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TREATING OFF-
BENCHMARK HOLDINGS
IN A BRINSON FRAME-
WORK

FLAMETREE TECHNOLOGIES PTY LTD

Introduction

A common issue in performance attribution analysis is the treatment of securities that are present in the portfolio but not in the benchmark. Should the return contribution of such securities be assigned to stock selection or to asset allocation? The arguments run along the following lines:

- The use of this off-benchmark stock implies that the investor wanted to invest from a sector that was not present in the benchmark. Therefore, this was an asset allocation decision.
- The investor chose this particular stock over all others. Therefore, this was a stock selection decision.

A sophisticated attribution system will allow the return of off-benchmark stocks to be assigned to either category.

Treatment in FIA

The *OffBenchmark* switch is provided in FIA version 2.4 and above to handle these cases. The switch has three settings (not case sensitive):

- None
- AA
- SS

Assigning any other value will generate an error.

The *OffBenchmark* switch need not be included or set, in which case its value is 'None' by default.

The *OffBenchmark* switch only applies to securities that have zero holding in the benchmark but non-zero holding in the portfolio.

Calculating the effects of off-benchmark holdings depends on the fact that asset allocation returns and stock selection returns are calculated at the security level, even though FIA only displays asset allocation return at an appropriate aggregated level.

If *OffBenchmark* is set to SS, any security-level return due to asset allocation is added to stock selection for that security, while stock selection return for that security is set to zero.

If *OffBenchmark* is set to AA, any security-level return due to stock selection is added to asset allocation for that security, while asset allocation return for that security is set to zero.

If *OffBenchmark* is set to None, no changes are made to asset allocation or stock selection returns.