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Active Portfolio Management

By Richard C. Grinold and Ronald N. Kahn

Part I Foundations

Chapter 1 Introduction

I. A process for active investment management

The process includes researching ideas, forecasting exceptional returns, constructing and implementing portfolios, and observing and refining their performance.

II. Strategic overview

1. Separating the risk forecasting problem from the return forecasting problem.
2. **Investors care about active risk and active return (relative to a benchmark)**.
3. The relative perspective will focus us on the residual component of return: the return uncorrelated with the benchmark return.
4. The **information ratio is the ratio of the expected annual residual return to the annual volatility of the residual return.** The information ratio defines the opportunities available to the active manager. The larger the information ratio, the larger the possibility for active management.
5. Choosing investment opportunities depends on preferences. **The preference point toward high residual return and low residual risk**. We capture **this in a mean/variance style through residual return minus a (quadratic) penalty on residual risk (a linear penalty on residual variance).** We interpret this as "risk-adjusted expected return" or "**value added**."
6. **The highest value added achievable is proportional to the squared information ratio**. **The information ratio measures the active management opportunities, and the squared information ratio indicates our ability to add value**.
7. According to the fundamental law of active management, there are two sources of information ratio:

   IR = IC * $\sqrt{BR}$

- **Information coefficient**: a measure of our level of skill, our ability to forecast each asset's residual return. *It is the correlation between the forecasts and the eventual returns.*
- **Breadth**: the number of times per year that we can use our skill.

8. **Return, risk, benchmarks, preferences, and information ratios constitute the foundations of active portfolio management**. But the practice of active management requires something more: expected return forecasts different from the consensus.
9. **Active management is forecasting**. Forecasting takes raw signals of asset returns and turns them into refined forecasts. This is a first step in active management implementation. The basic insight is the rule of thumb

   ALPHA = VOLATILITY*IC*SCORE

   that allows us to relate a standardized (zero mean and unit standard deviation)

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Active Portfolio Management, Second Edition, now sets the bar even higher Like its predecessor, this volume details how to apply economics, econometrics, and operations research to solving practical investment problems, and uncovering superior profit opportunities.. There is a substantial expansion in both depth and breadth on the original It clearly and concisely explains all aspects of the foundations and the latest thinking in active portfolio management.. Both fundamental and quantitative investment managers will benefit from studying this updated edition by Grinold and Kahn.

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The result is an updated, comprehensive set of strategic concepts and rules of thumb for guiding the process of-and increasing the profits from-active investment management.. '-Scott Stewart, Portfolio Manager, Fidelity Select Equity ® Discipline Co-Manager, Fidelity Freedom ® Funds.. Fundamental law of active management of Grinold and Kahn has been recovered, but with fewer assumptions, allowing for. Adobe Indesign Cs6 Crack Dll Files 32bit 64bit

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