

An unleveraged return is hypothetical, and it is not appropriate to include such a return in a composite, or to present this return as a pooled fund return in a GIPS Pooled Fund Report. This is true whether the leverage arising from derivatives is discretionary (decided by the firm) or non-discretionary (required by the client). Unleveraged performance is only permitted to be presented as supplemental information. A firm may calculate the performance of derivatives on an unleveraged basis by using their delta-adjusted exposure. For example, the exposure of an option can be calculated by multiplying the underlying market value of the instrument by the option delta. Using the delta-adjusted exposures instead of the instrument's actual value in the denominator would "deleverage" the performance. The following example illustrates this for a portfolio containing three call options:

Instrument	Beginning-of-day Value	End-of-day Value	Beginning of-day Underlying Value	Option Delta	Delta-Adjusted Exposure	Performance	
						Leveraged	Unleveraged
Call Option A	100	110	1,000	0.9	$1,000 \times 0.9 = 900$	$(110-100)/100=10\%$	$(110-100)/900=1.11\%$
Call Option B	200	210	5,000	0.8	$5,000 \times 0.8 = 4,000$	$(210-200)/200=5\%$	$(210-200)/4000=0.25\%$
Call Option C	300	360	10,000	0.7	$10,000 \times 0.7 = 7,000$	$(360-300)/300=20\%$	$(360-300)/7000=0.86\%$
<b>Total</b>	<b>600</b>	<b>680</b>			<b>11,900</b>	<b>13.33%</b>	<b>0.67%</b>

If the use of derivatives is non-discretionary (required by the client) and, as a result, the leverage arising in the portfolio can be considered non-discretionary, the non-discretionary derivatives positions can be removed from the portfolio in accordance with the allowed treatment to exclude a non-discretionary investment from the composite. The firm may choose to classify the restricted portion of the portfolio as non-discretionary.

The following table summarizes the possible options for the treatment of leverage:

	Option 1. Leveraged return	Option 2. Unleveraged return	Option 3 Removing derivatives
Meaning:	Derivatives are included in the portfolio and their return contribution is based on their market value (13.33% in the above example).	Derivatives are included in the portfolio and their return contribution is based on their delta-adjusted exposure (0.67% in the above example).	Derivatives are entirely removed from the portfolio as if they had never existed (i.e. their return contribution is nil).
Treatment:	Must be used for return calculation purposes, whether the use of derivatives is discretionary or non-discretionary.	Must not be used for return calculation purposes. Allowed to be presented as supplemental information only.	Only allowed for non-discretionary Derivatives.