

Alpha



What Does *Alpha* Mean?

1. A measure of performance on a risk-adjusted basis. Alpha takes the volatility (price risk) of a [mutual fund](#) and compares its risk-adjusted performance to a benchmark index. The excess return of the fund relative to the return of the benchmark index is a fund's alpha.
 2. The abnormal rate of return on a security or portfolio in excess of what would be predicted by an equilibrium model like the [capital asset](#) pricing model (CAPM).
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Investopedia explains *Alpha*

1. Alpha is one of five technical risk ratios; the others are beta, standard deviation, R-squared, and the Sharpe ratio. These are all statistical measurements used in modern portfolio theory (MPT). All of these indicators are intended to [help](#) investors determine the risk-reward profile of a mutual fund. Simply stated, alpha is often considered to represent the value that a portfolio manager adds to or subtracts from a fund's return.

A positive alpha of 1.0 means the fund has outperformed its benchmark index by 1%. Correspondingly, a similar negative alpha would indicate an under-performance of 1%.

2. If a CAPM analysis estimates that a portfolio should earn 10% based on the risk of the portfolio but the portfolio actually earns 15%, the portfolio's alpha would be 5%. This 5% is the excess return over what was predicted in the CAPM model.
