

YOLO, Meme, and EMH: What's Your Investment Style?

First Quarter 2021

Marlena Lee, PhD

Global Head of Investment Solutions, Dimensional Fund Advisors

You only live once! Social media investors have banded together on unconventional platforms to drive up the prices of a handful of “meme stocks,” seemingly without traditional evaluation of investing risks and rewards. They made headlines with their “short squeeze” of GameStop (GME), and, as they garner media attention, their tactics continue. While it’s not the intended victim of the YOLO traders, will the efficient market hypothesis be a casualty of these events? The answer depends a lot on your definition of efficient markets. Perhaps long-term investors would be better served questioning the potential impact on their investment philosophy.

Fama (1970) defines the efficient market hypothesis (EMH) to be the simple statement that prices reflect all available information. The rub is that it doesn’t say how investors should use this information. EMH is silent on the “correct” ways investors should use information and prices should be set. To be testable, EMH needs a companion model: a hypothesis for how markets and investors should behave. This leaves a lot of room for interpretation. Should asset prices be set by rational investors whose only concerns are systematic risk¹ and expected returns? It seems implausible to link recent meme-stock price movements to economic risks. Rather, they seem fueled by investor demand to be part of a social movement, hopes to strike it rich with a lucky stock pick, or plain old schadenfreude.

There is a vast ecosystem of investors, from individuals investing in their own accounts to governments and corporations who invest on behalf of thousands. Ask investors why they invest the way they do, and you’ll likely get a range of goals and approaches just as diverse. It’s this complex system that generates the demand for stocks. Another complex system fuels the supply of stocks.

Supply and demand meet at the market price. People may contend that the market is not always efficient, or rational, but the stock market is always in equilibrium. Every trade has two sides, with a seller for every buyer and a profit for every loss.

There are plenty of well-studied examples that show supply and demand at work. The huge increase in demand for stocks added to a well-tracked index often creates a run-up in the stock price. Some of this price increase can be temporary and reversed once the tremendous liquidity demands at index reconstitution² are met. Index reconstitution is just one example; instances of liquidity-driven price movements happen all the time. It is well documented that liquidity demands can produce temporary price movements.³ Investors may wonder if temporary price dislocations motivated by users of r/WallStreetBets differ from those caused by changes to an index. Lots of buying puts temporary upward pressure on prices, which later fall back to “fundamental value”—it sounds familiar. The more relevant observation may be that markets are complex systems well adapted to facilitate the supply and demand of numerous market participants.

There are numerous reasons people may be willing to hold different stocks at different expected returns. Can all those differences be explained by risks? Doubtful. To quote Professor Fama, “The point is not that markets are efficient. They’re not. It’s just a model.”⁴ EMH can be a very useful model to inform how investors should behave. We believe investing as if markets are efficient is a good philosophy for building long-term wealth. Trying to outguess markets might be a quick way to destroy wealth.

1. Systematic risk is the possibility of an investor experiencing losses due to factors that affect the overall performance of the financial markets in which he or she is involved.

2. Reconstitution involves the re-evaluation of a market index. The process involves sorting, adding, and removing stocks to ensure that the index reflects up-to-date market capitalization and style.

3. For example, see “Tesla’s Charge Reveals Weak Points of Indexing” (Dimensional, 2021)

4. “Are markets efficient?” – Interview between Eugene Fama and Richard Thaler (June 30, 2016)

YOLO, Meme, and EMH

It's true, you only live once. The good news is that investors can look to market prices, not internet fads, to pursue higher expected returns. Theoretical and empirical research indicate higher expected returns come from lower relative prices and higher future cash flows to investors. Long-run investors can be better served by using markets, rather than chatrooms, for information on expected returns.

The information in this document is provided in good faith without any warranty and is intended for the recipient's background information only. It does not constitute investment advice, recommendation, or an offer of any services or products for sale and is not intended to provide a sufficient basis on which to make an investment decision. It is the responsibility of any persons wishing to make a purchase to inform themselves of and observe all applicable laws and regulations. Unauthorized copying, reproducing, duplicating, or transmitting of this document are strictly prohibited. Dimensional accepts no responsibility for loss arising from the use of the information contained herein.

"Dimensional" refers to the Dimensional separate but affiliated entities generally, rather than to one particular entity. These entities are Dimensional Fund Advisors LP, Dimensional Fund Advisors Ltd., Dimensional Ireland Limited, DFA Australia Limited, Dimensional Fund Advisors Canada ULC, Dimensional Fund Advisors Pte. Ltd., Dimensional Japan Ltd., and Dimensional Hong Kong Limited. Dimensional Hong Kong Limited is licensed by the Securities and Futures Commission to conduct Type 1 (dealing in securities) regulated activities only and does not provide asset management services.

Named securities may be held in accounts managed by Dimensional. This information should not be considered a recommendation to buy or sell a particular security. Diversification does not protect against loss in declining markets. There is no guarantee strategies will be successful.

Eugene Fama is a member of the Board of Directors of the general partner of, and provides consulting services to Dimensional Fund Advisors LP.