Learn the FM: What is CAGR in finance management?

Compound Annual Growth Rate is the average annual growth rate of an investment over a specified period of time.

CALCULATION OF COMPOUND ANNUAL GROWTH RATE

CAGR is calculated by taking the Nth root of the total percentage growth rate where N is the Number of Years in the period being considered.

CAGR = ((End Value / Begin Value)$^{(1/N)}$) - 1

USAGE (APPLICATIONS) OF CAGR.

- Calculating and communicating the average returns of investment funds.

- Demonstrating and comparing the performance of investment advisors.

- Compare the historical returns of stocks with Bonds or with a savings account.

STRENGTHS (BENEFITS)OF CAGR.

- It is a useful formula to evaluate how various investments or a portfolio has performed over time.

- Can be used for comparing and for evaluating the performance of one stock against other stocks in a peer group or against a market index.

LIMITATIONS (DISADVANTAGES) OF CAGR.

- CAGR assumes that an investment grew at a steady rate. In reality there is volatility: investment results can vary significantly over time. This volatility,

or investment risk, is important to consider when one makes an investment decision.

- CAGR is a historical measure. Historical results are not always a reliable indicator of expected returns in the future.

- CAGR is sensitive to the period which you consider and it can be easily manipulated: an investment fund may tell you that it achieved an impressive CAGR of 35% over the last three years, but the Begin Value may be taken at a the lowest point that the fund ever had.

ASSUMPTIONS OF COMPOUND ANNUAL GROWTH RATE.

- CAGR assumes that an investment grows at a steady pace. This is normally not the reality. Therefore CAGR is an imaginary conception. It describes the growth of an investment as though it had grown at a steady pace.

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