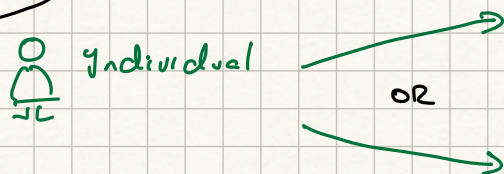


REQUIRED RATE of RETURN - minimum rate of return an investment must earn to accept the investment



Risk-free rate

= return on an investment

typically: return on S-T government debt

Risk premiums
premium

→ equity-related premium

↳ size risk
↳ value risk

→ debt-related premium:

↳ default risk
↳ liquidity
↳ maturity risk

Real risk-free rate

→ reflects pure time-preferences of individuals for current versus future real consumption

Inflation rate

or approximation: $\leftarrow$ ok for quick estimates, or

- when difference between r_f and infl small, or
- the rates are CONTINUOUSLY COMPOUNDED



r_i
↑
TOTAL RETURN for
any asset i