Measuring Performance and Risk in your Portfolio

Standard Deviation

Standard deviation measures the dispersion of data from its mean. In plain English, the more that data is spread apart, the higher the difference is from the norm. In finance, standard deviation is applied to the annual rate of return of an investment to measure its volatility (risk). A volatile stock would have a high standard deviation. With mutual funds, the standard deviation tells us how much the return on a fund is deviating from the expected returns based on its historical performance.

Sharpe Ratio

Developed by Nobel laureate economist William Sharpe, this ratio measures risk-adjusted performance. It is calculated by subtracting the risk-free rate of return (U.S. Treasury Bond) from the rate of return for an investment and dividing the result by the investment's standard deviation of its return.

The Sharpe ratio tells investors whether an investment's returns are due to smart investment decisions or the result of excess risk. This measurement is very useful because although one portfolio or security can reap higher returns than its peers, it is only a good investment if those higher returns do not come with too much additional risk. The greater an investment's Sharpe ratio, the better its risk-adjusted performance.

The Bottom Line

Many investors tend to focus exclusively on investment return, with little concern for investment risk. The five risk measures we have just discussed can provide some balance to the risk-return equation. The good news for investors is that these indicators are calculated for them and are available on several financial websites, as well as being incorporated into many investment research reports. As useful as these measurements are, keep in mind that when considering a stock, bond or mutual fund investment, volatility risk is just one of the factors you should be considering that can affect the quality of an investment.

Up-Market Capture Ratio

The up-market capture ratio is the statistical measure of an investment manager's overall performance in up-markets. The up-market capture ratio is used to evaluate how well an investment manager performed relative to an index during periods when that index has risen. The ratio is calculated by dividing the manager's returns by the returns of the index during the up-market, and multiplying that factor by 100. up market capture ratio = manager returns/index returns x 100

BREAKING DOWN 'Up-Market Capture Ratio'

An investment manager who has an up-market ratio greater than 100 has outperformed the index during the up-market. For example, a manager with an up-market capture ratio of 120 indicates that the manager outperformed the market by 20% during the specified period. Many analysts use this simple calculation in their broader assessments of individual investment managers.

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