

Annual Returns Hype

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Know the difference between annual compounded return and average annual return. Investment sellers often tout average annual return because this numerical figure inflates perceived performance. If an investment return is 14% annually over 5 years, its return over 5 years is 100% or doubles. Divide 100% by 5 years equals 20% so called average annual return when it is no more than 14% compounded annual return.

Conversely a loan provider touts a 5 year loan at 14% interest rate compounded monthly is in fact selling a loan with an effective annual rate of 14.93%.

Know the difference, insist on knowing compounded annual return for an investment and effective annual rate for a loan.