

ABSTRACT

This paper is concerned with the predictability of asset returns during periods of market inefficiency. Market efficiency could co-exist with heterogeneous beliefs and individual irrationality so long as individual errors are cross-sectionally weakly dependent. But at times of market euphoria or gloom these individual errors are likely to become cross-sectionally strongly dependent and the collective outcome could display significant departures from market efficiency. Market efficiency could be the norm, but it is likely to be punctuated with episodes of bubbles and crashes.

Keywords: Predictability, Market Efficiency, CAPM