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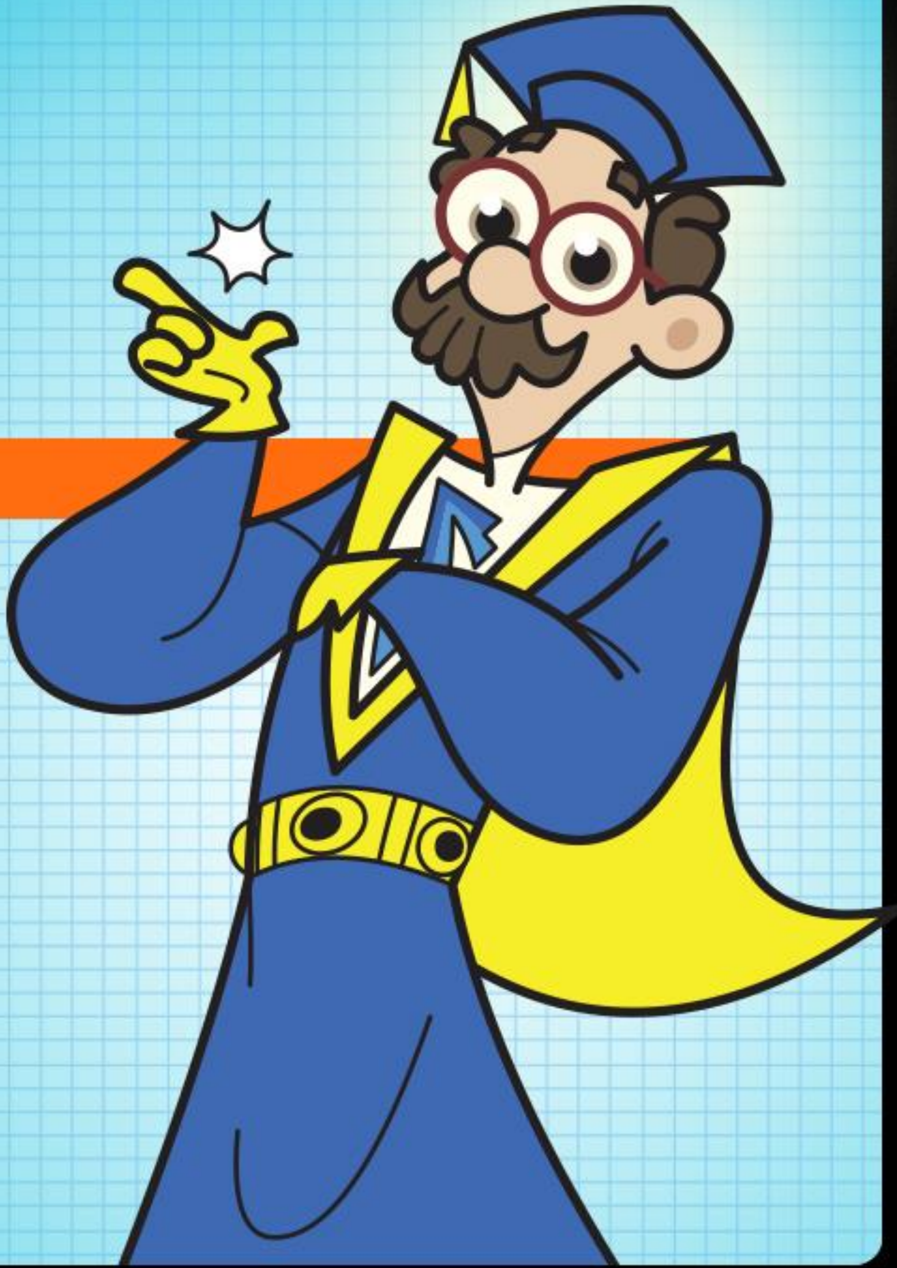

Understanding ‘Beta’

– By Prof. *Simply* Simple™

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We sometimes hear of a commonly used financial term called "Beta". But what is it?

Let me explain…

In finance, the Beta (β) of a stock is a number that tells you the relation of its returns with that of the financial market as a whole.

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When making an investment, it is necessary to check the fund returns but that alone is not a sufficient condition.

Evaluating other parameters like “beta” helps in making better investment decisions in keeping with one’s risk profile.

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You can think of beta as the tendency of a security's returns to respond to swings in the market.

A beta of 1 indicates that the security's price will move with the market.

A beta of less than 1 means that the security will be less volatile than the market.

A beta of greater than 1 indicates that the security's price will be more volatile than the market.

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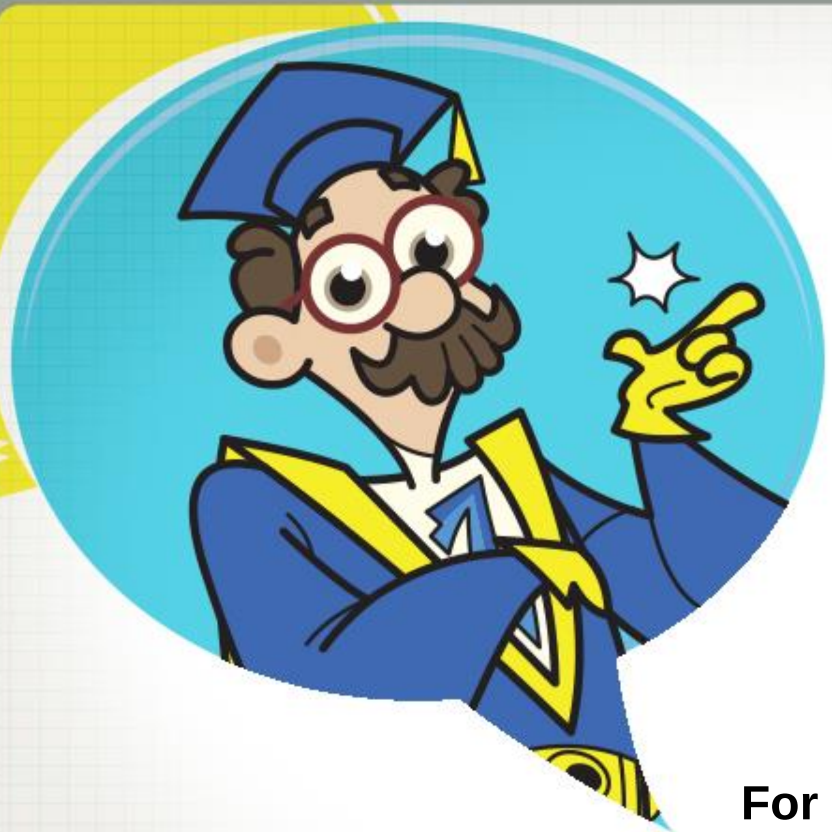

For example, if a stock's beta is 1.2, it's theoretically 20% more volatile than the market.

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Let's demonstrate this with an example. Say there's a housewife Mary.

Her son is a complete brat. Perhaps he is the naughtiest boy not only in the building where they live, but also in his boarding school where he stays.

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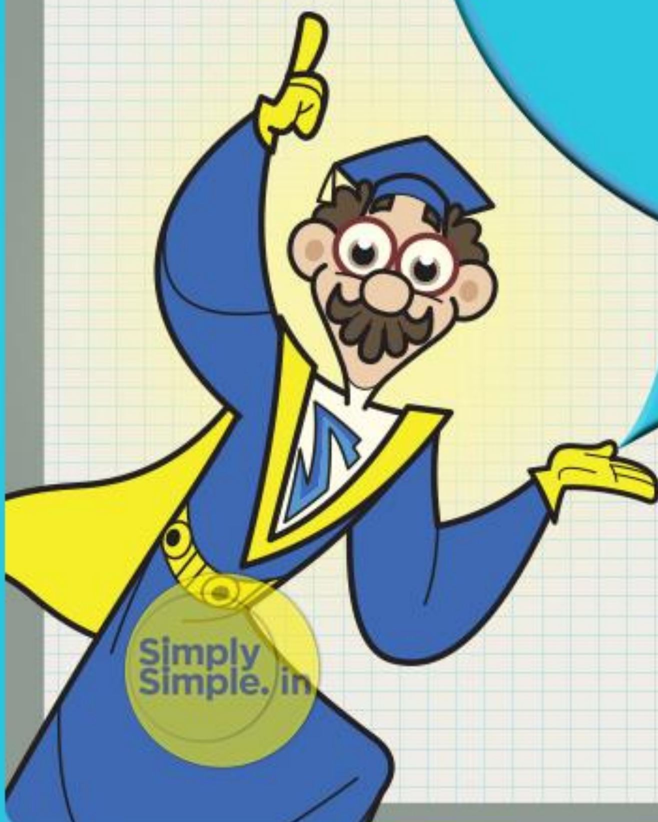
Now suppose, Mary’s neighbour Alice

has to attend to an emergency.



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Even Alice’s son is quite a brat and therefore most families in the neighborhood refuse to baby sit him.

However Mary willingly agrees because her own son is much naughtier than Alice’s son.

So as compared to managing her own son, she finds it extremely easy to look after Alice’s son.

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This example shows that certain decisions are taken by using comparison as a tool.

Hence while taking an investment decision, it becomes important to understand the expected volatility of your fund with respect to the benchmark and not just the performance.

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Hope this lesson has succeeded in clarifying the concept of ‘Beta’.

Thinking of Investment

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