

## Content

<b>Abstract</b> .....	V
1 Introduction .....	1
2 Risk-adjusted discount rates .....	2
2.1 Interpretation of common practice .....	2
2.2 Constant discount rate and constant risk premium .....	3
2.3 Using the CAPM to determine the risk premium .....	3
3 Certainty equivalents, risk-adjusted probabilities, and risk-adjusted growth rates .....	6
3.1 Outline of the risk-neutral valuation approach .....	6
3.2 Simplification of the time-state space: Binomial model .....	7
3.3 Risk-adjusted growth rates .....	11
4 Relationship between the two approaches .....	11
4.1 Model-based betas and risk premiums .....	11
4.2 Estimating the market risk premium .....	14
4.3 How to estimate $q$ ? .....	14
4.3.1 Logical boundaries for $q$ .....	15
4.3.2 Using an exogenous estimate for the expected market rate of return .....	16
4.3.3 Exogenous estimate for the market rate of return and its volatility .....	18
4.3.4 Using an exogenous estimate for risk premium and current betas .....	19
4.3.5 Heuristic approach .....	20
5 Example for practical application .....	21

<b>6 Conclusion.....</b>	<b>24</b>
<b>Appendix.....</b>	<b>25</b>
<b>References.....</b>	<b>28</b>