Isle of Wight Pension Fund

Q3 2023 - Investment Monitoring Report

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Market Background

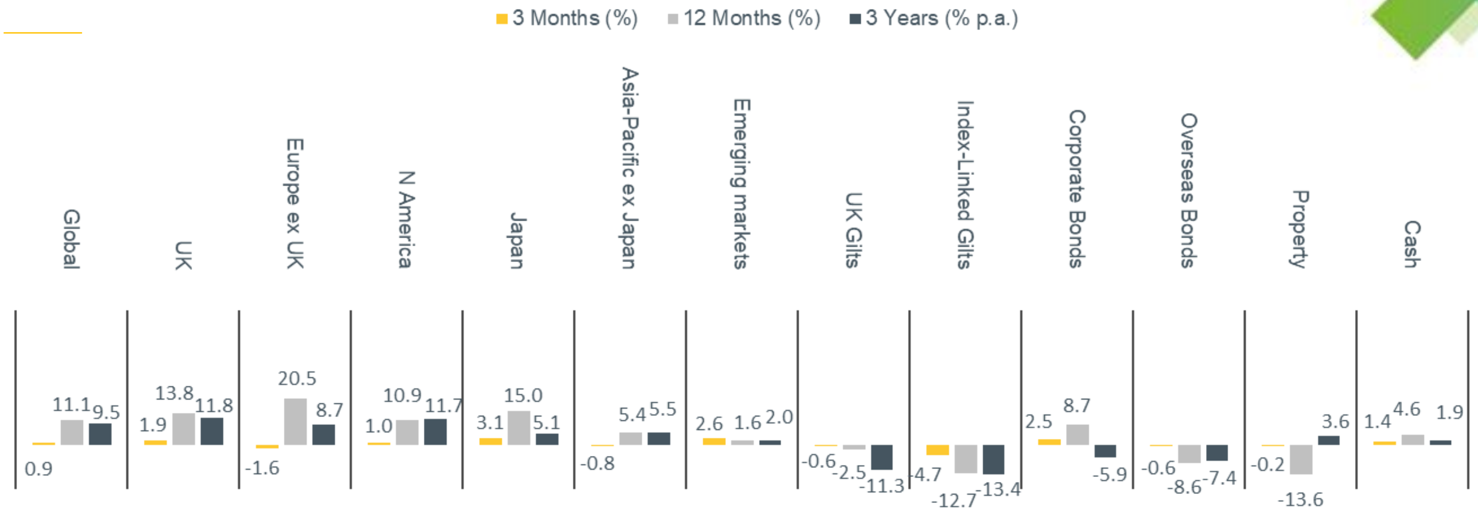
Better-than-expected Q2 data, released in Q3, led to further upwards revisions to 2023 global growth forecasts in Q3. However, survey indicators suggest that economic activity weakened throughout Q3, as services activity lost steam and the manufacturing sector remained in contraction. Europe looks a particular weak spot.

Headline inflation has generally stayed on a downwards trend, and came in at 3.7%, 6.7%, and 5.2% year on year in the US, UK, and eurozone, respectively. Core CPI inflation, which excludes volatile energy and food prices, has been falling more slowly, coming in at 4.3%, 6.2%, and 5.3%, in the US, UK and eurozone, respectively.

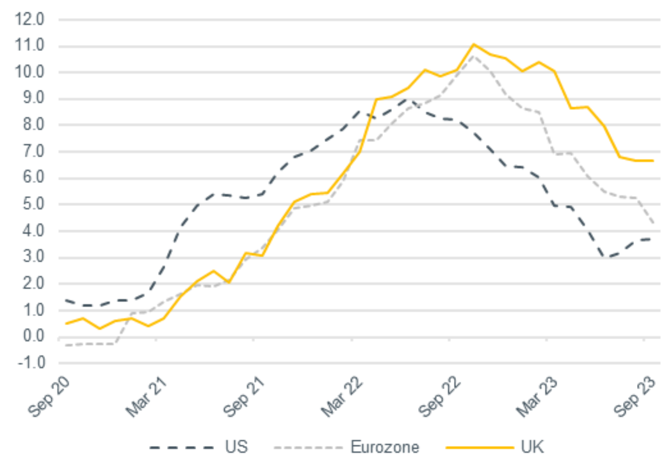
The Federal Reserve and Bank of England (BoE) raised rates 0.25% pa in Q3, to 5.5% pa and 5.25% pa. Both then left rates unchanged, unexpectedly so in the case of The BoE, at their September meetings. Meanwhile, the European Central Bank raised its deposit rate twice, to 4.0% p.a. The tone of central bank comments and market pricing suggest that policy rates are at, or close to peaking, but subsequent cuts will be more gradual than previously thought.

As a result, long-term sovereign bond yields rose. Heavy issuance amplified moves in 10-year US treasury yields which rose 0.7% pa to 4.6% pa. Equivalent German yields rose 0.5% p.a., to 2.8% p.a. Japanese government bond yields rose 0.4% pa, to 0.8% pa, as the Bank of Japan (BoJ) loosened its yield curve control policy in July. Short-term gilt yields fell, while longer-term yields rose – the 10-year yield saw more muted moves, rising 0.1% pa to 4.4% pa.

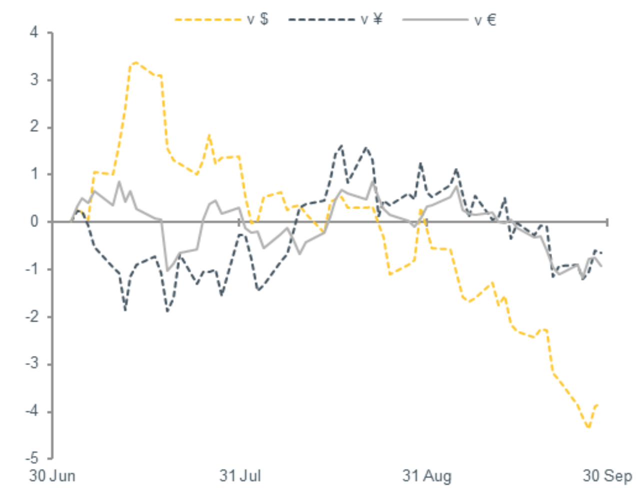
Historic returns for world markets [1]



Annual CPI Inflation (% p.a.)



Sterling trend chart (% change)



Source: DataStream. [1] Returns shown in Sterling terms. Indices shown (from left to right) are: FTSE All World, FTSE All Share, FTSE AW Developed Europe ex-UK, FTSE North America, FTSE Japan, FTSE AW Developed Asia Pacific ex-Japan, FTSE Emerging, FTSE Fixed Gilts All Stocks, FTSE Index-Linked Gilts All Maturities, iBoxx Corporates All Investment Grade All Maturities, ICE BofA Global Government Index, MSCI UK Monthly Property; UK Interbank 7 Day

Market Background

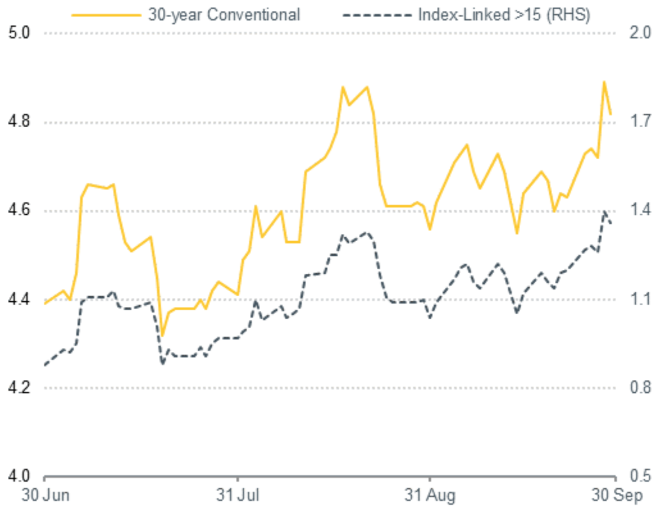
UK investment grade credit recorded positive total returns as short-term gilts yields and credit spreads fell. Global investment-grade spreads fell 0.1% pa to 1.3% pa. Speculative grade spread movements were muted with the US little changed, at 4.0% pa, and euro spreads tightening 0.1% to 4.4%.

The FTSE All World Total Return Index erased July's gains to end the quarter 2.1% lower, in local currency terms, as sovereign bond yields rose, and surveys indicated weaker global economic activity in Q3. Europe ex-UK underperformed, given weak business surveys and a large exposure to the struggling manufacturing sector. Above-average exposure to the tech sector saw North American equities also underperform. Japan outperformed as yen weakness lent support to the earnings of the export-heavy market. UK equities outperformed too, given above-average exposure to the energy sector.

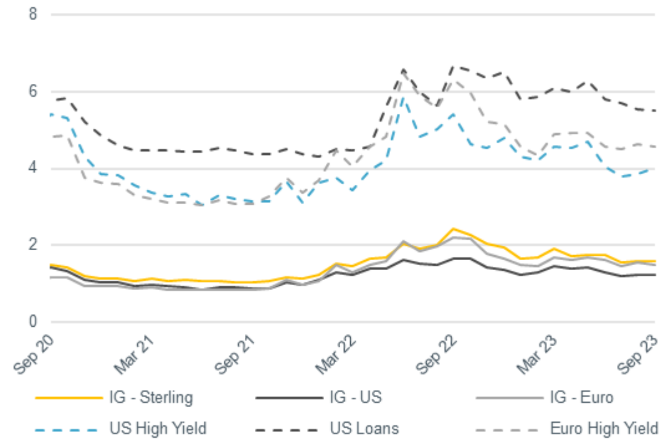
Oil prices rose 28% over the quarter on the back of supply shortfall fears, climbing close to $100 per barrel. On a year-over-year basis, oil prices are up 8.1%.Trade-weighted sterling fell 2.1% as near-term interest rate expectations fell, while the equivalent US dollar measure rose 2.0% and the Japanese yen fell a further 1.7%.

The MSCI UK Monthly Property Total Return Index returned -0.2% over the quarter as capital value declines in the office and retail sectors more than offset income. Over 12-months, capital values are down around 14%, 20%, and 23% in the retail, industrial, and office sectors, respectively. The office and retail sectors continue to see month-on-month capital value declines, while the industrial sector has recorded seven consecutive months of growth, though the pace has eased.

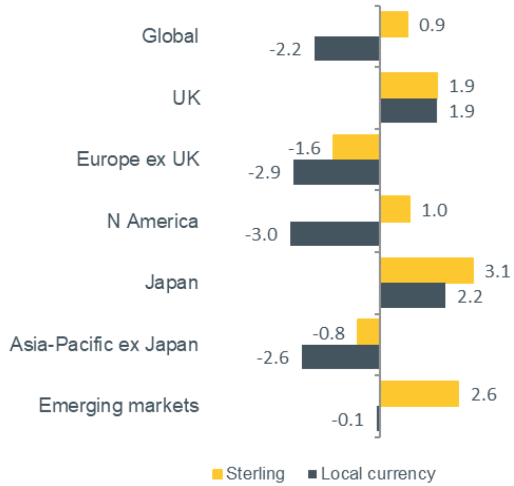
Gilt yields chart (% p.a.)



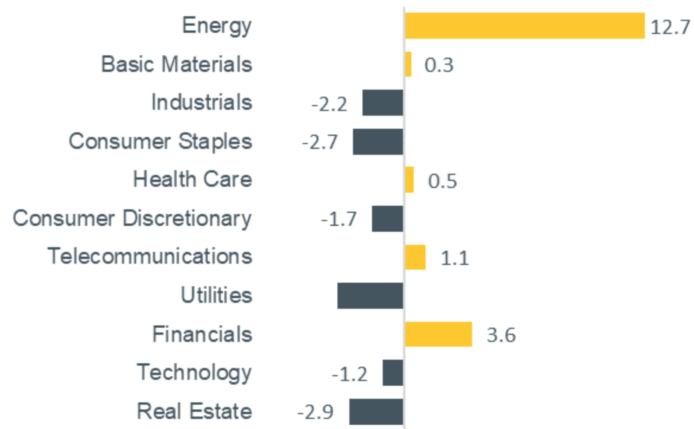
Investment and speculative grade credit spreads (% p.a.)



Regional equity returns [1]



Global equity sector returns (%) [2]



Source: DataStream, Barings, ICE [1] FTSE All World Indices. Commentary compares regional equity returns in local currency. [2] Returns shown in Sterling terms and relative to FTSE All World.

The page summarises our broad views on the outlook for various markets. The ratings used are Positive, Attractive, Neutral, Cautious and Negative.

The ratings are intended to give a guide to our views on the prospects for markets over a period of around three years; although they are updated quarterly, they are not intended as tactical calls. The ratings reflect our expectations of absolute returns and assume no constraints on investment discretion. In practice, they need to be interpreted in the context of the strategic framework within which individual schemes are managed.

Summary of Medium-term Capital Market Views

	June 2023	September 2023	Comment
Index-linked gilts	Attractive	Attractive	Real yields are also reasonably attractive and continued above-target inflation still lends some relative fundamental support to index-linked gilts. We also think the technical backdrop is slightly less challenging for index-linked gilts seeing as index-linked gilts are not being sold as part of quantitative tightening.
Conventional gilts	Neutral	Attractive	Given the weak real growth outlook and expected declines in inflation, we think the fundamental outlook for gilts has improved. The recent back-up in yields means longer-term nominal yields look increasingly attractive relative to fair value. We also think a fall in long-term implied inflation is more likely to be driven by a fall in nominal yields than a rise in real yields. However, the technical backdrop remains challenging amid Bank of England asset sales and heavy government issuance to meet financing requirements.
Sterling non-government bonds	Neutral to Attractive	Neutral	Slowing global economic activity and shrinking profit margins points to an unattractive fundamental backdrop for corporates and will put pressure on the strength of corporate balance sheets. Furthermore, the impact of previous interest rate hikes is yet to be felt fully and higher for longer central bank rhetoric may put longer term pressure on debt affordability. However, the impact will be less severe and take longer to materialize in investment-grade markets than in speculative-grade markets given lower debt levels and longer maturities.
Private Debt	Neutral to Cautious	Neutral	Leverage levels on newly originated debt are low compared to historic averages as underwriting focuses on fixed charge and interest coverage ratios in a rising cost environment. However, despite these lower leverage levels, the corporate earnings outlook (across the board) remains challenging which may impact debt affordability.
Equities	Neutral to Cautious	Neutral to Cautious	2023 aggregate earnings expectations appear to have bottomed out at an underwhelming 0.7%. Although consensus expectations suggest a more appealing earnings environment in 2024 and 2025, risks are skewed to the downside. One of the main uncertainties is whether markets have correctly assessed the longer-term impact of higher rates on the consumer and business activity. Moreover, there are risks surrounding central banks' ability to navigate the current inflation environment. Cyclically adjusted valuations are currently in line with long-term averages, but they appear more stretched in the context of higher real yields.
Cash Strategies	Neutral	Neutral	Higher base rates means investors can now generate positive (although below inflation) returns through cash holdings. The deteriorating economic outlook could provide opportunities further down the line.

Source: DataStream

As at 30 September 2023, the Fund's assets totalled £692.9m, decreasing by £1.2m over the quarter.

Better-than-expected Q2 GDP data, released in Q3, led to further upwards revisions to 2023 global growth forecasts for Q3, albeit survey indictors point towards economic slowdown.

As inflation remains high (although continues trending downwards), interest rates are forecasted to stay higher for longer – this expectation was the main driver behind global equities delivering negative performance over the last quarter.

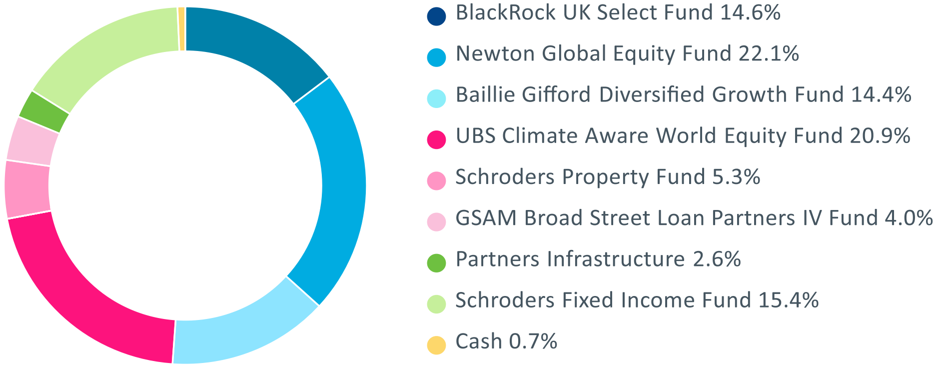
The Bank of England raised rates 0.25% pa in July, to 5.25% pa, however left rates unchanged at the following meeting in September.

Over the third quarter, gilt yields continued to rise at medium to long maturities but fell over the short term (reflecting August's downside inflation surprise and the BoE's unexpected pause in rate rises). Yields fell on shorter maturity issues, which led to overall positive performance for the Fund's fixed income mandate with Schroders.

Asset Allocation

Manager	Valuation (£m)		Actual Proportion	Benchmark	Relative
	Q2 2023	Q3 2023			
Newton Global Equity Fund	155.9	153.5	22.1%	18.8%	3.4%
Baillie Gifford Diversified Growth Fund	101.7	99.5	14.4%	10.0%	4.4%
UBS Climate Aware World Equity Fund	143.8	144.7	20.9%	18.8%	2.1%
BlackRock UK Select Fund	101.2	101.3	14.6%	12.5%	2.1%
Total Growth	**502.6**	**499.0**	**72.0%**	**60.0%**	**12.0%**
Schroders Property Fund	36.9	36.6	5.3%	8.0%	-2.7%
GSAM Broad Street Loan Partners IV Fund	25.9	27.8	4.0%	5.0%	-1.0%
Partners Infrastructure	16.1	18.2	2.6%	5.0%	-2.4%
Total Income	**78.9**	**82.6**	**11.9%**	**18.0%**	**-6.1%**
Schroders Fixed Income Fund	105.5	106.5	15.4%	22.0%	-6.6%
Total Protection	**105.5**	**106.5**	**15.4%**	**22.0%**	**-6.6%**
Cash	7.2	4.8	0.7%	0.0%	0.7%
Total Scheme	**694.1**	**692.9**	**100.0%**	**100.0%**	

Asset class exposures



Fund performance

Over Q3, the Fund returned -0.1% against its benchmark of 0.8%, a relative underperformance of 0.9%.

Over the medium term, the Fund fell short of its 12-month benchmark. Over the 3-year period the fund underperformed its benchmark by 0.5% p.a., delivering a 3.6% return per year. The recovery on the equity markets since Q4 2022 is evident over with a 5% absolute return over the 12-month period being a considerable improvement over the 3-year average of 3.6%.

The decrease in the Fund's value over Q3 was mainly caused by BG's diversified growth fund continuing to underperform and the Newton equity fund giving back a small fraction of its significant overperformance over the past 12 months.

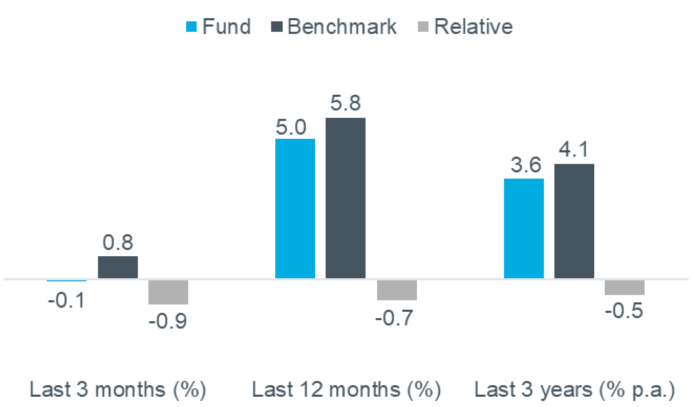
Capital values in the offices and retails sectors continued to drop over Q3. As a result, the Schroders property mandate delivered a slightly negative outcome over the three months.

With yields steepening in the 3 months to September (i.e., short duration yields decreasing and long duration yields increasing) the underlying assets in the Schroders Fixed Income fund saw mixed movements. Overall, the contribution to performance was slightly positive.

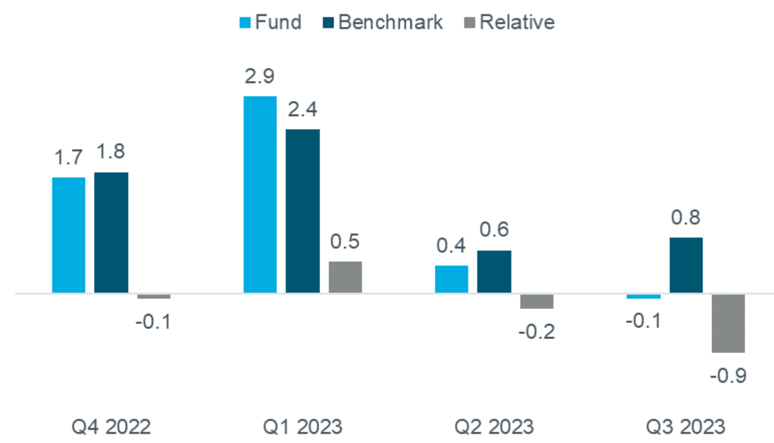
Manager performance (gross of fees)

	Last 3 months (%)			Last 12 months (%)			Last 3 years (% p.a.)		
	Fund	B'mark	Relative	Fund	B'mark	Relative	Fund	B'mark	Relative
Growth									
BlackRock UK Select Fund	1.7	1.9	-0.2	2.5	-1.7	4.3	-	-	-
Newton Global Equity Fund	-0.5	0.6	-1.1	14.1	10.5	3.3	9.4	9.0	0.4
Baillie Gifford Diversified Growth Fund	-2.0	2.1	-4.1	-0.2	7.7	-7.4	-1.2	5.2	-6.0
UBS Climate Aware World Equity Fund	0.7	0.7	0.0	12.2	12.2	0.0	-	-	-
Income									
Schroders Property Fund	-0.9	-0.4	-0.5	-18.5	-14.3	-4.9	0.2	3.2	-2.9
Protection									
Schroders Fixed Income Fund	0.9	0.7	0.2	2.3	2.7	-0.4	-9.4	-8.8	-0.6
Total	-0.1	0.8	-0.9	5.0	5.8	-0.7	3.6	4.1	-0.5

Fund performance vs benchmark/target



Historical quarterly performance summary



Source: Fund performance and valuation data provided by Investment Managers and is gross of fees. Benchmark performance provided by Investment Managers and DataStream. 12-month BlackRock UK Select Fund's performance is since inception (23.02.2023).Total Performance excludes the impact of private market allocations and any cash held.

This page includes details of the current investment manager ratings together with any relevant manager business updates.

This page also shows RI ratings for the current investment managers.

Manager ratings

Mandate	Hymans Rating	RI
Newton Global Equity Fund	Suitable	Good
BlackRock UK Select Fund	Preferred	Adequate
Schroders Fixed Income Fund	Positive	Good
Schroders Property Fund	Positive	Good
Baillie Gifford Diversified Growth Fund	Positive	Good
GSAM Broad Street Loan Partners IV Fund	Positive	Adequate
Partners Infrastructure	Preferred	Good
UBS Climate Aware World Equity Fund	Preferred	Good

Newton's team changes

In Q3, Paul Markham, previously Head of Newton's Global Opportunities team, left Newton. Louise Kernohan expanded her role to become Head of the team and portfolio manager on the Global Equity strategy. Louise has 18 years' investment experience, having joined Newton in 2020 from Aberdeen Standard Investments, where she had managed UK and Pan-European equity portfolios. Georgina Cooper and Tom Wilson also joined the management team of the strategy. Georgina joined Newton 18 months ago and is portfolio manager on the UK Equity and Sustainable UK Opportunities strategies. She has nine years' industry experience and has managed equity portfolios for the last eight years. Tom joined the Global Opportunities team in September from Insight Investment and has 15 years of industry experience.

Source: Investment Managers

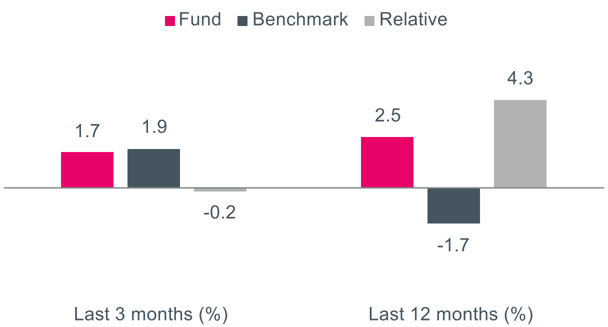
Blackrock UK Equity

The Liontrust UK Equity fund was replaced by the BlackRock UK Select fund as of the 23rd February 2023. The UK Equity allocation remains within the ACCESS LGPS Pool, despite the manager change.

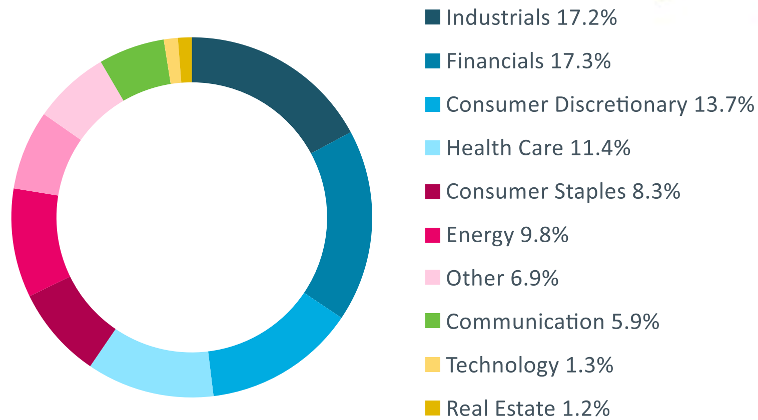
Over Q3 2023 the BlackRock UK Select Fund delivered a total return of 1.7%, marginally underperforming its FTSE All Share benchmark of 1.9%. The fund managed to perform better than its benchmark since the Fund's investment in the first quarter of 2023, with a relative outperformance of 4.3%.

The BlackRock Institutional Equity Fund ('BIEF') – UK Select takes active positions, with significantly overweight allocations to Communication and Industrials. On the other hand, the fund is materially underweighting the UK's Financial, Consumer Staples and Health Care sectors. This allocation is consistent with the fund's moderate quality/growth bias.

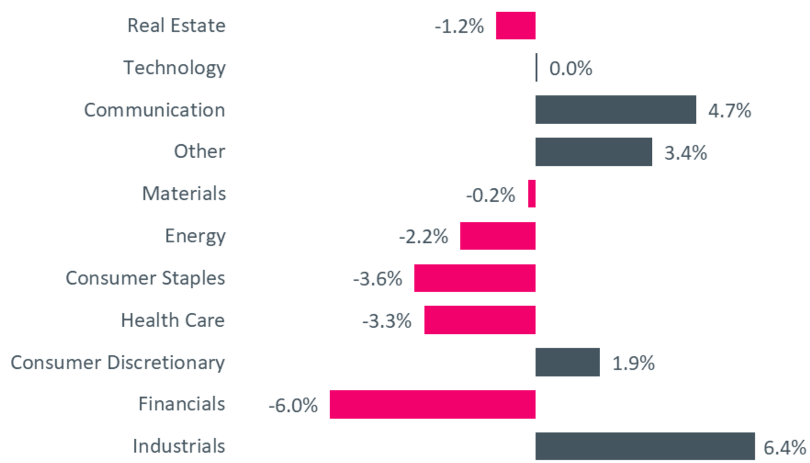
Performance summary*



Sector allocation



Allocation relative to benchmark



Source: Data and fund performance provided by Link Group and is gross of fees.
**12m performance represents the SI figure provided by manager. SI date is 23/02/2023*

Newton Global Equity

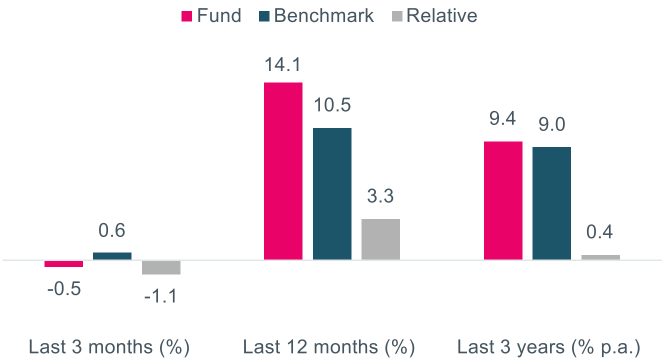
The Newton Global Equity Fund trailed its MSCI ACWI benchmark over Q3 2023, returning -0.5% in absolute terms. Despite this recent underperformance, the fund outperformed its 12-month and 3-year benchmarks by 3.3% and 0.4% respectively p.a.

Over the summer of 2023 the global equity market produced relatively muted results. Despite the UK not choosing to increase interest rates at the September BoE meeting, the US maintained its pace of interest rate hikes, continuing to build the investor expectations of higher rates persisting for longer.

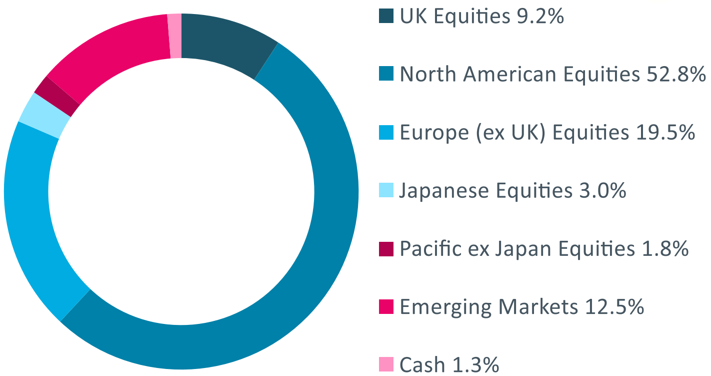
Underperformance was mainly driven by stock selection in financials and health care. The fund's underweight position in energy was also particularly detrimental in a quarter which saw a significant oil price increase. The technology sector was affected by the rising long-term yields, with growth stocks seen as having potential to deliver return in the distant future. Thus, the fund's overweight position in IT stocks also contributed to the negative absolute performance.

Strong stock selection in communication services and industrials reduced the extent of the underperformance over the quarter.

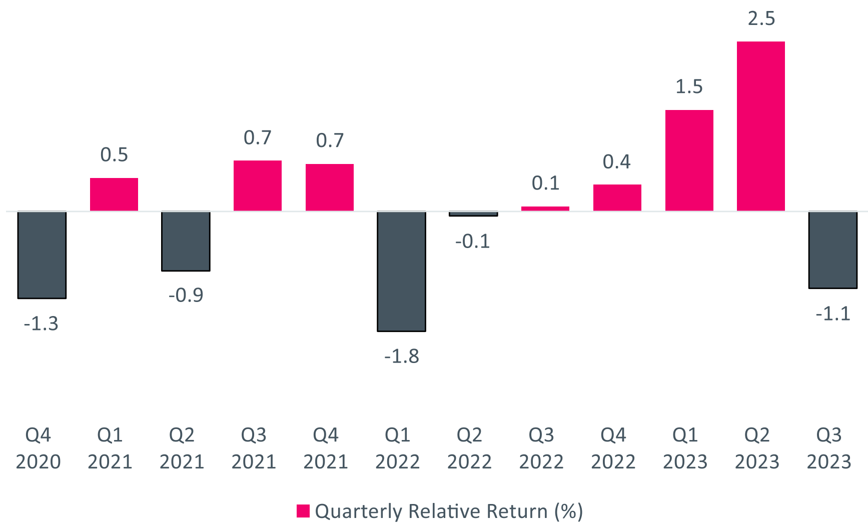
Performance summary



Asset allocation



Quarterly relative performance



Source: Data and fund performance provided by Newton and Link Group and is gross of fees.

UBS Climate Aware World Equity Fund

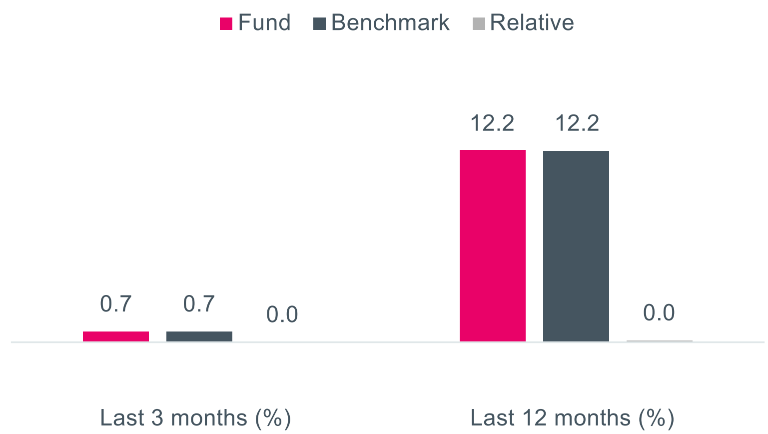
Following the equity review in November 2020, the Committee agreed to introduce a passively managed global mandate to provide a more balanced equity investment approach. In December 2021, the allocation of £145m was invested in the UBS Global Climate Aware mandate.

The aim of the mandate is to perform broadly in line with the FTSE AW Developed Index, delivering similar performance to standard global equity indices but with less carbon intensive investments.

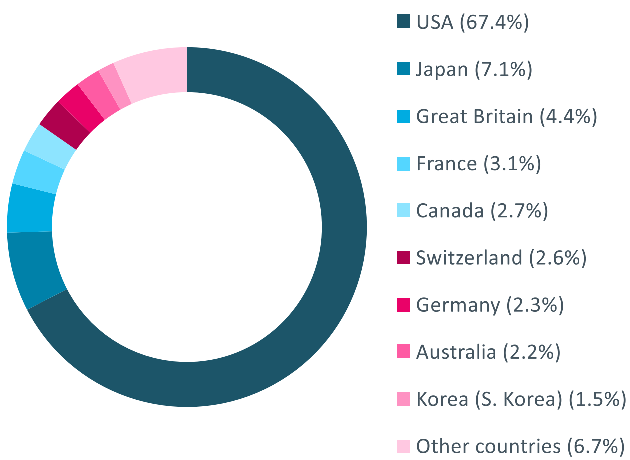
The positive return over the 3 months to September 2023 can be attributed to the relatively mixed signals received by investors. While unemployment in the US increased slightly, inflation came out higher than expected (headline 0.6% higher, core 0.3% higher, on a month-to-month basis). The mandate's exposure to Japanese equities detracted from performance, with inflation coming in above expectations.

The fund is performing broadly in line with the FTSE AW Developed Index over both the shorter and the longer term, some tracking error of +/- 0.5% is expected from this mandate.

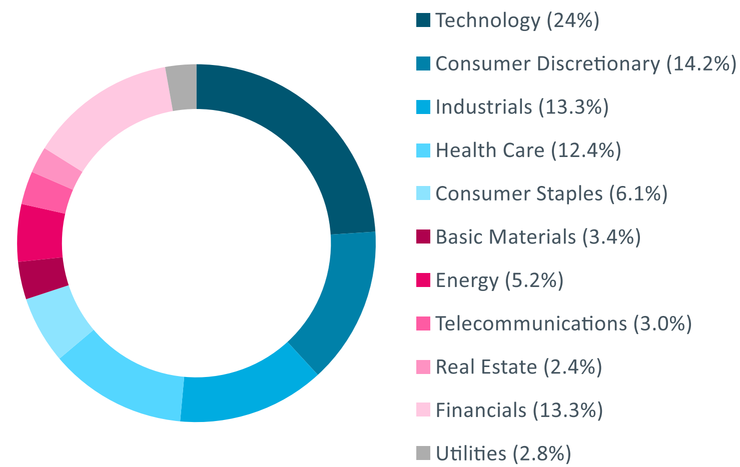
Performance summary



Geographical allocation



Sector allocation*



Source: Data and fund performance data provided by UBS and is gross of fees.
**Due to rounding the allocation total sums to over 100%*

Baillie Gifford Diversified Growth

Over Q3 2023, the Diversified Growth Fund returned -2.0%, underperforming its benchmark, by 4.1%. The fund also fell short of its longer-term benchmarks, with the 12-month relative performance remaining the greatest laggard against its benchmark by 7.4%.

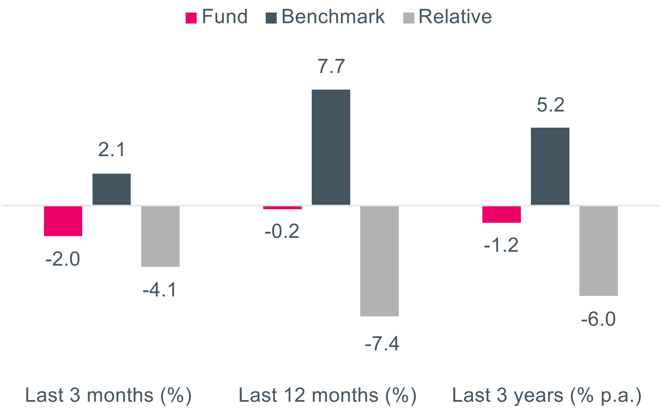
The quarter to September 2023 was characterised by markets continuing to adapt to increased rates and heightened inflation. This led to varied performance figures across the different asset classes held in the DGF.

The biggest detractor to performance was the fund's exposure to infrastructure, both through equity and debt instruments (9.6% allocation). The manager attributed this to an unexpected lack of diversification of risk between its listed holdings and its infrastructure exposure. Furthermore, as expected given the rising long-term yields over the quarter, holdings in Government Bonds (14.7% allocation), Emerging Market Bonds (18.4% allocation) and High Yield Credit (7.2% allocation) also detracted performance.

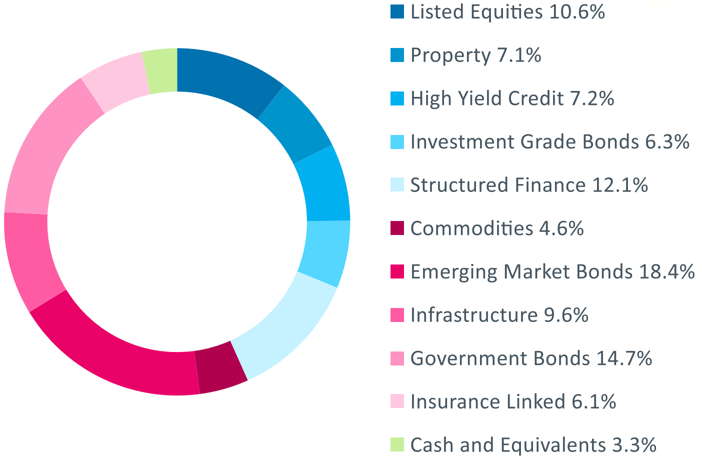
Structured finance and Insurance-linked securities (total allocation of c18.2%) were the top contributors to Q3 performance.

In terms of positioning, Baillie Gifford see opportunities in the assets affected by yield increases and are actively adding these to its portfolio.

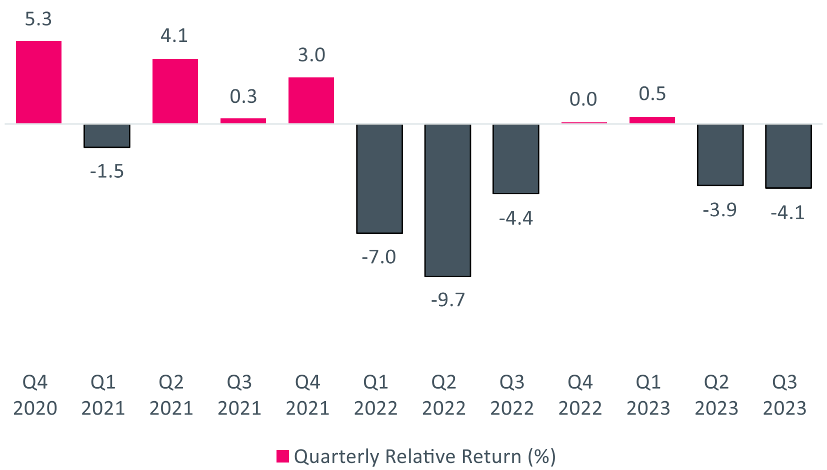
Performance summary



Asset allocation*



Quarterly relative performance



Source: Data and fund performance provided by Baillie Gifford and Link Group and is gross of fees.
**Due to rounding the allocation total sums to over 100%*

Schroders Property

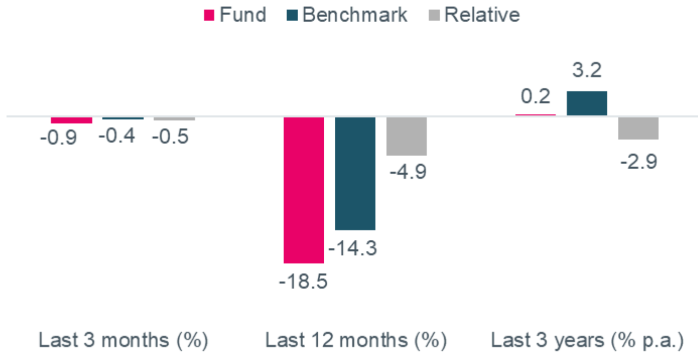
The Schroders UK Real Estate mandate returned –0.9% over Q3 2023, 0.5% below the benchmark return.

Weighed down by recent performance, the fund has delivered negative absolute and relative returns over all longer periods considered.

SCREF's performance during the quarter was driven mainly by continued capital value declines, primarily in the office and retail sectors. The fund is currently overweight to offices (c17%), especially outside of central London. Record-high vacancy rates in the offices are one of the reasons why the sector saw the highest falls in valuations over Q3, contributing to the fund's underperformance.

On the other hand, the fund's income return remains above the benchmark at 1.1% p.a. which aids absolute and relative performance.

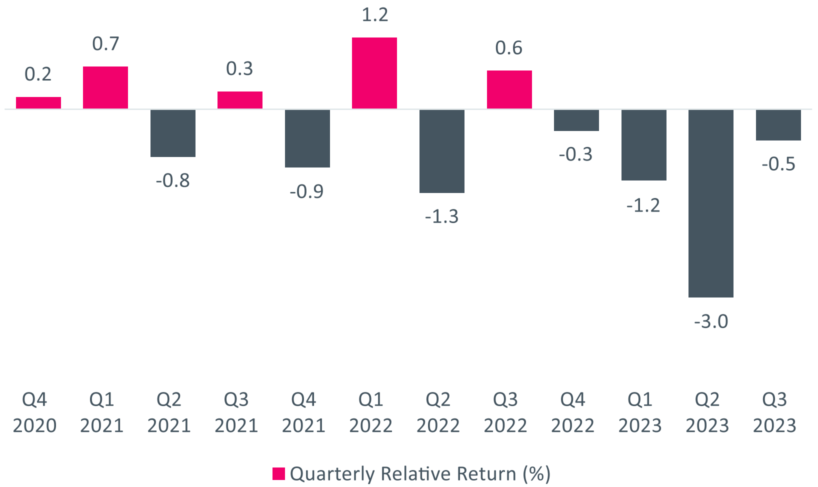
Performance summary



Key statistics

Fund size (gross)	£1,888.12m
Number of holdings	50
Number of tenants	664
Debt (% of NAV)	2.7%
Top 10 holdings as % of portfolio	46%

Quarterly relative performance



Source: Data and fund performance provided by Schroders and is gross of fees.

Schroders Fixed Income

The Schroders Fixed Income fund returned 0.9% over Q3 2023, outperforming its benchmark of 0.7%.

The fund also delivered a positive return over the past 12 months, only falling marginally short of its benchmark by 0.4%.

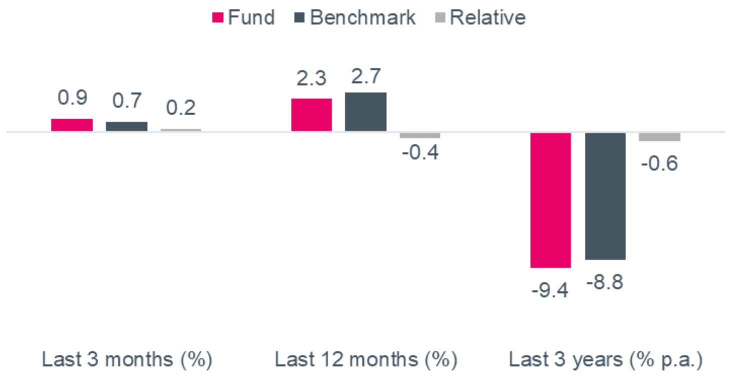
Performance over the 3-year period was also negative however more divergent from its target benchmark return due to the dramatic upward shift in yields which negatively impacted the fund in the first three quarters of 2022.

The fund's positive return over the quarter was aided by the US yield curve steepening over. The manager anticipated this move in yields given the growing confidence in the US avoiding a recessionary scenario and underweighted US holdings in favour of a German bund overweight position.

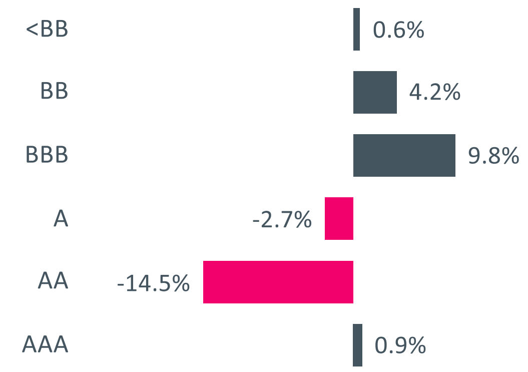
The fund also benefitted from asset allocation decisions in corporate bonds. An overweight allocation to GBP-denominated corporates benefited from credit spreads tightening over the quarter.

The transition of this fund onto the ACCESS pool is currently ongoing, with a similar mandate managed by Royal London expected to be in place soon.

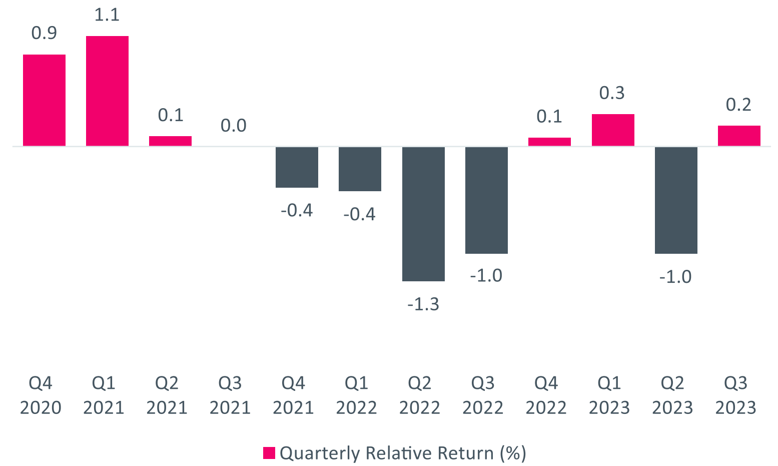
Performance summary



Relative credit allocation



Quarterly relative performance



Source: Data and fund performance provided by Schroders and is gross of fees.

GSAM Broad Street Loan Partners IV Fund

In July 2020, a new 5% allocation to private debt was agreed by the Committee which will be drawn down over time.

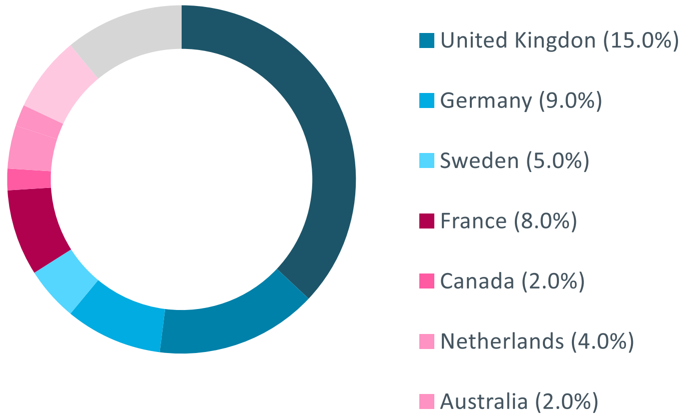
The table to the right reflects the key statistics since inception based on the estimated end of June figures from GSAM.

The estimated capital balance by GSAM as at 30 September 2023 was c.£27.8m and capital contributions were c.£30.6m (out of which £4.3m were distributed back).

First Lien term loans continue to hold the majority weighting, in line with the Fund's target investment profile.

*Net income allows for impact of currency movements. Over Q3 2023 the dollar appreciated against the pound, positively impacting returns

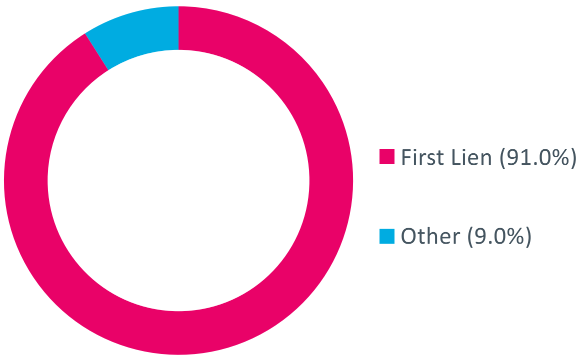
Geography split



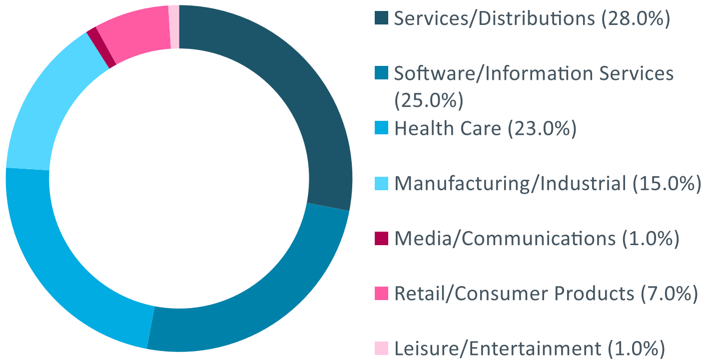
Key statistics since inception (£m)

Commitment	30.0
Capital contributed	30.6
Distributions	4.3
Estimated Capital balance	27.8
Estimated Net Income/Loss*	1.6

Security/Loan type



Industry split



Source: Fund data provided by GSAM and is gross of fees.

Partners Direct Infrastructure

In July 2020, a new 5% allocation to infrastructure was agreed by the Committee which will be drawn down over time. The first allocation to Partners Direct Infrastructure Fund was drawn on 10 July 2021.

The estimated net asset value for the fund as at 30 September 2023 was c.£18.2m (vs. c.£16.4m as at 30 June 2023). The latest valuation available (as at 31 August 2023) was adjusted for the latest capital call due on the 25 September 2023.

A capital call was issued in September, bringing the net contributions to the fund up to £16.7m (vs £14.9m in June 2023)

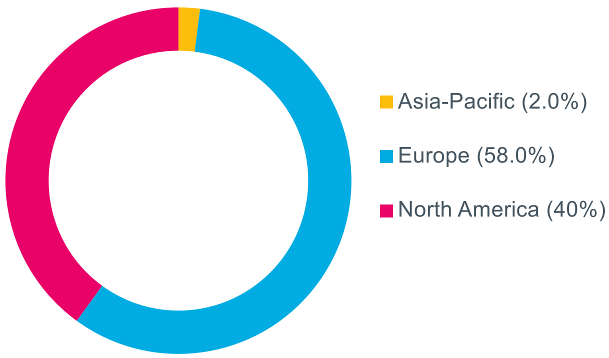
It should be noted that given this is a EUR fund, FX movements will impact the returns. During Q3 2023 the UK Sterling only mildly appreciated against the EUR and thus did not affect the reported NAV meaningfully.

Reporting for the fund will evolve over time as the fund establishes.

Key statistics (£m; 31st August 2023 statistics adjusted to 30th September 2023)

Commitment	35.1
Capital contributions	16.7
Distributions	0.4
Net contributions	16.3
Net asset value	18.2
Net multiple (as at 31st August)	1.14x

Regional allocation (as at 31st August 2023)



Source: Fund data provided by Partners.

This page sets out the benchmark, performance targets, and fees of each mandate.

It also provides descriptions of our ratings and the rationale behind our Hymans research and Responsible Investment ratings.

Benchmarks, Targets & Fees

Mandate	Date Appointed	Benchmark Description	Performance Target (% p.a.)
Newton Global Equity Fund	25/08/2009	MSCI AC World	+2% p.a. over rolling 5 years
BlackRock UK Select Fund	23/02/2023	FTSE All Share	+2% p.a. over rolling 5 years
Schroders Fixed Income Fund	31/08/2009	50% iBoxx Gilts and 50% iBoxx Non-Gilts Indices	Outperform benchmark by 1% p.a. (net of fees) over a market cycle before fees
Schroders Property Fund	31/08/2009	AREF/MSCI UK Quarterly Property Fund Index All Balanced Funds Median	Outperform benchmark by 0.5% p.a. (net of fees) over 3 year rolling period
Baillie Gifford Diversified Growth Fund	30/10/2013	UK Base Rate +3.5% p.a.	UK Base Rate +3.5% p.a. (net of fees) over 5 year rolling period
GSAM Broad Street Loan Partners IV Fund	25/01/2021	-	8% gross IRR
Partners Infrastructure	10/07/2021	-	8-12% p.a. net of fees
UBS Climate Aware World Equity Fund	08/12/2021	FTSE AW Developed Index	-

Source: Investment Managers

Hymans Ratings

Preferred	Our highest rated managers in each asset class. These should be the strategies we are willing to put forward for new searches.
Positive	We believe there is a strong chance that the strategy will achieve its objectives, but there is some element that holds us back from providing the product with the highest rating.
Suitable	We believe the strategy is suitable for pension scheme investors. We have done sufficient due diligence to assess its compliance with the requirements of pension scheme investors but do not have a strong view on the investment capability. The strategy would not be put forward for new searches based on investment merits alone.
Negative	The strategy is not suitable for continued or future investment and alternatives should be explored.
Not Rated	Insufficient knowledge or due diligence to be able to form an opinion.

Responsible Investment

Strong	Strong evidence of good RI practices across all criteria and practices are consistently applied.
Good	Reasonable evidence of good RI practices across all criteria and practices are consistently applied.
Adequate	Some evidence of good RI practices but practices may not be evident across all criteria or applied inconsistently.
Weak	Little to no evidence of good RI practices.
Not Rated	Insufficient knowledge to be able to form an opinion on.

Risk Warning

Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investment in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.

Hymans Robertson LLP and our group companies have a wide range of clients some of which are fund managers, who may be parties in our recommendations to you in various circumstances including but not limited to manager selection, moving money to or from a manager or supporting retention of or disinvestment from a manager. We have a research team that advises on shortlisting fund managers in manager selection exercises and forming views on managers, which is separate from our client and other relationships with fund managers and therefore we do not believe there will be a conflict that would influence the advice given.

Geometric v Arithmetic Performance

Hymans Robertson are among the investment professionals who calculate relative performance geometrically as follows:

$$\frac{(1 + Fund\ Performance)}{(1 + Benchmark\ Performance)} - 1$$

Some industry practitioners use the simpler arithmetic method as follows:

$$Fund\ Performance - Benchmark\ Performance$$

The geometric return is a better measure of investment performance when compared to the arithmetic return, to account for potential volatility of returns.

The difference between the arithmetic mean return and the geometric mean return increases as the volatility increases.