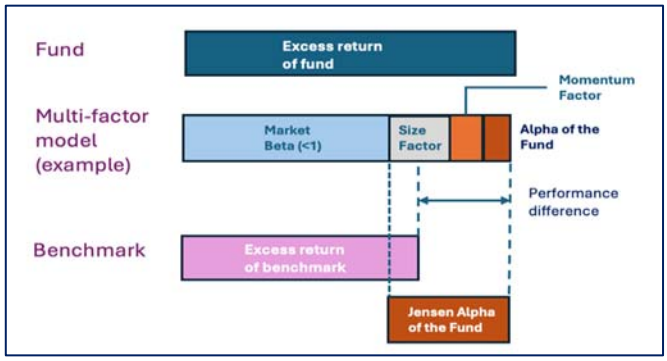
Under the Bonnet – A deep dive into Alpha

In our February 2026 Jargon Buster we discussed the term 'Alpha'. This metric is often used by investment firms and analysts in evaluating the skills of an active fund manager.

The common understanding is that an active fund's performance can be partially explained by market returns (especially the one that the fund is benchmarked against). This is called Market Beta. The remaining return not explained by Market Beta is known as Alpha (or Jensen's Alpha – see diagram below).

Important recap - Alpha is not outperformance

But Alpha is not outperformance. A fund can still perform well with a low Alpha if the fund manager adjusts the Market Beta well in a positive market. This can be done by tilting towards high Beta stocks or using some leverage. Or if the manager is good in a certain style that generates performance in the current economic or business cycle through one of the other Beta factors (value, size, momentum, quality etc.). One can argue that adjusting these Beta factors in a timely manner is also a fund management skill.

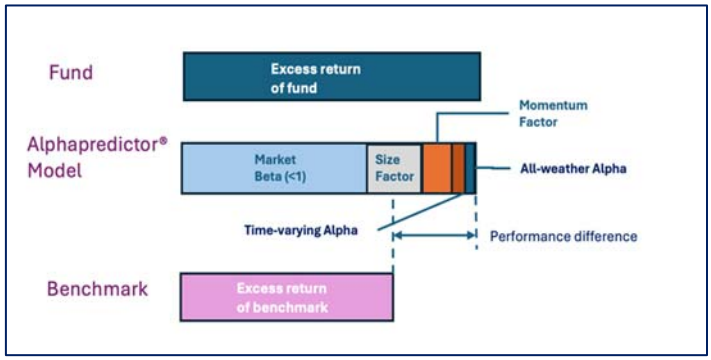


The two components of Alpha

If Alpha represents the performance that is not related to different Beta factors, then it should come from (a) selecting the right tilts on sectors and (b) in stock selection. But not all managers can get this right in all stages of an economic cycle. A manager may be very good at picking the right growth sector (like technology) when interest rates are low and economic growth is strong. But when interest rates rises or when economic growth slows, the manager's performance could suffer, and their Alpha deteriorates.

In fact, we can split the Alpha into two components:

1. A time-varying Alpha that is correlated to the skills of the manager in navigating different phases of a business cycle. This usually reflects their sector tilt skills.
2. An all-weather Alpha that is the manager's skills unrelated to the business cycle. This usually reflects their securities selection skills.



Examples of Alpha Analysis

The above model is based on previous academic studies. In conjunction with Parala Capital LLP, we have applied this model, the AlphaPredictor®, to analyse some of the largest active funds in the UK Equity Income Sector. Specifically, we looked at total Alpha and total expected return for these funds over the next 3 months on a forward-looking basis, based on current economic indicators in the UK, such as inflation. We then rank these funds according to their total expected return. The top (bottom) fund has the highest (lowest) expected return. See the table below for results.

If you want to see the full report including the names of the funds, please contact us at info@tricio-advisors.com.

Over next 3m from 1 March 2026	Time-varying Alpha	All-weather Alpha	Total Alpha	Total Expected Return
Top fund	0.46%	0.21%	0.67%	1.70%
Bottom fund	-0.16%	-0.16%	-0.32%	0.40%
Average	-0.02%	0.04%	0.02%	1.03%

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