Chapter – 13: Corporate Financing Decisions and Efficient Capital Markets

Concept Questions section

30. Level of Efficiency: What level of efficiency would the author must have assumed Indian equity markets to be while writing the above article (i.e., weak-form, or semi-strong form, or strong form, or none of them)? Do you agree with her assumption of the level of efficiency of Indian equity markets? Discuss.

The author has assumed that Indian equity markets are not even weak-form inefficient (assuming him to be able to generate consistently abnormal returns using this strategy). If the markets are weak form efficient then it would not be possible to predict stock prices based on past data.

About the level of efficiency of Indian equity markets: This question can be answered from two points of view:

(a) Academic (based on empirical studies): While there are studies favoring all type of results (including some even stating that the Indian markets are not even weak form efficient) yet most empirical literature on Indian equity markets clearly point out that the Indian markets are surely weak form efficient. In fact, the view of them being semi-strong form is split in the ratio of 50-50 (with equal number of studies stating that they are no semi-strong form).

(b) Practitioners: Most of the trading houses and business media (Dalal Street Journal, Capital Markets, CNBC & NDTV) do make extensive use of technical analysts to predict stock performance based on past stock prices. But, not much is known about (a) If they consistently make abnormal returns using the strategy or not. (b) If they make use of these themselves!! (c) If these are taken seriously by the large number of readers or not (for example, they could be used for just psychological satisfaction).