

Testing Equality of Modified Sharpe Ratios

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Abstract

The modified Sharpe ratio is commonly used to evaluate the risk-adjusted performance of an investment with non-normal returns, such as hedge funds. In this note, a test for equality of modified Sharpe ratios of two investments is developed. A simulation study demonstrates the good size and power properties of the test. An application illustrates the complementarity between the Sharpe ratio and modified Sharpe ratio test for performance testing on hedge fund return data.

Keywords: Bootstrap test; Hedge fund; Modified Sharpe ratio; Non-normal returns; Performance measurement

JEL classification: C12; C15; C22; C52