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Risk-free rate:

* we usually use 10- or 30-year government bonds rates as risk-free rates, implicitly assuming that the governments won’t default.
* 10-year Treasury bond rate

Equity risk premium:

* the premium that investors demand on an annual basis for investing in stocks instead of risk-free investments
* should be a function of how much risk is perceived in stocks and how concerned they are about that risk
* Between 1928 and 2010, stocks generated 4.31% more on an annual basis than treasury bonds.
* An alternative is to back out a forward-looking premium (called an implied equity risk premium) from current stock price levels and expected future cash flows.

Relative risk or beta:

* Generally estimate beta based on historical movement relative to the market (the slope of a regression of returns on the stock against a market index)
* These betas are always backward-looking and noisy (since they are estimated with error)
* One solution is to replace the regression beta with a sector-average beta, if the firm operates in only one business or a weighted average if it operates in several businesses.
* The sector beta is more precise than an individual regression beta because averaging across many betas results in averaging out your mistakes.

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