Absolute versus Relative Returns

Why the Difference Matters to You

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When assessing the performance of an investment manager, there are two basic frameworks: absolute performance and relative performance. At Burrard Investment Management within Odlum Brown Limited, our investment strategy is designed to deliver **absolute** returns that meet your needs and objectives.

Absolute performance measures the return generated versus a pre-established goal. An example for a balanced portfolio in today's interest rate environment might be 4% per year, net of fees. The 4% return figure may be the amount targeted to fund your retirement expenses and still pass on the bulk of your investments to your heirs. This return objective is measured irrespective of the performance of the general markets – it is not the performance of the markets that matters (good or bad), it is the performance of your portfolio.

Relative returns measure the performance of your portfolio against a pre-established benchmark, such as the S&P/TSX Composite Index. If the performance of the client's portfolio exceeds the performance of the benchmark, the returns are deemed to be satisfactory. This is the methodology used to measure the relative performance of mutual funds. We provide our clients with all the information needed for them to compare the performance of their accounts, net of fees, to the relevant indices. However, we do not build our portfolios to beat an index, we build them to meet your objectives. The difference is important to understand.

The performance of a mutual fund manager is typically measured against an index. For example, if the S&P/TSX Composite rises by 10% in a one-year period and a Canadian equity fund manager delivers a 12% return, they have beaten their benchmark, and both the investors and managers are happy. If the S&P/TSX Composite declines by 10%, and the mutual fund manager delivers a return of negative 8%, they have again beaten their index and their job remains secure. However, an 8% decline is not a good outcome for the client.

Keeping fund performance close to the relevant index is critical to the survival of a fund manager. This is the reason why the vast majority of mutual fund managers build portfolios that closely resemble the index they are measured against. The mutual fund managers are simply responding to the demands of their employers and the realities of their difficult jobs.

Our approach to portfolio construction, which focuses on generating absolute returns, frees us from the market excesses that can manifest themselves in the indices. For example, during the strong energy and materials markets of 2011-2014, the weight of energy and materials companies in the S&P/TSX Composite trended above 35% and at times exceeded 40%. While we found attractive energy and materials-related investments, at no time did a 40% allocation to this cyclical part of the markets seem prudent to us. Our weights remained approximately half of the S&P/TSX Composite's energy and materials weights. During the technology boom of the late 1990s, we were similarly underweight technology companies. Such a deviation from the S&P/TSX Composite would be risky (and rare) for a Canadian equity fund whose performance is measured relative to this index.

Based on the weightings of the hypothetical, all-equity Odlum Brown Model Portfolio* today, which is the primary source of stock selection and sector weighting for the portfolios we build, one can conclude that if the price of gold rises to US$2,000 an ounce, and the price of oil to US$150 per barrel, our clients' portfolios will underperform the S&P/TSX Composite. However, if current pricing trends remain, the opposite is also likely true. Our clients understand this. Their portfolios are built to deliver on their objectives, not mirror the S&P/TSX Composite.

Odlum Brown's Research Department has always operated independently and been given the leeway to recommend the equities and sector weights that our analysts believe will generate the best risk-adjusted returns for our clients. If this strategy produces an annual return that is below the S&P/TSX Composite (as it did in 1999, 2007, 2009-2010 and 2016), we accept this because these years are more than trumped by the years of outperformance, including 2000-2004, 2008, 2011-2015 and 2017-2018. Please contact me to request a detailed summary of the Odlum Brown Model Portfolio's returns.

In summary, a focus on absolute returns best aligns the needs and objectives of our clients with the portfolios we build for them. It has the added benefit of allowing us to objectively construct portfolios based on the prospects for companies and industries as we see them, not just the businesses that happen to dominate the benchmark index.

For more information, please contact:

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* The Odlum Brown Model Portfolio was established by the Research Department in December 1994, with a hypothetical investment of $250,000. Trades are made using the closing price on the day a change is announced. These are gross figures before fees. Past performance is not indicative of future performance.

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