K-Ratio

REVIEWED BY WILL KENTON | Updated Mar 23, 2018

DEFINITION of K-Ratio

K-ratio examines the consistency of an equity's return over time. The data for the ratio is derived from a value added monthly index (VAMI), which tracks the progress of a $1,000 initial investment in the security being analyzed. K-ratio is calculated as: K-ratio examines the consistency of an equity's return over time. K-ratio is calculated as:

K - Ratio = Slope of LogVAMI Regression Line * Square Root of the Number of Observations Per Year

(Standard Error of Slope * Number of Observations)

BREAKING DOWN K-Ratio

The K-ratio was developed by derivatives trader and statistician Lars Kestner as a way to address a perceived gap in how returns had been analyzed. Because investor scare about both returns and consistency, Kestner designed his K-ratio to measure risk versus return by analyzing how steady a security, portfolio or manager’s returns are over time. It takes into account not just the returns themselves, but the order of those returns in measuring risk. The calculation involves running a linear regression on the logarithmic cumulative return of a Value-Added Monthly Index (VAMI) curve. The results of the regression are then used in the K-ratio formula. The slope is the return, which should be positive, while the standard error of the slope represents the risk.