Yield versus return

Although they may seem similar, *yield* and *return* have very specific and distinct meanings when it comes to evaluating investments.

Yield is simply a measure of income, ignoring the possibility of the changes in market value that result in capital gains and losses. With common stocks, income comes from dividends, while bonds provide interest payments. For those investments that have stable values—bank CDs or money market funds, for example—yield and return are the same.

Return is a more inclusive measure of investment performance. Calculation of return starts with income, then adds changes (increases or decreases) in the market value of the investment. Total return can be either positive or negative, in contrast to yield, which must be positive. Return is the better measure to use to evaluate the historical performance of stocks, bonds or mutual funds.

An illustration

Let's say that a stock worth $100 today pays an annual dividend of $2.50. That's a dividend yield of 2.5% (dividend divided by price). If the price of the stock rises by $5 during the course of a year, the price increase is added to the dividend to obtain a total return.

	Dividend	$2.50
+	Price increase	$5.00
=	Total return	$7.50

Thus, the total return for the year is 7.5%. Notice, however, that by the end of the year, the yield has fallen slightly, even though the dollar value of the dividend is the same. The $2.50 dividend must now be divided by the higher $105 price.

Bond returns are calculated in a somewhat similar fashion. Say a $100 bond pays $6 in annual interest for a 6% yield. If the price of the bond rises by $3 (because, for example, interest rates fall), the total return for the bond will be 9%.

	Interest payment	$6.00
+	Price increase	$3.00
=	Total return	$9.00

But if the price of stocks or bonds falls, the total return can fall—to zero or below. In the short term, investors should expect occasional periods of negative returns—for example,

1999 was a very poor year for bond investors. But in the long run, good years overwhelm the bad ones, and most stock and bond investors have prospered.

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Any developments occurring after January 1, 2008, are not reflected in this article.