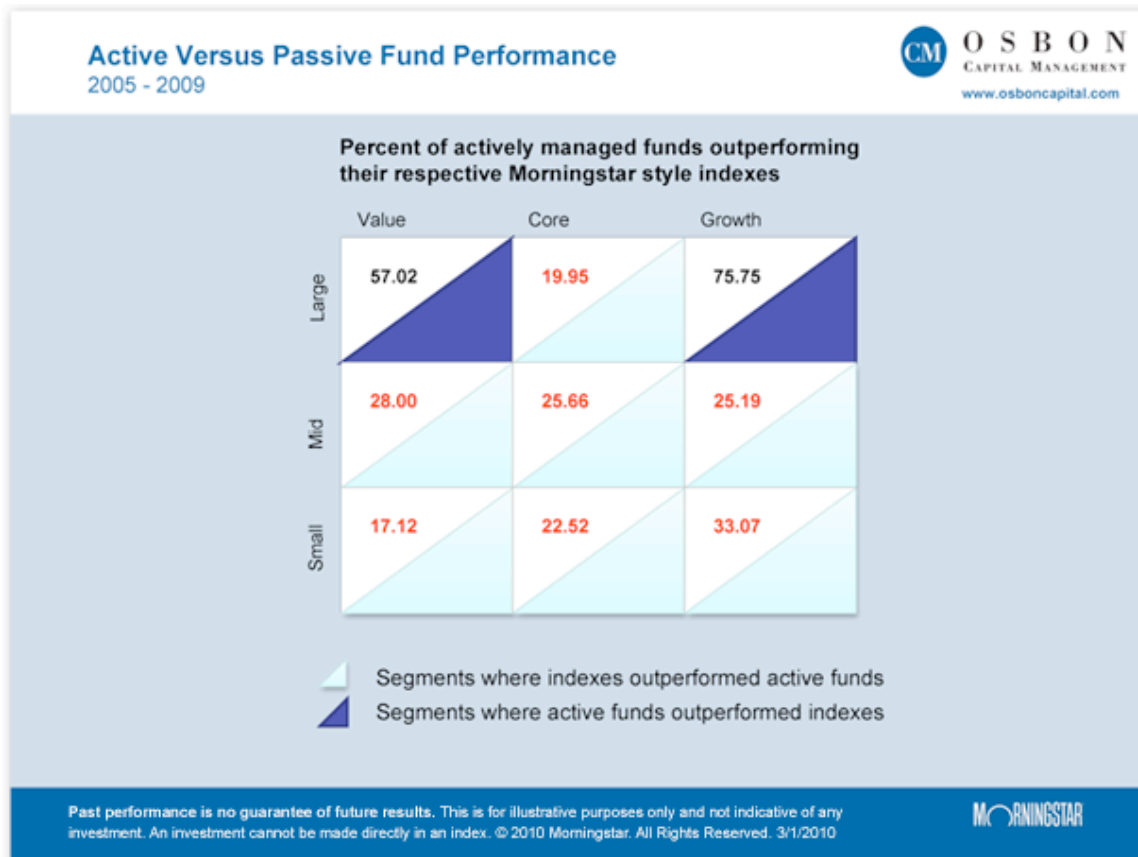




Quick Q & A #21

**Q: Are markets efficient, and does it matter?**



**A: Finding inefficiencies is difficult, and exploiting them even more so.**

A friendly debate about whether markets are efficient can easily turn into a heated argument. There are strong feelings on both sides.

What it all boils down to is whether an investor or money manager can use available information – including earnings reports, economic indicators, financial ratios, technology claims, analyst ratings, political news, and more – to find securities that are priced “too high” or “too low.” An investor who could systematically find these inefficiencies would easily outperform the



markets by buying the underpriced securities and selling them before they become overpriced.

### **Inefficiencies are elusive**

Systematically is the key word here. Surely there are cases when information and price do not match up. These inefficiencies are very easy to identify after the fact but difficult or impossible to systematically recognize and exploit in real time.

The challenge of exploiting inefficiencies is solidly supported by empirical evidence, including the chart above. The graphic shows the relative performance of actively managed mutual funds – whose managers, armed with the latest research and analysis tools, seek to earn their management fee by buying underpriced stocks and riding them upward – versus passively managed benchmarks.

Morningstar sorts funds into nine segments based on size and style. In only the two segments marked in purple did the active managers outperform the passively managed indexes over the last five years. In the other seven categories, less than a third of actively managed funds beat the benchmarks – worse performance than one would expect picking stocks at random.

At Osbon Capital we don't believe in chasing elusive or imaginary inefficiencies. We focus on the real factors that most affect return and risk: diversification, asset allocation, rebalancing, expense control, and tax efficiency. It is our belief that goal-driven asset management tailored to your needs is ultimately the best use of our time.

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**Next time:** Are “frontier markets” ready for investment?

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*The index returns are based on the following: iShares Morningstar Small Value Index Fund JKL; iShares Morningstar Small Growth Index JKK; iShares Morningstar Small Core Index Fund JKJ; iShares Morningstar Mid Value Index Fund JKI; iShares Morningstar Mid Growth Index Fund JKH; iShares Morningstar Mid Core Index Fund JKG; and iShares Morningstar Large Value Index Fund JKF. The mutual fund returns include the oldest share class for all U.S. diversified mutual funds with at least a one-year history. The performance is a representative snapshot of a select group of funds and indices and may not be reflective of all funds and indices.*

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