Efficient Market Hypothesis (EMH)

Efficient Market Hypothesis (EMH) – EMH is a theory that says the stock market is perfectly efficient and in equilibrium; any attempt to beat the market is futile; and if an active investor does beat the market, this outcome was pure luck and cannot be duplicated consistently except by pure chance.

There three forms of EMH.

Weak-Form

The weak-form of EMH says that all information contained in past prices is transmitted immediately to current market prices. In other words, any information in past prices is automatically reflected in current prices. Any attempt to study past prices to determine current intrinsic value or to predict future prices is a waste of time. Belief in even the weak-form of EMH renders technical analysis worthless. However, belief in the weak-form of EMH does not necessarily invalidate fundamental analysis or trading on insider information.

Semi-Strong-Form

The semi-strong-form of EMH states that current market prices reflect ***all*** publicly available information immediately. Belief in the semi-strong form of EMH renders all forms of analysis, including fundamental analysis, worthless. However, non-public information (i.e. insider information) could still be used to consistently beat the market.

Strong-Form

The strong-form says that all information, public or private, is reflected in prices. And trying to use even insider information to beat the market is useless.