

Benchmarking Investment Performance



YOU'VE ALREADY HIT THREE HOME RUNS FOR THE SEASON — SOUNDS LIKE A GREAT RECORD, RIGHT? WELL, THAT DEPENDS. ARE YOU PLAYING LITTLE LEAGUE BALL OR BATTING IN THE MAJOR LEAGUES? THE TRUTH IS, NUMBERS CAN TELL WHATEVER STORY YOU WANT THEM TO TELL IF THEY'RE NOT BEING MEASURED AGAINST APPROPRIATE COMPARATIVE BENCHMARKS.

By Michael J. Searcy

BENCHMARKS ARE STATISTICAL measures of, among other things, inputs, outputs and performance. They're one of the best indicators of how well your financial portfolio is performing against the market. However, many investors are often confused by the numbers. Some financial professionals are quick to promote their performance numbers against well-known indicators like the S&P 500 Index or the Dow Jones Industrial Average, especially when their numbers far outperform the standard. However, often you'll find these quoted benchmarks have little similarity to the allocation of your portfolio.

There are no legally enforceable benchmarks, or even a standard "fits all" measurement to compare to your portfolio, so finding the most appropriate benchmark may seem challenging. Other challenges come from inconsistent data collection and unusual activity or circumstances during a specific reporting period. The best way to find an appropriate benchmark is with the aid of a financial advisor who can help you compare your

portfolio to the appropriate indexes.

Using benchmarks really comes down to comparing apples to apples. For instance, if you're watching the news and comparing your portfolio to the S&P 500 Index, you need to understand that it is only an indicator of domestic equities. Depending on your risk posture and the composition of your portfolio, you may not be exposed to a high percentage of domestic equities. For example, if your portfolio consists of 60% equities and 40% fixed-income securities, it may be best to compare 60% to the S&P 500 index in combination with 40% to the Barclays Capital Aggregate Bond Index. This gets even more complicated if your portfolio is diversified into international equities, emerging markets, small company equities, real estate and/or commodities, as each has its own respective benchmark. In an ideal situation, you would want to compare each percentage allocation within each asset class to the same percentage allocation of its representative benchmark. By doing so, you would really have an idea of how your portfolio is doing compared to the

same segments of "the market" as represented by your portfolio design.

Tips to Defining Appropriate Benchmarks

- + Be consistent.

- + Measure your portfolio data over the same time period as the index data.

- + Apply the same percentage allocation to each asset class to coincide with your portfolio allocation.

The Point

If you desire to make comparisons, then benchmarks must be meaningful. Arbitrary comparisons might leave you feeling better or worse about how your portfolio is doing, but that "feeling" may be unfounded.

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