Answer on Question #61321 - Economics , Finance

Task: Discuss Markowitz's portfolio theory of asset pricing. Critically examine the efficient markets hypothesis.

In the second half of the twentieth century it was dominated by the idea that the portfolio of risky assets generated a priori has a high risk. Markowitz was a mathematical scheme of selection of optimal portfolios, focusing on the behavior of the portfolio, rather than its components.. Until the end of the last century stock prices of key companies involved in the stock exchanges, had a steady upward trend with small amplitude cyclic fluctuations, which clearly shows the behavior of the Dow Jones index in those years. Since conditions could always form a breakeven portfolio of assets, the main task of investment companies and funds is to create a portfolio of assets that provide a minimum risk of the expected return on assets portfolio, ie minimum of cyclical fluctuations of return established portfolio of assets with respect to the upward trend.

In subsequent years, the behavior of stock prices change, the development of Internet technologies, the possibility of electronic trading have increased the pace of trading on the stock exchanges again brings the agenda the question of the effectiveness of Markowitz's portfolio theory.

Despite the fact that scientists, economists much research has been carried out, the purpose of which is to deny or confirm the efficient market hypothesis, this theory is still the subject of heated debate. The proposed theory has not been refuted, its main provisions have been subjected to serious criticism.

Real market access to all information, not all the participants. Some of the information is always private, which is available, as a rule, to a narrow circle of persons, called insiders. These include, for example, may include corporations top managers, high-ranking officials of the government and the central bank, which by virtue of their official position, have access to information that is not available to the general public.

Practical psychology also right to question the assertion that all people act rationally. Moreover, market participants may have a different appetite for risk. This leads to the fact that in the same situation, investors can take various and often contradictory decisions, which is also contrary to the basic provisions of the efficient market hypothesis.

Given the above criticisms, it is clear that in its purest form efficient market can not exist in the real world, so that as a result of further development of the theory of the three basic forms of market efficiency were identified, which vary depending on the degree of access to information.