Published on *Adam Smith Institute* (http://www.adamsmith.org)

It wasn't the Efficient Markets Hypothesis wot did it [1]

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It's been a common enough trope, that it was the Efficient Markets Hypothesis (EMH) that led to the crash. Usually put forward by those who don't understand what is being claimed, true. What it actually says is that markets are efficient at processing information about what prices should be in markets. What some seem to think it says is that "markets are efficient". Which may even be true but that's not what is being claimed by the EMH. However, there are those slightly more clued up who do know what EMH means and blame it for the finanacial woes. Because everyone thought that markets were efficiently processing information no one was doing their own processing to see if they were right.

Thus dodgy mortgage bonds got rated AAA, everyone bought too many of them and thus we had collapse. However, via Tyler Cowen, we've a new paper which makes a very interesting point [3].

> The first statement (*ie, that the EMH is to blame-Tim*)is at odds with the fact that prior to 2007,collateralized debt obligations (CDOs),3 the mortgage-related bonds at the center of the financial crisis, were offering much higher yields than straight corporate bonds with identical ratings, apparently for good reason.4 Disciples of efficient markets were less likely to have been misled than those investors who flocked to these instruments because they thought they had identified an undervalued security.

Those bonds were more risky, those bonds were lower priced (had higher yields) to reflect that risk. Those who actually believed the EMH would therefore not have been mislead as to the calculating value of the EMH. It was those who did *not* believe the EMH who got biffed then.

There are a couple of other excellent insights like this in the paper and I recommend reading it all. For over and above those specific points, it really is an excellent over view of the various explanations that are being bandied about.

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