Q. NLH-117 CA (Re: Table, page 28)

Dr. Kalymon adjusts the five and ten year returns on equity by a current (”spot”) market-to-book ratio. Please explain why Dr. Kalymon believes a current market-to-book ratio rather than an average market-to-book ratio measured over the 5- and 10-year periods should be used.

A. The reason for using the current market to book ratio in the calculation is that the current cost of equity capital is being assessed and not that of the past. Thus the current market to book ration reflects the valuation investors currently place on the observed returns on equity. Past market to book ratios , if markets have changed, do not reflect current costs and market evaluation.