

Fingerprinting Your Portfolio Manager

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Traditional methods of monitoring manager style come with a time delay. They evaluate manager performance, but not in the context of how the manager's style performs in different markets. Jim C. Otar, a market technician, believes his 'Fingerprinting' method can depict manager performance in both rising and falling markets.

Sponsors hire active portfolio managers mainly for one reason: to outperform the underlying benchmark. Yet, history shows that only a small fraction of portfolio managers beat the benchmark. That being the case, the question that comes to mind is 'How do you select portfolio managers and monitor their performance?'

A portfolio manager may excel in rising markets and outperform when the markets

are going up. Another portfolio manager may excel in falling markets by playing defensively and losing less than the markets. In the final analysis, both of these managers may outperform the market because one plays well offensively and the other plays well defensively.

How can we visualize how well each manager is performing? How can we tell if a manager is efficient in rising and/or falling markets? Is it possible to be good in both?

There are several methods of monitoring manager performance such as the Sharpe ratio, the Jensen Alpha, quartiles, and so on. While many of these methods do a good job in evaluating past performance and risk, they usually come with a time delay. And often, they may not be clear enough for timely decisions.

An ideal performance gauge should have the following characteristics:

- ◆ It must depict the performance separately in rising and falling markets. This is necessary because when markets are under stress, the correlation between different portfolio managers increases. By assessing your portfolio manager separately in rising and falling markets, you may be able to manage risk more effectively.
- ◆ The method must be simple. This is needed to minimize the variety of different interpretations, explanations, and excuses by different portfolio managers.
- ◆ The method must be clear. Any person, regardless of

which side of the table he may be sitting on, should come to the same conclusion about the performance.

I believe the method I call 'Fingerprinting' has all of these characteristics. It is simple and clear and it helps visualize the portfolio's behaviour both in rising and falling markets in two dimensions:

- ◆ The vertical scale indicates how well the portfolio is performing in a rising market. The higher the point is on the chart, the better the portfolio is in outperforming the benchmark in a rising market as shown in *Figure 1*.
- ◆ The horizontal scale indicates how well the portfolio is performing in a falling market. The further to the left the point is on the chart, the better the portfolio is in outperforming the benchmark in a falling market as shown in *Figure 2*.

The calculation is straight-forward: Calculate the difference between the index growth and the portfolio growth each month, take a six-month rolling average of the difference in rising and falling markets, plot the outcome.

Figure 3 shows in detail how a Fingerprinting chart is prepared.

The Location Of The Fingerprint

The location of the Fingerprint on the chart reveals the relative performance of the portfolio. If the Fingerprint is in:

- ◆ the upper-left quadrant, the portfolio has been outperforming its benchmark both in up and down markets
- ◆ the upper-right quadrant, the portfolio outperforms the market when the market is going up and underperforms when the market is going down
- ◆ the lower-left quadrant, the portfolio outperforms the market when the market is going down and underperforms when the market is going up
- ◆ the lower-right quadrant, the portfolio

Figure 1

In A Rising Market ...

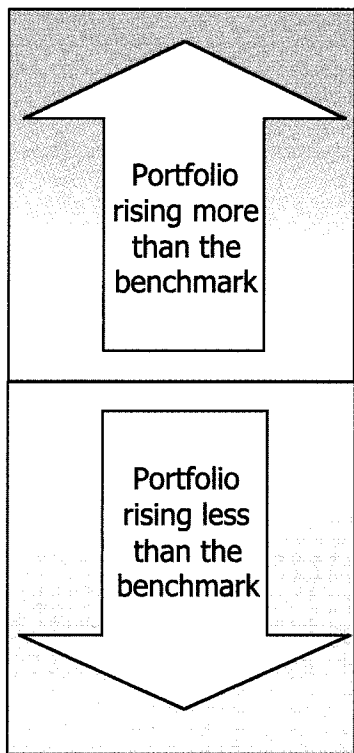


Figure 2

In a Falling Market ...

