

ONE-SIZE OR TAILOR-MADE PERFORMANCE RATIOS FOR RANKING HEDGE FUNDS?

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Abstract: Eling and Schuhmacher (2007) compared the Sharpe ratio with other performance measures and found virtually identical rank ordering using hedge fund data. They conclude that the choice of performance measure has no critical influence on fund evaluation and that the Sharpe ratio is generally adequate for analyzing hedge funds. Nevertheless, their analysis does not include the class of tailor-made performance ratios capable of being personalized to investment style as presented by Farinelli et al. (2009). Specifically, we deal with the Sortino-Satchell, Farinelli-Tibiletti, and Rachev ratios. Consider a large international hedge fund dataset, empirical experiments illustrate that if the ratios are tailored to a moderate investment style, they lead to rankings not too dissimilar to those found with the Sharpe ratio. But when the Rachev and Farinelli-Tibiletti ratios are used to describe aggressive investment styles rank correlations with the Sharpe ratio shrink drastically.

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