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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NEW THINGS ALL AROUND!

Happy New Year! It's a new year that's already bringing some changes.

First, if you're observant you'll note that my photo is different. I spoke at a plan sponsor conference in Mont Tremblanc (near Montreal) last year and they had a photographer take pictures for articles that would follow. I liked the photo and so obtained the rights to use it.

We've also changed our "tag line." It's now:

Performance Measurement is Our Passion™

We believe this communicates our role in the industry. Performance measurement has been our focus for several years. But we don't just *do* performance measurement. Rather, we're *passionate* about performance measurement.

Our firm has arguably been a major force for change in our industry, spearheading such initiatives as:

- the development of attribution standards
- the development of guidelines for error correction
- the realization that performance measurement is a *profession*
- the development of a formal certification program for performance measurers

and, most recently, the creation of working groups to develop standards / guidelines for:

- hedge fund performance
- an RFP (Request for Proposal) template
- return annualization.

We are constantly looking for ways to enhance our segment of the financial industry. We believe that this new tag line captures this.

"BACON"

Perhaps you've seen the television commercial that shows a dog being given a Rorschach Test and he responds "bacon" to everything that's shown. Well, it appears that at times whatever I'm shown yields the response "performance measurement." Pretty sick, right? (I said we were *passionate* about performance measurement).

My latest example occurred while reading G.K. Chesterton's *Saint Thomas Aquinas*. In the opening chapter Chesterton explains how St. Thomas Aquinas and St. Francis of Assisi were both, in their own ways, developing the doctrine of the Church. He wrote:

The Journal of Performance Measurement®:

UPCOMING ARTICLES

"Development is the expansion of all the possibilities and implications of a doctrine, as there is time to distinguish them and draw them out; and the point here is that the enlargement of medieval theology was simply the full comprehension of that theology." It occurred to me while reading this that performance measurement is undergoing a similar "development in doctrine." We have been at this for about 40 years[1] but are now rethinking much of what we've been doing and, at the same time, uncovering new areas that need to be addressed.

Thus, I continue to tell people that performance measurement is an exciting place to be. Hope you agree!

GIPS 2010

I expect that the GIPS Executive Committee (EC) will soon begin work on the next version of GIPS®. A question occurred to me: it's the intent of the EC to have new versions introduced every five years. The last one (code named "Gold GIPS") was published in 2005 but went into effect 2006. Will this mean that the next version will be published in 2010 to go into effect 2011? I imagine we'll learn some time in the next year or so.

An unfortunate item that seems to still be hanging about is the notion of "mandatory verification." I opposed this with the 2005 edition and will continue to oppose it. And, a majority of those who commented on this opposed it, too. Hopefully we will not see this come to fruition.

A planned change which I hope to get dropped is the planned requirement to eliminate the ability for firms to *allocate cash* for carve-outs (see 3.A.7) effective 2010. I see no reason why firms cannot continue to allocate cash on an on-going basis.

As we begin to learn more about the new version, we'll pass the details and our comments along to you.

MORNINGSTAR AND MONEY WEIGHTING

You may have read that Morningstar®, the firm perhaps best known for its "star ratings" has introduced money-weighted returns. When I first heard of this, I was a bit perplexed, wondering what a money-weighted return for a mutual fund would reveal. Taking into consideration the aggregated flows of all investors wouldn't do much, would it?

To learn more, I met with Don Phillips and Paul Kaplan of Morningstar in early November. The primary purpose for the visit was to interview Don for the Fall issue of *The Journal of Performance Measurement®*. It was quite an enlightening session.

1 If we use Peter Dietz's 1966 thesis as our starting point.

The Spaulding Group (TSG) can address any of these common problem areas

Types of Assignments

General Performance Measurement Issues

TSG assists firms in evaluating the broader areas of performance to include calculations (which to use and when), reporting (for internal use, for prospects, and for clients), systems issues, and other areas.

Verification/Certification

We also offer GIPS® verification, and if you are not claiming compliance but need your numbers certified, we can assist with that as well.

GIPS Compliance

Many firms need assistance understanding the GIPS standards and determining whether they should comply. Also, many need help developing a strategy to become compliant or remain compliant. Often, in just a day or two, TSG can help you address the opportunities, benefits, and tasks to be tackled in order to comply.

System Design

TSG can support you in the design and development of your performance system. We can also assist in documentation and testing.

Software Searches

TSG can help you decide which software product best meets your firm's needs, and we also support the implementation process.

Operational/Control Issues

TSG can assist you in dealing with a host of operational challenges including data integrity, reconciliation, policies and procedures, and much more.

INVESTORS DOLLARS SPEAK LOUDLY

Fund Family	10 Yr DWR	10 Yr TR	Success Ratio	2004/2005 Asset Flows
American Funds	10.07	10.58	95%	+169B
Vanguard	7.65	8.85	86%	+97B
Fidelity	8.01	8.85	91%	+29B
Dodge & Cox	12.55	12.77	98%	+33B
Franklin Templeton	7.86	8.38	94%	+24B
Putnam	4.28	6.37	67%	-48B
Janus	2.30	9.05	25%	-29B

10 years ending 12/31/05
Source: Morningstar

My initial reaction to the idea of providing a money-weighted return was not very favorable, since the managers don't control cash flows. However, when Morningstar did their research they found that there seemed to be a correlation between the money-weighted returns and asset flows (higher returns corresponded with larger flows). This suggests that investors tend to respond favorably to positive results, even though the money-weighted returns aren't reported.

Mutual Fund sponsors that attempt to respond to the latest "hot" area (e.g., the ".com" craze of the late '90s) often see very large positive returns followed by steep drops.

This month is probably a good example of another part of the problem: investors chase returns. Publications like *Money* publish the results of last year's mutual fund performance, showing the "top" and "not so top" performers. It's very typical to see large inflows into the top performers. But, as we say, *past performance is no indication of future results*. And since these top performers are often in sectors that may not necessarily repeat the following year, investors are often disappointed with the results.

I also saw a correlation between the money-weighted returns and the volatility of the time-weighted returns. This is probably not surprising.

A comparison between time- and money-weighted returns is a way to try to see how the market has responded to the performance of the manager. We can't *judge* the manager by the money-weighted returns, but we hope to gain some insights from these values.

This is an interesting idea and we look forward to learning more about it and the market's reaction to it.

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.

COMMENTS FROM READERS

Andre Mirabelli sent the following:

I am sorry I again missed out on being mentioned in your Performance Perspectives newsletter, this time in the December 2006 issue when you quoted my "longish" responses to your comments on asset-weighting vs. aggregation return calculations, and again when you twice paraphrased my last line in that quote "decide what the question is". As I mentioned when you used the PAR diagrams in a previous newsletter, I would have been happy to have my comments attributed to me in your newsletter and will proudly point them out to my friends who are interested in such matters.

In regards to your comments this month, did you mean that the money for B was present for 2/3 of the time (giving the 3.6% you mentioned for the result of the modified Dietz approach to the aggregate/total values) instead of "the money was present only one-third of the time" (which would have given 4.5%).

I continue to believe that these issues concerning performance, which you often highlight in your newsletter and in your other venues, still remain well worth considering in even more depth and I address them in the book I mentioned I am working on.

Regards,
Andre

My apologies to Andre for not identifying him in last month's issue.

THE SPAULDING GROUP'S 2007 INVESTMENT PERFORMANCE MEASUREMENT CALENDAR OF EVENTS

DATE	EVENT	LOCATION
February 12-13	Introduction to Performance Measurement Training	New York, NY (USA)
February 14-15	Performance Measurement Attribution Training	New York, NY (USA)
February 12-15	CIPM Principles Exam Preparation – Special 5-Day Night Class	New York, NY (USA)
February 26-27	CIPM Principles Exam Preparation	Los Angeles, CA (USA)
February 28-March 2	CIPM Expert Exam Preparation	Los Angeles, CA (USA)
March 5-6	CIPM Principles Exam Preparation	New Brunswick, NJ (USA)
March 7-9	CIPM Expert Exam Preparation	New Brunswick, NJ (USA)
March 12-13	Introduction to Performance Measurement Training	Boston, MA (USA)
April 16-17	Introduction to Performance Measurement Training	San Francisco, CA (USA)
April 18-19	Performance Measurement Attribution Training	San Francisco, CA (USA)
April 26-27	Performance Measurement Forum	New Orleans, LA (USA)
May 8-9	Introduction to Performance Measurement Training	Chicago, IL (USA)
May 10-11	Performance Measurement Attribution Training	Chicago, IL (USA)
May 15-16	PMAR Conference	Philadelphia, PA (USA)
June 4-5	Advanced Performance Measurement Training	New Brunswick, NJ (USA)
June 14-15	Performance Measurement Forum	Helsinki, Finland
July 16-20	Investment Performance Measurement Boot Camp	New Brunswick, NJ (USA)
August 20-21	CIPM Principles Exam Preparation	Boston, MA (USA)
August 22-24	CIPM Expert Exam Preparation	Boston, MA (USA)
August 27-28	CIPM Principles Exam Preparation	Los Angeles, CA (USA)
August 29-31	CIPM Expert Exam Preparation	Los Angeles, CA (USA)
September 17-18	Introduction to Performance Measurement Training	Los Angeles, CA (USA)
September 25-26	Introduction to Performance Measurement Training	Chicago, IL (USA)
September 27-28	Performance Measurement Attribution Training	Chicago, IL (USA)
October 8-9	Introduction to Performance Measurement Training	Boston, MA (USA)
October 10-11	Performance Measurement Attribution Training	Boston, MA (USA)
October 15-16	Advanced Performance Measurement Training	San Francisco, CA (USA)
November 8-9	Performance Measurement Forum	Athens, Greece
November 29-30	Performance Measurement Forum	Orlando, FL (USA)
December 3-4	Introduction to Performance Measurement Training	New Brunswick, NJ (USA)
December 5-6	Performance Measurement Attribution Training	New Brunswick, NJ (USA)

For Additional information on any of our 2007 events, please contact Christopher Spaulding at 732-873-5700

TRAINING...

Gain the Critical Knowledge Needed for Performance Measurement and Performance Attribution

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:

- February 12-13, 2007 – New York, NY
- March 12-13, 2007 – Boston, MA
- April 16-17, 2007 – San Francisco, CA
- May 8-9, 2007 – Chicago, IL
- September 17-18, 2007 – Los Angeles, CA
- September 25-26, 2007 – Chicago, IL
- October 8-9, 2007 – Boston, MA
- December 3-4, 2007 – New Brunswick, NJ

CFA INSTITUTE
PROFESSIONAL DEVELOPMENT
QUALIFIED ACTIVITY
12 CREDIT HOURS

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:

- February 14-15, 2007 – New York, NY
- April 18-19, 2007 – San Francisco, CA
- May 10-11, 2007 – Chicago, IL
- September 27-28, 2007 – Chicago, IL
- October 10-11, 2007 – Boston, MA
- December 5-6, 2007 – New Brunswick, NJ

CFA INSTITUTE
PROFESSIONAL DEVELOPMENT
QUALIFIED ACTIVITY
12 CREDIT HOURS

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 10 PD credit hours as granted by CFA Institute.

ADVANCE PERFORMANCE MEASUREMENT

- June 4-5, 2007 – New Brunswick, NJ
- October 15-16, 2007 – San Francisco, CA

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, over 1,500 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 transporting their staff to our training location and limits their time away from the office. And, because we discount the 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). The two-day Advanced Performance Measurement Class combines elements from both classes and expands on them.

TO REGISTER:

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