Fundamental Beta

Beta is a measure of an investment’s systematic risk. Systematic risk is risk that cannot be diversified away by combining investments into a portfolio. And, according to theory, it is the only risk that investors are rewarded for.

Investors normally calculate beta by regressing an investment’s return on the market return. Since most of an investment’s return is a result of the change in price, this estimate of beta is normally based mainly on price changes.

Fundamental beta is a measure of beta that is derived by incorporating fundamental measures of the underlying company. Instead of using price changes to estimate beta, the investor uses such things as earnings stability, financial leverage and company size.

Ultimately it is not the past beta of an investment that matters; it is the future beta that really matters. Proponents of fundamental betas claim fundamental betas are more accurate at forecasting future betas because they incorporate more and more relevant information than the more traditionally derived betas.