AdvisoryWorld

Key Terms used in the ICE Application

Modern Portfolio Theory
Overall investment strategy that seeks to construct an optimal portfolio by considering the relationship between risk and return, especially as measured by alpha, beta, and R-squared. This theory recommends that the risk of a particular stock should not be looked at on a standalone basis, but rather in relation to how that particular stock's price varies in relation to the variation in price of the market portfolio. The theory goes on to state that given an investor's preferred level of risk, a particular portfolio can be constructed that maximizes expected return for that level of risk.

Alpha
A coefficient measuring the risk-adjusted performance, considering the risk due to the specific security, rather than the overall market. A large alpha indicates that the stock or mutual fund has performed better than would be predicted given its beta (volatility).

BETA
A quantitative measure of the volatility of a given stock, mutual fund, or portfolio, relative to the overall index or portfolio. Specifically, the performance the stock, fund or portfolio has experienced in the last 5 years as the Index moved 1% up or down. A beta above 1 is more volatile than the Index, while a beta below 1 is less volatile.

Correlation
A relationship between two variables. A correlation of 1.0 indicates that the two variables move in direct parallel while a correlation of –1.0 indicates perfectly inverse performance relativity.

Efficient Portfolio
A portfolio that provides the greatest expected return for a given level of risk, or equivalently, the lowest risk for a given expected return. also called optimal portfolio.

R-squared
A measurement of how closely a portfolio's performance correlates with the performance of a benchmark index, such as the S&P 500, and thus a measurement of what portion of its performance can be explained by the performance of the overall market or index. Values for r-squared range from 0 to 1, where 0 indicates no correlation and 1 indicates perfect correlation.

Risk Adjusted Return
A measure of how much an investment returned in relation to the amount of risk it took on. Often used to compare a high-risk, potentially high-return investment with a low-risk, lower-return investment.

Style & R.P.M.
AdvisoryWorld measures the style of mutual funds with a 3-year performance based regression against 6 objective specific indices. The highest style percentage of a mutual fund is selected as the funds style although all weightings are offered in the Overview Report. A stock R.P.M. is calculated by regressing 3-year performance of all stocks versus Large, Mid and Small Cap Growth & Value indices. This process essentially gives insight as to how a stock performs regardless of its market cap or traditional weigthing (i.e. Altria Group acts like a Small Cap Growth stock even though it is traditionally thought of as Large Cap Growth).