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Abstract

A Review of the Efficient Market Hypothesis

RESEARCH PAPER

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The efficient market hypothesis (EMH) suggests that all available information is instantly and fully reflected in security prices. Consequently, market practitioners are incapable of making above-average returns. Depending on the completeness and speed at which information is incorporated in security prices, there are three levels of informational efficiency: (a) the weak form, (b) the semi-strong form, and (c) the strong form. In addition to presenting the theoretical and empirical genesis of the EMH, this paper discusses recent developments in market efficiency. While the concept of an efficient market emerged from the application of the rational expectations theory, the testing of market efficiency in practice is based on the martingale model and random walk hypothesis. This paper presents different procedures for testing the EMH along with the efforts of researchers in demonstrating its validity. The results of empirical studies suggest that the EMH is partially accurate. Despite numerous criticisms, the EMH remains in the focus of interest of investors, policymakers, and academics, because even if some investors face inefficiencies in certain time periods, the market is still proven to be efficient for most investors.

Keywords: efficient market hypothesis, random walk hypothesis

JEL classification: G14, D53, D82

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