

Sharpe Ratio

The Sharpe ratio is calculated by dividing the mean excess return of the index by its volatility, annualized over the horizon under consideration. In some years, the risk-free rate used to compute excess returns can be negative. The higher the Sharpe ratio, the higher the excess returns for a unit of risk.

$$SR_T = \frac{E\bar{R}_T}{\sigma_T}$$

where:

$E\bar{R}_T$ denotes the annualised mean [Excess Returns](#) of the index.

σ_T denotes the annualised [Index Return Volatility](#) measure.

We compute sharpe ratios depending on the choice of currency to report returns, assuming that for the 'risk-free' asset for any given investor is the domestic 3-month risk-free asset. A Sharpe Ratio based on local currency returns and risk-free rates is also computed using local currency excess returns, as described [here](#).

We also compute an **Adjusted Sharpe ratio** to account for the skewness and excess kurtosis in the returns distribution

$$AdjSR_T = SR_T \times [1 + \frac{S}{6} \times SR_T - \frac{(K-3)}{24} \times SR_T^2]$$

where:

S is the skewness of the return distribution

K is the excess kurtosis of the return distribution