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What is Risk-Based Performance Attribution (and why do we need it)?

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Performance Attribution

What was the source of our outperformance?

- Allocation
  - Under-over-weighting allocation to different sectors
- Selection
  - How did we do at picking individual securities relative to benchmark (BM)
- Interaction
  - Overlap of the two—this measures impact of allocation when security selection differs from the benchmark

Is it Alpha or Non-Risk-Adjusted Beta?

- “Is my outperformance due to superior management or adequate performance for taking higher risks compared to the benchmark?”
- Most managers market (and are judged by) non-risk adjusted returns
  - This gives credit for outperformance to selection/allocation no matter the risk
- The goal is not to combine risk attribution with return attribution, but to adjust returns for risks taken

Who has implemented a risk-adjusted performance attribution model?

David's Proposed Approach

Calculate Brinson Fachler attribution as usual, but substitute returns with M-Squared** values

Advantage of this approach

- Simplicity: minimal added work or data required
- Understandability: results in Bps are more meaningful, interpretive, and intuitive
- Flexibility: you can determine which risk measure you want to base the risk-adjustment on

*(The Journal of Performance Measurement, Summer 2016)
**See Spaulding (2007) for an explanation on how to derive M-Squared

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