

RETURNS-BASED STYLE ANALYSIS

Two Types of Style Analysis

- Holdings-based-analysis of actual holdings
- Returns-based-analysis of statistical returns

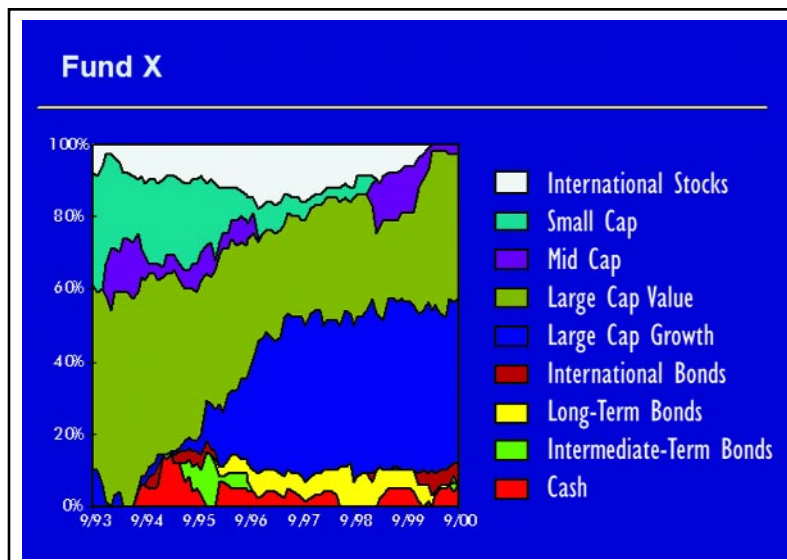
Ibbotson Associates Uses Returns-Based Style Analysis

- Pioneered by William Sharpe, returns-based style analysis estimates a fund's style or effective asset mix
- Monthly fund performance data is regressed against market benchmarks to determine an investment style by identifying combinations of benchmark returns that behave most like the fund returns

Benefits of Returns-Based Style Analysis

- Determines a fund's long-term style and consistency over time
- Explains past returns and identifies potential portfolio exposure
- Compares funds using tracking error and R-squared* statistics
- Effective in determining "window dressing," or buying and selling stocks right before the holdings are made public, in order to give the appearance of holding a winning position over a longer period of time, or not holding a losing position
- Information for analysis is readily available; whereas for holdings-based analysis, fund companies only have to report holdings twice a year

*R-squared: Identifies how well a set of benchmarks explains a fund's performance over a specified period.



Since consistency is necessary for strategic asset allocation, Fund X above might not be a good choice to use for implementation because of its drastic changes in style in recent years. The graph shows that in 1993 the fund's style was mostly Large Cap Value. By 1997, in contrast, Large Cap Growth was the predominate style and Small Cap exposure diminished.