Understanding Performance

Questions to ask when judging investment performance

Real vs Back-tested Results

Back-testing is a process whereby an investment strategy is simulated over historical stock market data to determine how the strategy would have performed if it had been run over that time period. Back-testing results are best applied to wholly systematic strategies (i.e. they follow a fixed sets of rules) as it can provide a statistical guide to future expected performance.

Real results come from a live trading account that has followed that investment strategy. These are the most reliable results since they are based on actual trading.

ASK:
- Are these real or back-tested results?
- If they are back-tested, what are the assumptions?

Fees and Charges

Performance can be presented both including or excluding fees and charges such as brokerage. As different brokers charge different rates it is important to understand whether the performance results presented are gross (before fees) or net. Performance presented gross of fees can be considered more useful as it has the advantage of allowing you to adjust your evaluation based on your brokerage rates.

The use of leverage (via margin loan or CFDs) is a great way to potentially gain higher returns. However, the cost of achieving this should be considered as there are generally interest costs that must be paid.

ASK:
- What fees and charges are included in this data? Does that cover all the fees and charges I should expect to pay?
- Is there any leverage inherent in these results?

Currency

The currency of the investment and the currency that the performance is presented in is another factor that must be considered. Returns can differ when performance is presented in different currencies due to the effect of exchange rates. You should determine whether an investment strategy has been hedged back into your home currency.

ASK:
- What currency are these results presented in?
- Do these results come from a hedged or unhedged investment?