

Chapter 6

Risk and Rates of Return

LEARNING OBJECTIVES

After reading this chapter, students should be able to:

- Define dollar return and rate of return.
- Define risk and calculate the expected rate of return, standard deviation, and coefficient of variation for a probability distribution.
- Specify how risk aversion influences required rates of return.
- Graph diversifiable risk and market risk; explain which of these is relevant to a well-diversified investor.
- State the basic proposition of the Capital Asset Pricing Model (CAPM) and explain how and why a portfolio's risk may be reduced.
- Explain the significance of a stock's beta coefficient, and use the Security Market Line to calculate a stock's required rate of return.
- List changes in the market or within a firm that would cause the required rate of return on the firm's stock to change.
- Identify concerns about beta and the CAPM.
- Explain how stock price volatility is more likely to imply risk than earnings volatility.