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Confidence, opinions of market efficiency, and investment behavior of finance professors

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Abstract

We identify finance professors' opinions on the efficiency of the stock markets in the United States and assess whether their views on efficiency influence their investing behavior. Employing a survey distributed to over 4,000 professors, we obtain four main results. First, most professors believe the market is weak to semi-strong efficient. Second, twice as many professors passively invest than actively invest. Third, our respondents' perceptions regarding market efficiency are almost entirely *un*related to their trading behavior. Fourth, the investment objectives of professors are, instead, largely driven by the same behavioral factor as for amateur investors–one's confidence in his own abilities to beat the market, *independent* of his opinion of market efficiency.

JEL classification: G11; G14

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1. Introduction

One of the most fundamental questions related to investing is whether one should actively or passively invest. Presumably, the first factor to consider in making this decision is the efficiency of the market in which one is considering investing. Actively investing in a

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perfectly efficient market will not yield consistent abnormal returns, so why bother? Many studies address market efficiency, with inconclusive results.

There is, however, very little empirical evidence corroborating or refuting the notion that an investor's decision to actively or passively invest is strongly influenced by his perception of market efficiency. We take a unique approach to provide evidence on this issue. We survey the experts in the field–finance professors–to assess (a) their views of the actual efficiency of stock markets in the United States and (b) whether their propensity to actively or passively invest is influenced by their perceptions of market efficiency.

We find that finance professors strongly agree that the market is not strong form efficient. To a slightly lesser degree they also concur that the market is weak form efficient. However, they show little agreement regarding the semi-strong form market efficiency. Despite their ostensible disagreement, their investing objectives suggest they generally believe that markets are semi-strong form efficient; twice as many of them passively invest as actively invest.

We also come to the surprising conclusion that a finance professor's opinion of market efficiency has little influence on his decision to actively or passively invest. Instead, they largely base their investing decisions on their confidence in their own abilities to beat the market, independent of their opinion about market efficiency. This contradicts the fundamental notion that the active versus passive decision is driven by an assessment of the market's efficiency. This finding adds to the practical importance of studies on market efficiency, highlights the importance of investor behavior, and motivates further work on confidence in investing.

The remainder of the study proceeds as follows. We describe the subjects, survey, and response rate in Section 2. We present finance professors' explicit opinions about market efficiency in Section 3. In Section 4 we analyze professors' opinions of market efficiency through an analysis of their investing objectives. We explore the question of whether a respondent's decision to actively or passively invest is related to his perceptions of market efficiency in Section 5. We conclude with Section 6.

2. Subjects, surveys, and response rates

Recently, surveys have gained greater acceptance in finance, exploring topics on executives' motives for taking the firm public, share-repurchase decisions, and the disclosure of earnings.[1] Closely related to our approach is a study by Welch (2000), who surveyed academics to assess their prediction for the equity premium over a set of future horizons. As a secondary matter, he also surveyed academics on a broad range of topics. Included was a question about the efficiency of stock markets, which led him to conclude, "financial economists feel that, by and large, financial markets are efficient."[2]

The subjects of our study are finance professors in the US. To identify the professors for the survey, we use the list of all regionally accredited US universities compiled by the University of Texas.[3] For each four-year university or college, we hand collect the names

[1]There are noted problems using survey data and methodology. See, for example, Welch (2000). However, this is the only way to obtain the desired data for our study.

[2]Other studies using survey methodology in finance include Pinegar and Wilbricht (1989), Trahan and Gitman (1995), Graham and Harvey (2001), Krigman et al. (2001), Jorgensen and Wingender (2004), Hartikainen and Torstila (2004), Brav et al. (2000), Graham et al. (2005), and Brau and Fawcett (2006).

[3]http://www.utexas.edu/world/univ/