PERFORMANCE PERSPECTIVES
with David Spaulding

VOLUME 10 – ISSUE 10 JUNE 2013

GIPS® 2015…NOT!

We conducted a brief survey and heard from just 37 folks, which isn't very much. But, we didn't do a very extensive job of promoting it, either. Here are the questions and the results.

1. Do you think there should be a 2015 edition of the Global Investment Performance Standards (GIPS); i.e., a GIPS 2015 edition?
   a. Yes 20/54%
   b. No 17/46%

Comments: Roughly a 50/50 split. I would think there's justification to have the 2015 edition, but obviously that won't happen.

2. Do you have suggested changes to the current, 2010 edition?
   a. Yes 9/24%
   b. Not today, but perhaps at some point in the future 20/54%
   c. No, with no expectations of identifying any 6/16%
   d. Not sure / Don't know 2/5%

Comments: Interesting that I'm not the only one that has changes in mind.

3. Do you think introducing new requirements in Guidance Statements is a good idea?
   a. Yes 15/41%
   b. No 18/49%
   c. Not sure / Don't know 4/11%

Comments: Again, close to a 50/50 split, with a sizable percentage that doesn't like the idea.

4. Do you think introducing new requirements in Q&As is a good idea?
   a. Yes 12/32%
   b. No 21/57%
   c. Not sure / Don't know 4/11%

Comments: Even more who don't like seeing requirements introduced in Q&As.

__A few comments__

I was sent a couple comments about this from two colleagues, one who wished to remain anonymous, and one who didn't mind being identified.

__From Anonymous__

For what it's worth, I don't believe a 2015 edition is required although surely there is on ongoing/perpetual need for interpretations that can be addressed through Q&As and/or guidance statements. They wouldn't (and shouldn't) create new requirements, but

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can rather clarify or indicate new options (which are different, in my mind, from new requirements).

I will say that in an ideal world, I believe there would be a new edition on a specific (e.g. five-year) cycle. But we don't live in an ideal world, and the world in which we live has finite resources. In this case, the notable finite resources are human – most of whom are volunteers. I understand that it's an incredibly time-consuming process to undertake a full bore revision of the standards. That's probably part of the reason you don't see things like organizations FASB or IASB doing it for accounting standards. I understand there's a belief the GIPS volunteer and staff resources can (and will) be better utilized through a deployment that's intended to be more nimble and responsive.

Surely I'd have suggested changes to the current edition. I don't believe anybody in the world, including those who were on the EC and collectively created the current 2005 edition, agrees with every single provision. As you can appreciate, there would be a good number of compromises and concessions as part of a process like that. But that's a different matter than believing there should be a new edition in 2015.

Interesting point that new requirements should not be introduced through Q&As and Guidance Statements; but that's apparently what's planned. I also wouldn't favor a "full bore revision." I don't believe that's necessary.

Carl Bacon

David,

I hope you are well

I don't mind admitting section 0 was my idea - and I think it was a good one. You're right I suggested it to maintain the existing numbered sections - but actually I think it's a reasonable idea anyway - I often see initial or introduction sections numbered zero so for the "fundamentals of compliance" section it makes sense. It is strange in the US you have an aversion to the number zero - I see the same in lifts (or elevators) you guys insist on calling the ground floor the first floor - its not the first floor is obviously the first floor up. In many lifts where the ground floor button is not called ground floor its called zero - take a look when you are next in Europe.

After the GIPS decision I saw a similar decision taken at King's Cross station in London. King's Cross station had 8 platforms originally -numbered 1 to 8 East to West - many years later 3 platforms were added to the West numbered 9 to 11 and a couple of years ago a platform was added to the East - what did they call it - well of course platform 0 - logical really.

By the way I don't think there should be GIPS 2015 - very dangerous to slip into a 5 year cycle (and it was never intended to have a 5 year cycle as far as I recall it was never expected their should be a 2015 version)- asset managers want stability they don't want constant change - it also creates unnecessary effort re-writing the core standards which needs very careful checking - it also opens up old issues and debates - and whether we like the end result or not (and often I don't) we should let them rest. The EC's efforts are best directed on new and novel issues and concerns.

And whilst I'm writing of course I think money-weighted returns are an absolute non-starter for GIPS - Whether you think money weighted returns are relevant or not (and

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

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

for all the reasons I've shared with you already they are fundamentally wrong) GIPS is about comparing performance - either against other managers or published benchmarks - and that is simply not appropriate with GIPS

Best regards
Carl

In response to Carl, I don't believe Americans have an "aversion" to the number zero. As in many cases, we differ on certain things (Brits, for example, insist on driving on the wrong (left) side of the road, while Americans (and most everyone else) drive on the right (right) side. Zero literally means nothing ("naught"); and so, to have a floor zero means it's a "nothing" floor. But, we're used to its use in GIPS, though I'd like it to conform with most numbering schemes.

As to King's Cross, what if another station was added to the east, would it be −1 (minus one)?

When new exits are added to a highway in the U.S., sometimes we see the whole system renumbered, though this is very rare. What has begun to happen is that exits are aligned with mile markers (e.g., the 19th exit is at or about Mile Marker #19). If additional exits are added between exits, they get an "A" assigned.[1]

Carl's aversion to money-weighting is well known. Others (like me, Steve Campisi, and Stefan Illmer) realize money-weighting's value, and the nonsensical rules that now apply and restrict its applicability.[2]

Carl's reference to the "danger" of having a five year cycle is interesting; I'd be curious to know what danger he's referring to. The understanding (which has been mentioned many times) is that there would be a five-year review, to determine if changes are necessary. To my knowledge, this review has not occurred. I have not advocated changes every five years; simply that what was intended be maintained. I've already identified the dangers[3] of introducing changes within Q&As and guidance statements. The Standards are a nicely organized book[4]; they should be the sole repository and source for the rules.

Enough Said! Okay, I'm done talking about this. There will not be a GIPS 2015…so get over it!

REPORTING GUIDELINES

I had hoped to have read this document by now, but my travels and other activities have gotten in the way; hopefully soon. In the meantime, if you wish to "chime in" with your thoughts, reactions, etc., just send me an email. Note, if you'd like we'll show your comments as "anonymous," though you need to identify yourself to us. Thanks!

1 For example, on the New Jersey Turnpike we had exits 8 and 9; one was added in between and was given the number 8A. Likewise, there's a 13A. I suspect that if one was added before exit 1, it would not be called "0." If we did number it zero and added yet another, having "Exit −1" wouldn't work too well.

2 I'm reminded of the saying, *if it walks like a duck, looks like a duck, and sounds like a duck, chances are it's a duck.* Consequently, to have certain rules for only select asset classes, that clearly apply to other cases, is unnecessarily and inappropriately restrictive.

3 Clearly not my word, but it fits here.

4 Save for section zero.

PUZZLE OF THE MONTH

Only one person got this right; and, interestingly, he was the victor at the first annual Performance Jeopardy contest at PMAR North America: Richard Mitchell from Canada.[5] Not only did Richard give the wagers, he provided the rationale behind his answers, which aligns quite well with what I have written below.

My wife and I regularly watch the show, and I've come to conclude that while anyone who makes it on this show is quite bright, and possesses extensive knowledge about many subjects and possesses a solid memory, many of the players simply don't know how to bet during "Final Jeopardy."

During this part of the show, Alex identifies a topic, and the players must write down the amount they wish to wager. Then, the question (actually, it's an answer) is disclosed, and the players have 30 seconds to write down their response. Key points:

- The person with the highest amount wins the amount they end up with, and returns for another show.
- The person that finishes in second place wins $2,000 and the player who finishes in third place wins $1,000.

Before going over the "games" that were outlined for this month, it's important to state the following: IF the person in second place has more than half the amount of the person in first place (e.g., the first place player has $10, 000 and the second has $7,000), it is *generally expected* that the second place player will wager his/her total amount (e.g., $7,000; meaning he/she will have $14,000 if they are correct), in order to win. Therefore, it is also quite common for the first place player (who "knows" this) will wager just enough to beat the player, should they both get the question right (e.g., in this example $4,001, so that he/she will have $14,001 should they have the question right, and beat the second place player by one dollar.

Another thing to know: if two players end up tied for first place, they both (a) get the amount they end up with and (b) return for the next show.

We posed three scenarios ("games"), with questions for each.

Game #1
Player A: $14,000
Player B: $10,000
Player C: $2,000

How much should Players A and B wager?

Recalling that it's expected that Player B will double his/her bet (i.e., wager $10,000, to arrive at $20,000 should he/she get the right answer) Player A MUST bet at least $6,001, in order to beat Player B. This is the ideal amount to bet; if they get the answer wrong, then they will end up with $3,999, which will beat Player B should he/she get the answer wrong.

What about Player B? Should he/she do what is expected?

5 Coincidentally, a Canadian won the first annual Performance Jeopardy at PMAR Europe in London this month! And, as someone pointed out, the host of Jeopardy, Alex Trebeck, is Canadian!

THIS, to me, is the greatest opportunity that is overlooked by most players. Think about it: Player B KNOWS that Player A will expect him/her to double his/her bet, and so will bet just enough to win, should they both get the answer right. And so, let's consider what happens if he/she DOES double:

	Starting Amount	Wager	Both are right	Both are wrong	A right; B wrong	A wrong; B right
Player A	$14,000	$6,001	$20,001: wins	$3,999: wins	$20,001: wins	$3,999: loses
Player B	$10,000	$10,000	$20,000: loses	$0: loses	$0: loses	$20,000: wins

And so, we can see that of the four possible outcomes, the ONLY time Player B will win is if (a) he/she is right and (b) Player A is wrong.

How can Player B improve his/her chances? ANSWER: by betting nothing (i.e., Zero!).

	Starting Amount	Wager	Both are right	Both are wrong	A right; B wrong	A wrong; B right
Player A	$14,000	$6,001	$20,001: wins	$3,999: loses	$20,001: wins	$3,999: loses
Player B	$10,000	$0	$10,000: loses	$10,000: wins	$10,000: loses	$10,000: wins

Now, Player B will win in two scenarios: when they both get the question wrong and when B is right and A is wrong. Since by doubling the only chance they have is if they're right and the first place player is wrong, why not add yet another possible way to win?

Therefore, the correct answer:

Player A: wager $6,001 (the player MUST believe that B will wager his/her entire amount)[6]

Player B: wager $0.

Game #2
Player A: $15,000
Player B: $2,500
Player C: $1,000.

How much should B and C wager?

As is noted above, the second place player wins $2,000 and the first $1,000. Player C cannot catch Player B. And so, the most Player B should wager is $499 (anticipating that Player C bets $1,000). To wager any more would be ill advised. And, if you think about it, what's the point in wagering anything? They will end up with $2,000 if they stay in second place.[7]

6 On very rare occasions we'll see the leader not bet enough to beat the second place player, should that player double their bet. And, in almost every instance, the leader loses. Therefore, they have no choice but to bet in anticipation of the second place player doubling.

7 Occasionally we see the second place player wager too much and get the wrong answer, ending up in third place; why make such a blunder? Yes, it's only $2,000 vs. $1,000, but why not get as much as you can?.

Player C should bet $1,000, in the event Player B bets incorrectly. Worst case: they end up with $0, and still win $1,000; best case: Player B makes a bad wager, and C ends up in second place.

Answer
Player B: NO MORE THAN $499
Player C: $1,000.

Game #3
Player A: $15,000
Player B: $7,500
Player C: $1,000

How much should A and B wager?

I mentioned above that it's expected that Player B will double their bet and that the first place player must therefore bet enough to win. This holds EXCEPT in this case (i.e., where they have exactly double what the second place player has). In this case, don't bet anything. If it's a tie, Player A still earns the amount they have, and both return for another show.

	Starting Amount	Wager	Both are right	Both are wrong	A right; B wrong	A wrong; B right
Player A	$15,000	$0	$15,000: tie	$15,000: wins	$15,000: wins	$15,000: tie
Player B	$7,500	$7,500	$15,000: tie	$0: loses	$0: loses	$15,000: tie

We see that Player A wins or ties in all cases. If they were to have bet enough to win by a dollar, they will lose if they get the answer wrong but B gets it correct. IN ADDITION, should they both get it wrong, and if player B bet zero, they'd lose. Safe bet: zero; don't be greedy and want to win by yourself.

What about Player B? Earlier I said that he/she should bet zero. This holds except in this case. Here they have a 50/50 chance of winning (actually, tying). If, however, the category is one that the player is very uncomfortable with, then by betting zero they have a 50/50 chance of winning (they'll win if A gets the wrong answer).

Wagers
Player A: $7,500 (play for the tie)
Player B: $7,500 (unless it's a category they aren't comfortable with, in which case $0).

A couple recent examples from actual games

I didn't right the details down, other than the amounts.

Player A: $19,200
Player B: $15,600
Player C: $5,200

Here's how the betting was done and how they did on the question:

KEEP THOSE CARDS & LETTERS COMING

We appreciate the e-mails we receive regarding our newsletter. Mostly, 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.

Player A bet $12,001(anticipating that B would double); got it wrong, so ended up with $7,199.
Player B bet $15,600 and also got it wrong, ending up with $0.
Player C also got it wrong (I don't recall what they bet).
Player A won.
Had B taken my advice (they never listen!), he would have had $15,600 and won.

On June 4th the following was what occurred:

The question: In August 2012 "the Telegraph of London ran the headline 'He opens ceremony with a ''big bang.'"

Answer:
$6,200: Stephen Hawking (bet $1200; got it right)): ended with $7,400
$20,000: Elton John (wrong) (bet $19,999): ended with $1.
$21,600: David Cameron (wrong) (bet $18,401): ended with $3,199

And so we see the third place player, who had not done well, managed to win. But again, had the second place player bet zero, they would have won with $20,000.

Conclusion
Perhaps I over-think or, as my wife puts it, over-analyzes this. But, watching five episodes a week for several years has led me to conclude that players often bet incorrectly.

July Puzzle

A rich merchant had collected many gold coins. He did not want anybody to know about them. One day, his wife asked, "How many gold coins do we have?"

After pausing a moment, he replied, "Well! If I divide the coins into two unequal numbers, then 26 times the difference between the two numbers equals the difference between the squares of the two numbers."

The wife looked puzzled. Can you help the merchant's wife by finding out how many gold coins they have?

FROM OUR READERS

Debi Rossi offered the following, in response to last month's issue:

Interesting blog on "performance holidays" - I do not recall ever seeing that terminology before.

My first thought when I saw this was that it was referring to actual "holidays" that may differ across different markets, eg. Memorial Day in the U.S. is a national holiday and the U.S. markets are closed but non-US markets are open. This actually may cause some interesting issues when analyzing global portfolios….but I digress.

Agree that a firm policy for these performance holidays would be important, but would think it may be somewhat challenging to set up since each scenario may be unique due to the client's preferences. This may lead to inconsistent approaches to performance holidays based on individual client and even based on scenarios that differ across time with the same client.

THE SPAULDING GROUP'S 2013 INVESTMENT PERFORMANCE MEASUREMENT CALENDAR OF EVENTS

DATE	EVENT	LOCATION
July 16-17, 2013	Fundamentals of Performance Measurement Training	San Francisco, CA (USA)
July 18-19, 2013	Performance Measurement Attribution Training	San Francisco, CA (USA)
July 23-24, 2013	Fundamentals of Performance Measurement Training	Sydney, Australia
July 25-26, 2013	Performance Measurement Attribution Training	Sydney, Australia
August 19-20, 2013	CIPM Principles Exam Preparation	Chicago, IL (USA)
August 21-23, 2013	CIPM Expert Exam Preparation	Chicago, IL (USA)
September 18, 2013	Portfolio Risk	Boston, MA (USA)
September 24-25, 2013	Fundamentals of Performance Measurement Training	Vancouver, BC, Canada
September 26-27, 2013	Performance Measurement Attribution Training	Vancouver, BC, Canada
October 22-23, 2013	Fundamentals of Performance Measurement Training	Chicago, IL (USA)
October 24-25, 2013	Performance Measurement Attribution Training	Chicago, IL (USA)
November 19-20, 2013	Fundamentals of Performance Measurement Training	Boston, MA (USA)
November 21-22, 2013	Performance Measurement Attribution Training	Boston, MA (USA)
December 10-11, 2013	Fundamentals of Performance Measurement Training	New Brunswick, NJ (USA)
December 12-13, 2013	Performance Measurement Attribution Training	New Brunswick, NJ (USA)

For additional information on any of our 2013 events, please contact Christopher Spaulding at 732-873-5700

I would imagine, that in most cases, clients do not want a break or disruption in their track record with the manager. Agree that ideally, a "temporary account for the cash flow" would probably provide the best approach but operationally may be challenging to fully implement.

Ultimately, it is the client that should be fully on board with the approach taken and should sign off on the method chosen. It should be of no surprise if the client comes back and requests to see what would be the results if a different method was applied. This does NOT change the returns that will be utilized for composite purposes, but may change returns that the client wishes to see.

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- July 16-17, 2013 – San Francisco, CA
- July 23-24, 2013 – Sydney, Australia
- Sept. 24-25, 2013 – Vancouver, BC, Canada
- October 22-23, 2013 – Chicago, IL
- November 19-20, 2013 – Boston, MA
- December 10-11, 2013 – New Brunswick, NJ

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This class is intended for investment professionals who would like to gain a better understanding of investment risk as it pertains to portfolio risk reporting, as well as it's use in predicting results.

Sept. 18, 2013 – Boston, MA

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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.

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