

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

OUR FOURTH YEAR!

This issue marks the beginning of our fourth year in publishing this monthly newsletter. Amazing that each month I'm able to think of something given my tendency to not be very opinionated. I have to confess at times it's a challenge, but so far I've succeeded. We appreciate you reading this; we also appreciate occasionally hearing from some of our readers.

DOLLAR-WEIGHTED RETURNS AND MORNINGSTAR

In the June 5, 2006 issue of *Investment News* we read an article titled "Morningstar to publish dollar-weighted returns" with a subtitle "Aims to provide gauge of 'fund experience.'"

Now, anyone who's read this newsletter for any amount of time knows how I feel about money-weighting, so at first glance you probably think I'm thrilled to learn of Morningstar's plans. Well, I am...kind of. First, I'm very pleased that they are using dollar-weighting (actually, it should be money-weighting, but that's just me being (a) nit-picky and (b) pc (politically correct)).

The article states "As defined by Morningstar, dollar-weighted returns will take into consideration the monthly total assets of mutual funds." But the value of this is unclear to me, since the managers don't control the flows. The whole argument against judging managers by using dollar-weighting is they usually don't control flows, so the results can be misleading.

We're hoping to gain some greater insights into exactly what's going on here. I'm hoping to interview Morningstar's president for an upcoming issue of *The Journal of Performance Measurement*[®]; in addition, we're hoping for an article that goes into some detail on their approach

HOW TO BE OFFENSIVE, IN ONE SIMPLE LESSON

As I write this, I'm sitting in my hotel room at the Fairmont Tremblant in Mont Tremblant, Quebec (about two hours north of Montreal). I was asked to give a talk at the Canadian Investment Review's annual Risk Management Conference for plan sponsors. The topic? You guessed it, money-weighting vs. time-weighting. And the title I chose: "Time-weighting vs. Money-weighting — You're Probably Calculating Your Returns Wrong!"

The Journal of Performance Measurement®:

UPCOMING ARTICLES

Evaluation of Portfolio Performance: Attribution Analysis

– Brian Singer

Currency Overlay Attribution: A Practical Guide

– Jeroen Geenen, Marten Klok,
& Elske van de Burgt

A New Approach to Decomposition of Yield Curve Movements for Fixed Income Attribution

– Andrew Colin, Mathieu Cubilie
& Frederic Bardoux

Risk Exposure in the Real World

– Mark P. Kritzman, Ritirupe
Samanta and Jennifer Bender

Performance Attribution with Zero Weighted Sectors

– Damien Laker

Fixed Income Attribution the Combined Methodology

– Bernard Homolle and
Philippe Gillet

The Journal Interview

– Barton Biggs

Now, was I trying to be offensive with such a title? I don't think so. But, it's definitely offering the potential, isn't it? Telling someone that they're wrong isn't exactly the best ice breaker when first meeting a group. But, the reality is that most plan sponsors *are* doing it wrong by solely relying on time-weighting.

Time-weighting is great to know how the *manager has done*; but to know how the *plan has done*, we really need money-weighting.

WHAT TO INCLUDE...WHAT NOT TO.

If you haven't received a copy of the recently republished *Global Investment Performance Standards (GIPS®) Handbook*, you should. It's a great resource to have along with the standards themselves.

I recently came across a table which discusses various cases managers typically run into and whether or not the assets should be included in the "firm assets."¹ There are two rows in particular we will reproduce here and touch briefly upon:

Asset	Included?	Reason
Nondiscretionary Assets in all asset classes: Firm has conditional trading authority; strategy implementation restricted.	Yes	Client-imposed restrictions result in firm having limited control over investment decisions.
Assets within advisory-only client relationships	No	Firm has no control over implementation of investment decisions and no trading authority for the assets.

The term "nondiscretionary" can be confusing, especially when there's a regulatory body (e.g., the Securities & Exchange Commission) involved. A client might, for example, sign an agreement with their client giving them discretion over their assets, but may impose certain restrictions (e.g., no sin stocks) such that the manager feels he/she cannot fully implement their strategy, in which case they (the manager) declares the account to be non-discretionary (for GIPS purposes); this is different from the case where the agreement with the client is one where the relationship is non-discretionary and where the manager does *not* have the ability to invest for the client but rather may offer advisory services. The first case in the table above (as I understand it) has to do with the situation where we have a discretionary account that has restrictions that cause the manager to declare it non-discretionary. For accounts that are, by definition, non-discretionary, we would use the second row (referencing advisory-only relationships).

¹ Please see pages 67-68 of the handbook.

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I think the real question is: does the manager have the ability to invest for the client? If the manager gives advice which may or may not be followed, then the assets are not to be included.

A similar case happens when the manager makes available their model to a third party. We've seen cases where a firm will include these assets in their "firm assets." However, this would be inappropriate since they have no way to confirm whether their strategy is actually being implemented; and even if they did, they don't have control over the assets; a third party does.

Another interesting case is with *restricted assets*. These are assets that the client brings to the client and says "don't trade these." For example, a client gives a manager \$5 million in cash and \$1 million in stocks. They then tell the manager that the stock isn't to be sold. This might be a case where the presence of these restricted assets causes the firm to declare the account to be "non-discretionary." As we can see from our table, the assets would be included in the firm's assets; but what assets? I'd suggest just the \$5 million, because the other \$1 million isn't available to them (the client could just as easily hold these assets elsewhere; they have them here for convenience or to see consolidated reporting).

I have asked for confirmation on my interpretation from the CFA Institute, and if I learn that I am in error, I will surely let you know.

ANNUALIZING RETURNS – STANDARDS OR GUIDANCE TO FOLLOW

In our July newsletter we touched on the issue of annualizing returns for odd time periods and how some use 365 days but how this can cause problems when we have leap years (which happen from time-to-time). So what's a person to do? We suggested that 365.333 seemed to be a good divisor in many cases, but admitted that 365.25 seems more intuitive.

Well, we decided to solicit the help of several industry leaders to contribute to standards or guidance on this matter. We're in the group-assembling stage and have already gotten several folks involved:

Cecilia Wong – Base-Two

Carl Bacon – Statpro

Anthony Howland – Performa

Mark Osterkamp – Wilshire

Todd Brunskill – First Rate

Pat Schumacher – Mellon Analytical Solutions

John Kahila – Thomson.

We plan to invite a few more folks before moving to our next stage of the process: discussion and formulation of guidance / standards. We'll keep you abreast of our progress.

To optimize your CGIPS preparation, please consider attending our two-day courses.

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

2006 CGIPS Principles Exam Preparation Training Schedule

Chicago, IL

September 12-13, 2006
4 Points Sheraton

Boston, MA

September 14-15, 2006
Boston Sheraton

Princeton, NJ

September 25-26, 2006
Princeton Marriott

2006 CGIPS Expert Exam Preparation Training Schedule

Princeton, NJ

September 6-7 2006
Princeton Marriott

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9/11 TRIBUTE

We often get our newsletters out towards the end of the month, but this month we're early because we wanted to get it out before the 11th. September 11th simply won't be the same ever again for many of us.

I was recently asked to visit a client in Boston and we settled on September 11th. But as soon as I hung up the phone, I realized "the 11th is the 11th." It's not just *any* 11th...it's September 11th. And, ironically I'd be flying from Newark to Logan, the two airports from which the terrorists flew that fateful day, five years ago. I immediately called back and said I couldn't go that day, because (a) it was the 11th (and my wife wouldn't let me (nor would I choose to fly)) and (b) because our town has its annual memorial service which I must attend.

I realize that not all of our readers are old enough to recall *where they were when JFK died*. But those from my generation or earlier do (at least the Americans), no doubt do (I was in school). Likewise, I know where I was when the stock market had its adjustment in 1987 (attending a Q-group meeting in Colorado Springs). Such events tend to make a lasting impression on us such that we know where we were when the event occurred. We can often recall vivid images, too.

I'd say that most people, and not just Americans, know where they were five years ago on September 11th (I was in London attending a meeting of the Investment Performance Council). Five year anniversaries are usually special events, but not when they involve tragedies. They do, however, provide an even greater reason for reflection.



I'm quite proud of the memorial our town erected for the victims of 9/11. I was mayor at the time and was the one who created the committee that oversaw the fund raising, design, and construction, as well as the organizing of our annual memorial services. U.S. Route 1 (a rather major highway) passes through our town, and signs are now being placed on the road to give directions to the memorial. When I was mayor, I asked our State Senator to get legislation passed to name this stretch of road "9/11 Memorial Highway." While it's taken a few years for this to happen, we're hopeful that this will be a reality in early 2007.

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.

There's a song that we sing at our church whose words, to me, tie in very well with 9/11:

YOU ARE MINE, BY DAVID HAAS

1

I will come to you in the silence
I will lift you from all your fear
You will hear my voice, I claim you as my choice,
be still and know I am here.

Refrain:

Do not be afraid I am with you.
I have called you each by name.
Come and follow me, I will bring you home;
I love you and you are mine.

2

I am hope for all who are homeless,
I am eyes for all who long to see.
In the shadows of the night, I will be your light,
come and rest in me.

3

I am strength for all the despairing,
healing for the ones who dwell in shame
All the blind will see, the lame will all run free,
and all will know my name.

4

I am the Word that leads all to freedom,
I am the peace the world cannot give,
I will call your name, embracing all your pain,
stand up, now walk, and live!

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I can't sing the song without feeling emotion. I hope that you find some comfort in these words.



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

DATE	EVENT	LOCATION	DEADLINE TO REGISTER
September 6-7	CGIPS/ CIPM Expert Preparation Class	Princeton, NJ (USA)	September 4
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
September 25-26	CGIPS/ CIPM Principles Preparation Class	Princeton, NJ (USA)	September 22
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

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F I A

Fixed Income Attribution

SYMPOSIUM

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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:

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

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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:

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

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