

Information Ratio (IR)



Introduction:

When assessing mutual fund performance, investors often seek more than just simple return numbers. One powerful tool in performance evaluation is the Information Ratio (IR), which is a risk-adjusted return number. This metric indicates how effectively a fund manager delivers returns over and above the benchmark, while factoring in the consistency and risk of that performance.

The IR offers valuable insight into whether excess returns are driven by managerial skill or simply by market movements.

Let's explore what the Information Ratio is, how it's calculated, and how to interpret its significance across different investment scenarios.

What is the Information Ratio (IR)?

The Information Ratio measures a fund manager's ability to deliver superior risk-adjusted returns relative to a benchmark, considering the risk taken to achieve that performance. It helps investors determine whether the excess returns are a result of genuine skill or merely due to market fluctuations.

- ✓ A High IR indicates good and consistent risk-adjusted performance.
- ✓ A low or negative IR signals underperformance or high variability in returns.

The IR is especially useful when comparing funds with similar strategies, to identify which manager has delivered better risk-adjusted returns.

Formula for Calculating Information Ratio (IR)

Information Ratio (IR) = (Portfolio Return – Benchmark Return) / Standard Deviation of Excess Return where excess return means Portfolio return - Benchmark return.

Explanation of Terms:

- **Portfolio Return:** The annualized return generated by the fund or portfolio over a specific period.
- **Benchmark Return:** The annualized return of a relevant index (e.g., Nifty 50, BSE 30) over the same time frame.
- **Standard Deviation of Excess Return:** Measures how much a funds return deviate from its benchmark return overtime.

How is the Information Ratio Used?

01 Evaluating Active Fund Managers

Investors use the IR to assess whether a fund manager consistently adds value. A higher IR reflects skillful and reliable active management.

02 Comparing Funds with Similar Strategies

IR enables fair comparison among funds with similar objectives. It highlights which fund manager delivers better risk-adjusted returns for the same level of risk.

03 Assessing Long-Term Consistency

IR helps evaluate whether the fund manager can reliably outperform the benchmark across different market phases, not just in isolated periods.

04 Focusing on Risk-Adjusted Performance

The IR looks beyond absolute returns and considers the risk taken to achieve those returns, offering a more meaningful view of performance.

Key Takeaways

- ✓ A high IR suggests strong, consistent, risk-adjusted performance.
- ✓ Use IR to compare funds within the same category or strategy.
- ✓ Always assess IR in conjunction with other metrics like the Sharpe Ratio, Sortino Ratio, and Alpha for a well-rounded view.
- ✓ IR helps investors select fund managers who deliver returns efficiently—not just aggressively.

To know more about Information Ratio please visit:
www.amfiindia.com/otherdata/fund-performance/information-ratio

**MUTUAL FUND INVESTMENTS ARE SUBJECT TO MARKET RISKS,
READ ALL SCHEME RELATED DOCUMENTS CAREFULLY.**

Mission: To be the wealth creator for every Indian

Vision: To be the most respected asset manager in the world