CHAPTER 1

Investment Performance Measurement

Investment is an initial forfeit of something we value in exchange for the anticipated benefit of getting back more than we put in. The difference between what we put in and what we got back is the *return*; we invest in order to yield this return. For financial assets return includes both the gain we receive when we finally either sell them to someone else, or they mature, as well as the income earned between the purchase and sale. Return is compensation for giving up the use of the capital in the interim. For most investments at the outset we cannot be sure of the value of the income and gains we will receive. The spectrum of instruments we could invest in provides a varying degree of return uncertainty. We can predict the return we will earn on a one-month T-bill with complete accuracy where we couldn't hazard a guess as to the return of an investment in an emerging markets stock fund. Financial theory and experience suggest that the highest return given a particular level of risk taken is likely to be achieved via the diversification of our assets across multiple security holdings. So we usually invest via a portfolio of securities, or a set of portfolios each managed to a particular objective. The higher the degree of return uncertainty, or *risk*, in a given investment, the more return we demand.