

According to Modern Portfolio Theory, the risk of a portfolio is	The standard deviation of the portfolio returns.
According to Modern Portfolio Theory, the risk of a single asset is	The additional risk it adds to the portfolio.
Criticisms of Modern Portfolio Theory	<ol style="list-style-type: none"> <li>1) Markets are not necessarily efficient</li> <li>2) Risk is not measured correctly</li> <li>3) Overly technical</li> <li>4) Beta explains little of expected stock returns</li> </ol>
Fat tails	Probability distributions with more probabilities in the “tails” than predicted by the normal distribution. A higher probability of getting an especially good or bad result.
Risk	Variation where we mostly know how often outcomes will occur.
Uncertainty	Variation where we don’t know how often outcomes will occur.
Black Swan Risk	The chance of something occurring that we didn’t include in our possible events.
Risk that can’t be diversified away	<p>Non-diversifiable risk</p> <p>Market risk</p> <p>Systematic risk</p>
Risk that can be diversified away	<p>Diversifiable risk</p> <p>Business-specific risk</p> <p>Non-systematic risk</p>
Expected Market Risk Premium	$E(R_m) - R_f$
Multi-Factor Model	A model that attributes expected stock returns to multiple causes.
Capital Asset Pricing Model (Equation)	Expected stock return is a function of market risk. Assumes that the investor holds a well-diversified portfolio.
Beta	A measure of market risk
CAPM Equation	$E(R_i) = R_f + B_i(E(R_m) - R_f)$
Sharpe Ratio	<p>Evaluates portfolio performance using standard deviation (SD) as a measure of risk.</p> <p><math>= (E(R_i) - R_f) / SD</math></p>
Alpha	<p>Measures the “value added” by the investor.</p> <p>Calculated as the difference between the actual return and the expected return (given some model of expected stock returns).</p>