



Mutual Fund Directors Forum

# Fund Boards' Oversight of Investment Performance

Indices, Benchmarks and Advised Trustee Inquiries

*Keil Fiduciary Strategies LLC*

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# Measuring Investment Results



Market  
Indices

Fund  
Indices/  
Benchmarks

[*Board  
Materials*]

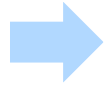
Custom  
Indices

Volatility/  
Risk

*Trustees may 'require' a sampling of many data points to achieve comfort with an assessment of performance*

# Performance Data in Board Materials

## Market Indices



- Core comparison to subject fund
- Required disclosure for investors
- Should be “best-fit” to subject fund

## Fund Indices, Benchmarks



- Lipper fund indices – largest funds
- Refinitiv Lipper fund category averages

## [*Board Materials, Data*]



- Comprehensive, accurate, verifiable
- Executive Summaries, as warranted
- Appropriate data points to ‘explain’ returns
- Independent party materials beneficial

## Custom Indices



- Warranted when market indices do not include the fund’s “investable universe of securities”
- Should supplement any widely-recognized market indices

## Volatility/ Risk



- Measures of volatility useful for risk context
- Volatility measures are numerous – none are perfect and useful in every situation (see *KFS definitional grid*)
- Trustees - understand measures’ limitations

# Fundamental Board Inquiries

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*CORE requirements or issues which should be considered or raised during investment performance review:*

- Is the performance source reputable and trusted across the industry?
- Are the data timely and as current as feasible?
- Investment objective categories used for comparison appropriate?
- Are shorter and longer-term periods represented?
- Advisor's new fund benchmark determination process? Performance expectations? Correlations to benchmarks? Tracking error?
- Would detailed performance attribution data be useful for certain funds?
- Investment approach consistent with stated strategies in prospectus?
- What differences exist, if any, between a fund's strategies and peers in the chosen category?
- Do a fund's performance results tend to match what one would consider "investor expectations?"

*[Questions are examples – list not exhaustive]*

# Board Inquiries – Market Indices

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*Questions or issues regarding widely-accepted security market indexes which should be understood, raised or examined during investment performance review:*

- What is the fund advisor's rationale behind use of an index?
- Is the chosen market index a good yardstick for a fund's relative returns?
- Would a blended index potentially be more appropriate?
- How does the construction of an index differ from the ways in which a target fund's portfolio is assembled?
- Are there other applicable market indices that may be embraced or supplement the current index?
- Under what market or economic conditions would a fund be expected to closely mimic the index? When would it deviate materially?
- Are there any components of the index which are, by design, not considered for a target fund's portfolio? Why?
- Is it feasible that no market index is truly an appropriate benchmark??!!

# Board Inquiries – Fund Indices, Benchmarks

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*Questions or issues regarding fund-based indices and benchmarks which should be understood:*

- How are the various fund-based indices assembled?
- What are the upsides or downsides to using a Morningstar vs. a Refinitiv Lipper index?
- Why has an advisor chosen one index over another?
- For funds for which there is no computed, recognized fund-based index (in the appropriate category) what is the advisor's solution for peer-based benchmarks? Why?
- Is an investment objective category index a good yardstick for your fund?
- Beyond indices, what other fund benchmarks may be appropriate, e.g., a hand-selected sub-set of the category, a blended index etc.?
- Does the applicability of an index hold up under all market conditions?
- If an advisor changes a fund's benchmark(s), what is the rationale?

# Board Inquiries – *Custom* Indices, Benchmarks

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*Questions or issues regarding custom fund-based benchmarks or blended indices which should be understood:*

- Generally speaking, why is the advisor proposing a fully custom benchmark or blended index beyond the use of a widely accepted securities market index?
- What are the exact limitations of the widely-available securities market indices and why are they not appropriate?
- On what basis was the custom bogey assembled?
- Does the advisor intend to very closely mimic the custom benchmark?
- Is it feasible the custom benchmark will become obsolete over time? How?
- Under what circumstances might a fund deviate from a custom bogey?
- Does the advisor anticipate changes to the custom benchmark over time? Why the moving target?

# Board Inquiries – Volatility, Risk Measures

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*Questions or issues regarding fund volatility, i.e. risk measures and benchmarks, regarding which Trustees should have background:*

- A fund's return volatility provides context on the amount of risk assumed vs. the performance which was achieved or realized – return data without a sense of volatility may be seen as myopic
- Does a fund's actual return and volatility patterns during certain market periods match what investors would expect given the disclosure documents filed? Why or why not?
- Why has the advisor provided the Trustees a certain measure of return volatility and why is it appropriate vs. the other alternatives?
- Do the Trustees understand the computational rigors of the risk-adjusted returns or volatility measures reported? [They need to!]
- How does a fund's volatility compare to its fund universe brethren? By design or unexpected investments and possible "stretching?"



# Board Review of Performance in Context

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*Added color and 'truisms' Trustees should bring to bear on their review of funds' returns quarterly or during the 15(c) process:*

- In general, no funds consistently top the fund rankings – managers can have very stellar periods followed by significantly lagging periods
- Funds' returns – over the long-term – “regress to the mean” many times
- Fund benchmarks, i.e. peer returns, are given more weight by Trustees (when assessing relative results) than are securities market indices
- Understanding how a fund is likely to perform during certain market conditions and in relation to peers is key
- Limitations of reported benchmarks and volatility measures?
- Funds which realize material multi-year lags vs. return benchmarks warrant Board attention and an action plan submitted to the Trustees by the advisor
- An outperforming, acutely outlying fund: what risks were incurred?
- Attribution can be a core tool in understanding the “whys” of returns

# Conclusion

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Questions, comments and discussion