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

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DO YOU NOTICE A PATTERN?

I'm late again; darn! I actually began working on this issue on June 15, but with PMAR Europe, the European Forum, and some family business I needed to deal with, it slipped. And so, I'm a bit late; sorry; I'll try to do better.

WHY SECURITY LEVEL ATTRIBUTION?

The Spaulding Group's most recent attribution survey reported that 78.7% of the participants calculate equity attribution at the security level (a figure that is down slightly from the 2007 result, when 83.1% so reported). We, of course, do not know whether by "attribution" they mean *relative* or *absolute*, but we do know from observation that many use the same model at the security level that they do at the sector: e.g., looking at selection and allocation effects.

My question: do many firms actually *allocate* at the security level? My guess is for most firms, the allocation is done at the sector level; securities are mostly selected. If this is the case, what value is obtained by calculating allocation at this level? I'd say, none; instead, contribution should be measured at the security level (or at least only security level attribution).

There are only three possible cases that involve a single security:

- In the benchmark; not in the portfolio
- In the portfolio; not in the benchmark
- In the portfolio and the benchmark.[1]

If the security is in both, then the selection effect will be zero (since one of the factors is the difference in performance).[2] The allocation and interaction effects will be nonzero. And so, if you *overweight* a security, you'll see a difference. But seriously, does the manager actually overweight relative to the index? Chances are, no. Any overweighting that is done is relative to other securities they selected; that is, if they feel more strongly about one security they bought than another, they'll invest more in it.

The index will no doubt have many more securities than the portfolio has; consequently, each security's representation in the index is much smaller than it is in the portfolio. Therefore, we will expect that any time there is a match (that is, where both the index and portfolio hold the same security), we'll have an overweighting situation. But to bother to reflect this as "allocation" is, I believe, misleading.

The Brinson models both (Brinson-Fachler and Brinson-Hood-Beebower) act in a non-sensical manner when there is something in the portfolio which isn't in the index, or

1 Of course there's a fourth: not in either, but we don't worry about this case.

2 If a money-weighted method is used for attribution, then there can be a difference, even though it's the same security.

The Journal of Performance Measurement®:

UPCOMING ARTICLES

vice versa.[3] And so, for the other two scenarios, expect to see some strange results, unless intervention occurs.

If the index has a lot of securities, will you actually list all of them in your analysis? The S&P 500 has (as the name suggests) 500 securities, which is a lot, but some indexes have THOUSANDS! This can make for a very long report. So much detail, so much triviality, so little value.

My recommendation: stop at the sector level; at the security level, show contribution. That is, to focus on how each security contributed to the overall return. Have a different view? Please chime in!

INVESTMENT REPORTING STANDARDS…NECESSARY, OR NOT?

At both Performance Measurement, Attribution & Risk conferences this year, we held debates on the subject of investment reporting standards. The "against" challenger (Neil Riddles) was victorious in Philadelphia (against Frances Barney), while the "for" challenger (Stefan Illmer) won in London (against my colleague John Simpson).

Some background

The CFA Institute has launched a working group, chaired by Stefan, to develop these standards. The makeup of this group is unknown, which I must confess seems a bit strange, but that's a different matter.[4] At last year's PMAR Europe, Stefan provided us with a brief introduction to the group's work. He frequently used the term "best practice," and continues to do so.

He has agreed with me that "best practice," in this context, amounts to the opinion of the group who develops the rules. Thus, we can expect that a different group may very well develop a different set of "best practices." Consequently, I favor making this point clear, as too many see a lot of value in "best practices," when in reality it's merely some group's opinion; a group that was handpicked and not necessarily representative of the broad views of the larger marketplace.[5]

Stefan previously chaired the European Investment Performance Committee (EIPC), which developed reporting guidance. Guidance, I am fine with; standards, I don't. I will come back to this point shortly.

3 Some additional commentary is probably justified for me to make such a strong statement. I actually have opined on this in the past, though cannot immediately identify an example. And in my haste to get this completed before we reach August, I'd better just stop with this, but promise I'll provide more in the future, in the way of explanatory commentary.

4 That is, why is the group's membership confidential? It's almost like the Manhattan Project; such secrecy!.

5 You might be tempted to respond, "yes, but won't the committee's work be provided for public comment before it's finalized?" My reply: of course! However, there is no assurance that the committee will listen to the voices of the market. GIPS® (Global Investment Performance Standards) revisions and guidance, for example, are put out for public comment, but evidence has shown that regardless of the preponderance of opinions, the committee decides what will be included (i.e., if the market strongly opposes something, it may still be included).

Why I oppose these standards:

1) What's the problem? That is, why do we need these rules? In his debate, Stefan mentioned cases where, for example, a manager calculates a positive return for their client, and receives a performance-based fee. Later, they determine there was an error, but doesn't correct it. Such reporting rules would mandate that it be corrected.

   First, was this anecdotal or does Stefan know first hand of firms who have done this?

   Second, in the United States (and I believe the rest of the world) we would refer to this as fraud.

   Third, chances are, if the firm would behave in such a manner, standards will not cause them to suddenly become ethical.

   Fourth, if this has occurred, how often and to what extent? I am unaware of any evidence that this is a widespread problem.

   The GIPS standards (and its predecessor, the AIMR-PPS®) were developed to solve a problem: many firms were using inappropriate means to promote their business. But where's the problem that needs to be solved with these standards? There is no problem.

2) Clients often direct what they want the manager to provide.

3) Firms are constantly striving to improve their client reporting, and often see this as a way to distinguish themselves from their competitors. Why must they be forced to abide by someone's opinion as to what the reports should look like?

4) To comply will no doubt be costly.

5) The CFA Institute carries a big stick. We can expect that just as with the GIPS standards, those who have the CFA charter will be expected to encourage their firms to adopt these rules.

6) Stefan has indicated that the standards will recommend that firms have their claim of compliance verified, meaning more costs.

7) When this idea was first discussed, I was told that if the market didn't want it, it wouldn't be developed. Since there has been no attempt to take the pulse of the market, it seems as if it's "full steam ahead!" In addition, I was told that there will be no survey of the market; the standard will be developed, regardless of the sentiments of the market.

   We have conducted several polls at both conferences and meetings of the Performance Measurement Forum,[6] and on every occasion the vote has been against.

   We will once again address this in our upcoming GIPS survey. Granted, the reporting standards aren't part of GIPS, but a question is included, nonetheless.

6 See http://www.spauldinggrp.com/forum.html.

The Journal of Performance Measurement® is beginning a series on performance measurement professionals, and we need your help to identify the folks we should include. We plan to focus on one or two people in each issue, but want the list to be driven by input from other PMPs.

And so, please contact our editor, Doug Spaulding (732-873-5700) with your suggestions.

8) Stefan and I agree on virtually everything, including the value of money-weighted performance for client reporting. And we have both worked to encourage firms to adopt such reporting. However, I would oppose this being mandated as part of a "standard," as the firm should recognize the value of such reporting on their own.

I will admit that I am also a bit troubled by the secrecy of this effort; specifically regarding the makeup of the committee. While we know that Stefan is chairing the group, who else is involved and what segments of the market do they represent? While I would expect that there be one or two from the "client" side (the asset owners), I'd expect to see a few representing the asset managers, too. Perhaps a software vendor representative or two, and possibly someone from a custodian bank. But at this time, we do not know. Perhaps when it's released we will.

UAPS MOVING ALONG

We are pleased that the development of the Universal Advisor Performance Standards is moving ahead quite well. The UAPS advisory board has been formed (though we're expecting to add a few more members). The membership, as it stands today:

- Todd Brunskill - First Rate
- Larry Campbell, PhD - Raymond James
- Trevor Davies - Albridge Solutions
- Christopher L. Davis - Money Management Institute
- Ric Edelman - Edelman Financial Services LLC
- James Edmonds, CFA - Morgan Stanley Smith Barney
- Brian H. Graff, Esq. APM - The American Society of Pension Professionals & Actuaries
- Joseph Klimas - Natixis
- Carlos Leute - UBS Financial Services Incorporated of Puerto Rico
- John Rekenthaler - Morningstar
- John Scully- Merrill Lynch
- Steven W. Stone, Esq. - Morgan, Lewis & Bockius LLP
- Franklin Tsung - Appcrown

We held our first meeting at the end of June, and they will continue on a monthly basis until the document is finalized.

We've gotten some great press, too, with writeups in a number of publications including *The Wall Street Journal, Forbes*, and *USA Today*.

To learn more please visit http://www.uapstandards.org/.

PARDON A BRIEF BIT OF SELF PROMOTING

We recently learned that many folks who have known us for years didn't know we offered GIPS® (Global Investment Performance Standards) verification. I'll confess that I was a bit surprised, because we actively promote this part of our business, but apparently not quite as much as we should, so I will briefly touch on our services.

First, our website (www.SpauldingGrp.com) recently underwent a complete "facelift." Patrick Fowler and Chris Spaulding managed the whole process, working with our website designer. It took several months, but it's now just about done,[7] and we're really pleased with it.

We had the accompanying logo designed a few years ago to summarize our services. In reality, we do more than what's here, and one can only say so much in a logo. I'll briefly expand upon these areas here.

- CONSULTING
  - Performance systems software design and development
  - Software searches
  - Software certification
  - Operational reviews
- VERIFICATION
  - GIPS verifications
  - Non-GIPS verifications
  - And yes, we also offer Performance Examinations, though generally discourage our clients from having them done.
- PUBLISHING
  - *The Journal of Performance Measurement*® [now in its 16th year!]
  - *The Spaulding Series* of books [Five books published to date]
  - *Formula Reference Guide* [3rd edition planned for later this year]
  - CIPM® Flashcards
- TRAINING
  - Fundamentals of Investment Performance
  - Performance Attribution
  - GIPS Fundamentals
  - Portfolio Risk
  - Performance Measurement for the non-Performance Measurement Professional
  - CIPM Prep Courses
  - Both scheduled, "open enrollment" classes, as well as in-house classes available
  - Monthly webinars

7 I qualify this statement because so much had to be changed that we know we'll find some lingering items for a while that need to be addressed. In addition, we have a few more things to add, which we think will be very exciting.

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.

- CONFERENCES & FORUMS
  - Performance Measurement, Attribution & Risk (PMAR) North America
  - PMAR Europe
  - Annual webinar week of training, focused on a single topic; in 2011 it was performance attribution; in 2012 it will be risk measurement.
  - Performance Measurement Forum (membership group; meets twice a year in North America, and twice a year in Europe.
- RESEARCH
  - Annual performance surveys on a variety of rotating topics; since 1993.
  - Proprietary research for clients
- JOB PLACEMENT
  - PerformanceJobs.com

Our website provides much more details on these items, and you can learn more by contacting Chris Spaulding (CSpaulding@SpauldingGrp.com), Patrick Fowler (PFowler@SpauldingGrp.com) (732-873-5700).

HOW YOU CAN HELP FIGHT CHILDHOOD CANCER AND BENEFIT!

You're probably familiar with Alex's Lemonade Stand: a young girl, stricken with cancer, decided to sell lemonade to raise money to fight the disease. Her legacy lives on.

We have teamed up with the foundation to raise money. Through the end of 2012, we will donate:

- 10% of proceeds from renewals to *The Journal of Performance Measurement®*
- 10% of proceeds from new subscriptions to *The Journal of Performance Measurement*
- 50% of proceeds from purchases of my *Handbook of Investment Performance Measurement,* 2nd edition that is missing a portion of the bibliography (which has been significantly reduced in cost).[8]

To renew your subscription, subscribe, or order, contact info@SpauldingGrp.com, visit our website (www.SpauldingGrp.com), or call our office (732-873-5700).

8 This was addressed in a recent blogpost: http://investmentperformanceguy.blogspot.com/2012/05/half-of-performance-measurement-book.html

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

DATE	EVENT	LOCATION
July 10-11, 2012	Fundamentals of Performance Measurement Training	San Francisco, CA (USA)
July 12-13, 2012	Performance Measurement Attribution Training	San Francisco, CA (USA)
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 29-30, 2012	Performance Measurement Forum	San Francisco, CA (USA)

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

TRAINING...

Gain the Critical Knowledge Needed for Performance Measurement and Performance Attribution

TO REGISTER:

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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:

July 10-11, 2012 – San Francisco, CA
October 23-24, 2012 – Chicago, IL
September 18-19, 2012 – Boston, MA

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 12-13, 2012 – San Francisco, CA
October 25-26, 2012 – 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

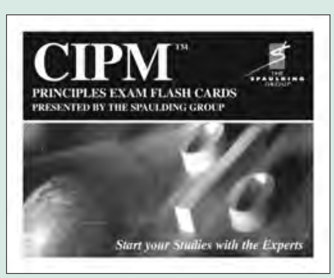
The Spaulding Group has offered in-house training to our clients since 1995. Beginning in 1998, we formalized our training, first with our Introduction to Performance Measurement class and later with our Performance Measurement Attribution class. We now also offer training for the CIPM program. To date,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

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