Terminology

Expected return: E(r) = rf + rp,

where rf = risk-free rate (return on T-bills)

rp = risk premium (increases with risk)

Oftentimes E(r) is also called the required rate of return.

Actual (realized) return: ractual

Excess return = Realized riskpremium = ractual – rf

Oftentimes, we use the same term (i.e., excess return) for a different meaning:

Excess return = ractual – E(r) = abnormal return = Jensen’s alpha (α)