

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

GOOD NEWS & BAD NEWS

We're having a fireplace installed in our home, and the guy doing the work said last week "I've got some good news, and I've got some bad news." (Not a generally welcome expression.) So, I asked what the bad news was: that the shop had used the wrong measurements to build the mantle; I then asked about the "good" news: that the mantle was done...big deal!

Well, I likewise have both good and bad news; but I learned from last week's discussion, so I'll start with the good news: that some folks at the CFA Institute read our newsletter! We were pleased to hear this. And the bad news? That I goofed a couple times in the last issue.

I had mentioned that the denominator for the standard deviation calculation had changed from the original AIMR-PPS[®] standards (when it was "n") to GIPS[®] (with it being "n-1"). It was pointed out to me that either is permitted and "firms are encouraged to disclose how it" is done.¹ I also boldly stated "as for asset-weighting of standard deviation, this was encouraged in the AIMR-series of standards, but nary a word can be found within GIPS." Well, I was mistaken: in the glossary section of the GIPS standards we find that asset or equal weighted standard deviation may be employed.²

It's nice to have friends who will keep me straight. We appreciate the errors being pointed out and hope that my error didn't cause you any inconvenience.

ADVERTISING COMPLIANCE

I don't recall seeing as many advertisements touting compliance with the AIMR-PPS[®] as I've seen recently referencing GIPS. Such public pronouncements are fantastic and will contribute to the widening commitment to these standards. There's just one problem: if you're going to advertise, you need to abide by the rules.

There was a recent one-page ad in *The Wall Street Journal* which boldly proclaimed that they had been verified! Again, fantastic! But, where was the reference as to how one could obtain a presentation and/or list and description of composites? And what about the official "GIPS advertising compliance statement?" That was missing, too! And, since the ad referenced verification, I'd suggest that it should have indicated the period for which the verification was done (unless the verification was for the entire period). There was plenty of white space available in this ad for the missing pieces.

1 "GIPS Handbook." 2002: 4-5.A.1(d) Page 2.

2 "Global Investment Performance Standards." 2005: page 44.

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

In a recent issue of *Pensions & Investments* I spied two advertisements, this time with numbers (where the requirements are a bit greater)! While the ads provided much of what is needed, some things were lacking. For example, they both showed supplemental information, which is totally permissible, but it must be “clearly labeled.” It wasn’t. And one ad didn’t indicate whether the returns were net or gross of fees.

The ad rules are pretty straightforward and are included in the GIPS standards. Anyone planning to advertise their compliance should take the time to become familiar with them and create a checklist to insure that they’ve got it right.

WHEN CLOSE IS GOOD ENOUGH

I attended an Investment Counsel Association of America³ workshop in 1988 that dealt with the subject, accuracy vs. cost in performance measurement. This topic remains an important one for me, and we could argue that we’ve made some headway in recent years to keep people mindful of the tradeoff between cost and accuracy. For example, “Gold” GIPS originally planned to mandate revaluation of portfolios for any cash flow, effective January 1, 2010. But, after a lot of comments from the public, this was changed to “any large cash flow,” where the firm gets to define what large means. We encourage firms to adopt this rule today, as large flows can distort the accuracy of a return, especially in volatile markets (and when was the last time the markets haven’t been volatile?).

When it comes to accuracy, I think there are generally two camps:

- those who want numbers to be precise to the greatest degree of accuracy, and
- those who are content with approximations.

These two groups don’t typically get along and this is why the modification of the GIPS rule helps.

I happen to fall in the latter group. I recall several years ago, when stating an estimate for something, saying something like “I think it’s around 96.” I was soundly corrected: “No! It’s 97.40.” I guess that the word “around” doesn’t extend far enough. I’d have understood the correction had I said “I think it’s around 12.”

Have you ever been on a plane when the pilot comes on and says something like “our flight time today will be approximately 6 hours and 7 minutes.” My response? You’re kidding. I’m fine with the “6 hours” part, but “7 minutes”? Perhaps some understood the reason for the qualifying “approximately” because he failed to include seconds, but I would have been fine with “approximately 6 hours” or perhaps “6 hours and 10 minutes.”

³ The ICAA is now the Investment Adviser Association.

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.

I've encountered several quotes which give testimony to the notion that "close is often good enough":

"I'd rather be approximately right than exactly wrong."

I credit our friend Steve Campisi with this saying, although I believe Peter Drucker may deserve the credit.

From Barton Biggs' new book (see below for further commentary on this item):

"Trying to determine what is going on in the world by reading newspapers is like trying to tell the time by watching the second hand of a watch."

I am finishing a book on art history (which I also reference below) and came across the following quote from Monet:

"I think most people are content with mere approximations."

With performance measurement, one needs to weigh the costs versus accuracy, especially when we're dealing with less-frequently traded instruments (e.g., bonds) and huge volumes of data. This is why some institutions that deal with thousands of accounts will use a holdings based attribution system rather than a transaction-based system: they simply cannot justify the added expense.

BOOK RECOMMENDATION

I am reading Barton Biggs' book, "Hedgehogging." What a great book it is: well written, educational, insightful. If you're involved with (or plan to be involved with) hedge funds, I'm sure you'll enjoy it.

I have already selected a few quotes from his book and incorporated them into our training class:

"Managing money is about one thing: performance."

"Because performance is measured impersonally by clearly defined quantitative standards, losers don't last long."

"As an investor in hedge funds, what would you rather have over five years? A very choppy 20% to 25% compound or a steady 10% to 12%?"

"When you are managing risk in a portfolio, you always have to remember that there is a possibility of a catastrophic outcome."

"...the greatest mathematicians and geniuses in the world are far from infallible in their ability to compute and manage risk." (regarding LTCM)

In politics, we call these "sound bites."



Consulting and Verification Services

The Spaulding Group can address any issue in the field of investment performance measurement.

Our services include consulting, verification, training, research, publishing, conferences and interactive forums. We are recognized globally as the leader in investment performance measurement products and services.

TYPES OF ASSIGNMENTS

We help clients address performance measurement in a variety of ways, for example:

- GIPS® Compliance — the *why* and *how*
- Verification/Certification
- Performance Measurement Needs
- System Design
- Software Searches
- Operational/Control Issues

OUR CLIENTS

TSG has consulted to clients from all areas of the money management industry. We serve investment advisors, banks, mutual fund companies, insurance companies, hedge funds, custodians, broker dealers, investment consulting firms, plan sponsors and software vendors.

For more information on how we can support you and your firm please contact Christopher Spaulding at 732-873-5700 or CSpaulding@SpauldingGrp.com, or visit our website at www.SpauldingGrp.com

QUOTING FROM A BOOK ON FRENCH ART

I don't know what possessed me to purchase "The Judgment of Paris" by Ross King, but I did.⁴ And, I've been enjoying it immensely. And in reading it, I picked up several quotes which seem apropos for performance measurement. Now how can a French art book have anything to do with performance? Well, when we read how some of the now legendary artists were originally critiqued, we can see how the notion of "performance" comes into play. Granted, this is subjective, not objective as we typically measure performance, but performance is still being assessed. And some of these quotes:

"No one could drag art into the gutter with greater technical virtuosity."

"The brushwork was so lacking in finesse that it could have been done with a floor mop."

And, I'll preface the following with the preface which accompanied it when it appeared in *Le Figaro*, "I'm sorry to say this to delicate readers, but it's like the taste of a sick man's handkerchief."

As you can imagine, such comments were generally unwelcome. And to think that the artists at whom they were directed went on to become masters! (Perhaps it's a good thing that we limit the performance of portfolio managers to numbers⁵).

CHINESE TRANSLATION IS ON ITS WAY!

We're pleased to announce that my latest book ("Handbook of Investment Performance: A User's Guide") is being translated into Chinese.⁶ We're at the very early stages of supporting this effort, so it most likely won't be available until year-end or 2007.

We've also provided some counsel to a group within mainland China that's interested in pursuing adoption of GIPS, which is obviously quite exciting, too.

⁴ I'm sure that the picture of the woman on the cover had no influence on me whatsoever.

⁵ Saying this, I recall a comment from a client when I worked for an investment advisor prior to starting our firm. The remark was made in early 1988, after the October 1987 "market adjustment": it's easy to know when to buy; it's difficult to know when to sell." Well, he transferred out his entire portfolio, which, in a few short months would have regained its full pre-October market valuation. Oh, well...

⁶ My first book ("Measuring Investment Performance") was translated into Japanese several years ago, so we're excited that our new offering is felt to be worthy of similar treatment.

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

DATE	EVENT	LOCATION	DEADLINE
March 30-31	CGIPS Preparatory Training	San Francisco, CA	
April 18-19	Introduction to Performance Measurement Training	Princeton, NJ (USA)	March 31
April 20-21	Performance Measurement Attribution Training	Princeton, NJ (USA)	March 31
April 27-28	Performance Measurement Forum	Scottsdale, AZ (USA)	April 24
May 9-10	Introduction to Performance Measurement Training	London, England	May 2
May 11-12	Performance Measurement Attribution Training	London, England	May 2
May 22-23	Performance Measurement, Attribution, & Risk Conference	Philadelphia, PA (USA)	May 19
June 15-16	Performance Measurement Forum	Dublin, Ireland	June 9
June 20-21	Introduction to Performance Measurement Training	Vancouver, Canada	June 13
June 22-23	Performance Measurement Attribution Training	Vancouver, Canada	June 13
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
August 7-11	Performance Measurement Boot Camp	New Brunswick, NJ	August 4
September 12-13	Introduction to Performance Measurement Training	Boston, MA (USA)	September 4
September 14-15	Performance Measurement Attribution Training	Boston, MA (USA)	September 4
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	TBA	October 17
November 9-10	Performance Measurement Forum	Milan, Italy	November 3
Nov. 30 - Dec. 1	Performance Measurement Forum	Orlando, FL (USA)	November 24
December 6-7	Introduction to Performance Measurement Training	Chicago, IL (USA)	December 1
December 8-9	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*

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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:

April 18-19, 2006 – Princeton, NJ

May 9-10, 2006 – London, England

June 20-21, 2006 – Vancouver, Canada

July 11-12, 2006 – Chicago, IL

September 12-13, 2006 – Boston, MA

September 18-19, 2006 – Los Angeles, CA

October 9-10, 2006 – New York, NY

December 6-7, 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:

April 20-21, 2006 – Princeton, NJ

May 11-12, 2006 – London, England

June 22-23, 2006 – Vancouver, Canada

July 13-14, 2006 – Chicago, IL

September 14-15, 2006 – Boston, MA

September 20-21, 2006 – Los Angeles, CA

October 11-12, 2006 – New York, NY

December 8-9, 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.



CGIPS PRINCIPLES EXAM PREPARATION

The two-day CGIPS Principles Exam Preparation class will provide you with a solid foundation for your formal study of the CGIPS Principles Exam. It will also help you identify any areas in your performance background that might need reinforcement. The earlier you commit yourself, the greater the probability of success.

March 30-31, 2006 – San Francisco, CA