# 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**

**http://www.SpauldingGrp.com**

## SOCIÉTÉ GÉNÉRALE – A WAKE UP CALL?

> *"By nature, organizations abhor control systems. Ineffective governance is a major part of the problem with internal control mechanisms; they seldom respond in the absence of a crisis."* – *Michael C. Jensen*[1]

It seems as if every few years we hear of some horrific event involving a wayward trader causing huge losses for their company. The most recent example is Société Générale. It appears that there was a lack of risk oversight that resulted in the loss of billions of euros. While we might find an analysis of the perpetrator an interesting study in human behavior, what's really needed is a detailed review of their risk management system to see where the holes are, so that others can look to fill them.

Unfortunately, a reality might be that no matter what steps are taken, some unscrupulous individual may still seek to find another way to cause havoc. But the more extensive the controls, the greater chance that problems won't arise.

When it comes to performance measurement controls are needed, too. I've encountered advertisements claiming compliance with GIPS® that didn't comply with the advertising rules; in some cases, the head of performance wasn't consulted as to the requirements. I'm aware of one firm whose compliance officer responded, upon hearing that the firm wasn't in compliance with the standards, that they would continue to claim compliance and hope that the SEC didn't find out! And, as I've opined before, some firms know they're not compliant but because their verifier issued a report suggesting they were okay, refuse to take any corrective action.

I think it's human nature to think "I won't get caught." And probably lots of folks never are caught. But I'd rather live by the credo of always striving to do the right thing. And having the proper controls in place is one way to increase your level of confidence that as a firm you'll be doing the right thing, too.

## MONEY-WEIGHTED ATTRIBUTION

I'm pleased to announce that the long-awaited *Journal of Performance Measurement®* supplement for last year will soon be available. And, it will include a debate, of sorts. Steve Campisi and I wrote an article enthusiastically calling for the adoption of money-weighted attribution while Carl Bacon took a different view and wrote how time-weighting (the currently accepted approach) is the appropriate method. We welcome your thoughts.

1 Quote from Studies in International Corporate Finance and Governance Systems: A Comparison of the U.S., Japan, & Europe Edited by Donald H. Chew. Oxford Press 1997. "The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems." Michael C. Jensen

*The Journal of Performance Measurement®:*

## UPCOMING ARTICLES

**Multi-currency Attribution – Part 2 – Factoring in Interest Rate Differentials**
– *Carl Bacon, CIPM, StatPro Group*

**Performance Attribution Against Transient Buckets**
– *Timothy P. Ryan, Hartford Investment Management Company*

**Derivative Products in Performance Attribution**
– *Mathieu Cubilié, StatPro Group*

**Evaluating Target Date Lifecycle Funds**
– *Ronald J. Surz, PPCA, Inc., and Craig L. Israelsen, Ph.D., Brigham Young University*

**The Role of Conceptual Context in Finding the Rate of Return**
– *Yuri Shestopaloff, Ph.D., SegmentSoft Inc., and Konstantin Shestopaloff, SegmentSoft Inc.*

**The Journal Interview**
– *Douglas Lempereur CFA, CIPM, FRA, Franklin Templeton*

## IRR STANDARDS WORKING GROUP

I'm also pleased to announce that we have formed a working group to develop standards for the internal rate of return. We will shortly announce the makeup of this group. We think it's fair to say that no where else have you seen more interest shown in employing money-weighting than our newsletter and we're now pleased that we are seeking to formalize this methodology.

It's too early to outline all of the areas that we'll tackle, but among these will be a recommendation on the preferred approach to solving the IRR (there are several optional methods available), how to handle cases when multiple solutions might exist, and how frequently a portfolio should be revalued.

Our group recently held its first conference call and we now plan to meet for a full day in person so that we can make some serious progress on this important area. It's one thing to champion an idea, but to do so without providing all the necessary details is probably less than ideal, so we hope to fill this void.

## REPORTING RETURNS AT THE AGGREGATE LEVEL

I recently taught a GIPS class for the CFA Institute and was asked by one of the students how to calculate the return when multiple portfolios are aggregated together. This can happen in several ways, for example:

- a plan sponsor who has multiple external managers and wants to group them together
- a fund-of-funds manager who wishes to group the portfolios together to show one return
- a retail brokerage account that has multiple portfolios.

I think the answer depends on *what the question is*! That is, what question are you trying to answer? If you want to report to the client how they did overall, we'd want to aggregate the portfolios and calculate a money-weighted return. If we want to know how our external managers performed overall, then we could see calculating an asset-weighted time-weighted return. I believe that in most cases, an IRR is the best approach.

### 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.*

# Verifiers' Corner

Some questions were recently sent to me:

- Is gross of fee performance presented before manager and custody fees, but after all trading expenses?

*Before manager fees, yes. Custodian fees are treated as cash flows so they don't impact the return.*

- Is net of fee performance presented net of management fees only?

*Net of management fees and trading expenses.*

- Are custody fees ever included in NOF performance?

*No. Custodian fees are treated as cash flows so they don't impact performance.*

- If so, how would you deal with custody fees that are not paid from the account and therefore not clear to the manager?

*Not a problem since they don't impact performance.*

- How about security lending income?

*In general, the income should be treated as a cash flow. Managers don't typically make decisions regarding securities lending; it's a service that's provided by the custodian. The managers under most circumstances should not benefit from securities lending.*

And another question we've run into several times recently:

*A third-party pays us a fee for our model. We provide them the model as well as any updates. They execute the model themselves. How do we handle these accounts?*

This seems to be a version of a "wrap fee" account. Rather than have the investment manager manage the accounts, the sponsor does using the manager's model.

First, these accounts are most likely not your accounts. Therefore, they will not be included in any of your composites as you don't have control over them. You cannot assure that the sponsor actually carries out your instructions and can't control the timing of their execution. In addition, the assets aren't yours, either!

## THE SPAULDING GROUP'S 2008 INVESTMENT PERFORMANCE MEASUREMENT CALENDAR OF EVENTS

| DATE | EVENT | LOCATION |
|---|---|---|
| March 3-4 | CIPM Principles Prep Class | New Brunswick, NJ (USA) |
| March 5-7 | CIPM Expert Prep Class | New Brunswick, NJ (USA) |
| March 17-18 | Introduction to Performance Measurement Training | Boston, MA (USA) |
| March 19-20 | Performance Measurement Attribution Training | Boston, MA (USA) |
| April 15-16 | Introduction to Performance Measurement Training | New York, NY (USA) |
| April 17-18 | Performance Measurement Attribution Training | New York, NY (USA) |
| April 24-25 | Performance Measurement Forum (North America) | San Francisco, CA (USA) |
| May 6-7 | Introduction to Performance Measurement Training | Los Angeles, CA (USA) |
| May 8-9 | Performance Measurement Attribution Training | Los Angeles, CA (USA) |
| May 21-22 | Performance Measurement, Attribution, & Risk (PMAR) Conference | Philadelphia, PA (USA) |
| June 3-4 | Introduction to Performance Measurement Training | Baltimore, MD (USA) |
| June 5-6 | Performance Measurement Attribution Training | Baltimore, MD (USA) |
| June 12-13 | Performance Measurement Forum (Europe) | Paris, France |
| July 14-18 | Performance Measurement Boot Camp | New Brunswick, NJ (USA) |
| August 25-26 | CIPM Principles Prep Class | New Brunswick, NJ (USA) |
| August 27-29 | CIPM Expert Prep Class | New Brunswick, NJ (USA) |
| October 7-8 | Introduction to Performance Measurement Training | New York, NY (USA) |
| October 9-10 | Performance Measurement Attribution Training | New York, NY (USA) |
| October 7-8 | Introduction to Performance Measurement Training | San Francisco, CA (USA) |
| October 9-10 | Performance Measurement Attribution Training | San Francisco, CA (USA) |
| October 22 | Trends in Attribution Symposium (TIA) | Philadelphia, PA (USA) |
| November 4-5 | Introduction to Performance Measurement Training | Boston, MA (USA) |
| November 6-7 | Performance Measurement Attribution Training | Boston, MA (USA) |
| November 13-14 | Performance Measurement Forum (Europe) | Amsterdam, The Netherlands |
| December 4-5 | Performance Measurement Forum (North America) | Orlando, FL (USA) |
| December 9-10 | Introduction to Performance Measurement Training | New Brunswick, NJ (USA) |
| December 11-12 | Performance Measurement Attribution Training | New Brunswick, NJ (USA) |

*For additional information on any of our 2008 events, please contact Christopher Spaulding at 732-873-5700*

# TRAINING...

*Gain the Critical Knowledge Needed for Performance Measurement and Performance Attribution*

**TO REGISTER:**

***Phone: 1-732-873-5700***
***Fax: 1-732-873-3997***
***E-mail: info@SpauldingGrp.com***

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## 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:

March 17-18, 2008 – Boston, MA
April 15-16, 2008 – New York, NY
May 6-7, 2008 – Los Angeles, CA
June 3-4, 2008 – Baltimore, MD
October 7-8, 2008 – New York, NY
October 7-8, 2008 – San Francisco, CA
November 4-5, 2008 – Boston, MA
December 9-10, 2008 – New Brunswick, NJ

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.

CFA INSTITUTE PROFESSIONAL DEVELOPMENT QUALIFIED ACTIVITY 12 CREDIT HOURS

## 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:

March 19-20, 2008 – Boston, MA
April 17-18, 2008 – New York, NY
May 8-9, 2008 – Los Angeles, CA
June 5-6, 2008 – Baltimore, MD
October 9-10, 2008 – New York, NY
October 9-10, 2008 – San Francisco, CA
November 6-7, 2008 – Boston, MA
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## 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, over 1,500 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 transporting their staff to our training location and limits their time away from the office. And, because we discount the 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). The two-day Advanced Performance Measurement Class combines elements from both classes and expands on them.