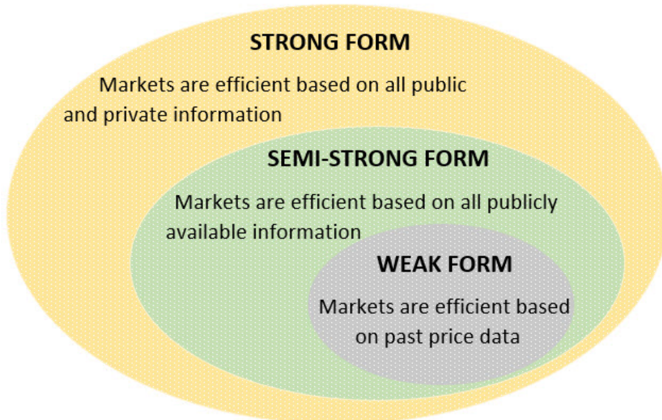

Figure 5.2.1: Forms of the efficient market hypothesis.

For a more thorough analysis of market efficiency, see the Efficient Markets Hypothesis Handout in Appendix B.