Testing Efficient Market Hypothesis in Current Indian Stock Market

KEYWORDS

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ABSTRACT *Over the past 40 years the importance of Efficient Market Hypothesis (EMH) is well documented and discussed. EMH is useful for analyzing the way equity markets function and consequently for providing appropriate information for investment decision.*

Market Hypothesis says that each and every investor have equal right to get earliest arrived information in financial market and to react on that. This paper provides a review about how now a days market is inefficient either because of not getting all the fresh news related to stocks on time or they do not care about those news or they do not want to react on that piece of arrived information because of their own psychology or sentiments.

Introduction

The Efficient Market Hypothesis (EMH), introduced by Markowitz in 1952 and subsequently named by Fama in 1970 assumes that financial markets incorporate all public information and asserts that share prices reflect all relevant information.

The efficient market hypothesis (EMH): Foundation

EFFICIENT MARKET HYPOTHESIS: A market theory that evolved from a 1960's Ph.D. dissertation by Eugene Farma, the efficient market hypothesis states that at any given time and in a liquid market, security prices fully reflect all available information. The EMH exists in various degrees: weak, semi-strong and strong, which addresses the inclusion of non-public information in market prices. This theory contends that since markets are efficient and current prices reflect all information, attempts to outperform the market are essentially a game of chance rather than one of skill.

The **weak form of EMH** assumes that current stock prices fully reflect all currently available security market information. It contends that past price and volume data have no relationship with the future direction of security prices. It concludes that excess returns cannot be achieved using technical analysis.

The **semi-strong form of EMH** assumes that current stock prices adjust rapidly to the release of all new public information. It contends that security prices have factored in available market and non-market public information. It concludes that excess returns cannot be achieved using fundamental analysis.

The **strong form of EMH** assumes that current stock prices fully reflect all public and private information. It contends that market, non-market and inside information is all factored into security prices and that no one has monopolistic access to relevant information. It assumes a perfect market and concludes that excess returns are impossible to achieve consistently.

Literature Review

Conrad and Kaul (1988) for example reported positive serial autocorrelations for stocks listed at the New York Stock Exchange (NYSE). Jegadeesh and Titman (1993) found both short-term momentum and long-term reversal for stocks from the database maintained at the Center for Research in Securities Prices at the University of Chicago (CRSP).

De Bondt and Thaler (1985) documented negative serial correlation for the same underlyings.

Fama and French (1988) & Poterba and Summers (1988) studied negative serial correlation over longer time periods.

Rouwenhorst (1998) extended the analysis to twelve European countries, finding a similar momentum-and-reversal effect for his 1978–1995 samples.

Later studies, however, provided evidence that this effect might be decreasing or disappearing over time (e.g., **Jegadeesh and Titman (2001))**, or disputed its presence altogether **(Fama (1998).**

Similarly well-known is the turn-of-the-year effect, January effect, or the small-firms-in-January effect, which refers to the pattern that returns tend to be higher in January than over the rest of the year, particularly for small firms.e.g**., Keim (1983); Rogalski (1984); Ziemba (1988); Ritter and Chopra (1989).)**

The neglected-firm effect and the effect of stock prices' reaction to the inclusion of a stock into an equity index can be subsumed under the heading of liquidity effects. The former was coined by studies which showed that, compared to larger firms, small and less-reported-on firms offer a liquidity premium, because investors purchasing them are subject to liquidity risk (e.g., **Amihud and Mendelson (1986, 1991); Pratt (1989); Chordia et al. (2000); Ross et al. (2005)**).

Finally, the evidence on the question of whether individuals privy to inside information can earn excess returns (i.e., markets not immediately adjusting to inside information) is relatively unequivocal. It was confirmed in studies like **Pratt and DeVere (1968); Jaffe (1974); Lorie and Niederhoffer (1968); Seyhun (1986). In a rare conflicting result, Hawawini (1984)** found evidence consistent with strong-

form market efficiency for French, Spanish and U.K. mutual funds

Reliability of EMH in Current Indian Stock Market

The current conditions of Indian Stock Markets have drastically improved. There is absolute transparency and instant transactions. All Indian stock markets are now computerized and internet trading has become common phenomenon. Indian stock markets have also developed a dynamic nature and can exchange from a bullish temperament to a bearish slide. Any small bit of information or even a rumor from any part of the country can affect the market and is fairly accurate indicator of the prevalent atmosphere in the region or country. People from across the country and globe get in touch with minute wise reading on the stock market and gain a lot of trading aptitude after daily seeing BSE Stock Gainers or BSE top losers list which does a world of good to their investment portfolio.

The Indian market scenario is just getting better and the investors should not be worried about the fact that the market has not been stable at all. It is necessary to understand the fact that loss and profit depends on the way the investor makes an investment.

The Indian Stock Market can be a very rewarding avenue of investment but the constant changes and the inherent dynamic nature of the markets can wipe out your funds or savings within a minute. Keeping once eyes and ears open investors can insure against any major losses.

Recent Cases of testing Efficient market hypothesis
CASE- I
The Murthy's return

The spurt in activity in shares of Infosys on Friday 31st May 2013, a day before the company announced the return of its cofounder N R Narayana Murthy as the executive chairman, has raised a few eyebrows. A theory doing the rounds on Dalai Street is that some traders might have got a whiff of the development in advance that drove up Infosys shares by as much as nine per cent on Monday 3rd June 2013.

About 24 million shares of Infosys worth Rs 575 crore were traded on both the major exchanges on Friday 31st May 2013 compared to a three-month daily average of 14.5 million shares worth about Rs 365 crore. The stock had advanced 2.7 per cent on Friday 31st May 2013when the benchmark Sensex fell 2.3 per cent and the BSE's IT index gained 0.4 per cent

Brokers said the surge in volumes in Infosys shares of Friday 31st May 2013 was aided by a few large deals on the bourses in the last hour of the trading session.

"Going by the size of the trades (on Friday), it looked more like individual high net worth traders' positions, rather an institutional positions," said a Mumbai-based broker. The size of these trades could not be ascertained.

So, if an investor bought 1,000 shares of Infosys on Friday 31st May 2013at a volume-weight average price of about Rs. 2,383 he would have made a profit of about Rs. 2.42 Lakh if the shares were sold at the highest level of Rs. 2,624.90 on Monday 3rd June 2013.

A section of market believes it would be premature to conclude the spurt in volumes in Infosys on Friday 31st May 2013 was driven by trades of people in the know. Traders

could have created fresh positions in Infosys shares after the expiry of the May series on Thursday 30th May 2013, said a derivative analyst with an institutional broker. The decline in the rupee against the dollar could have prompted traders to take bullish bets on Infosys, which derives a major chunk of its revenues from the US.

CASE II
Stocks shrug off SEBI Non-compliance order

There were more companies which ended with gains than with losses among those named on 4th June 2013 night's penal order from the Securities and Exchange Board of India (SEBI) for defaulting on the deadline for meeting the minimum public share holding norm. Shareholding pattern shows the number of shares which are held by various category of investors like the promoter and promoter group and the public shareholding. Companies equity comprises 100 percent out of this certain percentage is hold by promoters and rest by outside parties like retail, institutional, FII and so on.
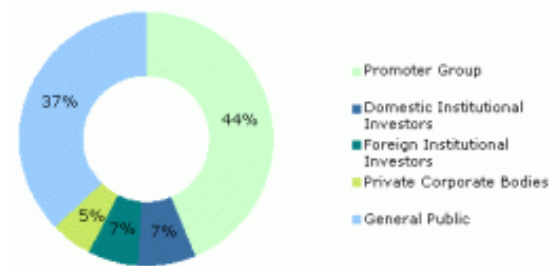
Source: Sharemarketschool.com

Fifteen companies ended in the red. The number of stocks which ended with gains was one more, at 16, according to an analysis by Business Standard. Another 41 remained unchanged. The analysis looked at stocks which have been actively traded and excluded suspended companies or those with no trading volume among those named in the SEBI order.

There had been no change in outlook for the companies named in SEBI's list. And, hence, little effect on the share price. There is nothing wrong fundamentally with the companies, so people are not panicking, It is expected to take urgent steps to deal with the issue.

All the 16 companies which ended with gains actually performed at par with or better than the BSE Sensex, an index whose returns are said to be representative of how the market is faring. The Sensex closed at 19,568.22 on5/06/2013 up 22.44 points or 0.1 per cent to 8.6 per cent.

TOP GAINERS AMONG NON-COMPLIANT COMPANIES

COMPANIES	4 JUNE 2013	5 June 8, 2013	% CHANGE
Marathon Nextgen Reality Ltd	122	132.5	8.61
Best Eastern Hotels Ltd	24.25	24.45	4.95
Parshawnath Corp Ltd	18.55	19.45	4.85
Ras Resort & Apar Hotels	39	40.85	4.74
Starcom Information Technology	260	270	3.84

LIST OF COMPANIES AND PROMOTERS IMPACTED

Sr. No	NON-COMPLIANT COMPANY	MARKET-CAP(Rs. Cr)	PROMOTER HOLD-ING	NAME OF PROMOT-ERS	SHAREHOLDING FREEZE
1	Adani Ports	30,802	77.50	Adani Enterprises	10.00
2	Videocon Industries	8,061	75.94	VN Dhoot, RN Dhoot & Family, Videocon Reality	3.76
3	Essar Port	3119	75.54	Essar Shipping, Essar Projects	2.16
4	Omaxe	2,425	87.19	Rohtas Goel Family, SA Finvest, Kautilya Monetary	48.76
5	Bombay Rayon	2,386	93.15	Janardan Agrwal, AAA United, Reynold Shirting	72.60
6	Freseniues Kabi	1974	81.00	Freseniues Kabi (Singapore)	24.00
7	Tata Tele	1,369	77.21	Tata Sons, Tata Teleservices, Tata Power, NTT Docomo	8.84
8	BGR Energy	1,190	81.13	BG Raghupathy, Sasikala Raghupathy	24.52
9	Hubtown	997	82.49	Hemant Shah & Family	29.96
10	Plethico Pharma	701	77.70	Shashikant Patel Family	10.80
11	Sundarm Clayton	580	80.00	TV Sundaram Lyengar & Sons, Sundaram Industries	20.00
12	Jolly Board	418	89.89	Arvinf Kumar Jolly & Family	59.56
13	Elantas Beck	370	78.39	Elantas Gmbh	13.56
14	Marathon Nextgen	251	89.14	Ithaca Informatics, Ramniklal Shah Family	56.56

Conclusion

There have been several decades since the initiation of efficient market hypothesis and there is an abundance of relevant research. After a thorough review it was found that some of the research support and some reject this hypothesis, even for the same region or country.

A definitive conclusion supporting or rejecting Efficient Market Hypothesis cannot be drawn. A clear answer concerning market efficiency that includes all markets cannot be given. In today's market scenario Efficient Market Hypothesis is questionable as it says, each and every investor have equal right to know right information at right time and it also presumes that investors will react on each & every piece of information and adjust their processing accordingly.

But in today's scenario we can't see as we have discussed in above two cases, EMH came in queue of questions as in one case information was not spread on right time and in another case although SEBI declared the companies black listed but its effect was not seen properly in terms of profit and loss on those company's shares.

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