

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, we focus 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

VERIFIER INDEPENDENCE

One topic that can be a challenge for many firms is the notion of *verifier independence*. The recently adopted guidance statement from the Investment Performance Council should help clarify a few items (www.cfainstitute.org/cfacentre/ips/pdf/GuidanceStatementVerifierIndependencefinal.pdf).

One of the issues that seemed to be a bit gray had to do with the notion of a verifier creating the client's GIPS® composite materials. We encountered this for the first time earlier this year, when we were helping a client with software issues. In the course of our conversations, I asked "should the new system be able to automatically generate your presentation materials," to which the client responded "no, because our verifier prepares them for us."

After I got back onto my seat (after falling off the chair), I asked them to clarify what I thought they had said.¹ No, my hearing wasn't failing me, I heard correctly; they then showed me the actual document, which had the verifier's identity right there.

Given that the standards call for the verifier to "review a sample of composite presentations,"² how can a verifier check their own work? (In this case the verifier got the presentation materials wrong!)³

The draft of the guidance statement was a bit unclear on this point, but the final document, as adopted by the IPC is much clearer. Such actions are not permitted as they violate the independence of the verifier.

When we get involved with verification assignments, we're often asked to also provide some up-front consulting. We make it clear that we cannot cross the line which would cause our independence to be jeopardized; if this were to happen we would have to ask that another firm be engaged in the actual verification. We think this is a wise practice.

ANNUALIZATION OF ATTRIBUTION EFFECTS

We were recently asked "can you annualize attribution effects." The answer: yes! As long as they were arrived at by a linking methodology, such as Jose

¹ My wife, Betty, accuses me of having selective hearing loss, but our client assured me that I had heard her correctly.

² See Global Investment Performance Standards, Paragraph III.B.2.g, page 25 (2005).

³ This was a verification for the AIMR-PPS®, which required the disclosure of the firm's fee schedule. The materials referred to the ADV Part II, which is an inadequate representation of the fee schedule B the actual schedule must be shown.

The Journal of Performance Measurement®:

UPCOMING ARTICLES

The Impact of Equity Dividends on Segment-level Performance

– Mark Osterkamp, Wilshire
Associates Incorporated

Contrasting Time- and Money-weighted Returns: When Each Should be Used

– David Spaulding,
The Spaulding Group

A Modest Proposal to Modernize the Performance Evaluation of Hedge Funds

– Ronald J. Surz, PPCA, Inc.

The Journal Interview

– Philip Lawton, CFA,
CFA Institute

A Consistent Linking Concept for Fast Calculation of the Rate of Return and Research of Investment Strategies

– Alexandre Chestopalov,
University of Toronto and
Konstantin Chestopalov,
University of Toronto

A Primer On Time-weighted and Dollar-weighted Return

– Steven J. Lerit, New York Life
Investment Management

Menchero's, David Cariño's, Andrew Frongello's, etc.^{4,5} The reason for this condition is that these methods yield compounded effects, which just like compounded returns, can be annualized, where annualization is an average which takes compounding into effect. If they weren't compounded, I would argue against annualization.

A quick example. Table 1 shows the annual attribution effects for a portfolio.

	Stock Selection	Allocation
Year 1	1.00%	-0.86%
Year 2	0.33%	-0.15%
Year 3	0.44%	-0.02%

Table 1

Using the linking methodology developed by Jose Menchero⁶ we obtain the linked effects as shown in Table 2.

	Stock Selection	Allocation
3-Year Linked	1.86%	-1.08%

Table 2

We can easily annualize these values by taking the cube root of the values (plus one), and then subtracting one. The results are shown in Table 3.

	Stock Selection	Allocation
3-Year Annualized Effects	0.61%	-0.36%

Table 3

BOOK OF THE MONTH

I haven't finished reading Iain Pears' *An Instance of the Fingerpost*, but already know it's good (and I'm only up to page 31). What's great is that this author does what I understand greater writers do — write one word at a time. His sentence construction is excellent. A few samples:⁷

I taunted my poor good father by saying that unless he was kind to me, I would take my revenge by becoming a physician.

I was suddenly struck by a burning enthusiasm to become a citizen of the Republic of Learning...This sudden passion I can no longer recall, so completely has it left me.

I could also consult a lawyer but, if England and Venice differ in many ways, they are alike in one, which is that lawyers have an insatiable love of money.

4 While it's not a requirement that a linking method developer's name end in "o," it apparently is quite common, yes?

5 Another alternative case would be if the attribution was based on a geometric model, such as Carl Bacon's, in which case the effects have been compounded.

6 See Menchero, Jose. "An Optimized Approach to Linking Attribution Effects Over Time," *The Journal of Performance Measurement*. Fall 2000: 36-42.

7 A couple points to consider: first, the book's story is set in the 17th century; second, while I cite some comments about various professions, please do not conclude that I hold any of these despicable opinions.

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.

The poorer you appear, the poorer you become.

...not wishing to have to refer to a book of instruction in mid-operation, as this does not reassure the patient. *[spoken when about to perform an operation]*

Considering the pain I was giving her, a corpse would have become aware of its surroundings.

Sometimes being a gentleman and physician do not coexist easily.

Although I had studied the proper way of cleansing wounds and setting bones, I had never had the opportunity to do so in practice. It was very much more difficult than the lectures had made it seem...

I do hope that you are not offended by any of these. I was simply taken by the clever wording and hope you appreciate it. The book was recommended somewhere (I do not recall where; perhaps *The Wall Street Journal*) as a great mystery, suggesting that if one enjoyed Umberto Eco's *The Rose*, they would enjoy this, too. And since I have enjoyed a couple of Eco's books, I decided to take the writer's advice, and so far am finding the book quite enjoyable.

CLOSING OUT THE YEAR

We very much hope that 2005 was a wonderful year for you. Our firm had a fabulous year in numerous ways. We have much to be thankful for. Perhaps our most significant event was hiring John Simpson and establishing our California office. We were successful in holding a record number of in-house training classes and thank our clients: the OPEC Fund for International Development, the Abu Dhabi Investment Authority, Fidelity, State Street, Prudential, and GMO. Our two conferences were once again quite successful, and we thank our speakers who shared their time and knowledge with our attendees. We thank our many cosponsors who supported our research efforts, our publications, and our conferences. Our consulting business (including verification and pre-verification) has expanded considerably as we were able to take on numerous new clients this year. I'm grateful for the opportunity to have worked with the many professionals who serve on the Investment Performance Council, the AIMR-PPS Implementation Committee, and the IPC's Interpretations Subcommittee.

I want to thank our management and staff for their hard work, support, dedication, and many contributions this past year. They are a phenomenal group to work with.

We wish you a Merry Christmas, a Happy Chanukah, and a blessed, safe, healthy, peaceful, and prosperous New Year. May God bless you, your family, and your associates.

With warm regards,

Dave



THE SPAULDING GROUP'S 2005-2006 INVESTMENT PERFORMANCE MEASUREMENT CALENDAR OF EVENTS

DATE	EVENT	LOCATION	DEADLINE
January 23-24	CGIPS Preparatory Training	New York, NY (USA)	January 16, 2006
January 23-24	CGIPS Preparatory Training	Los Angeles, CA (USA)	January 16, 2006
January 26-27	CGIPS Preparatory Training	Boston, MA (USA)	January 19, 2006
January 26-27	CGIPS Preparatory Training	Chicago, IL (USA)	January 19, 2006
January 30-31	CGIPS Preparatory Training	London, England	January 23, 2006
February 14-15	Introduction to Performance Measurement Training	New York, NY (USA)	February 7, 2006
February 16-17	Performance Measurement Attribution Training	New York, NY (USA)	February 7, 2006
March 14-15	Introduction to Performance Measurement Training	Boston, MA (USA)	March 7, 2006
March 16-17	Performance Measurement Attribution Training	Boston, MA (USA)	March 7, 2006
March 21-22	Introduction to Performance Measurement Training	San Francisco, CA (USA)	March 19, 2006
March 23-24	Performance Measurement Attribution Training	San Francisco, CA (USA)	March 19, 2006
April 4-5	Introduction to Performance Measurement Training	Somerset, NJ (USA)	March 31, 2006
April 6-7	Performance Measurement Attribution Training	Somerset, NJ (USA)	March 31, 2006
April 27-28	Performance Measurement Forum	Los Angeles, CA (USA)	April 24, 2006
May 9-10	Introduction to Performance Measurement Training	London, England	May 2, 2006
May 11-12	Performance Measurement Attribution Training	London, England	May 2, 2006
May 22-23	Performance Measurement, Attribution, & Risk Conference	Philadelphia, PA (USA)	May 19, 2006
June 20-21	Introduction to Performance Measurement Training	Vancouver, Canada	June 13, 2006
June 22-23	Performance Measurement Attribution Training	Vancouver, Canada	June 13, 2006
June 27-28	Introduction to Performance Measurement Training	Paris, France	June 20, 2006
June 29-30	Performance Measurement Attribution Training	Paris, France	June 20, 2006
July 11-12	Introduction to Performance Measurement Training	Chicago, IL (USA)	July 5, 2006
July 13-14	Performance Measurement Attribution Training	Chicago, IL (USA)	July 5, 2006

For Additional information on any of our 2005-2006 events, please contact Christopher Spaulding at 732-873-5700

Save the Date!



TRAINING...

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Customized In-House Training is also available. Please call or email for additional details.

INTRODUCTION TO 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 Introduction to Performance Measurement on these dates:

February 14-15, 2006 – New York, NY
 March 14-15, 2006 – Boston, MA
 March 21-22, 2006 – San Francisco, CA
 April 4-5, 2006 – Somerset, NJ
 May 9-10, 2006 – London, England
 June 20-21, 2006 – Vancouver, Canada
 June 27-28, 2006 – Paris, France
 July 11-12, 2006 – Chicago, IL

15 CPE Credits upon course completion

PERFORMANCE MEASUREMENT ATTRIBUTION

A day and a half devoted to this increasingly important topic. The Spaulding Group, Inc. invites you to attend Performance Measurement Attribution on these dates:

February 16-17, 2006 – New York, NY
 March 16-17, 2006 – Boston, MA
 March 23-24, 2006 – San Francisco, CA
 April 6-7, 2006 – Somerset, NJ
 May 11-12, 2006 – London, England
 June 22-23, 2006 – Vancouver, Canada
 June 29-30, 2006 – Paris, France
 July 13-14, 2006 – Chicago, IL

11 CPE Credits upon course completion

These programs may qualify for the CFA Institute's Professional Development Credit. If you are a member of the CFA Institute, please refer to their website to determine whether this program meets the criteria for CFA Institute PDP credit, to calculate credit hours, and to verify documentation requirements. www.cfainstitute.org/pdprogram

CGIPS PRINCIPLES EXAM PREPARATION

The two-day CGIPS Principles Exam Preparation class will provide you with a solid foundation for your formal study of the CGIPS Principles Exam. It will also help you identify any areas in your performance background that might need reinforcement. The earlier you commit yourself, the greater the probability of success.

January 23-24, 2006 – New York, NY
 January 23-24, 2006 – Los Angeles, CA
 January 26-27, 2006 – Boston, MA
 January 26-27, 2006 – Chicago, IL
 January 30-31, 2006 – London, England