Editorial – Benchmark Issues

There have been a number of recent utterances on the frailty of peer group benchmarks. I note a piece by Pamela Atherton in *Pensions Week* (2003), and of course the substantive criticism of such benchmarks in Myners (2001).

Myners (in Sections 5.53 to 5.63) points out that peer group benchmarks do not lead to investor behaviour that either matches the investors' liabilities or maximizes their 'utility'. Myners also mentions that peer grouping leads to median hugging; in effect, everybody gets the index, while having to pay active fees.

Given this barrage, can we see any worth in peer group benchmarks? Whilst most of the criticisms are valid, I think it is worth pointing out the contexts in which peer groups can be useful. The WM Company does point out that trustees and consultants like to know the ranking of their portfolio/fund within an appropriate universe. I concur with this view; ranking is a very basic instinct to which the popularity of polls and TV programmes of the '100 Greatest ...' category attest.

An issue not discussed is the fact that

if we move to customised benchmarks, we need indices for all asset classes. This is not a problem for equity where capitalisation provides a reasonable weighting, as long as it is free float adjusted, which is, by the way, a rather recent development in the UK.

When we move to over the counter/illiquid assets, this is where the problems arise. Bond and hedge fund indices are replete with construction problems, too long to list in this Editorial. However, a peer group hedge fund/bond benchmark is simply defined in terms of the value of the assets held by the peer group over the relevant period. There are complications here with the timeliness of data which bring about delays in the release of results, but conceptually this is a victory for peer groups.

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Editor

References

- Atherton, P. (2003) 'Cutting the Ties That Hold You Back', *Pensions Week*, 331, 25 August, pp. 18–19.
Myners, P. (2001) 'Institutional Investment in the UK: A Review', HM Treasury.