

Active Management

A form of investment management which involves buying and selling financial assets with the objective of earning positive risk-adjusted returns.

Alpha

This statistic measures a portfolio's return in excess of the market return adjusted for risk. It is a measure of the manager's contribution to performance with reference to security selection. A positive Alpha indicates that a portfolio was positively rewarded for the residual risk which was taken for that level of market exposure.

Arithmetic Return

The sum of the period returns divided by the number of periods. This is the simple average return and should be contrasted with the Geometric Return

Asset Allocation Effect

This attribution return measures the additional return produced by the difference between the target portfolio's asset class weights and the actual plan asset class weights. For each time period where the return for one of the asset class targets in the plan is greater than the Total Return of the plan target benchmark as a whole and where the actual asset class weight was greater (less) than the target asset class weight, the asset class will show a positive (negative) Asset Allocation Effect for the time period. For each instance where the return for one of the asset class targets in the plan is less than the Total Return of the plan target benchmark as a whole and where the actual asset class weight was greater (less) than the target asset class weight, the asset class will show a negative (positive) Asset Allocation Effect for the time period. The cumulative Asset Allocation Effect is the compounded factor of each single time period factor over the cumulative time period.

Balanced Fund

An investment strategy which is a combination of equities and bonds in an effort to obtain the highest return consistent with a low-risk strategy. A balanced fund typically offers a higher yield than a pure stock fund and performs better than such a fund when stocks are falling. However, in a rising market, a balanced fund usually will not keep pace with an all-equity fund.

Basis Point

100 Basis points = 1%

Benchmark

A portfolio against which the investment performance of a money manager can be compared for the purpose of determining the value-added of a manager. A benchmark can be a market indicator such as the S&P 500 as well as a fund universe such as a database of Value managers. For the most accurate comparison of manager performance, the benchmark must represent the same style of the manager and must exhibit similar levels of risk.

Beta

A statistical measure of the volatility, or sensitivity, of rates of return on a portfolio or security in comparison to a market index. The Beta value measures the expected change in return per on percent change in the return on the market. Thus, a portfolio with a Beta of 1.1 would move 10% more than the market.

Cash Flows/Sales

Cash flows divided by sales. Cash flow is the cash generated by a company after all cash expenses, including income taxes and minority interest, but before provision for dividends. Expenses do not include non-cash expenses such as depreciation. Sales represent gross sales reduced by cash discounts, return sales, etc.

Cumulative Returns

The cumulative return for a portfolio or an asset is the cumulative compound return over the full length of a specified time period. The percentage measure of this return is not annualized and as such represents the actual total return of the portfolio or asset over the period. By annualizing the percentage figure, one can calculate the average annual return of the portfolio or asset over the period.

Efficient Market

A portfolio which claims that a security's market price equals its true investment value at all times since all information is fully and immediately reflected in the market price.

End Point Sensitivity

The performance of a manager/fund may vary depending on which ending time periods are used to analyze performance. Therefore it is important to look at performance for a number of market cycles or time periods to gain an accurate assessment of the manager/fund's performance.

Equal Weighted

In a portfolio setting this is a composite of a manager's return for accounts managed that gives equal consideration to each portfolio's return without regard to size of the portfolio. Compare to Size Weighted Return. In Index context, equal weighted means each stock is given equal consideration to the index return without regard to market capitalization. The Value Line Index is an example of an equal weighted index.

Geometric Return

A method of calculating returns which links portfolio results on a quarterly or monthly basis. This method is best illustrated by an example, and a comparison to Arithmetic Returns, which does not utilize a time link. Suppose a \$100 portfolio returned +25% in the first quarter (ending value \$125) but lost in the second quarter (ending value is \$100). Over the two quarters the return was 0% - this is the geometric return. However, the arithmetic calculation would simply average the two returns: $(+25\%)(.5) + (-20\%)(.5) = +2.5\%$

Manager Selection Effect (Asset Class)

This attribution return measures the additional return produced by the managers within a management style group in the asset class compared to the return of the target benchmark for the style. Each style of an asset class whose return is higher than the target benchmark return will show a positive Manager Selection Return. Each style of an asset class whose return falls short of the target benchmark return will show a negative Manager Select Return. The Manager Selection Effect is the compound factor of each single time period factor over the cumulative time period.

Manager Selection Effect (Total Fund)

This attribution return measures the additional return produced by the managers within an asset class in the plan compared to the return of the target benchmark for that asset class. Each asset class of a plan whose return is higher than the target benchmark return will show a positive Manager Selection Return. Each asset class of a plan whose return falls short of the target benchmark return will show a negative Manager Selection Return. Manager Selection Effect is the compounded factor of each single time period factor over the cumulative time period.

Performance Attribution

The process of evaluating the factors that contribute to a total rate of return of a portfolio. Performance attribution is most commonly used in the monitoring of common stock portfolio performance, where breakdowns of sector performance are readily available for comparison. Two other types of performance attribution, Total Fund and Style Structure Attribution, can be used to provide additional insight into the factors that contribute to the total return of a portfolio.

Policy Return

The Policy Return is the portion of the Total Fund Return that is attributable to the historical policy weights and returns associated with the benchmarks used to define the target portfolio. This return is the return that would have been achieved if the plan had invested in a passive plan replicating the target portfolio.

Relative Returns

The relative return for a portfolio or asset measures the return relative to a specified benchmark return. The relative return value is a ratio where values above one represent a period where the portfolio outperformed the benchmark and where values below one represent a period where the portfolio underperformed the benchmark. The ratio is calculated by dividing the portfolio return factor by the benchmark return factor.

Relative Cumulative Returns

The relative cumulative return for a portfolio or asset measures the cumulative return relative to a specified benchmark cumulative return. A period where the portfolio underperformed the benchmark would cause the return ratio for that period to be below one. However, over the length of the entire time period, the portfolio may have a cumulative return above the benchmark. The relative return value is a ratio where values above one represent total performance over the period above the benchmark and where values below one represent total performance over the period below the benchmark.

Residual Risk

Residual Risk is the unsystematic, firm-specific, or diversifiable risk of a security or portfolio. It is the portion of the total risk of a security or portfolio that is unique to the security or portfolio itself and is not related to the overall market. The Residual Risk in a portfolio can be decreased by including assets that do not have similar unique risk. For example, a company that relies heavily on oil would have the unique risk associated with a sudden cut in the supply of oil. A Company that supplies oil would benefit from a cut in another company's supply of oil. A combination of the two assets helps to cancel out the unique risk of the supply of oil. The level of residual risk in a portfolio is a reflection of the "bets" which the manager places in a particular asset class or sector. Diversification of a portfolio can reduce or eliminate the residual risk of a portfolio.

R-squared (R^2)

Formally called the coefficient of determination, this measures the overall strength of "explanatory power" of a statistical relationship. In general, a higher R^2 means a stronger statistical relationship between the variables estimated, and therefore more confidence in using the estimation for decision-making.

Sharpe Ratio

This statistic is a commonly used measure of risk-adjusted return. It is calculated by subtracting the Risk-free Return (usually 3 Month Treasury Bill) from the portfolio return and dividing the resulting "excess return" by the portfolio's total risk level (standard deviation). The result is a measure of return gained per unit of total risk taken. The Sharpe ratio can be used to compare the relative performance of managers. If two managers have the same level of risk but different levels of excess return, the manager with the higher Sharpe ratio would be preferable. The Sharpe ratio is most helpful when comparing managers with both different returns and different levels of risk. In this case the Sharpe ratio provide a per-unit measure of the two managers that enables a comparison.

Standard Deviation

A statistical measure of portfolio risk. It reflects the average deviation of the observations from their sample mean. Standard deviation is used as an estimate of risk since it measures how wide the range of returns typically is. The wider the typical range of returns, the higher the standard deviation of returns, and the higher the portfolio risk. If returns are normally distributed (i.e. has a bell shaped curve distribution) then approximately 2/3 of the returns would occur within plus or minus one standard deviation from the sample mean.

Style Allocation Effect

This attribution return measures the additional return produced by the difference between the target management style weights in the asset class and the actual weights of the managers representing the management styles. For each time period where the return for one of the style targets in the plan is greater than the Total Return of the asset class target benchmark as a whole and where the actual style weight was greater (less) than the target style weight, the style will show a positive (negative) Style Allocation Effect for the time period. For each instance where the return for one of the style targets in the plan is less than the Total Return of the asset class target benchmark as a whole and where the actual style weight was greater (less) than the target style weight, the style will show a negative (positive) Style Asset Allocation Effect for the time period. The cumulative Asset Allocation Effect is the compounded factor of each single time period factor over the cumulative time period.

Systematic Risk

Attributable to common macroeconomic factors and sometimes referred to as market risk. It is the part of a security's total risk that is related to movements in the market portfolio and therefore cannot be diversified away.

Total Fund Attribution

This type of performance attribution provides historical insight into how and why actual investment plan performance has differed from the performance of a plan's target portfolio. The target portfolio consists of relevant benchmarks for each asset class in a portfolio, weighted by the planned allocation of that asset class in the investment plan. The premise of Total Fund Attribution is that actual plan performance is a result of two factors: the performance of the investment plan target asset mix, and the value added to the plan through the implementation and maintenance of the policy mix. The Total Return of the plan is broken down into three components: Policy Return, Asset Allocation Effect and Manager Selection Effect.

Total Risk

Total risk is a measure of the total volatility of the excess returns of an asset or portfolio. The total risk is comprised of two measures of risk: Market (non-diversifiable or systematic) risk and residual (diversifiable or firm-specific) risk.

Unsystematic Risk

A risk pertaining to one element in a large environment or system. The risk of one stock is unsystematic, while the risk of the entire market of which it is an element is systematic.

Variance

The Variance is a statistical measure that indicated the spread of values within a set of values. For example, the range of daily prices for a stock will have a variance over a time period that reflects the amount that the stock price varies from the average, or mean price of the stock over the time period. Variance is useful as a risk statistic because it gives an indication of how much the value of a portfolio might fluctuate up or down from the average value over a given time.

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