IQIC - Markets & Returns

#3: Understanding Investment Returns

Key Terminology

- **What is an investment return?**
  - How much money you made (or lost) on an investment
- **Where it comes from:** Price going up or down + any payouts you get along the way (dividends, interest)
- If it's worth more than you paid → gain
- If it's worth less than you paid → loss
  - You only actually lock in the gain or loss when you sell
- E.g. You buy a share at $50. If it goes to $60, that's a $10 gain. If it drops to $45, that's a $5 loss.

Finding percentage return

- **How do you calculate percentage return?**
  - (Ending Value - Starting Value + Any Payouts) ÷ Starting Value
- **Core Process:** Find how much it changed → Add any dividends → Divide by what you started with → Turn it into a %
- E.g. You invest $1,000 and it grows to $1,150
  - ($1,150 - $1,000) ÷ $1,000 = 15%
- E.g. You invest $1,000, it grows to $1,100, and you got $20 in dividends
  - ($1,100 - $1,000 + $20) ÷ $1,000 = 12%

Dollar return vs. percentage return

- Dollar return = how many dollars you made
- Percentage return = how much you made compared to what you put in
- E.g. Person A puts in $10,000 and makes $500 → 5% return
- E.g. Person B puts in $1,000 and makes $200 → 20% return
  - A made more money, but B's investment actually did 4x better
- Percentage return lets you compare investments fairly, no matter how much money went in

Why timeframe matters

- **Why does time matter?**
  - Making 15% in 6 months is way more impressive than making 15% in 5 years
- To compare fairly, investors convert returns into a yearly rate (annualized return)
  - E.g. 20% over 3 years works out to about 6.3% per year
  - E.g. 10% in 6 months works out to about 21% per year
- Always compare returns over the same amount of time
- One great month doesn't mean it's a great investment

Return isn't everything

- **Is return the whole story?**
  - No. Two investments can have the same return but very different risk
- E.g. Portfolio A averages 8% a year and moves between 6% and 10%
- E.g. Portfolio B also averages 8% a year, but swings from -20% to +35%
  - Same average, but B is a much bumpier ride
- Big drops make people panic and sell at the worst time
- So the real question is: how much risk did you take to get that return?

Additional Resources

- Investor.gov: Compound Interest Calculator, to see how return, time, and contributions interact
- Investor.gov glossary: “Compound Returns” and “Compound Interest and Time”
- Book: The Little Book of Common Sense Investing by John Bogle (how costs and time shape real returns)