

## RISK ADJUSTED RETURN

Consider the following:

Portfolio Manager (PM) Jim has annual investment returns of 6% for the past 10 years, and PM Sally has also achieved portfolio earnings of 6% over the same period. Meanwhile, the S&P 500 has achieved annual returns of 6%, also over the same time-frame.

It appears as if both PMs have achieved the same returns, and so you might argue that they have both performed the same. However, a deeper dive may reveal that Jim took more risk in in order to accomplish market-like returns.

The best way to evaluate performance is to examine, using a number of mathematical relationships, how much risk each portfolio has assumed in order to achieve the results. Each investment performance is then measured against a comparative benchmark such as the S & P 500.

So in truth, Sally performed better than Jim did. Because if the markets were negative over the period, then Jim's portfolio would most likely have shown greater declines due to the higher risk inherent in his portfolio.

The absolute ideal situation would be if Sally's portfolio were actually less risky than the market (S&P 500), and yet achieved the same returns as, or perhaps even higher than the market. By exposing an investor's funds to less risk and actually achieving the same or higher returns than the market would be an **out-performance by any measure**.

The critical concept is not just to compare different portfolios, but to compare these portfolios on a **risk-adjusted basis**.