Prices Move More Than Businesses Do

Pick a large, familiar American company. Look up the highest price its stock traded at over the past year, and the lowest. Then ask whether the business underneath really changed that much in twelve months.

I ran that across the S&P 500 for every year since 2001. In a typical year, the median stock's high is about one and a half times its low. Using the same companies' annual filings, the median change in revenue is about 8 percent. The business changes by single digits. The gap between its high and low price is about 50 percent. The price moves several times as far as the business does.

This was measured carefully a long time ago. In 1981 Robert Shiller showed that stock prices had moved far more than the dividends that followed could justify. LeRoy and Porter reached the same conclusion that year by a different route. Kenneth West tested it again in 1988 and found the standard model could not account for the size of the swings.

Economists still argue about it. The argument is over what the gap implies, not over whether it is there.

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References

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