



WHAT ARE INVESTMENT RETURNS?

**THE EQUITY
COMPASS**

 EDITION
15

Understanding the different ways investors measure and evaluate investment performance.

A scorecard tells you who won the match. But it does not always tell you how the match was played, whether the opponent was strong, whether the win came steadily, or whether the result depended on one exceptional moment.

Investment returns work in a similar way.

A fund may show a 20% return, but that number alone does not answer every question. Was the return earned over six months or five years? Did it beat the benchmark? Was it consistent across different time periods? Did it come after a sharp fall and recovery?

This is why investors look at different types of returns. Each one answers a slightly different question about performance.



WHAT ARE RETURNS?

Returns show how much an investment has gained or lost over a period of time.

In simple terms:

$$\text{Return} = \frac{\text{Gain or Loss on Investment}}{\text{Initial Investment}} = \frac{₹20,000}{₹1,00,000} (\%) = 20\%$$

If an investor invests ₹1,00,000 and the value becomes ₹1,20,000, the gain is ₹20,000. But this is only the starting point. To understand performance better, investors use different return measures.

1. ABSOLUTE RETURNS

Absolute return measures the total percentage gain or loss on an investment over a specific period, without comparing it to any benchmark or adjusting for the length of the investment period.

It simply answers the question: How much did my investment grow or fall?

Formula:

$$\text{Absolute Return} = \left[\frac{(\text{Current Value} - \text{Initial Investment})}{\text{Initial Investment}} \right] (\%)$$

Example:	Investment Amount	Current Value	Absolute Return
	₹1,00,000	₹1,25,000	25%

Absolute returns are easy to understand and useful when you simply want to know the total gain or loss on an investment. However, they do not account for the length of the investment period, making it difficult to compare investments held for different durations.

2. ANNUALISED RETURNS (CAGR)

CAGR, or Compound Annual Growth Rate, shows the annual rate at which an investment would have grown if it had grown at a steady compounded rate over the investment period. This makes it easier to compare investments held for different periods.

It answers the question: At what annual rate did my investment grow over the period?

Formula:

$$\text{CAGR} = \left[\left(\frac{\text{Ending Value}}{\text{Beginning Value}} \right)^{\frac{1}{\text{Number of Years}}} \right] - 1 (\%)$$

Example:	Investment Amount	Value after 5 years	Absolute Return	CAGR
	₹1,00,000	₹1,61,000	61%	10% per annum

Although the investment gained 61% overall, CAGR shows this as an annualised compounded return of around 10% over five years.

CAGR is one of the most widely used measures for evaluating long term lump sum investments because it adjusts returns for time.

3. XIRR

XIRR, or Extended Internal Rate of Return, is used when investments or withdrawals happen on different dates. Unlike CAGR, it considers both the amount and timing of every cash flow.

It answers the question: What annualised return did I actually earn after considering when I invested or withdrew money?

Formula: There is no simple manual formula for XIRR. It is calculated using an iterative method that considers the amount and timing of every cash flow.

In practice, XIRR is usually calculated using spreadsheet functions such as XIRR() in Microsoft Excel.

Example:

Date	January	February	March	Current Value
Cash Flow	₹10,000 invested	₹10,000 invested	₹10,000 invested	₹35,000

Since each instalment remained invested for a different duration, CAGR would not accurately represent the investor's experience. XIRR calculates the annualised return after considering the timing of every investment.

For investors making regular SIPs or additional purchases, XIRR provides a more meaningful measure of performance.

4. POINT TO POINT RETURNS

Point to point return measures performance between one specific start date and one specific end date. Depending on the length of the period, the return may be expressed as an absolute return or an annualised return.

It answers the question: What was the return between these two dates?

Formula:

$$\text{Point to Point Return} = \left[\frac{(\text{Value on End Date} - \text{Value on Start Date})}{\text{Value on Start Date}} \right] (\%)$$

Example: Suppose you compare a fund's performance between 1 January 2021 and 1 January 2026.

Investment	Fund	Benchmark
Return	78%	65%

Now suppose you instead measure the same fund between 1 October 2021 and 1 October 2026.

Investment	Fund	Benchmark
Return	48%	45%

Although it is the same fund, the return differs because the selected start and end dates have changed.

Point to point returns are simple and widely used, but they can be heavily influenced by market conditions prevailing on the selected start and end dates.

5. ROLLING RETURNS

Rolling returns calculate returns over multiple overlapping periods instead of one fixed period.

Rather than asking, "What was the three year return?", rolling returns ask, "What were all the possible three year returns?"

Formula: Rolling Return = The return calculated repeatedly for a fixed holding period by shifting the start and end dates at a predefined frequency.

Example: Suppose you want to analyse a fund's 3 year performance between January 2018 and December 2025.

Instead of calculating only one 3 year return, returns are calculated repeatedly over different 3 year periods.

Period	Jan 2018 to Jan 2021	Feb 2018 to Feb 2021	Mar 2018 to Mar 2021	Jan 2022 to Jan 2025
3 Year Return	14%	13%	15%	12%

This produces multiple overlapping observations, depending on the frequency selected, allowing investors to assess how consistently the fund performed across different market environments.

Rolling returns reduce the impact of choosing one particularly favourable or unfavourable start date and provide a more reliable assessment of consistency over time.

6. TRAILING RETURNS

Trailing returns are the returns generated over a given period. It can be the year to date (YTD), one year, three years, and so on.

It answers the question: How has the investment performed over commonly tracked time periods?

Formula: For periods longer than one year, trailing returns are generally presented as CAGR.

$$\text{Trailing Return (CAGR)} = \left[\left(\frac{\text{Ending Value}}{\text{Beginning Value}} \right)^{\frac{1}{n}} \right] - 1 (\%)$$

Example:

Assume an investment of ₹1,00,000 in a mutual fund on 1 June 2023, where its value has grown to ₹1,40,000 on 1 June 2026.

$$\text{CAGR} = \left[\left(\frac{1,40,000}{1,00,000} \right)^{\frac{1}{3}} \right] - 1 (\%) = 11.87\%$$

This means the fund generated an average annualised return of around 11.87% over the last 3 years.

Trailing returns make it easier to compare funds over standard investment horizons. However, like point to point returns, they still depend on one specific end date.



COMPARING DIFFERENT RETURN MEASURES

RETURN MEASURE	ANSWERS THIS QUESTION	COMMONLY USED FOR
Absolute Return	How much did my investment grow?	Measuring total gain or loss
Annualised Return (CAGR)	At what annual rate did my investment grow over the period?	Long term lump sum investments
XIRR	What annualised return did I earn on investments and withdrawals made at different times?	SIPs and irregular investments
Point to Point Return	What was the return between two specific dates?	Measuring performance between two specified dates
Rolling Return	How consistently has the investment performed?	Evaluating consistency across market cycles
Trailing Return	How has the investment performed over recent standard periods?	Comparing funds and benchmarks over standard recent periods



KEY TAKEAWAY

- A return number is meaningful only when the time period, benchmark, and cash-flow pattern are clear.
- For lump sum investments, point-to-point, trailing, CAGR and rolling returns can help evaluate performance from different angles.
- For SIPs or multiple transactions, XIRR gives a more practical view of the investor's actual return experience.
- Returns should not be viewed in isolation. They should be read along with risk measures, market conditions, investment objective, and consistency of performance.
- A higher return is not always better if it comes with excessive volatility, poor consistency, or higher risk than the investor is comfortable with.

Returns are useful indicators, but they are only one part of the investment picture. The better question is not just "How much did it earn?" but "How was that return earned, over what period, and with what level of consistency?"

Note: All return formulas shown in percentage terms are multiplied by 100 to express the result as a percentage.

Mutual Fund investments are subject to market risks, read all scheme related documents carefully.