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

GIPS®, GIPS and more GIPS. Lately it seems that GIPS is dominating our newsletters. Sorry about that. Given the major changes coming to the standards, this is naturally our focus. We'll broaden out with the next issue…I promise.

THE FIVE THINGS I HATE MOST ABOUT GIPS 2010

I *hate* the word "hate." I won't watch a show called "Everybody Hates Chris" because of that word. It's an ugly word. But I used it to start this section off, so perhaps I should tone it down. Okay, how about "The five things I detest most…"? Nah. How about "The five things I dislike most…" That's better. So, let's continue…

So, what are the five things I ~~hate~~ dislike most about the proposed changes to GIPS? Let's count them down:

Number 5: A new disclosure: ¶ 4.A.20: "Firms must disclose the composite description which must include sufficient information to allow a prospective client to understand the key characteristics of the composite strategy, including risks." I object to this for two reasons: (1) it's more work added to what already requires a lot of work and (2) it's highly subjective. The 2005 edition of the standards mandated the inclusion of a composite description, which I think was a good idea; but this additional info is unnecessary.

Number 4: Another new disclosure: ¶ 4.A.29: "Firms must disclose, for a minimum of 12 months, any change to the compliant presentation due to a correction of a material error." Why? Firms should have *error & correction* policies which spell out their procedure for communicating errors: I support this. But now that I've found and corrected an error, I need to tell everyone who gets it that "oh, by the way, I made an error and fixed it"? More work; another disclosure; unnecessary.

Number 3: ¶ 3.A.9: "Do you agree with changing 3.A.9 from a recommendation to a requirement." Two issues:

- First, it's misleading. The proposed wording does not change what was there from a recommendation to a requirement. What's there today? "Firms should not market a composite to a prospective client who has assets less than the composite's minimum asset level." What's proposed? "Firms must not present a composite to a prospective client known to have portfolio assets less than the composite's minimum asset level."

  The mere presentation of a presentation to a prospect is apparently being equated with "marketing." I disagree. Marketing is a process to actively persuade prospects to seek out your services. But you may be presenting your composite to someone who was referred to you. It's quite common for managers to make exceptions and take on smaller clients who have relationships with larger ones, but they may not be necessarily "marketing" to these individuals or groups.

- Second, I see nothing wrong with firms providing prospects who have assets below their minimum, copies of their presentations.

The Journal of Performance Measurement®:

UPCOMING ARTICLES

Balanced Portfolio Attribution
– *Stephen Campisi, CFA, Intuitive Performance Solutions*

Private Investments and Performance Implications from a Fund Sponsor's Perspective
– *Guy M. Holappa, CFA, BNY Mellon Asset Servicing*

Establishing Benchmarks for Currency; The Disentangling of Currency Returns
– *Eric B. P. Busay, CFA, CalPers*

Value-based Performance Measurement: A Further Explanation
– *Seth Armitage, Ph.D., University of Edinburgh and Gordon Bagot.*

Utility-Adjusted Performance
– *Charles E. Appeadu, Ph.D., CFA, CFA Institute and Luis García-Feijóo, Ph.D., CFA, CFA Institute*

The Journal Interview
– *David Spaulding, CIPM, The Spaulding Group Inc.*

What would I agree with? The following language: "Firms must not market a composite to a prospective client who has assets less than the composite's minimum asset level." THIS is changing a *recommendation into a requirement*. [1]

Number 2: ¶ 5.A.8: "For periods beginning on or after 1 January 2011, if a composite contains any proprietary assets, the firm must present, as of the end of each annual period, the percentage of the composite assets represented by the proprietary assets." I STRONGLY oppose this. I see no reason for it. More work for no benefit.[2]

Number 1: ¶ 0.B.2: "Firms should provide to each existing client, on an annual basis, a compliant presentation for the composite(s) in which the client's portfolio is included." At a minimum, half of your clients will want to know why their return is below average.[3] work. This will require more work, more staff, more headaches. For what benefit?[4]

DON'T BE SO NEGATIVE…

Please don't interpret my remarks as suggesting that I oppose everything about the proposed changes, because I don't. There's much I agree with. For example:

¶ 3.A.1: "All actual discretionary portfolios must be included in at least one composite." Translation: you must include non-fee paying accounts. I support this; I just don't want "proprietary" assets to be included.

¶ 4.A: The idea of having time limits for certain disclosures. This was discussed several years ago and never got implemented, so I'm glad it's being incorporated.

¶ 4.A.27 "If the firm has adopted a significant cash flow policy for a specific composite, then the firm must disclose how the firm defines a significant cash flow for that composite, [sic] and for which period(s)." This requirement was imbedded in the guidance statement; it was an oversight for it not to be included within the body of the standards, which no doubt resulted in it not always being shown.

¶ 4.A.29 "Firms must disclose the 3 year annualized ex-post standard deviation…" I'm glad that a risk measure is being mandated. And while standard deviation is a measure which is often challenged as being a legitimate measure of risk, mandating a statistic like this, which is quite easy to calculate, is a great idea. However, a) I don't like annualized standard deviations – I'd prefer non-annualized,[5] and b) a clear formula should be given or a disclosure should indicate which method was used. There are two approaches to standard deviation:

1 Please see our December 2008 issue for further commentary on this proposed change. (www.spauldinggrp.com/images/stories/PDF/newsletters/dec08nl.pdf)

2 Please see our November 2008 issue for further commentary on this proposed change. (www.spauldinggrp.com/images/stories/PDF/nov08nl.pdf)

3 You can respond "Hey, half had to be below, you're just in the unlucky half" or "you're part of the half that made the top half possible" or some other witty statement that surely won't satisfy your inquisitive client. No doubt some research will be in order to determine the cause of this egregious act.

4 Please see our November and December 2008 issues for further commentary on this proposed change. (www.spauldinggrp.com/images/stories/PDF/nov08nl.pdf) / (www.spauldinggrp.com/images/stories/PDF/newsletters/dec08nl.pdf)

5 Please see our June 2008 issue for further commentary on this topic. (www.spauldinggrp.com/images/stories/PDF/jul08nl.pdf)

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$$Standard\ Deviation_{Population} = \sqrt{\frac{\Sigma (r_i - \bar{r})^2}{n}}$$

$$Standard\ Deviation_{Sample} = \sqrt{\frac{\Sigma (r_i - \bar{r})^2}{n-1}}$$

Arguments can be made for using either, so I can see a reluctance to require one or the other. But, the firm should indicate which they used.

WHAT'S MISSING?

The GIPS Executive Committee has provided us with two documents:

- the proposed changes:
  (www.gipsstandards.org/news/releases/2009/pdf/gips_2010_exposure_draft_unmarked.pdf)
- a "redlined" version of the proposed changes:
  (www.gipsstandards.org/news/releases/2009/pdf/gips_2010_exposure_draft_track_changes.pdf)

Unfortunately, the proposed changes document doesn't highlight all of the changes, just a few major ones, and tackling the redlined version can be quite tedious.

So, we decided to summarize the changes in a spreadsheet
(see: http://www.spauldinggrp.com/services/resource-center/93-tips.html).
Sabina Hastings spent countless hours going through the redlined version to organize these items in (what we believe is) a more digestible format.

Please, please, please familiarize yourself with ALL of the proposed changes. And please voice your opinion. If you agree with something, great! If not, let them know! If you are apathetic, you may not like what happens. If you're involved in the world of performance measurement (why else would you be reading this) and are a fan of GIPS, then make your opinion (a) heard and (b) be counted!

A WEBINAR IS COMING TO A THEATER (COMPUTER SCREEN) NEAR YOU…

We're hosting a webinar at 11:00 AM EST on March 4 to further acquaint you with what's being planned. Our verification clients get "comped," but others (sorry) have to pay. But, the fee is quite nominal. You'll hear from two of the members of the Executive Committee. I will *chair & share* my opinions and will promise to be good and not overly boisterous. [hey, the entertainment alone is worth the price of admission] Please join us. There's a single fee per dial-in, so you can have anyone and as many as you want on your end of the phone (what a deal!). Plus, you will be able to ask questions!

BERNIE & OJ

It occurred to me that Bernie Madoff and OJ Simpson have something in common: they fooled a lot of people. I was fooled by OJ (as were a lot of folks); and the SEC was fooled by Bernie (again, like a lot of folks). As Ronald Reagan opined, "doveryai, no proveryai" (trust, but verify).

WHAT HAPPENS WHEN THE NEW VERIFIER FINDS THAT THE OLD VERIFIER DIDN'T DO SUCH A GOOD JOB?

The GIPS standards don't give any guidance on what a verifier is to do when they discover that a firm that had (a) been claiming compliance for a while and (b) had been verified actually (c) isn't compliant and (d) may not have EVER been compliant. We've had this happen a few times.

There is no requirement for us to "look back" at prior periods; if we're brought in, for example, to look at the 2008 returns, that's our focus. But, we may discover things that we know (or at least believe) occurred previously. What to do?

First, the firm must address 2008, right? But what about the prior periods? Given that the standards "were developed in order to provide an ethical framework for the calculation and presentation of the investment. performance history of an investment management firm,"[6] we would expect that the firm should make similar adjustments to their history. Otherwise, they will be knowingly claiming compliance for a period for which they aren't compliant. Can a verifier mandate that the firm take these steps? Perhaps not, but they can refuse to issue a verification letter until the firm takes such action. What's the worse thing that can happen? They'll get fired. But, would they want a client who knowingly makes false claims?

FURTHER INFORMATION IS AVAILABLE…

The standards require that a compliant firm make certain information available if its asked for (a list and description of their composites; details on how they calculate and report performance). What about a compliant statement?

I was recently given a report from a firm that claims compliance that shows their returns along side benchmark returns. There is nothing wrong with this. However, it isn't a fully compliant presentation. Well, if you want one, just ask! (They have a footnote that reads "More detailed Global Investment Performance Standards compliance disclosure information is available upon request"). I think the proper thing for firms to do is to always give a compliant presentation.

POSTSCRIPT

In our last newsletter I wrote about a client who was seriously ill. Well, her struggle has come to an end: she passed away on Valentine's Day. Fitting, perhaps, because she was a loving person who was loved by many. She leaves two young children, a devoted husband, and countless friends. Life and death remain a mystery.

6 *Global Investment Performance Standards*. Page 1.

THE SPAULDING GROUP'S 2009 INVESTMENT PERFORMANCE MEASUREMENT CALENDAR OF EVENTS

DATE	EVENT	LOCATION
April 21-22, 2009	Introduction to Performance Measurement Training	New York, NY (USA)
May 12-13, 2009	Introduction to Performance Measurement Training	Chicago, IL (USA)
May 14-15, 2009	Performance Measurement Attribution Training	Chicago, IL (USA)
May 20-21, 2009	PMAR VII Conference	Philadelphia, PA (USA)
July 20-24, 2009	Investment Performance Measurement Bootcamp	New Brunswick, NJ (USA)
September 15-16, 2009	Introduction to Performance Measurement Training	Boston, MA (USA)
September 17-18, 2009	Performance Measurement Attribution Training	Boston, MA (USA)
October 20-21, 2009	Introduction to Performance Measurement Training	San Francisco, CA (USA)
October 22-23, 2009	Performance Measurement Attribution Training	San Francisco, CA (USA)
November 18, 2009	Trends in Attribution Symposium (TIA III)	Philadelphia, PA (USA)
December 8-9, 2009	Introduction to Performance Measurement Training	New Brunswick, NJ (USA)
December 9-10, 2009	Performance Measurement Attribution Training	New Brunswick, NJ (USA)

For additional information on any of our 2009 events,
please contact Christopher Spaulding at 732-873-5700

TRAINING...

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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:

April 21-22, 2009 – New York, NY

May 12-13, 2009 – Chicago, IL

September 15-16, 2009 – Boston, MA

October 20-21, 2009 – San Francisco, CA

December 7-8, 2009 – New Brunswick, NJ

15 CPE & 12 PD Credits upon course completion

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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:

May 14-15, 2009 – Chicago, IL

September 17-18, 2009 – Boston, MA

October 22-23, 2009 – San Francisco, CA

December 9-10, 2009 – New Brunswick, NJ

15 CPE & 12 PD Credits upon course completion

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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 2,000 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 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.