

How's Your Investment Mileage?

Fuel efficiency is a hot topic these days. As the cost of fuel rises, it becomes all the more important to have a vehicle that gets the most out of every gallon of gas. When it comes to your investments, there is another measure of efficiency that is often ignored, but shouldn't be. That is how much return you are getting for the amount of risk are you taking. In other words, what is the mileage of your investment portfolio?

Investment risk is a bit of a nebulous term, and there have been many ideas about how it should be measured. The most widely accepted measure of risk is the volatility of returns. This is generally measured by looking at the **standard deviation** of investment returns over a specific time period. For those unfamiliar with the term, the standard deviation is a measure of the average difference of the various returns for the period from the median or central return. The more volatile (or risky) an investment is, the higher the standard deviation.

Advantage Investing strives to provide our clients with the maximum return for the minimum amount of risk. To see if we are doing our job properly, we can look at two different statistics based on the standard deviation. The first is called the **Standard Return**, and it is simply the total annualized return divided by the standard deviation. This is a pure measure of just how much return you get for

each unit of risk. For this measure, the higher the number, the more efficient the return.

The other risk measure is known as the **Sharpe Ratio**. This is very similar to the standard return except that it strives to measure only the return generated by an investment that is in excess of the "risk free rate". The risk free rate is simply the return any investor could achieve by putting their money into US T-Bills and receiving a return that is essentially free of risk because it is guaranteed by the US Government. Once again, a higher number shows a more efficient investment. Also of note, if the Sharpe Ratio is negative, then the investment did not even keep pace with a risk free investment, so it was very *inefficient*.

The table below shows these risk measures for each of our investment strategies, for three major market benchmarks, and for a group of well known individual blue-chip stocks. As you can see, each of our investment strategies have been doing a great job at maximizing return while minimizing risk. In particular, both the Bond and Strategic Allocation strategies took top honors in both of the efficiency measurement categories, as well as handily outperforming the market benchmarks for total return. For clients of Advantage Investing, it is almost like getting the mileage of a Toyota Prius Hybrid with the performance of a Dodge Viper! That is a combination that is pretty tough to find.

	Annualized Return	Standard Deviation	Standard Return	Sharpe Ratio
Bond Strategy	10.3%	3.0%	3.5%	2.6%
Current Income Strategy	8.2%	4.4%	1.9%	1.3%
Strategic Allocation Strategy	16.1%	6.0%	2.7%	2.3%
Stock Strategy	4.8%	7.2%	0.7%	0.3%
S&P - 500 Stock Index	4.2%	7.4%	0.6%	0.2%
Dow Jones US Corp Bond Index	6.5%	2.8%	2.3%	1.4%
Shearson Treasury Bond Index	6.7%	4.5%	1.5%	0.9%
Berkshire Hathaway Inc (BRKA)	7.2%	7.4%	1.0%	0.6%
Exxon Mobile Corp (XOM)	15.8%	9.2%	1.7%	1.4%
General Electric Co (GE)	0.3%	8.1%	0.0%	-0.3%
Microsoft Corp (MSFT)	-0.8%	10.4%	-0.1%	-0.3%
Wal-Mart Stores Inc (WMT)	-3.1%	6.5%	-0.5%	-0.9%

All returns are shown after fees for all investment strategies. Past performance cannot guarantee future results.
Source for index and stock data: Investor's Fast Track