# Trading Performance

"What has the asset manager done for us?" To answer this question, Cantaluppi & Hug has developed a new tool: the "Trading Performance".

Investors, as well as their investment counselors, are permanently confronted with the question: "What has the asset manager done for us?" Traditionally this analysis is carried out with the help of performance attribution. The performance attribution decomposes the effective performance of the investment in a passive and an active component. The passive component results from an investment replicating exactly the underlying benchmarks and maintaining the target weights of the investment strategy. The active component of the performance is the difference between the effective performance of the investment and its passive performance. This difference results from a weighting of the asset classes that differs from the investment strategy and a security selection that differs from that of the underlying benchmarks. The performance attribution, however, shows an inherent flaw: the weighting of the asset classes does not only deviate from that of the investment strategy because of active decisions of the asset manager but also as a result of the different market tendencies of the asset classes. Thus under the performance attribution model, such "doing nothing" is seen as active management and contributes in an active performance component. The investor generally has an entirely different perception of the active asset management.

We suggest a more intuitive tool to assess "What has the asset manager done for us?" We compare the effective performance of the investment with the "do nothing" performance, which would have been obtained if no investment decision had been taken during the time period under scrutiny. Only the active trades of the asset manager influence the active component of the performance, which we call the *trading performance*.

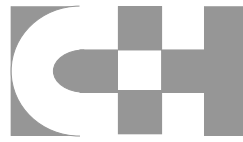### Trading Performance vs. "do nothing" Performance
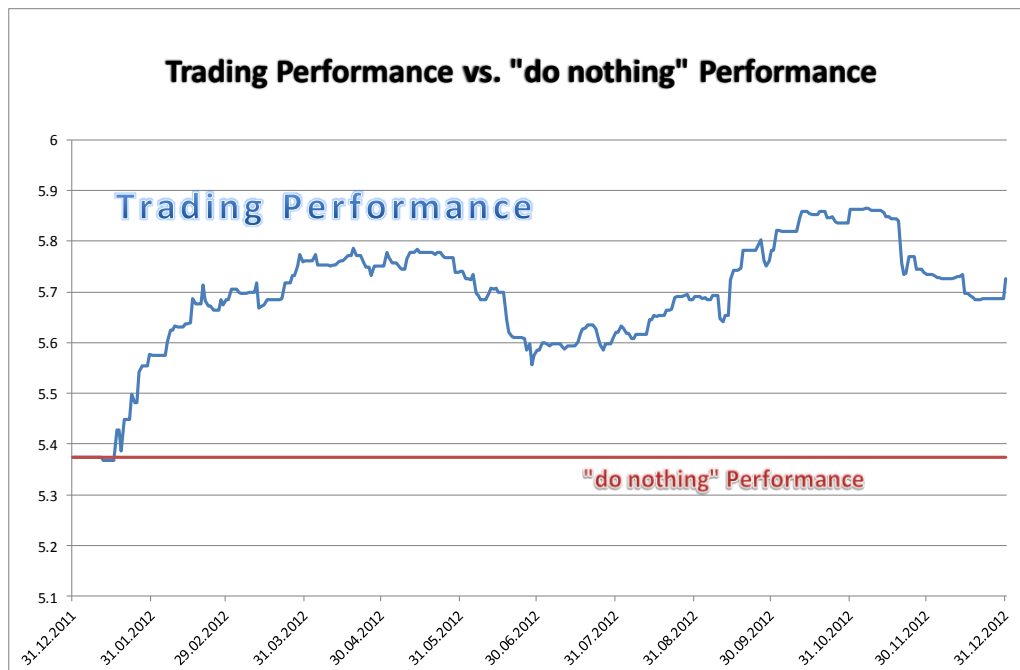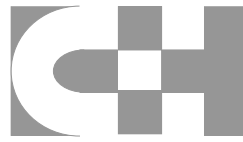
The graph above illustrates this analysis with an example of a pension fund for the year 2012. Please note that this graph has another interpretation than usual performance graphs. Each point on the blue line represents the performance for **the whole year** 2012. It is the performance that would have been attained if the asset manager had stopped any trading activity beyond the date corresponding to this point. The starting point of the line on January 1, 2012 thus gives the "do nothing" performance and the ending point of the line on December 31, 2012 gives the effectively obtained MWR performance. The intermediate points show the influence of all decisions of the asset manager on the performance, transaction after transaction.

We have in this example a "do nothing" performance of 5.37% and an effective performance of 5.72%. This means that the asset manager has, with her decisions, realized an outperformance of 0.35% relative to the "do nothing" performance. In this case the asset manager has done something for us, since an investment of USD 100 million would have resulted in an extra gain of USD 350'000 compared to the "do nothing" strategy.

The trading performance thus shows much more than the final outperformance of 0.35%. It shows the influence of each transaction on performance, resulting in a time series of out- and underperformance. In consequence, the trading performance becomes an extremely efficient "quality check" tool. The sensitive performance jumps stick out very clearly and can be analyzed in detail.

No other current method, such as traditional performance attribution, exposes the impact of transactions on performance as clearly as the trading performance. It helps to efficiently identify critical groups of transactions that have had a significant influence on the performance.

The highlights

The highlights of the trading performance can be summarized as follows:

- The question of the effect of the asset management on the performance is answered with full transparency. Only the decisions of the asset manager are considered as active management. Whether a trade was carried out for rebalancing purposes or for actively over- and underweighting some asset classes is irrelevant and not considered in effective performance analysis. The interpretation of the results is very simple and easily understandable.

- The investors and their counselors have a simple tool at their disposal for discerning the sensitive transactions and analyzing them in detail, since the impact on the performance of each individual transaction is calculated and displayed.

- The trading performance is calculated independently of an investment strategy, and more importantly independently of the underlying benchmarks. The trading performance cannot be questioned because of the selection of an inappropriate benchmark or a change of benchmark. The reference is always the "do nothing" performance, which is an intuitive and neutral "benchmark". Actually no investment strategy and no benchmarks are necessary to compute the trading performance.

Reference

The theoretical basis for this new performance measure has been published in the following article:

Cantaluppi, Laurent, « Contributions of Initial Holdings and Transactions to Performance », The Journal of Performance Measurement, Summer, pp. 30-40, 2014.

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