COLUMBIA THREADNEEDLE INVESTMENTS

Digging deeper: Reckoning with risk

1. Beta

Category: **Investment insights**

Beta

Beta is a measure of an investment's volatility compared with that of the broader market.

It is derived from the relationship between the market return, the risk-free rate (a notional figure usually derived from short-term government bond yields) and the actual return received.

Beta of security/portfolio:

- **Equal to 1** = expected to deliver the same return as the broader market.
- **Less than 1** = expected to be less volatile than the market.
- **Close to 0** = will behave more like cash.
- **Greater than 1** = expected to be more volatile than the market.

Beta allows investors to calculate the relationship between market movements (market volatility) and price movement of the individual security or a portfolio.

Formula for calculating beta (β) of a fund:

There are several ways to calculate beta, but this formula provides a simple way:

β = (Ri – Rf)/(Rm – Rf)

- β = beta
- Ri = return of the investment
- Rf = risk-free rate of return
- Rm = market return

Example

Ri = return of the investment = 12%

Rf = risk-free rate of return = 3%

Rm = market return = 8.5%

β = (12 – 3)/(8.5 – 3) = 1.64

The fund in this example has produced **a beta (β) greater than 1.**

You would expect the fund to be more volatile than its market.

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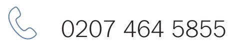
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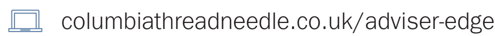
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