
FAMA'S INDEX

Description of the Measure:

The Fama's Net Selectivity Measure is an absolute measure of performance. It is given by the annualized return of the fund, deducted the yield of an investment without risk, minus the standardized expected market premium times the total risk of the portfolio under review.

Interpretation:

The Fama's Index gives the excess return obtained by the manager that cannot have been obtained investing in the market portfolio. It compares the extra return obtained by the portfolio manager with a specific risk and the extra return that could have been obtained with the same amount of systematic risk.

Use:

The magnitude of the Ferson-Schadt Measure depends on three variables: the return of the fund, the market return and the manager's stock picking ability.

Potential Misuse:

Accuracy and reliability of this measure is based on the quality of the market proxy.

Formula:

$$NS_{p,t} = [E_t(R_{p,t}) - R_f] - \left\{ \left[\frac{E_t(R_{m,t}) - R_f}{\hat{\sigma}_{R_m}} \right] \times \hat{\sigma}_{R_p} \right\},$$

where:

$E_t(R_{p,t})$ is the annualized mean return on the fund considered over period;

$E_t(R_{m,t})$ is the annualized mean return on the market portfolio considered over period;

R_f is a proxy for the riskless rate;

$\hat{\sigma}_{R_p}$ is the standard deviation of the fund return over period;

$\hat{\sigma}_{R_m}$ is the standard deviation of the market portfolio return over period.

Two year data of weekly series is considered.

References:

- ✧ Fama E., (1972), “ Components of Investment Performance ”, *Journal of Finance* 27 (3), June 1972, 551-567.