THE RISK-FREE RATE OF RETURN

Q. WHAT IS GENERALLY USED AS THE RISK-FREE RATE OF RETURN IN THE CAPM MODEL?

A. U.S. Treasury Bills are generally considered to be "riskless" investments, where the investor can be confident that he is guaranteed a known rate of return on his investment. The interest rate on three-month U.S. Treasury bills is often used for the risk-free rate.[1]

Q. WHAT DID MR. MEREDITH USE FOR THE RISK-FREE RATE (Rf) IN HIS COST OF EQUITY ANALYSIS?

A. Mr. Meredith used the quoted rate for a 10-year T note yield, as reported in the Wall Street Journal on September 2, 2005, which was 4.03%.[2] This is shown on page 2 of Schedule TMR-2.

Q. WHAT RISK-FREE RATE OF RETURN DO YOU RECOMMEND?

A. I recommend that the interest rate on three-month U.S. Treasury bills be used as the risk-free rate. I recommend using the average of the rate over the 90-day period July 4, 2005 through November 4, 2005. The average interest rate for three-month U.S. Treasury bills over that 90 day period was 3.47%. The calculation of the 3.47% rate is shown on Schedule TMR-3. I recommend that 3.47% be used as the current risk-free rate of return.

---

[1] http://www.investopedia.com/terms/r/risk-freerate.asp, visited on October 25, 2005.
[2] Exhibit CCS 5.5.2 to Carbon/Emery's response to CCS Data Request CCS 5.5.2.