7.7: How do we Interpret Beta?

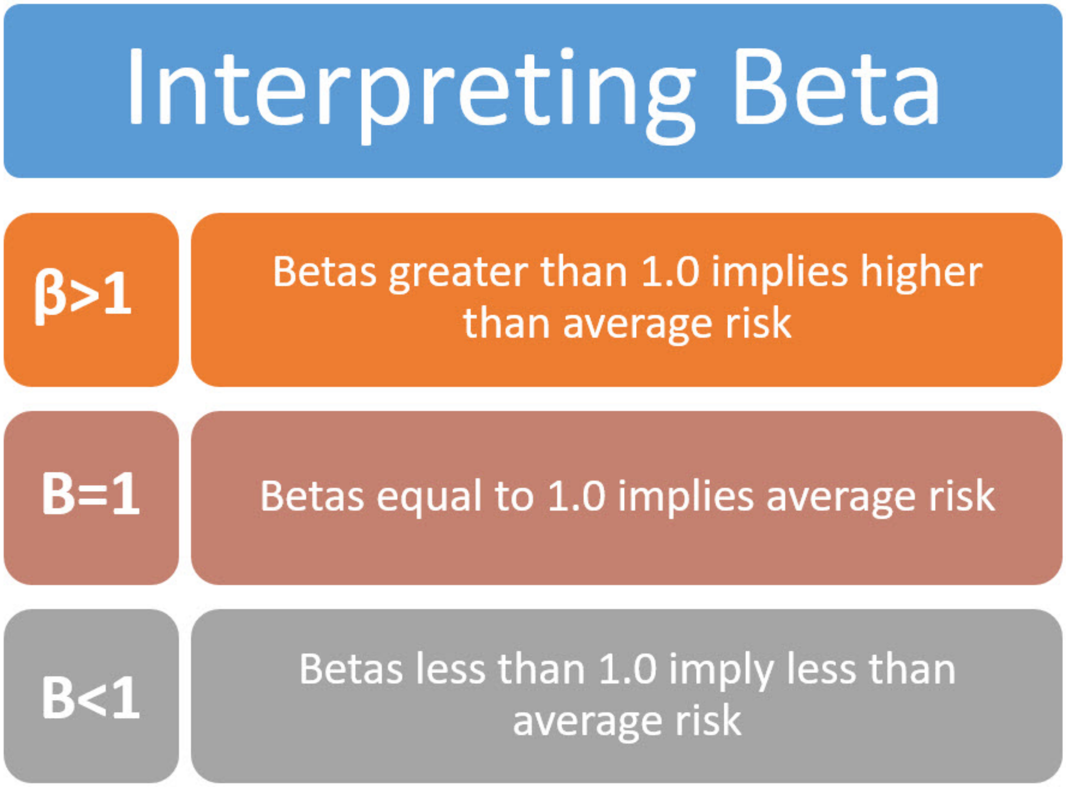

Figure 7.7.1: Beta helps evaluate risk

Most betas range between 0.35 and 1.8 (there are many outside this range, but the majority of stocks fall in this range – review Observed Correlations, Returns, Standard Deviations and Betas Table in Appendix B and note that all the stocks other than Wal-Mart fall in this window.)

Go back to our example where we calculated the beta for stock A. By itself, stock A is much riskier than the overall market as determined by its standard deviation. However, when we consider it as part of an overall portfolio its risk is much lower (less than average) due to the fact that it has a relatively low correlation to the overall market. The riskiness of stock A depends on whether we plan to use it as a stand alone investment or as part of a portfolio.