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Sharpe Ratio

The golden industry standard for risk-adjusted return

Written by CFI Team

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What is the Sharpe Ratio?

Named after American economist, William Sharpe, the Sharpe Ratio (or Sharpe Index or Modified Sharpe Ratio) is commonly used to gauge the performance of an investment by adjusting for its risk.

The higher the ratio, the greater the investment return relative to the amount of risk taken, and thus, the better the investment. The ratio can be used to evaluate a single stock or investment, or an entire portfolio.

Sharpe Ratio Formula

Sharpe Ratio = (Rx – Rf) / StdDev Rx

Where:

Rx = Expected portfolio return

Rf = Risk-free rate of return

StdDev Rx = Standard deviation of portfolio return (or, volatility)