Omega as a Performance Measure

In a recent paper, Shadwick and Keating (2002b) presented a new measure of performance called Omega. According to the authors, Omega was developed to overcome the inadequacy of many traditional performance measures when applied to investments that do not have normal return distributions. Unlike other measures of performance, Omega was developed with the intent of taking the entire return distribution into account. In this paper we show that Omega is essentially the ratio of a call price to a put price. This result has several implications as far as this measure of performance is concerned. We also introduce a new measure Sharpe-Omega, which preserves all its features and is similar to the Sharpe Ratio and thus more intuitive.

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INTRODUCTION

Performance measurement has evolved considerably in the last forty years. Treynor (1965) was the first to propose a risk-adjusted measure of performance, which was followed by the works of Sharpe (1966) and Jensen (1968) on mutual fund performance. Early research on hedge fund performance has focused on the measures used by Sharpe (1966) and Jensen (1968) as well as multifactor models (Liang (1999), Agarwal and Naik (2000) and others). However, the dynamic nature of hedge fund strategies leads to returns that do not always table normality. To overcome this limitation, conditional evaluation measures that allow for