

RISK, RETURN, AND THE COST OF CAPITAL

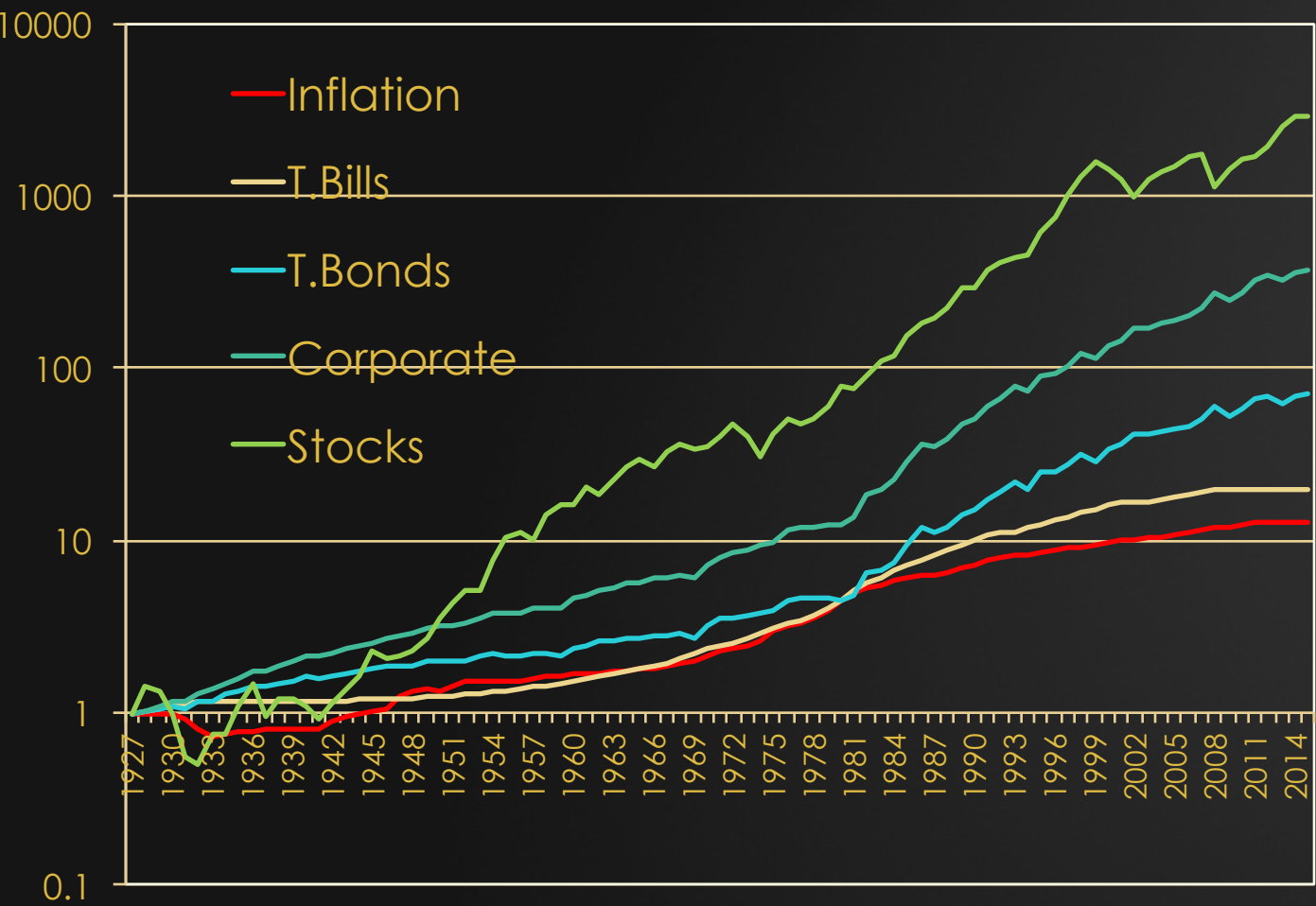
Historical Risk and Return

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ONE PICTURE SAYS IT ALL



HISTORICAL RATES OF RETURN

	Inflation	T.Bills	T.Bonds	C.Bonds	Stocks
Mean	3.0%	3.5%	5.2%	7.2%	11.4%
Standard Dev.	4.2%	3.1%	7.8%	7.8%	19.8%
Minimum	-10.1%	0.0%	-11.1%	-8.9%	-43.8%
25th percentile	1.2%	1.0%	1.2%	2.9%	-1.2%
Median	2.7%	3.1%	3.5%	5.2%	13.9%
75th percentile	4.2%	5.2%	8.5%	10.8%	25.3%
Maximum	18.1%	14.3%	32.8%	35.5%	52.6%

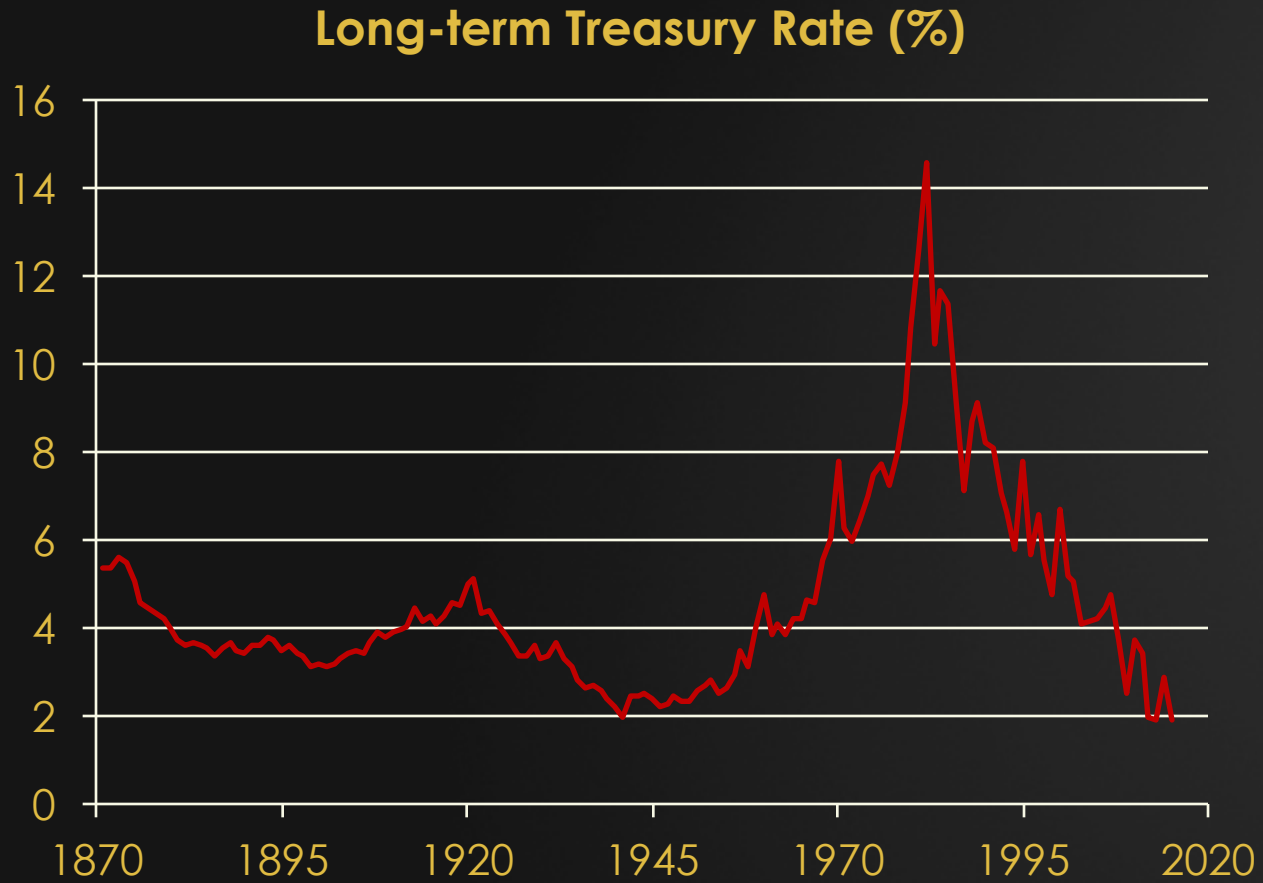
RISK FREE RATE

Rate of return

= risk free rate

+ risk premium

HISTORICAL RATES



RISK FREE RATES: MATURITY

- ▶ Yield curve
- ▶ Longer maturity = higher rates
 - ▶ Rates may rise
 - ▶ Greater liquidity risk

SUMMARY

- ▶ Risk free rates sets the floor
- ▶ Risky returns earn a premium
- ▶ Benchmark is U.S. Treasury
- ▶ Rates rise with maturity