

PERFORMANCE PERSPECTIVES

with David Spaulding



VOLUME 9 – ISSUE 11

JULY 2012

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

SUPPLEMENTING YOUR GIPS® PRESENTATION

Supplemental information remains a very difficult aspect of the Global Investment Performance Standards. What is it? Are there limitations? What to flag, what not to?

It is essentially any performance or risk information that you provide a prospect, that is neither required nor recommended by the Standards. For example, performance attribution, of either the composite or a representative portfolio, is supplemental information, and must be flagged as being “supplemental.” On the other hand, any information you provide in response to a prospect’s request (e.g., “send us the returns for your composite without cash”) would not be supplemental.



You must ensure that, where appropriate, you provide a narrative to fully explain what you’re showing. For example, if you include an attribution report of a prospective client, you need to make it clear that the results may not be typical. Ideally, you explain why this account was chosen.

If you mistakenly flag something that is actually recommended (e.g., your composite’s equal-weighted return), not to worry. When you learn of this error, simply remove the flag. Likewise, we don’t feel that overlooking the annotation is a “sin,” as long as you correct it once it’s been pointed out to you.

Providing supplemental information is not a way to give your prospect information that is misleading, or that contradicts any required information. But what you can show is virtually limitless. Since GIPS no longer has after-tax performance rules, any after-tax performance would be supplemental. GIPS no longer allows you to allocate cash for carve outs, but doing so as supplemental is, in our view, permitted, provided you offer a detailed explanation as to what you’ve done.

DOCUMENTING YOUR RISK MEASURES

In a recent blog post¹ I introduced the notion of providing appropriate documentation with your risk measures, when reporting to clients or prospects. Why is this important?

First, because there are different formulas that one might use, and so simply identifying something by its name may not be sufficient. For example, Bill Sharpe’s original formula² for his risk-adjusted return metric is:



¹ <http://investmentperformanceguy.blogspot.com/2012/06/documenting-your-risk-measure.html>

² Sharpe, William. 1966. “Mutual Fund Performance.” *Journal of Business*.

The Journal of Performance Measurement®:

UPCOMING ARTICLES

Venture and Private Equity Performance Update: One Cheer for FAS157

– Susan Woodward

A New Choice in Multi-period Investment Performance Attribution: Effective Return versus Geometric Smoothing

– Ronald J. Surz

Analyzing Diversification Effects, Sector Allocations, Market Conditions, and Factor Tilts in Advanced Equity Beta Strategies: The Case of Efficient Indices

– Felix Goltz and Dev Sahos

Flows and Woes: The True cost of spot Trading Policy

– Matthew Lyberg and
Alexander Dunegan

Rethinking Portfolio Risk in Asset Management

– Charles T. Hage

$$SR = \frac{\bar{r}_p - \bar{r}_f}{\sigma_p}$$

He amended this formula in 1994:³

$$SR = \frac{\bar{r}_p - \bar{r}_f}{\sigma(r_p - r_f)}$$

Note that the numerator (referred to as the equity risk premium) hasn't changed, though the denominator has. Sharpe made it clear that he prefers this alternative form. It no doubt was influenced by the Information Ratio,⁴ as Sharpe mentioned that his ratio was a special case of it.

Regardless, it appears that the earlier form is much more in common use. But since there are two versions, explaining which you chose would be helpful. Okay, so actually including the formula in your material might be a bit much, but at least providing some information about the ratio can be helpful. More about this shortly.

Standard deviation also takes alternative forms, and again the denominator is what varies. When measuring against the “population” it is calculated as:

$$\sigma = \sqrt{\frac{\sum [r_i - \bar{r}]^2}{n}}$$

If we are measuring standard deviation against a sample, then we replace “n” with “n-1.” And though the differences aren't normally material, it's still important to indicate which was used.

Okay, so as noted above we probably don't want to see formulas, though I wouldn't object to their inclusion. Better to have a glossary that (a) explains WHAT the measure is and does and (b) that further information about it can be provided upon request. It also wouldn't hurt to explain limitations. For example, *ex ante* (forward looking) measures make assumptions; highlighting this fact would, I think, be appropriate.

The role of risk hasn't been greater. Providing appropriate risk measures, along with your returns, is critically important. But ensuring your audience is provided help to understand what it all means is also necessary.

³ Sharpe, William. 1994. “The Sharpe Ratio.” *Journal of Portfolio Management*

⁴ Treynor, Jack & Fischer Black. 1973. “How to Use Security Analysis to Improve Portfolio Selection.” *Journal of Business*.

THE SPAULDING GROUP'S 2012 INVESTMENT PERFORMANCE MEASUREMENT CALENDAR OF EVENTS

DATE	EVENT	LOCATION
August 13-14, 2012	CIPM Principles Exam Prep Course	New Brunswick, NJ (USA)
August 15-17, 2012	CIPM Expert Exam Prep Course	New Brunswick, NJ (USA)
September 18-19, 2012	Fundamentals of Performance Measurement Training	Boston, MA (USA)
October 23-24, 2012	Fundamentals of Performance Measurement Training	Chicago, IL (USA)
October 25-26, 2012	Performance Measurement Attribution Training	Chicago, IL (USA)
November 8-9, 2012	Performance Measurement Forum	Istanbul, Turkey
November 12-16, 2012	Risk Week – An Online Conference Event	
November 29-30, 2012	Performance Measurement Forum	San Francisco, CA (USA)
December 4-5, 2012	Fundamentals of Performance Measurement Training	New Brunswick, NJ (USA)
December 6-7, 2012	Performance Measurement Attribution Training	New Brunswick, NJ (USA)

For additional information on any of our 2012 events, please contact Christopher Spaulding at 732-873-5700

THE SPAULDING GROUP IS HIRING!

*Position: Sales and Client Relations –
West Coast Territory*

Our consulting and GIPS® verification business continues to grow, and we are looking for an experienced professional to head up sales and client relations for our West Coast office. The ideal candidate will bring a minimum of 3-5 years of industry experience, preferably in a sales or consulting capacity. The primary responsibilities will include promoting our services to asset managers, custodians, broker dealers, plan sponsors, and software vendors in the western United States and Canada.

A hunger and passion for success, along with excellent communication skills is a must.

Compensation will include a base salary plus commissions and benefits.

Send resumes to: CSpaulding@SpauldingGrp.com

RISK week

NOVEMBER 12-16, 2012

*An online
conference event*

AGENDA

A Framework for Risk Management of Hedge Funds

Dr. John Longo, CFA
Rutgers University

Risk Adjusted Measures
John D. Simpson, CIPM
The Spaulding Group

Value at Risk

Dr. Ben Sopranzetti, CPA
Rutgers University

A Client's Perspective on Risk

Stephen Campisi, CFA
US Trust

Risk Attribution

Dr. Philippe Gregoire
Orfival

TRAINING...

Gain the Critical Knowledge Needed for Performance Measurement and Performance Attribution

TO REGISTER:

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E-mail: info@SpauldingGrp.com



The Spaulding Group, Inc. is registered with the National Association of State Boards of Accountancy (NASBA) as a sponsor of continuing professional education on the National Registry of CPE Sponsors. State boards of accountancy have final authority on the acceptance of individual courses for CPE credit. Complaints regarding registered sponsors may be addressed to the National Registry of CPE Sponsors, 150 Fourth Avenue North, Suite 700, Nashville, TN 37219-2417. www.nasba.org

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:

September 18-19, 2012 – Boston, MA
October 23-24, 2012 – Chicago, IL

December 4-5, 2012 – 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.



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:

October 25-26, 2012 – Chicago, IL

December 6-7, 2012 – 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.



IN-HOUSE TRAINING

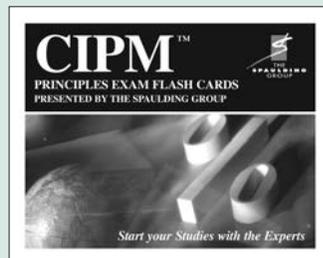
The Spaulding Group has offered in-house training to our clients since 1995. Beginning in 1998, we formalized our training, first with our Introduction to Performance Measurement class and later with our Performance Measurement Attribution class. We now also offer training for the CIPM program. To date, 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
- Immediate feedback
- Strengthen and reinforce core CIPM principles

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