

Your Ulcer Index

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Did the markets make you nervous last October and November? Were your investments highly leveraged? When you watched the business news, did you get butterflies in your stomach?

Well, perhaps you should review your holdings from the "Ulcer Index" perspective.

What is the "Ulcer Index"? It is a measurement of how much damage markets can inflict on your investments during market corrections. Knowing the Ulcer Index of your investments can guide you towards a more tolerable risk level.

The Ulcer Index¹ is calculated by adding all the paper losses in a given investment on the day of market correction (or market crash, as the case might be), at the end of that week, two weeks after and four weeks after. It is then compared to its value shown in the previous month-end statement.

After four weeks, either you get used to your losses, or markets may edge up again, allowing you to go back to your daily routine. Usually, it is a combination of both.

A high Ulcer Index may mean several things:

Advisors tell investors, that investing is for the long-term. Some investors still panic and sell during a correction. Some fund managers may also be endowed with these same emotions. They may be selling into a crash, doing the opposite of what they tell their investors. This will decrease the net asset value of units, and keep them from recovering more quickly. Worse, it may create larger than usual capital gains distributions, creating much unhappiness among

some of its investors.

It may also mean that the fund manager did not use derivatives effectively. Some funds make use of derivatives, usually "put" options, to protect the investment portfolio from market corrections. If derivatives are used in an untimely manner, they may further erode fund's unit prices.

Of course, a fund may be more heavily invested in a particular market segment that was perhaps harder hit. This would also create a higher Ulcer Index.

On the other hand, some managers do the right things during a

corrections, perhaps you may want to include the funds that have a lower Ulcer Index in your portfolio. However, do not forget that past performance is not necessarily indicative of the future performance of any investment.

The Ulcer Index measures only the short-term (acute) pain of market corrections. On the other end, by using funds with the highest² OEM's, the long-term (chronic) pain of holding low-performing funds can be largely avoided.

Cemil Otar, P. Eng., author of "Commission Free Investing:

HOW IS ULCER INDEX CALCULATED:

On October 27, 1998 world markets experienced what a business newspaper called a "Market Meltdown". As an example, let's calculate the Ulcer Index for Sceptre Equity Growth fund:

Step 1: Determine the unit prices at preceding month end, at the end of the day of "Meltdown", at the end of the week, two and four weeks thereafter:

	Preceding Month End	Week of Meltdown	2 weeks after Meltdown	4 weeks after Meltdown
	<u>Sept 30</u>	<u>Oct 27</u>	<u>Oct 31</u>	<u>Nov 14</u>
NAV:	\$39.03	\$36.79	\$38.12	\$36.76

Step 2: Calculate the percent loss of value from value of Sept 30th

	\$39.03-	\$39.03-	\$39.03-	\$39.03-
	\$36.79	\$38.12	\$36.76	\$34.67
	=\$2.24	=\$0.91	=\$2.27	=\$4.36
Paper Loss in %:	5.7%	2.3%	5.8%	11.2%

Step 3: Add up all the losses (in percent), 5.7 + 2.3 + 5.8 + 11.2 = 25.0

⇒ Ulcer Index = 25.0

correction. They may be buying additional shares, or using derivatives effectively during a correction. As markets recover, their investments appreciate more quickly.

The Ulcer Index table shows the Ulcer Index, as well as the Otar Efficiency Measure (OEM) of some popular equity funds.

If you get nervous during market

Handbook of Canadian DRIPs and SPPs", is an independent financial advisor with W. H. Stuart & Associates, Phone (905) 889-7170.

¹ In Technical Analysis literature, a different Ulcer Index is defined as "the standard deviation to the power of 1.35". This has no relation to my Ulcer Index described in this article.

² See my article "Fund Efficiency" June 1997, Canadian MoneySaver

Ulcer Index
of Popular Equity Funds
for October 27/1997 Correction

CANADIAN EQUITY	<u>Ulcer Index</u>	<u>OEM</u>
AGF Dividend	10.2	0.21
AIC Diversified	18.4	0.44
Altamira Equity	28.8	0.03
Bissett Canadian Equity	14.6	0.42
Dynamic Dividend Growth	8.2	0.26
Elliot & Page Equity	26.8	0.06
Fidelity Canadian Growth	9.8	0.24
Ivy Canadian Equity	3.1	0.19
Ivy Enterprise	0.0	0.30
PH & N Dividend Income	1.9	0.67
Sceptre Equity Growth	25.0	0.34
Scudder Canadian Equity	2.7	N/A
Spectrum United Can. Equity	23.8	0.09
Trimark Canadian	21.2	0.08
Universal Canadian Growth	5.4	N/A
U.S. EQUITY		
AIC Value	6.1	0.35
Altamira Select American	19.3	0.09
CI American	14.1	0.18
Clarington U.S. Equity	4.4	N/A
Dynamic Americas	19.5	0.23
Fidelity Growth America	8.7	0.23
Investors U.S. Growth	2.0	0.31
PH & N U.S. Equity	7.4	0.54
Spectrum United Am. Growth	12.2	0.16
INTERNATIONAL EQUITY		
AGF International Value	20.6	0.11
CI Global	22.8	0.05
Cundill Value	6.0	0.02
Dynamic International	29.0	0.06
Fidelity International Portfolio	18.0	0.09
Ivy Foreign Equity	2.0	0.15
Saxon World Growth	22.0	0.07
Scudder Global	15.8	N/A
Templeton Growth	20.8	0.12
Trimark Fund	21.8	0.13

OEM - 3-year Otar Efficiency Measure
All data based on end of December 1997,
courtesy of PalTrak

Calculation of Ulcer Index



