Which Return Is It? — Comparison Tables

Reading 1 introduces many kinds of return. Exam questions test whether you can tell them apart. These tables put every pair side by side.

Pairs of Return Measures

Pair	First measure	Second measure	Key point
Price vs distribution return	Price change ÷ P_0	Income ÷ P_0 (dividend yield, current yield)	Total return = sum of the two
Ex post vs ex ante	**Actual** return from past prices and income	**Expected** return for a future period	Difference between expected and actual = risk
Realized vs unrealized	Based on cash received (income, sale proceeds)	Based on current market price of an asset still held	Matters for tax: gains usually taxed when realized
Arithmetic vs geometric mean	Simple average; ignores compounding	Compound rate actually earned	Geometric ≤ arithmetic; gap grows with variability
Holding period vs annualized	Return over the actual holding period	Restated per year: $(1 + r)^{365/days} - 1$	Annualizing assumes the return repeats
Discrete vs continuously compounded	Ordinary returns: compound across periods	$\ln(1 + r)$; **additive** across periods	$\ln(1.20) = 18.232\% < 20\%$
Nominal vs real	Includes inflation	Adjusted for inflation: $(1 + \text{nominal})/(1 + \text{inflation}) - 1$	Real return = change in purchasing power
Return vs excess return	Investment's own return	Return relative to a benchmark or reference rate	8% vs 3% → 4.85% exact
Gross vs net	After transaction costs, before management fees	After management and administration fees	Return before commissions is neither
Pretax vs after-tax	Before taxes	After taxes on gains and income (often different rates)	30% pretax → 21.75% after tax in the example
Unleveraged vs leveraged	Return on own capital only	Return when borrowed funds or derivatives add exposure	Magnifies gains **and** losses

© 2026 RBei Classes. For RBei students' personal revision only.

Assets, Instruments and Indicators

Category	Definition	Examples	Generates cash flows?
Financial assets	Items investors can own that represent value	Cash; equity ownership; debt (an asset of the lender); debt–equity hybrids	Yes (except cash)
Financial instruments	Standardized means of trading financial assets in markets	Equity and debt securities; tradable standardized contracts such as some derivatives	Yes
Financial indicators	Observable measures of value	Interest rates; currency exchange rates; market indexes	**No**

What Makes Up a Required Rate of Return?

Component	What it compensates for	Applies to	Example
Real risk-free rate	Time preference — preferring consumption now to later	All investments	No inflation, no default; pure time value
Inflation premium	Expected loss of purchasing power	All nominal rates	Real r_f + inflation premium ≈ nominal r_f (T-bill rate)
Default risk premium	Borrower may not pay on time	Bonds	Corporate bond yields above government yields
Liquidity risk premium	Receiving less than fair value if sold quickly	Bonds (and other assets)	Thinly traded bonds yield more
Maturity risk premium	Longer bonds are more sensitive to rate changes	Bonds	10-year yields usually above 1-year yields
Size risk premium	Small-cap vs large-cap return difference	Stocks	Investors demand more from small caps
Value risk premium	Value (high book-to-market) vs other stocks	Stocks	Value stocks' extra expected return
Market risk premium	Market portfolio return - risk-free return	Stocks / portfolios	Used later in the CAPM

Three ways to read an interest rate: a **required rate of return** (what savers need to lend), a **discount rate** (to bring future payments to today) and an **opportunity cost** of current consumption. A risk premium can be — but is not always — part of it.

© 2026 RBei Classes. For RBei students' personal revision only.