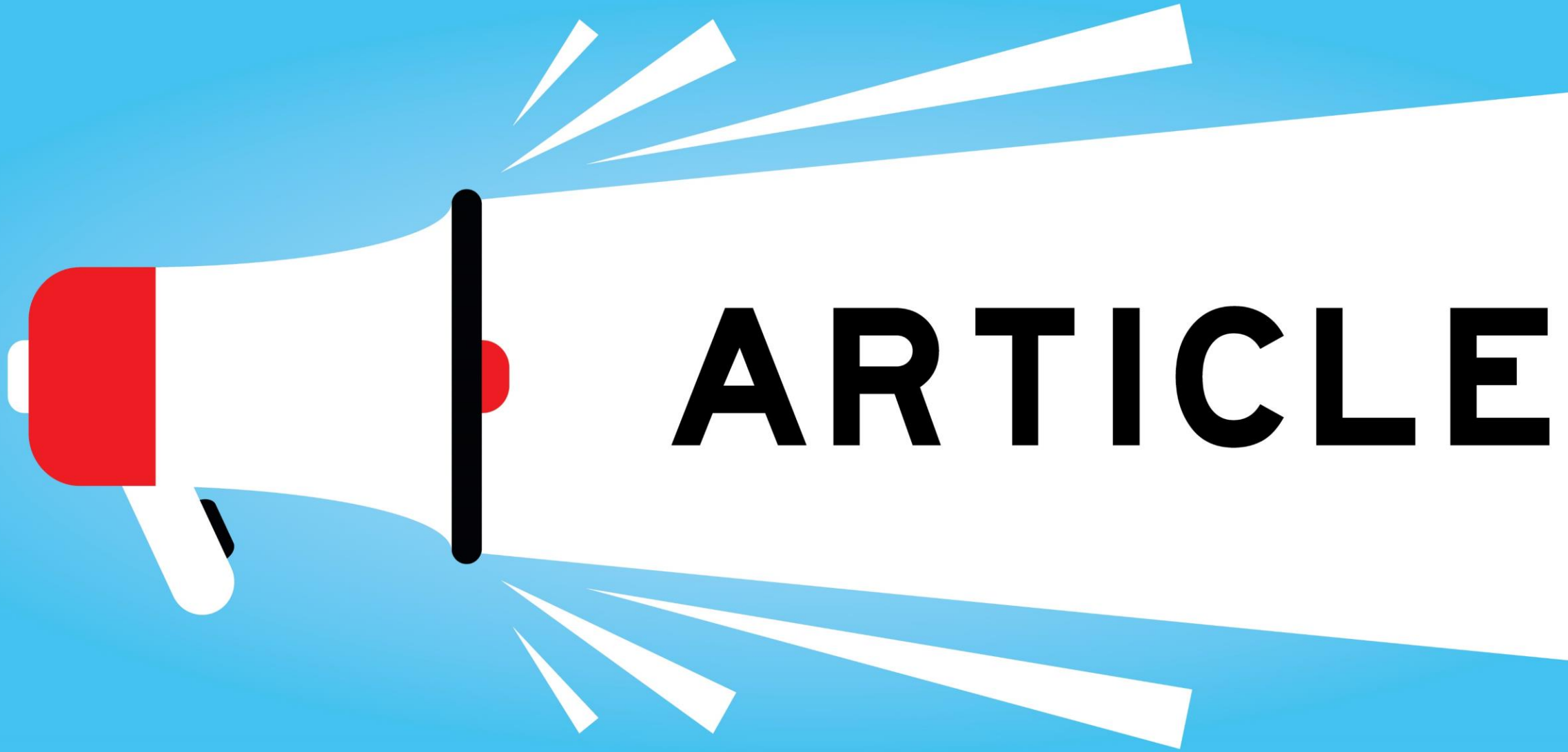# Thoughts & Clarifications on Risk-Adjusted Returns

David D. Spaulding, DPS, CIPM

23 June 2023   **Edinburgh Forum**

Typical bifurcation of risk

Risk-Adjusted Measures

Risk Measures

Risk Measurement

"Risk Measures" include (but not limited to)

- Standard Deviation
- Tracking Error
- Beta
- Downside Deviation
- Up/Downside Capture Ratio
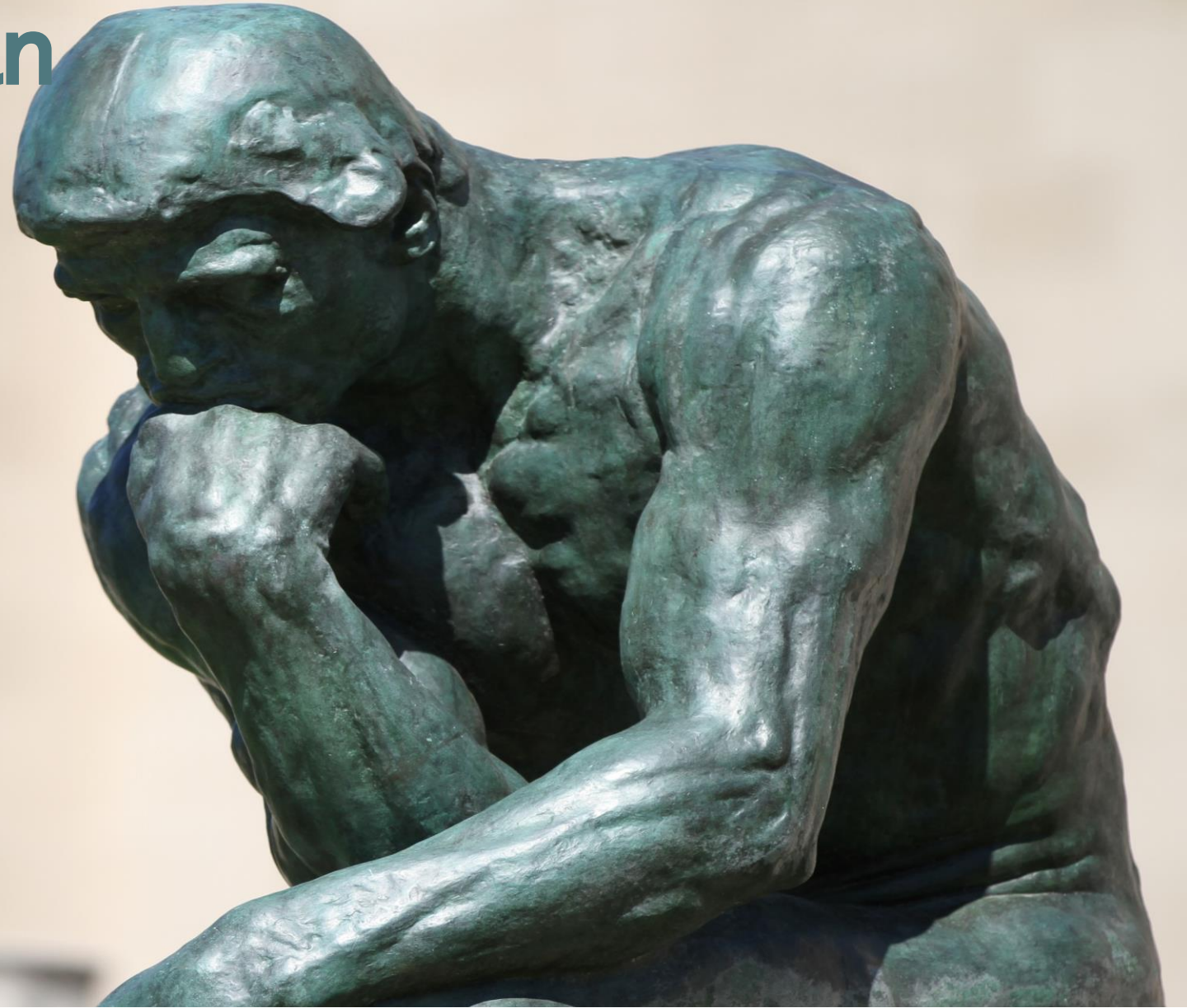
TSG
We Are Performance®

"Risk-Adjusted Measures" include

- Treynor Ratio
- Sharpe Ratio
- Sortino Ratio
- Information Ratio
- Jensen's Alpha
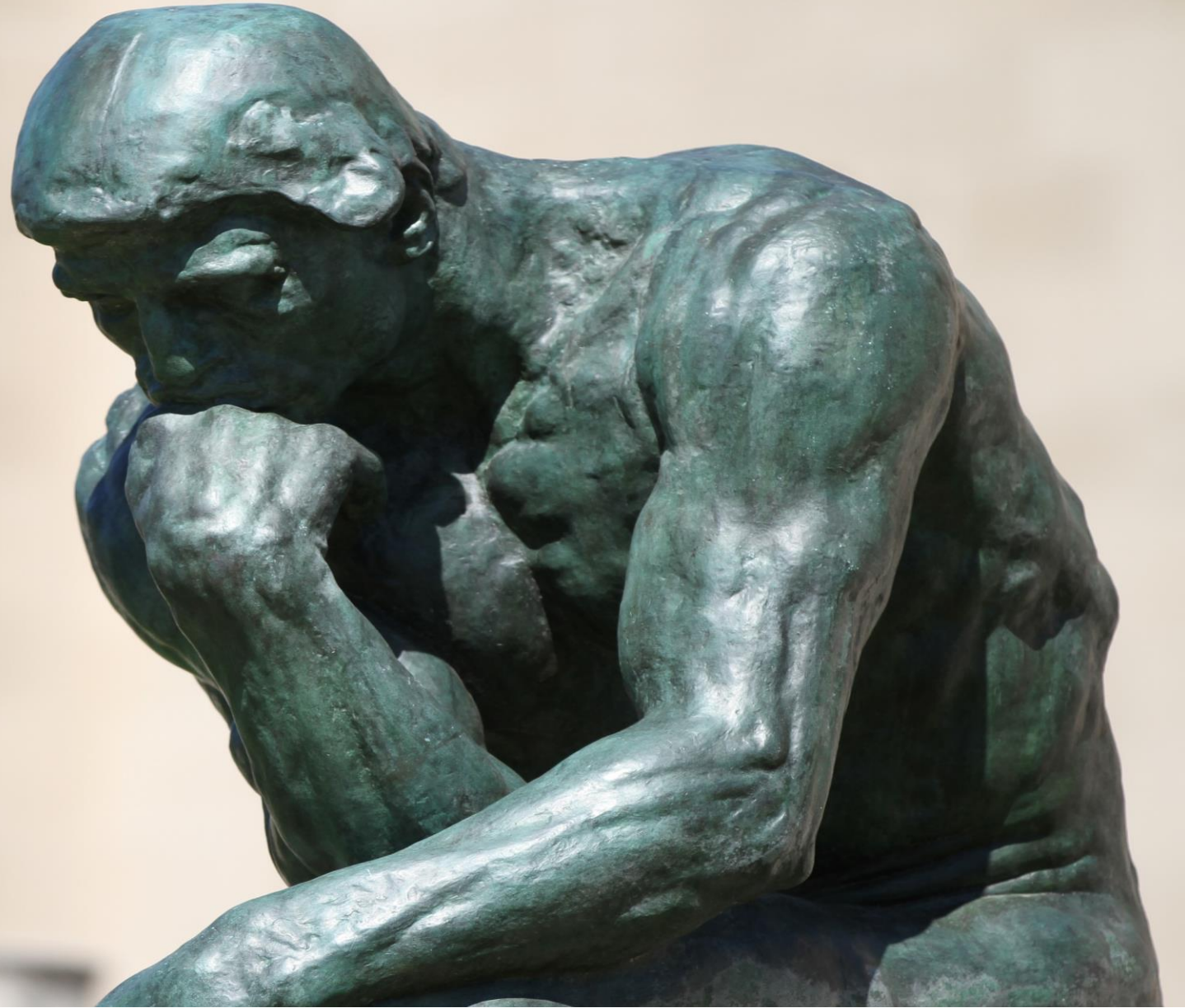- Modigliani-Modigliani [M^2]

What does it mean …

max

to <u>adjust</u> performance or returns?

TSG

— We Are Performance® —

Wouldn't that mean

that the return values
are actually <u>adjusted</u>?
Or altered?

TSG
We Are Performance®

How does a ratio
adjust or alter the return?

Answer: it doesn't

TSG
We Are Performance®

In my view,

The Sharpe, Treynor, Sortino, and Information Ratios
<u>do not</u> adjust or alter returns or performance.

In a recent LinkedIn Post

- I coined* the term, "return-risk ratio," because this is what they are.

- They are <u>not</u> risk-adjusted returns.

- They are ratios:
  <u>Some Return Measure ÷ Some Risk Measure</u>

- They provide the return received [typically an excess return of some sort] per unit of risk taken.

* Source: https://tinyurl.com/3swdepf4

TSG
We Are Performance®

SO

What are the risk-adjusted return measures?

TSG
We Are Performance®

What are the risk-adjusted return measures?

- Modigliani-Modigliani (M^2) is a risk-adjusted return or risk-adjusted performance (RAP) measure

- Jensen's Alpha is a risk-adjusted excess return measure

- I cannot think of any other measure that qualifies to be labeled as risk-adjusted

- Can you?

Risk should be trifurcated

Return-Risk Ratios
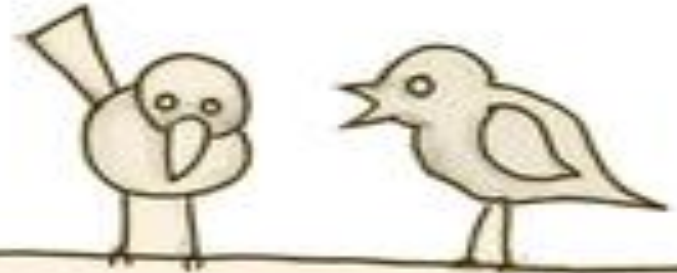
Risk-Adjusted Measures

Risk Measures

Risk Measurement

TSG
We Are Performance®

David D. Spaulding, DPS, CIPM
DSpaulding@TSGperformance.com
www.TSGperformance.com

We Are Performance™

The institutionally recognized boutique performance measurement consulting and GIPS® standards specialist firm serving the investment industry

www.TSGperformance.com

TSG
We Are Performance®