The Ben Graham Centre's 2015 Value Investing Conference

How to keep your wits when your suspicion is the world has lost theirs: A look inside Graham's tool box

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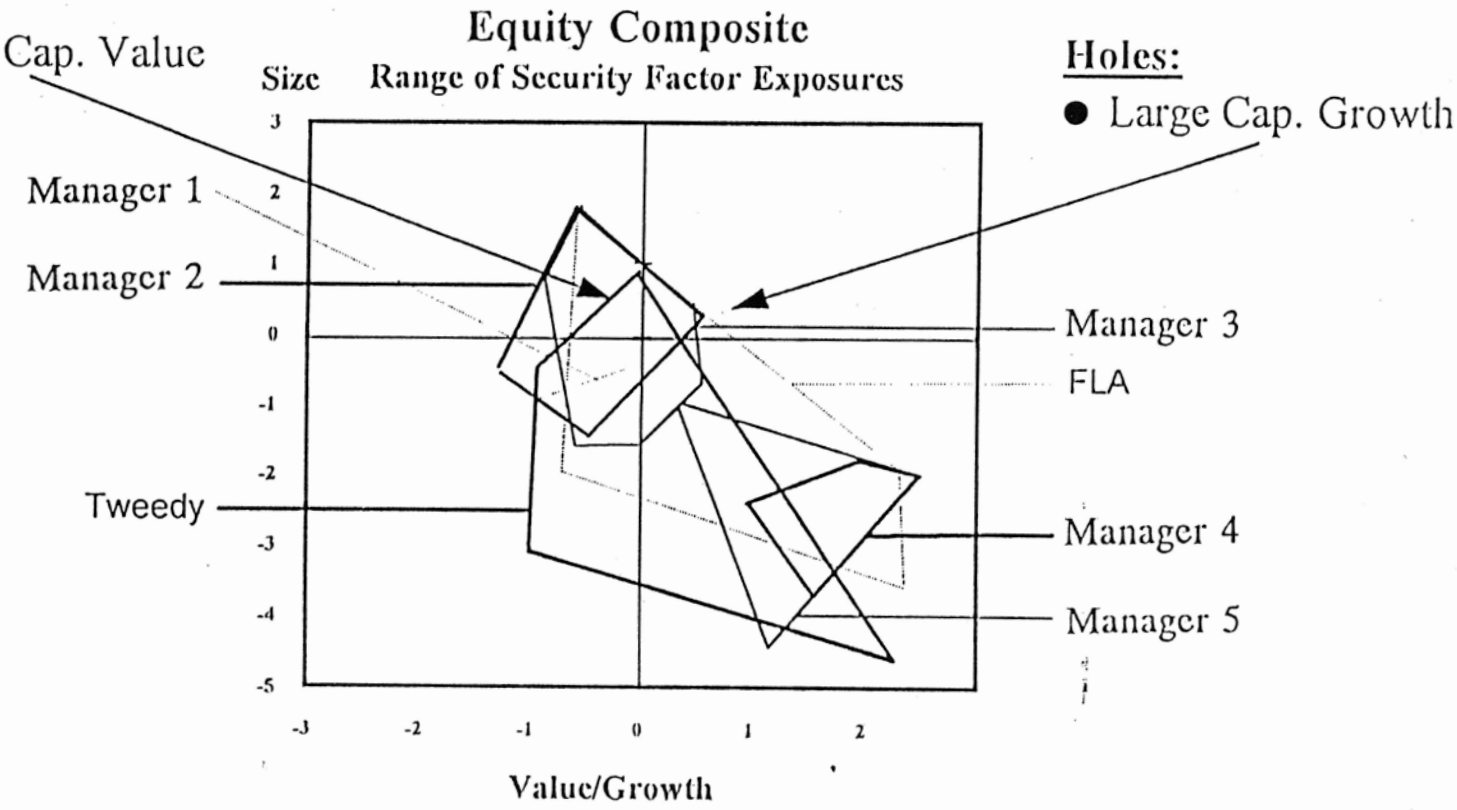
Identify the Portfolio's Risks.

Cluster:

- Large Cap. Value

Holes:

- Large Cap. Growth



Note: Analysis based on BARRA "Size" and "Growth" factors relative to the S&P 500.

Then, the excess return is the difference between the portfolio return and the common (or market) return:

$$\begin{aligned} R_{excess} &= R_{equal\_wt\_port\_of\_n\_stocks} - R_{common} \\ &= R_{common} + \frac{1}{n}\sum_{i=1}^{n} R_i - R_{common} \\ &= \frac{1}{n}\sum_{i=1}^{n} R_i . \end{aligned}$$

The volatility of the excess return is

$$\begin{aligned} \sigma^2_{excess} &= vol\left(\frac{1}{n}\sum_{i=1}^{n} R_i\right) \\ &= \left(\frac{1}{n}\right)^2 \sum_{i=1}^{n} vol(R_i) \\ &= \left(\frac{1}{n}\right)^2 \sum_{i=1}^{n} \sigma^2_{stock\_specific} \\ &= \left(\frac{1}{n}\right)^2 n\sigma^2_{stock\_specific} \\ &= \frac{\sigma^2_{stock\_specific}}{n}. \end{aligned}$$

Then, the tracking error (TE) is the square-root of this volatility of the excess return:

$$\begin{aligned} TE &= \sqrt{\sigma^2_{excess}} \\ &= \sqrt{\frac{\sigma^2_{stock\_specific}}{n}} \\ &= \frac{\sigma_{stock\_specific}}{\sqrt{n}}. \end{aligned}$$


JUST A NORMAL DAY AT THE NATION'S MOST IMPORTANT FINANCIAL INSTITUTION...
I'VE GOT A STOCK HERE THAT COULD REALLY EXCEL
REALLY EXCEL?
EXCEL?
SELL?
SELL?
SELL
SE
SELL!
SELL!
ELL!
SELL!
SELL!
SELL!
THIS IS MADNESS! I CAN'T TAKE ANYMORE
GOOD BYE!
GOOD BYE?
BYE?
Buy?
Buy!
Buy!
Buy!!!
Buy!
Buy!
Buy!
I'VE GOT A STOCK HERE..