

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

THE NAME GAME

So, what is in a name? As (I think it was) Shakespeare said, "a rose by any other name would smell as sweet." But, can we say the same for CGIPS? No, I'd say it smells a whole lot sweeter with the new name.

In a June 2, 2006 newsletter, the CFA Institute announced that CGIPS is being renamed to CIPM (Certificate In Investment Performance Measurement), effective November 1. This means that CGIPS is going away, and being replaced by CIPM (for you lovers of acronyms, we suggest the pronunciation "sip-um").

The release stated that the head of the CGIPS (soon to be CIPM) Program, "[Philip] Lawton said the change came in response to advice from candidates, employers, volunteers, and Country Sponsors of the GIPS standards in finding a name that best reflects the curriculum's scope." We applaud this change as it does several positive things, including:

- the broader name better represents the extensiveness of the performance measurer's role
- "CGIPS" gave many the impression that the exam was only (or primarily) about GIPS®
- the change removes GIPS from the possibly perceived center of performance measurement.

We have supported certification from the beginning and this name change only makes it better!

AND SPEAKING OF CGIPS...

I don't usually make public announcements like this, but in this case I will: I passed! (And so did John Simpson). In our April 2006 newsletter we commented briefly on the exam and I indicated some concern about whether or not I passed. The 300+ people who took it were pretty brave to be guinea pigs, taking a previously untested exam, with virtually no reference points available as to how difficult it would be.

We know that roughly two-thirds passed, which is probably a pretty good ratio. After all, we want the exam to be challenging enough to properly validate someone's level of expertise.

I have yet to review the material for the next exam but recognize that it will be significantly more challenging. We will continue to offer training to candidates as an aid to their preparation process.

<http://www.SpauldingGrp.com>

The Journal of Performance Measurement®:

UPCOMING ARTICLES

How to Build Your Own Linking Formula – A Unified Linking Theory on Contributions
– Gary Kahan

Obstacles to Overcome in Performance Measurement
– Stefan Tangen

Actual Results Achieved by 401(k) Investors over a Market Cycle – Surprising Conclusions
– Colin Fernandes, Shiv Mehta

Performance Attribution Method – Update
– Teri Geske

Fixed Income Attribution – a Flexible Approach
– Per Sögaard-Andersen Ph.D. and Lars Bjerre Hansen

The Attribution of Portfolio and Index Returns in Fixed Income
– Timothy Lord

The Journal Interview
– Gary Brinson

ANNUALIZING RETURNS (CONT'D)

In our last newsletter, we touched on the issue of calculating annualized returns when the period crosses leap years and we want to use a day-count approach. I suggested using 365.333. I also indicated that an article will be forthcoming, where I will go into greater detail.

I've already been approached by a few people about this...apparently a number of folks have previously settled on 365.25. I have to admit that this is much more intuitive. In my article I'll try to justify why I think 365.333 is better. However, that being said, I think that 365.25 is perfectly fine; the differences in my findings weren't that significant. So if that's what you do, keep doing it!

In the article, I will go into much greater detail on timing and when this rule should be employed.

SUBPORTFOLIO RETURNS

If you've been reading this newsletter for a while, you know how much I favor money-weighted returns at the subportfolio level (as well as others). My rationale is based on the notion that the manager controls these (internal) cash flows. The one somewhat valid argument against this: that some of these flows are a result of external cash flows that are controlled by the client. Agreed. However, once the money is in the portfolio, it's up to the manager to decide what to do with the cash, thus I think the argument holds.

A client recently suggested that while at the sector level money-weighting made sense, they didn't see the wisdom at the security level. So, I prepared the following table as an aid to compare the approaches.

	Start			Mid-month trades				End			Returns	
	#	Price	MV		#	Price	MV	#	Price	MV	TWRR	MWRR
Security A	1,000	10	\$10,000	Buy	1,000	5	\$5,000	2,000	11	\$22,000	10.00%	56.00%
Security B	1,000	10	\$10,000	Sell	-500	10	\$(5,000)	500	11	\$5,500	10.00%	6.67%
Sector			\$20,000							\$27,500	37.50%	37.50%

In this scenario, we began with \$20,000 invested in this sector, with the funds split evenly across two securities (A and B). At mid-month, security A's price had dropped to \$5, so the manager saw this as a buy opportunity and decided to sell half of his position in B and purchase an additional 1,000 shares of A. At the end of the month, both securities ended at \$11 per share.

As we can see, there are no flows into or out of this sector, so the TWRR and MWRR¹ returns are identical. However, the TWRR returns eliminate the affect of cash flows and therefore only show the change in the securities' prices, and thus report a 10% for each, while the MWRR takes into consideration the activity.

The problems with using TWRR at the security level:

- we don't properly assess the manager's mid-month trades
- we can't tell where the sector's 37.50% return came from.

Still not convinced? Let me know, and I'll keep trying!

A FEW WORDS ON SHORTS

We don't know if it's the significant growth in the hedge fund space or some other reason, but we're getting lots of questions about calculating returns on short positions. If you're using a time-weighted method (which most people do, although from the above you can tell we oppose), you should simply take the absolute value of the denominator. A forthcoming article will go into much greater detail on this.

One other comment: don't net the long and short positions together. Unfortunately, some systems don't distinguish between longs and shorts, meaning that the positions are netted (so, for example, if the portfolio had 200 shares long and 100 shares short, the net would be 100 shares long). The problem with this (from a return perspective) is that we can't calculate returns when there are mixed short and long positions (we can calculate the returns when the starting positions are both long or both short, but not when one is short and the other long). If you're involved in this kind of trading, you should insist on the positions being treated separately. Again, more details will be presented in an upcoming article.

CONGRATULATIONS ARE AGAIN IN ORDER

We just learned that Neil Riddles of Hansberger Global has been named to represent the United States on the GIPS Country Council. The Country Council includes representatives from each of the sponsoring countries. We have known Neil for a long time and know of his vast experience and contributions to the industry; we doubt that there could be a better individual to represent the U.S. Congratulations, Neil!

¹ In keeping with the theme of "full disclosure," I'm obligated to tell you that I used Modified Dietz as a proxy for the IRR.

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.

REMINDER!!!

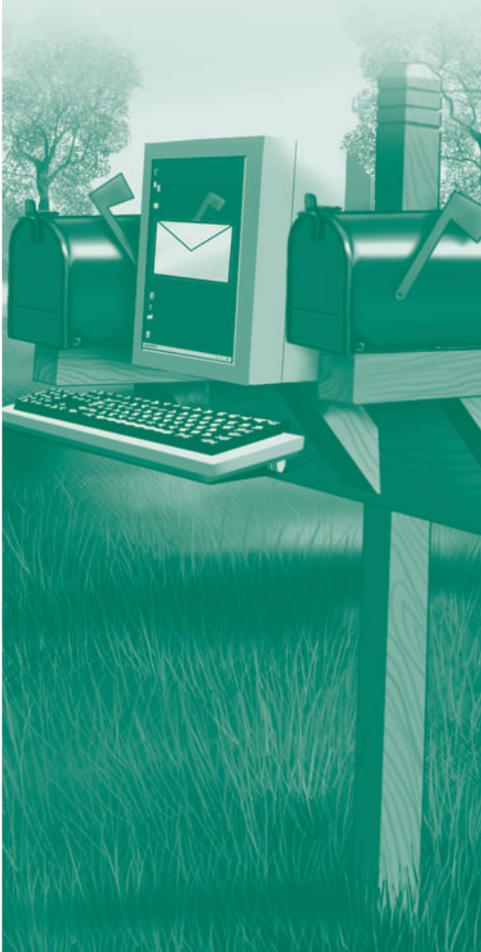
If you haven't completed your performance technology survey yet, please do. Your comments are very much welcome. And, you get a complimentary copy of the results for your efforts.

Please visit our website to download a copy of the survey at:
www.SpauldingGrp.com.

SOME PERSONAL REFLECTIONS

One of the huge benefits of writing a book is that it allows the author a chance to acknowledge people who are important to them through the book's dedication. My first book was dedicated to my wife and two sons, and my second was dedicated to both my and my wife's parents. My third book was dedicated to a friend of mine, Ian Harvey, who I've known for more than 40 years.

The reason I decided on Ian was not just because of our friendship; Ian had been struggling with cancer and we all knew that the end could come at any time, so this gave me a chance to let him know how important he was to me and my family. After a five-plus year battle with this dreaded disease, his body finally succumbed to it and Ian passed away this month, just shy of his 59th birthday. He leaves behind his wife of 35 years, three lovely daughters, and many, many friends. His wife Linda told me how important my book's dedication was to Ian; how it was one of the "highlights of his life." I was obviously touched by this, but I felt more blessed that he so appreciated my gesture. God bless Ian Harvey.



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

DATE	EVENT	LOCATION	DEADLINE TO REGISTER
July 11-12	Introduction to Performance Measurement Training	Chicago, IL (USA)	July 5
July 13-14	Performance Measurement Attribution Training	Chicago, IL (USA)	July 5
July 18-19	Introduction to Performance Measurement Training	Denver, CO (USA)	July 11
July 20-21	Performance Measurement Attribution Training	Denver, CO (USA)	July 11
August 8-9	Introduction to Performance Measurement Training	Sydney, Australia	August 4
August 10-11	Performance Measurement Attribution Training	Sydney, Australia	August 4
August 21-22	CGIPS/ CIPM Principles Preparation Class	Los Angeles, CA (USA)	August 16
August 24-25	CGIPS/ CIPM Principles Preparation Class	Princeton, NJ (USA)	August 18
August 28-29	CGIPS/ CIPM Expert Preparation Class	Los Angeles, CA (USA)	August 23
August 30-31	CGIPS/ CIPM Expert Preparation Class	Princeton, NJ (USA)	August 25
September 12-13	Introduction to Performance Measurement Training	Boston, MA (USA)	September 4
September 12-13	CGIPS/ CIPM Principles Preparation Class	Chicago, IL (USA)	September 6
September 14-15	Performance Measurement Attribution Training	Boston, MA (USA)	September 4
September 14-15	CGIPS/ CIPM Principles Preparation Class	Boston, MA (USA)	September 8
September 18-19	Introduction to Performance Measurement Training	Los Angeles, CA (USA)	September 11
September 20-21	Performance Measurement Attribution Training	Los Angeles, CA (USA)	September 11
October 9-10	Introduction to Performance Measurement Training	New York, NY (USA)	October 2
October 11-12	Performance Measurement Attribution Training	New York, NY (USA)	October 2
October 18	Fixed Income Attribution Symposium FIA	Philadelphia, PA	October 17
October 23-24	Introduction to Performance Measurement Training	Dallas, TX (USA)	October 16
October 25-26	Performance Measurement Attribution Training	Dallas, TX (USA)	October 16
November 9-10	Performance Measurement Forum	Milan, Italy	November 3
November 14-15	Introduction to Performance Measurement Training	Portland, OR (USA)	November 7
November 16-17	Performance Measurement Attribution Training	Portland, OR (USA)	November 7
Nov. 30 - Dec. 1	Performance Measurement Forum	Orlando, FL (USA)	November 24
December 5-6	Introduction to Performance Measurement Training	Chicago, IL (USA)	December 1
December 7-8	Performance Measurement Attribution Training	Chicago, IL (USA)	December 1

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

*The Journal of Performance Measurement®
Third Annual International*

F I A

Fixed Income Attribution

SYMPOSIUM

October 18, 2006

Save The Date!

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



The Spaulding Group is registered with CFA Institute as an Approved Provider of professional development programs. These programs (Introduction to Performance Measurement & Performance Measurement Attribution) are eligible for PD credit hours as granted by CFA Institute.

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:

July 11-12, 2006 – Chicago, IL

July 18-19, 2006 – Denver, CO

August 8-9, 2006 – Sydney, Australia

September 12-13, 2006 – Boston, MA

September 18-19, 2006 – Los Angeles, CA

October 9-10, 2006 – New York, NY

October 23-24, 2006 – Dallas, TX

November 14-15, 2006 – Portland, OR

December 5-6, 2006 – Chicago, IL

15 CPE 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

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:

July 13-14, 2006 – Chicago, IL

July 20-21, 2006 – Denver, CO

August 10-11, 2006 – Sydney, Australia

September 14-15, 2006 – Boston, MA

September 20-21, 2006 – Los Angeles, CA

October 11-12, 2006 – New York, NY

October 25-26, 2006 – Dallas, TX

November 16-17, 2006 – Portland, OR

December 7-8, 2006 – Chicago, IL

11 CPE 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 10 PD credit hours as granted by CFA Institute.

