Alpha

Alpha is the return investors achieve over and above the return they are rewarded for taking on a given level of risk. Alpha is not simply return on investment. It is return adjusted for the amount of risk assumed.

Those people who adhere to the strong-form of the Efficient Market Hypothesis would contend that it is impossible to achieve a positive alpha. And if investors even try, they will likely earn a negative alpha.

Active investors are in search of alpha. They are active investors precisely because they believe achieving a positive alpha is possible, and doing so is worth the time and effort they put in to find the best investments.

Exactly how to measure alpha is not well established. Some investors like to use the Jensen Index; some investors like to use the Treynor Index; others like to use the Sharpe Index; still others simply compare return to risk. All three of the above mentioned statistics are based on the Capital Asset Pricing Model (CAPM).

One thing is clear, if an investor can achieve an above average return and a below average risk, then that investor has earned a positive alpha.