

PERFORMANCE PERSPECTIVES

with David Spaulding



VOLUME 9 – ISSUE 2

OCTOBER 2011

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 CSpaulding@SpauldingGrp.com

<http://www.SpauldingGrp.com>

FIVE WAYS YOU MAY BE WASTING MONEY IN PERFORMANCE MEASUREMENT

To my blog readers, you have already seen an introduction to this topic. But one can only say so much in a blog, and so we thought it would be a good idea to repeat this topic here, and expand upon it a bit.

We're sure everyone is interested in saving money, and so if there are areas in your operation where money is being wasted, why not correct it, right? And while we will only discuss five ways, there are no doubt countless others that occur (we'll touch on a couple of these at the end, so the title should actually read seven!)

#1 Not Being GIPS Compliant

Failing to comply is a greater waste of money in your marketing and sales areas than performance, because of your inability to place a checkmark next to the question "Is your firm compliant with the GIPS® standards (Global Investment Performance Standards)" on the RFPs (requests for proposal) that you receive. You're also probably wasting money in your performance areas, because you're preparing reports for your sales folks which won't compete well with your competitors who have GIPS compliant presentations.



In the institutional space, lack of compliance places a firm at a marketing disadvantage, and therefore results in wasting money in pursuit of many prospects that are beyond your reach. If your particular market isn't institutional, where compliance is a *de facto* standard, you're still wasting money, because you're competing on a level playing field with the other firms that aren't compliant. Why not make an investment in compliance, so that you obtain a marketing advantage!

Becoming or maintaining GIPS compliance isn't an expense, it's an investment. Failing to comply is a waste of money, that is being spent on pursuits for which you're not getting the returns you should.

#2 Using spreadsheets to maintain your GIPS composites

In the early 1990s, when the AIMR-PPS® was going into effect, there were no packaged solutions available to help firms comply. Back then, there really weren't many vendors who specialized in any performance measurement niche areas: most asset managers relied on their portfolio accounting vendor for all of their requirements. And so, unless the vendor was willing to invest in a composite management system, firms wishing to comply had to consider alternative methods.

The most commonly used alternative was spreadsheets. In fact, in our 1993 survey on the AIMR-PPS we found that 39% of the respondents relied on their portfolio accounting system, 31% used a separate composite system, and 50% used spreadsheets for their

The Journal of Performance Measurement®:

UPCOMING ARTICLES

Fatal Flaws of the Sharpe Ratio or How to Make Yourself Look Good
– Don Chance

An Introduction to the Efficient Construction of Intuitive and Transparent Equity Multi-factor Models
– William Wynne and Ed Rachham

Globalization of an asset manager and working in global teams
– Mark Goodey

A Case For Fixed Income Holdings-Based Attribution: Techniques For Achieving Cleaner Results
– Edward Ha

The Myth of GIPS – Money-Weighted Returns for Client Performance Reporting
– Trevor Davies and David Spaulding

Expanding our Market Vocabulary
– Timothy P. Ryan

composites. [Contrast this with today, where we have 27% using their portfolio accounting system, 46% a separate composite system, and 29% using spreadsheets].¹

Although we've seen a significant drop in the past two decades, from 50% to 29% usage of spreadsheets, the number is still too high.

Spreadsheets are cumbersome, manually intensive, error prone, time consuming, and not a database. Most firms who use them should seriously consider a system that is designed specifically for composite maintenance.

Having to account for

- accounts falling below or above the composite's minimum
- accounts going from non-discretionary to discretionary (or vice versa)
- accounts having significant cash flows, meaning they depart and then return to the composite
- accounts going into the composite in accordance with the firm's policies
- accounts departing the composite in accordance with the firm's policies



and so on, manually can be a daunting task for many firms. As verifiers we often find problems with firms that use spreadsheets, because it's simply too easy to miss things.

Spreadsheets are a great invention: I use them all the time. But for systems they fall short. They were a necessity for many in the early to mid 1990s; that is no longer the case. There are loads of great systems to consider.

Are there exceptions to this? Of course there are. A firm with a limited number of composites and accounts can probably do quite well with their spreadsheets. And for some, the cost of a package is considered excessive, and so spreadsheets remain their *composite maintenance method of choice*. For just about everyone who uses spreadsheets, the time invested to maintain them is a waste of money that can be better spent on a packaged solution.

#3 Not training your staff

How can not spending money be a waste of money? Because the spending here, is an investment. And failing to do that means you're wasting a portion of your money on staff who are undertrained.

We occasionally conduct a review of a firm's performance operations. And we often find cases where things are done incorrectly. Sometimes it's using improper attribution models (e.g., a domestic model for a global portfolio, which means the absence of a currency effect, and thus misleading information being reported). At other times, it's discovering a new way to measure performance that the firm designed and has been using, which happens to be invalid (yes, it makes intuitive sense; it's just wrong!). These are exercises which waste money, yes?

¹ Results can exceed 100% because firms could use more than one approach.



Save the Dates!

To learn more about Attribution Week, email PFowler@SpauldingGrp.com or call 732.873.5700
 Registration link:
<http://spgshop.com/attributionweek-aweeklongwebconferenceseriesdedicatedtoperformanceattribution.aspx>

Three other examples: a few years ago someone attended our Fundamentals of Performance Measurement class. He was from a very large financial institution, which was building a performance system for their brokerage area. They were designing it to use time-weighting. However, after being exposed to our material, he recognized that money-weighting made more sense. I ultimately consulted to this firm, and provided further justification for the alternative approach. Without this training they were going to waste money on an arguably flawed and incorrect method.

Another consulting client was developing a daily security-level transaction based attribution system, which would have required storing daily positions, which would have cost a considerable amount in computer storage. Had they attended our attribution course, they would have learned that for transaction-based approaches, doing daily doesn't improve accuracy, so this additional work wasn't necessary.



We strongly encourage our new GIPS verification clients to allow us to conduct a pre-verification in advance of the actual verification, to ensure that they are heading in the right direction. Part of this day is spent educating the client about the standards, to help them avoid making costly mistakes. Firms that fail to take advantage of training almost always make many errors as they move towards compliance, because of the Standards' complexity and areas of confusion. Moving towards GIPS compliance without proper training is usually a waste of time and money.

Investing in proper training is not only good for the firm, it's also very good for the team members. They recognize the organization's desire for them to grow and to enhance their ability to contribute. They appreciate their company's willingness to invest in them. It is a motivational factor that leads to more productive employees.

Training can take many forms, from formal class room programs, to conferences, webinars, and even reading industry publications, like *The Journal of Performance Measurement*[®] (and even my books, or those written by other authors, such as my friends Carl Bacon and Bruce Feibel).

#4 GIPS Performance Examinations

We conducted a webinar on the new guidance statement on performance examinations, and I went to some length explaining why I abhor them. Okay, perhaps "abhor" is a bit strong; let's just say that I'm not a fan of them. Our firm will be happy to do them (after all, we are a "for profit company," in spite of the countless things we offer at no cost), and we do for a small percentage of our verification clients, but we generally recommend not doing them unless they can be justified.

Here's a typical conversation we have with new verification clients who have spent tens of thousands of dollars every year on examinations:

A common examination discussion

by DSpaulding



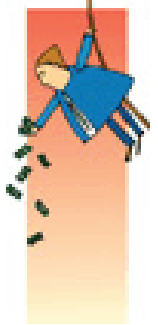
Images © 2011 Pixton.com

PERFORMANCEJOBS.COM

Visit PerformanceJobs.com and you'll see that we have several jobs posted. We're very excited with the initial interest this venture has caused and look forward to it becoming the major resource for individuals seeking employment as well as firms looking to hire. If you know of someone who is looking for a career in investment performance, please direct them to our site and encourage them to submit their resume today.

PERFORMANCE
JOBS.COM

Examinations test to see if the firm is “cooking its books”; they have little to do with the standards themselves. While it's true that firms (a) move to compliance and (b) undergo verifications primarily for marketing purposes, the rationale behind examinations is less clear, especially since most RFPs fail to ask about them. We believe that for many firms they are simply a continuation of their Level II verifications, that were done when many large verification firms wouldn't do Level I's. And while this is no longer the case (*i.e.*, these same verifiers will do GIPS verifications), the practice has continue



We discourage our verification clients from having them done, and very few do (even those who used to, have, for the most part, stopped). This has resulted in tens of thousands of dollars in savings each year for our clients.

If a firm is going to have examinations done, they should only be for those composites for which they have seen requests for them from prospective clients. We have seen cases where verifiers performed them for all of the firm's marketed AND non-marketed composites. Sadly, the only one who benefits from this is the verifier.

If yours is like most firms, chances are you're spending a lot of money on examinations each year. Do yourself the favor of asking “why?”

#5 Using the wrong approach to measure, analyze, and report performance and risk

As noted above, there was a time when most firms relied almost entirely on their portfolio accounting system for their needs. But over the past 15 years or so, we've seen expansion in a number of areas of performance measurement (*e.g.*, composites, attribution, risk measurement), and not surprising, specialist firms who have developed pretty sophisticated systems which provide heightened functionality.



When we're asked to assist with a software search, it's common for us to be asked “what's the best system?” Although every vendor understandably considers theirs to be the best, the reality is that everyone has unique requirements, and so there is no “best” that will work in all cases. This means that proper due diligence is needed when looking for a new system. It also means that some firms simply have the wrong system(s) in place.

In all too many cases, these “systems” are spreadsheet-based. I must confess a bit of envy when I see a firm's spreadsheet-based systems: they can be quite impressive. As a former computer programmer, I am in awe of the amount that can be accomplished by using Visual Basic scripts or macros. But, for the most part these efforts are a huge waste of money. And why is that? Because of the amount of time that goes in to building “systems” with no documentation, that are often quite difficult to maintain, and which too often place the firm at risk. We have several clients who are trying to break away from these systems and on to packaged solutions, which will be more efficient and much less risky. Many firms who allow their staff to develop spreadsheet based systems place themselves in a “people risk” position, because if the developer leaves, the knowledge and understanding of this “system” goes with them.

Another problem occurs when firms produce reports that fail to provide the information needed. Many firms do not to take an inventory of what is being used and what isn't,

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.

meaning that much of what they do may, in fact, be wasteful, in terms of computer processing, paper, and manpower.

All firms should periodically assess where they stand, from a systems and operational perspective.

- Is the firm using the right measures?
- Do the reports contain the right information?
- Are the processes smooth, with the appropriate controls?
- Is there unnecessary redundancy, in processing or systems?
- Are there more efficient ways to operate?

Some firms have moved to or are considering outsourcing part or all of their performance and risk measurement process. One can debate the appropriateness of this, but the reality is that many firms find benefits in taking these steps. Even these, though, are worthy of occasional reviews to ensure they are meeting the firm's needs.

A COUPLE OTHER MONEY WASTERS

In a recent blog post² I commented on how some firms are calculating returns improperly; here I specifically spoke about cases where returns are shown for a longer period than the asset was held. This results in distorted and incorrect returns, which means investigations and phone calls from clients who are curious how a return can be so high (or so low). I could say more, but I think the blog post probably says enough.

Another point might *ruffle* a few folks, but I am known for speaking my mind, so I will do it here: wasting time responding to client calls, because you have chosen to adopt the GIPS recommendation to give presentations to all of your clients.³

Recommendations are defined as “best practice,” but as I’ve mentioned countless times, this term hasn’t been defined, and we can conclude that it simply means what the GIPS Executive Committee thinks is best practice. But is this truly “best practice,” in that it benefits the firms who comply? We would say “no.” All it does is create the opportunity for roughly half of your clients (the half whose return fell below the composites’ averages) to call and ask why their returns weren’t higher. This can then result in hours of research. I opposed this recommendation, as did most of the individuals who commented on the exposure draft. If your firm is doing this, you will know if it’s causing you any headaches. We do not recommend adopting this reporting. Your clients no doubt get reports which reflect their performance vis-à-vis benchmarks. That should suffice. If a client asks to see their respective presentation(s), that’s a different story, and you must, of course, comply. But why *open up a can of worms*?

² <http://investmentperformanceguy.blogspot.com/2011/10/how-to-make-your-returns-look-better.html>.

³ See ¶ I.0.B.4 of the 2010 edition of the standards.

THE SPAULDING GROUP'S 2011 INVESTMENT PERFORMANCE MEASUREMENT CALENDAR OF EVENTS

DATE	EVENT	LOCATION
November 10-11, 2011	Performance Measurement Forum	Budapest, Hungary
November 14-18, 2011	Attribution Webinar Week	Online Webinar
December 1-2, 2011	Performance Measurement Forum	Orlando, FL (USA)
December 6-7, 2011	Fundamentals of Performance Measurement Training	New Brunswick, NJ (USA)
December 8-9, 2011	Performance Measurement Attribution Training	New Brunswick, NJ (USA)
February 7-8, 2012	Fundamentals of Performance Measurement Training	Los Angeles, CA (USA)
February 9-10, 2012	Performance Measurement Attribution Training	Los Angeles, CA (USA)
March 13-14, 2012	Fundamentals of Performance Measurement Training	Boston, MA (USA)
March 15-16, 2012	Performance Measurement Attribution Training	Boston, MA (USA)
March 19-20, 2012	CIPM Principles Prep Class	Chicago, IL (USA)
March 21-23, 2012	CIPM Expert Prep Class	Chicago, IL (USA)

For additional information on any of our 2011 events, please contact Christopher Spaulding at 732-873-5700

Save the Dates!

To learn more about Attribution Week, email
PFowler@SpauldingGrp.com or call **732.873.5700**

Registration link: <http://spgshop.com/attributionweek-aweeklongwebconferenceseriesdedicatedtoperformanceattribution.aspx>



THE SPAULDING GROUP
ATTRIBUTION WEEK
An Online Conference Learning Event

November 14-18, 2011

Simpson, Spaulding, Menchero, Campisi & Elliott

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, Inc. is registered with the National Association of State Boards of Accountancy (NASBA) as a sponsor of continuing professional education on the National Registry of CPE Sponsors. State boards of accountancy have final authority on the acceptance of individual courses for CPE credit. Complaints regarding registered sponsors may be addressed to the National Registry of CPE Sponsors, 150 Fourth Avenue North, Suite 700, Nashville, TN 37219-2417. www.nasba.org

FUNDAMENTALS OF 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 Fundamentals of Performance Measurement on these dates:

December 6-7, 2011 – New Brunswick, NJ March 13-14, 2012 – Boston, MA
February 7-8, 2012 – Los Angeles, CA

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:

December 8-9, 2011 – New Brunswick, NJ March 15-16, 2012 – Boston, MA
February 9-10, 2012 – Los Angeles, CA

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.



IN-HOUSE TRAINING

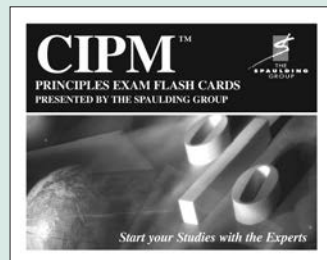
The Spaulding Group has offered in-house training to our clients since 1995. Beginning in 1998, we formalized our training, first with our Introduction to Performance Measurement class and later with our Performance Measurement Attribution class. We now also offer training for the CIPM program. To date, close to 3,000 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 of transporting their staff to our training location and limits their time away from the office. With the discounted 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).

UPDATED CIPM Principles and Expert Flash cards are now available on our web store. Please visit www.SpgShop.com today to order your set.

Our performance experts have created a study aid which can't be beat: **flash cards!** These handy cards will help you and your associates prepare for the upcoming CIPM Principles Exam. Unlike a computer-based study aid, you can take them anywhere to help you test your knowledge.



Benefits of Flash Cards:

- Work at your own pace
- Immediate feedback
- Strengthen and reinforce core CIPM principles

These cards are a **must have** for anyone preparing to take the CIPM Exams.