

PERFORMANCE PERSPECTIVES

with David Spaulding



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Since 1990, The Spaulding Group has had an increasing presence in the money management industry. Unlike most consulting firms that support a variety of industries, our focus is on the money management industry.

Our involvement with the industry isn't limited to consulting. We're actively involved as members of the CFA Institute (formerly AIMR), the New York Society of Security Analysts (NYSSA), and other industry groups. Our president and founder regularly speaks at and/or chairs industry conferences and is a frequent author and source of information to various industry publications.

Our clients appreciate our industry focus. We understand their business, their needs, and the opportunities to make them more efficient and competitive.

For additional information about The Spaulding Group and our services, please visit our web site or contact Chris Spaulding at CSpaulding@SpauldingGrp.com

ONE SIZE DOESN'T FIT ALL

I am composing this month's newsletter while visiting Asia, where I am giving a couple talks for DST Global Solutions on the topic, "Performance Measurement: One Size Doesn't Fit All."



I was asked to prepare a session that (a) wasn't on GIPS^{®1} and (b) avoided formulas. Imagine, doing a performance measurement talk without formulas! Well, I managed to do this. And although GIPS was mentioned, it wasn't the dominant part of the presentation.

My main point is that, given that performance measurement and risk reporting permeates every sector of our market today (from institutional clients to internal management; from private wealth to retail), there is often an attempt to extend what one does in one area to everywhere else, and that's simply wrong, as each has unique needs, requirements, and abilities to understand what's being reported.

What an asset manager shares with their clients must be relevant, appropriate, meaningful, and of value. It must not be so complex that the reader cannot understand what is being shared.

The result: a need for flexibility in one's performance measurement and risk systems, to ensure the appropriate calculations are done and the right reports produced.

Fortunately, most vendors today are up to this challenge. There was a time when vendors focused on specific markets (e.g., trust, institutional, insurance), but this is no longer so common, as vendors see the market as offering many opportunities that they feel capable of responding to.

HANDLING FEES PAID BY ANOTHER ACCOUNT WITHIN THE FAMILY

Ian Fremer of Merrill Lynch sent me this note:



I just read your article² about calculating net vs gross. This is a good article and easy to follow.

What I would like to hear you expand upon is when the fee is paid from outside the account. My question is more on the account that money is actually paid from. Here a fee paid outside the account is typically paid by another account within the household. My thought is that it is a withdrawal from the 'paying' account with no impact to market value. Since we are systematically coded, today the net number hits in the 'paying' account. If we wanted to apply the fee to the actual managed account, we need to adjust the other so we don't double count the fee.'

<http://www.SpauldingGrp.com>

1 Apparently the region has been inundated with such presentations of late.

2 In a recent article for the CFA Institute I discussed the topic of net of fee returns in great detail, save for what we're addressing this month. (See <http://www.cfapubs.org/doi/pdf/10.2469/ipmn.v2011.n1.1>).

The Journal of Performance Measurement®:

UPCOMING ARTICLES

A Sector Based Approach to Fixed Income Performance Attribution
– *Stephen Campisi*

Golf And The Art of Portfolio Performance Measurement
– *Larry Campbell*

The Choice of Performance Measure Does Influence the Evaluation of Hedge Funds
– *Valeri Zakamouline*

Properties of IRR Equation with Regard to Ambiguity of Calculating of Rate of Return and a Maximum Number of Solutions
– *Yuri Shestopaloff and Wolfgang Marty*

The Journal Interview
– *Dean LeBaron*

A New Empirical Method for Yield Curve Attribution
– *Maria Vieira*

This is definitely an accounting issue, isn't it, as well as a performance issue? If there is a "family account" that pays the fees for two or more accounts, we don't want the main account's return to reflect the entire fee (when reporting net-of-fee returns), as this would understate their performance. Also, we want to be able to provide a correct net-of-fee return for the accounts that aren't actually paying the fee. We'll use the following account scenario to demonstrate how to handle this situation:

	BMV	EMV	Gross-of-fee Return	Fee paid	Net-of-fee Return
Account A	150,000	154,675	3.45%	-500	3.12%
Account B	50,000	51,090	2.18%	0	2.18%
Totals	200,000	205,765	3.13%	-500	2.88%

We see that Account A is being charged the full fee. As a "family" the fee is 1%, billed quarterly. However, Account B isn't showing any fee, so its net-of-fee return matches its gross-of-fee return, while Account A is penalized (and actually being billed 1.33%).

The first step is to allocate the fee across the various accounts; this can be done based on relative market values. And so, in the following example, if Account A pays the fee for it and Account B, we'd have:

	BMV	Fee paid	Allocation Percent	Allocated Fee
Account A	150,000	-500	75%	-375
Account B	50,000	0	25%	-125
Totals	200,000	-500		-500

Or, we could simply charge the fee percent to each account (in this case, 1% billed quarterly (i.e., 0.25%) of the beginning market value); you will see that you get the same result.³

The accounting system needs to be able to distinguish between the fee paid and the amount to be used for performance purposes. Perhaps "Fee Paid" and "Fee Charged" might work? Whatever you call it, you need to distinguish between them. For a gross-of-fee return, fees are treated as cash flows; however, for net-of-fee we need to utilize them in our return.



We'll begin with Account A. In the above table we have shown the actual fee that should have been charged (375). This is what we will use to determine our return. However we must also take into consideration the difference between the fee that was charged (500) and this amount, and reflect it as a cash flow. And so our return is:⁴

$$ROR_A^{Net} = \frac{EMV - CF}{BMV} - 1 = \frac{154,675 - (-125)}{150,000} - 1 = 3.20\%$$

As you can see it's higher than what was derived previously (3.12%), when we charged the entire fee to this account.

³ Of course, in this example, we're ignoring any possible cash flows which might impact the fee, so you'll have to determine the best approach for allocating the fee so that each account is charged the appropriate amount.

⁴ I'm using a daily return methodology, though the same rules would apply if you did this using a monthly Modified Dietz approach.

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Visit PerformanceJobs.com and you'll see that we have several jobs posted. We're very excited with the initial interest this venture has caused and look forward to it becoming the major resource for individuals seeking employment as well as firms looking to hire. If you know of someone who is looking for a career in investment performance, please direct them to our site and encourage them to submit their resume today.

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Now we'll look at Account B. Because the fee is paid outside of the account⁵ we need to treat the fee as an addition:

$$ROR_B^{Net} = \frac{EMV + CF}{BMV} - 1 = \frac{51,090 + (-125)}{50,000} - 1 = 1.93\%$$

and the fee is lower than what we had earlier (2.18%) because now a fee is being charged.

The following table reflects all of the values used in this example:

	BMV	EMV	Gross-of-fee Return	Fee paid	Original NOF Rtn	Allocation Percent	Allocated Fee	Net Cash Flow	Revised NOF Rtn
Account A	150,000	154,675	3.45%	-500	3.12%	75%	-375	-125	3.20%
Account B	50,000	51,090	2.18%	0	2.18%	25%	-125	0	1.93%
Totals	200,000	205,765	3.13%	-500	2.88%		-500		2.88%

I hope this explanation makes sense. Please let me know your thoughts.

SURVEYS THAT WILL TAKE NO MORE THAN FIVE MINUTES OF YOUR TIME, BUT PROVIDE GREAT INFO!

We've decided to launch "mini surveys" to gather information that we believe will have value to many. They are designed to take less than five minutes to complete. And, if you join in you will receive a copy of the results!

Information is critical, and this approach is one way to gather it. We have employed this within the Performance Measurement Forum for more than ten years, and have decided to expand it to a broader audience.

We also welcome your ideas on questions and topics.

Our first survey can be found at:

<http://survey.constantcontact.com/survey/a07e3jv78bfgl9upu59/start>. To participate we will need your responses by May 15, so please take the time today to join in. Thanks!



THE "PMAR EXPERIENCE"

As you may be aware, we have taken our highly successful Performance Measurement, Attribution & Risk conference to Europe, where last year saw a very good start and this year is shaping up to be even better.

It occurred to me recently that because of the uniqueness of these events, the creativity, innovations, energy, excitement, and fun that they engender, that it's fair to describe them as providing a unique experience, the "PMAR Experience," if you will.

If you have never attended a PMAR Conference, you owe it to yourself to either attend PMAR North America next month in Philadelphia or PMAR Europe in London this June. Both events attract a wide audience, from various locales. Our speakers and topics are "top notch," and include some engaging and exciting events. If you have already joined us for PMAR, then you can testify to how great it is.

⁵ Outside of Account B, that is.

KEEP THOSE CARDS & LETTERS COMING

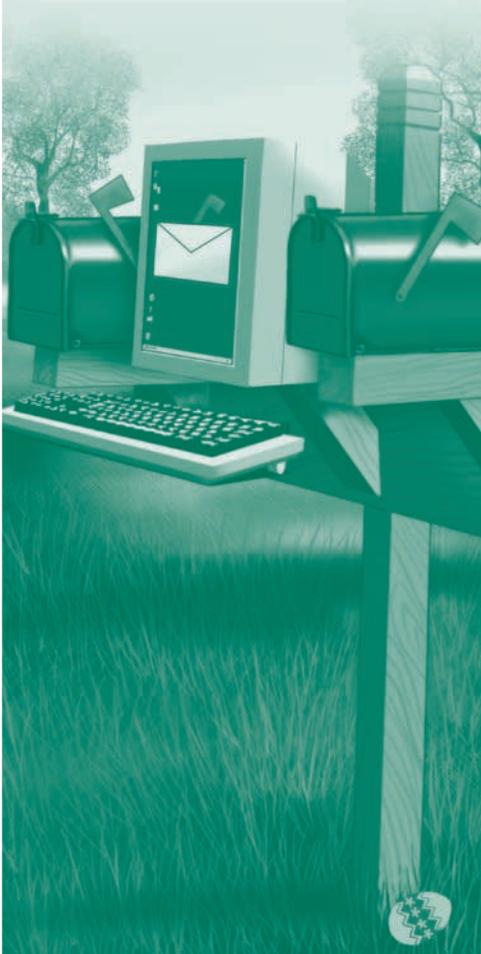
We appreciate the occasional e-mail we get regarding our newsletter. Occasionally, we hear positive feedback while at other times, we hear opposition to what we suggest. That's fine. We can take it. And more important, we encourage the dialogue. We see this newsletter as one way to communicate ideas and want to hear your thoughts.

We're not a conference company hosting a performance measurement event. We're a performance measurement services company hosting a performance measurement event: we believe this is a critical difference and a major contributor to the PMAR Experience.

Work on next year's programs begins even before this year's are held! We are always identifying interesting topics and speakers, as well as innovative ideas to make the events even better.



We offer a better than "money back guarantee," since you will be taking the risk by investing in this program. And so, if you sign up and discover that the event isn't what you expected and isn't providing the value we claim it will, then we will refund 100% of your money, plus you get to keep all of the materials. Your investment of time and resources is important and we respect that. We promise to deliver you a comprehensive event that not only adds value and useful knowledge to your performance career, but does so in a way that removes the risk from you and your firm.



THE SPAULDING GROUP'S 2011 INVESTMENT PERFORMANCE MEASUREMENT CALENDAR OF EVENTS

DATE	EVENT	LOCATION
May 16-17, 2011	Fundamentals of Performance Measurement Training	New Brunswick, NJ (USA)
July 12-13, 2011	Fundamentals of Performance Measurement Training	Toronto, Ontario
July 14-15, 2011	Performance Measurement Attribution Training	Toronto, Ontario
August 22-23, 2011	CIPM™ Principles Exam Preparation Class	New Brunswick, NJ (USA)
August 24-26, 2011	CIPM™ Expert Exam Preparation Class	New Brunswick, NJ (USA)
September 13-14, 2011	Fundamentals of Performance Measurement Training	San Francisco, CA (USA)
September 15-16, 2011	Performance Measurement Attribution Training	San Francisco, CA (USA)
October 11-12, 2011	Fundamentals of Performance Measurement Training	Chicago, IL (USA)
October 13-14, 2011	Performance Measurement Attribution Training	Chicago, IL (USA)
December 6-7, 2011	Fundamentals of Performance Measurement Training	New Brunswick, NJ (USA)
December 8-9, 2011	Performance Measurement Attribution Training	New Brunswick, NJ (USA)

For additional information on any of our 2011 events, please contact Christopher Spaulding at 732-873-5700

Register Today!

*The Journal of Performance Measurement®
Ninth Annual International*

PMAR

Performance Measurement,
Attribution & Risk

Conference

May 18th - 19th, 2011

*The Journal of Performance Measurement®
In Association with RIMES Technologies*

PMAR II

Performance Measurement,
Attribution & Risk Conference

EUROPE

14 - 15 June 2011 – London

TRAINING...

Gain the Critical Knowledge Needed for Performance Measurement and Performance Attribution

TO REGISTER:

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E-mail: info@SpauldingGrp.com



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FUNDAMENTALS OF PERFORMANCE MEASUREMENT

A unique introduction to Performance Measurement specially designed for those individuals who require a solid grounding in all aspects of performance measurement. The Spaulding Group, Inc. invites you to attend Fundamentals of Performance Measurement on these dates:

May 16-17, 2011 – New Brunswick, NJ

October 11-12, 2011 – Chicago, IL

July 12-13, 2011 – Toronto, Ontario

December 6-7, 2011 – New Brunswick, NJ

September 13-14, 2011 – San Francisco, CA

15 CPE & 12 PD Credits upon course completion

The Spaulding Group is registered with CFA Institute as an Approved Provider of professional development programs. This program is eligible for 12 PD credit hours as granted by CFA Institute.



PERFORMANCE MEASUREMENT ATTRIBUTION

Two full days devoted to this increasingly important topic. The Spaulding Group, Inc. invites you to attend Performance Measurement Attribution on these dates:

July 14-15, 2011 – Toronto, Ontario

December 8-9, 2011 – New Brunswick, NJ

September 15-16, 2011 – San Francisco, CA

October 13-14, 2011 – Chicago, IL

15 CPE & 12 PD Credits upon course completion

The Spaulding Group is registered with CFA Institute as an Approved Provider of professional development programs. This program is eligible for 12 PD credit hours as granted by CFA Institute.



IN-HOUSE TRAINING

The Spaulding Group has offered in-house training to our clients since 1995. Beginning in 1998, we formalized our training, first with our Introduction to Performance Measurement class and later with our Performance Measurement Attribution class. We now also offer training for the CIPM program. To date, close to 3,000 individuals have participated in our training programs, with numbers increasing monthly.

We were quite pleased when so many firms asked us to continue to provide in-house training. This saves our clients the cost of transporting their staff to our training location and limits their time away from the office. With the discounted tuition for in-house training, it saves them even more! We can teach the same class we conduct to the general market, or we can develop a class that's suited specifically to meet your needs.

The two-day introductory class is based on David Spaulding's book, *Measuring Investment Performance* (McGraw-Hill, 1997). The attribution class draws from David's second book *Investment Performance Attribution* (McGraw-Hill, 2003).

UPDATED CIPM Principles and Expert Flash cards are now available on our web store. Please visit www.SpgShop.com today to order your set.

Our performance experts have created a study aid which can't be beat: *flash cards!* These handy cards will help you and your associates prepare for the upcoming CIPM Principles Exam. Unlike a computer-based study aid, you can take them anywhere to help you test your knowledge.

Benefits of Flash Cards:

- Work at your own pace
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- Strengthen and reinforce core CIPM principles

These cards are a **must have** for anyone preparing to take the CIPM Exams.

