CAPM

Pricing risk, and what beta actually measures.

Accounting & Finance

Expected return equals the risk-free rate plus beta times the market risk premium.

$$E(R) = Rf + \beta(Rm - Rf)$$

$\beta = 1$	**Moves with the market**
$\beta = 2$ Higher required return.	**Twice as volatile**
$\beta = 0$	**Risk-free rate**

THE COMMON MISTAKE

× **Treating beta as total risk**

✓ **It measures systematic risk only**

Specific risk is diversifiable, so the market does not pay you to bear it. Only market risk earns a premium.

> Empirically CAPM explains less than it once claimed. It remains the standard because it is simple and widely understood.