Performance Calculations

Personalized Rates of Return On-Demand

One of the best ways advisors can differentiate their practice is by demonstrating their value to investors by providing them with a personalized rate of return.

Albridge Wealth Reporting dynamically calculates and generates performance results on demand, giving advisors immediate online access to detailed performance results, as well as the ability to provide clients with their personalized rate of return. With the click of a mouse button advisors can access the critical performance information they need to present clients with more informed financial recommendations and better communicate to clients how well they are progressing towards their financial goals.

Through the Albridge platform, advisors have the flexibility to select from multiple rates of return calculations to measure and report on performance at the individual holding, asset class, account, investor and consolidated portfolio levels, allowing them to perform more comprehensive financial analysis for their clients and provide a higher level of client service.

Financial institutions and their advisors have the ability to select from dollar-weighted rates of return, including Modified Dietz and Internal Rate of Return (IRR) and time-weighted rates of return, including Daily Time-Weighted Return (DTWR). It is important for investors to understand and take both time-weighted and dollar-weighted rates of return into consideration when evaluating both their advisor’s and their portfolio’s performance. Only by using both methodologies can investors get the complete picture of their financial situation and their investment success.

Time-Weighted Rates of Return

Time-weighted rates of return, such as DTWR, take into account the amount of time an investor has been invested in a particular portfolio and eliminate the effect of individual cash flows on portfolio performance. They attempt to answer the investor question, “What would my return have been if I did not make any contributions or withdrawals?” and are useful when comparing one money manager with another.

Since time-weighted rates of return do not weight performance based on the amount of money invested, the performance calculated can be far different from what the investor actually realizes. Rates of return calculated using time-weighted methodologies would give exactly the same weight to a three-year-time-period when an investor had $1,000 invested as it would to the same time period when an investor had $100,000 invested. Because of this, time-weighted rates of return can show an investor having a positive return when their portfolio actually lost money. For this reason, DTWR is generally recommended only for measuring manager performance in a managed account.

KEY BENEFITS

- Calculate and generate performance results dynamically on demand
- Provide clients with their personalized rate of return
- Multiple rates of return calculations to select from, including:
  - Modified Dietz
  - Internal Rate of Return
  - DTWR
- Measure and report on performance at the individual holding, asset class, account, investor and consolidated portfolio levels
- Differentiate your advisory practice by illustrating your financial planning capabilities with personalized rates of return for your clients

Performance Calculations
Dollar-Weighted Rates of Return

Dollar-weighted rates of return, sometimes called money weighted rates of return, such as Modified Dietz and Internal Rate of Return (IRR), are used to measure a portfolio’s actual performance realized by the investor. Unlike time-weighted rates of return, dollar-weighted rates of return account for all cash flows (deposits and withdrawals) moving in and out of an investor’s portfolio. Personal rates of return calculated using dollar-weighted methodologies are useful in evaluating a client’s overall rate of return in relation to their investment objectives and answer the investor question, “How did my money perform overall?”

The timing of an investor’s contributions or withdrawals can impact their portfolio’s performance. In contrast to time-weighted rates of return, in dollar-weighted rates of return the larger the value of the cash flow, the more it will contribute to the total return. Therefore, dollar-weighted rates of return weight a three year time period when an investor had $1,000 invested much less than the same time period when an investor had $100,000 invested. For this reason, rates of return calculated using dollar-weighted methodologies are less likely to show a positive rate of return when a portfolio has lost money than rates of return calculated using time-weighted methodologies.

What is the Best Choice of Calculation Method?

When deciding the best calculation method to use, you must first determine for what the performance measurement will be used. If the purpose is to show the investor how well their money has worked for them, a dollar-weighted rate of return, namely IRR, is the most useful rate of return for an investor to see, whether or not the account is managed. If the investor wants to compare managers, or if the manager does not control the timing or value of the cash flows and wants to compare managers, a time-weighted rate of return is more useful. For investors that are not in managed accounts, or are only concerned about their actual portfolio return, IRR is usually the best choice.

It’s All in the Numbers

The chart on the following page compares two hypothetical portfolios and their rates of return over the same three year period using the hypothetical market returns listed. Both investors have cash flows totaling $100,000 over three years. In both cases the time-weighted rate of return, or the actual market return on the investment, is the same: 7.2%. But the difference in portfolio growth is significant due to the impact cash flows have on the portfolio’s performance.
Investor 2 loses money because he invests more during a year when market returns are sharply negative. This is indicated in the dollar-weighted rate of return, which takes into account the portfolio’s cash flows. Only by taking both time-weighted and dollar-weighted rates of return into consideration can advisors and investors fully monitor portfolio performance and investment schedules to develop a financial plan that will achieve the highest expected return at the investor’s expected level of risk.

For More Information

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