

PERFORMANCE PERSPECTIVES

with David Spaulding



VOLUME 7 – ISSUE 1

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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 CSpaulding@SpauldingGrp.com

GIPS EXAMINATIONS: ARE THEY REALLY NECESSARY?

Please don't get me wrong: we love to make money; after all, our firm is a "for" profit organization. BUT, I continually am forced to ask the question "why get a GIPS Examination done?" Let's begin with a bit of history.



In 1993 the AIMR-PPS® had barely two pages devoted to the subject of "verification." Back then, verification took two forms: Level I and Level II. Level I was "firm wide," while Level II could be done at the composite level. Both were voluntary, but the '93 standards CLEARLY stated that firms had to do Level I before they did a Level II. Our firm began offering verification services in 1992 and often encountered prospects that told us "no, XYZ Firm told us we could just get a Level II done." Duh, no! And so, I contacted Sue Martin (most of our readers have NO idea who Sue is or was, but she was the "Jonathan Boersma" of the AIMR-PPS "back in the day." (I.e., she was responsible for the standards). Sue agreed with me that compliant firms MUST get a Level I done first. So, what's the problem? Well, the larger CPA firms didn't want to do Level I's. I'll let them explain why; suffice it to say, they wouldn't do them. And so, they only offered Level II's.

After about two years verification was suddenly changed: Level II's were replaced with "Modified Level II's," that included "segments of Level II." Wow! And so, a firm could bypass a Level I and just get a Level II done. Amazing.

Then we get to GIPS. Unlike the PPS, the GIPS committee decided to have a single form of verification. But, that didn't last long as they introduced the concept of "examinations" (read "Level II"). But, at least an examination isn't considered a verification. The accounting firms WILL do a verification now. Why? While it's a bit unclear, we do know that verifiers no longer comment on a firm's status vis-à-vis the standards (as they did under the AIMR-PPS rules): this is apparently felt to be more acceptable to the accounting community.

So where do examinations fit in? Well, since many firms historically had "Level II's" done, it probably seemed quite natural to continue to have them done, although they're now called "examinations." But why?

As former AIMR-PPS Implementation Committee chairman Chuck Tschampion told me in an interview¹ a number of years ago, Level II verifications have very little to do with whether or not the firm complies. He feels the same way today about examinations (he expressed this in an e-mail to me some time ago). To me, examinations essentially test whether or not the firm is "cooking the books." We know of some firms whose verifier talked them into getting ALL of their composites examined...what a deal! And the reason for this was what again?

<http://www.SpauldingGrp.com>

¹ The Journal of Performance Measurement. "The Journal Interview." Spring 1998.

The Journal of Performance Measurement®:

UPCOMING ARTICLES

**Determining the Optimal
Mutual Fund Style
Classification Methodology**
– David M. Blanchett, CFA and
Craig Israelson, Ph.D.

**101 Ways to Measure
Performance**
– Philippe Cogneau, and
Georges Hübner

Risk Attribution
– Philippe Grégoire, Ph.D.

Refining the Sharpe Ratio
– Craig L. Israelsen, Ph.D.,
Brigham Young University

**On Turning Three: Reflections
on the CIPM® Program**
– Philip Lawton, CFA, CIPM,
CFA Institute

Performance Analytics Systems
– In House or Vendor Package
– Kyle Ringrose, CFA,
Wilson HTM Investment Group

**A Global Investment Attribution
Analysis Based on a Symmetrical
Arithmetic Attribution Model**
– Yuri Shestopaloff, Ph.D.,
SegmentSoft Inc.

**A Comparison of Plan Sponsor
Attribution Methodologies:
Multi-Level Brinson Attribution
vs. Macro Attribution**
– John D. Simpson, CIPM,
The Spaulding Group, Inc.

It's interesting to note that in Europe most firms do NOT get examinations done. E&Y partner Martin Schliemann affirmed this in a recent interview² for *The Journal of Performance Measurement*.

Most RFPs simply ask “do you comply” and “have you been verified.” And so, why get an examination done? I would only do this if prospects are specifically asking for this and then only for the composite(s) that apply. Otherwise, in my opinion, you are simply wasting your money. Again, this is my opinion and I'm sure many verifiers would disagree with us.

WE COMPLY BECAUSE...

A few years ago we were called in to consult to a NYC manger who had failed an SEC examination, partly because they falsely claimed compliance with the AIMR-PPS®. When I met with the firm's president he seemed somewhat incredulous about the whole situation, explaining that they were sure they complied because the portfolio accounting system they used was “compliant,” and therefore they were, too. Well, for a long time we've tried to educate folks that software cannot be compliant...only a firm can be.



A similar problem sometimes occurs relative to custodians. We've had several discussions with custodians, including a panel at last Spring's PMAR conference, that make it evident that many firms ask if their custodian complies with GIPS. Since custodians cannot comply, only asset managers can, the question is an inappropriate one; nevertheless, many custodians have made it clear that they're regularly asked. On occasion, some managers interpret the custodian's response to suggest that the custodian is, in fact, compliant, and then the manager assumes that they, too, must comply. This isn't the case, however.

Custodians may calculate returns in a manner that's consistent with the standards. They may actually have composite software available for their clients. But they, themselves cannot comply. There is no “short cut” to compliance.

QUESTIONING CONVENTIONAL WISDOM

I hardly consider myself a “maverick,” though in some ways I guess I am. For quite some time I've challenged the tradition to use TWRR as the universal method to derive returns. I also question the notion of ex ante measures as well as the use of certain measures / models that presume that distributions are normally distributed. Therefore, it's not surprising that I take to folks like Nassim Taleb and Pablo Triana. However, being a maverick comes with some unspoken guidance, I believe, such as avoid being too extreme in your language.



Taleb wrote the foreword to Triana's new book, *Lecturing Birds on Flying: Can Mathematical Theories Destroy the Financial Markets?* In it he suggests that members of the CFA Institute should resign and that they should embarrass other members, presumably for using models which he deems as being inappropriate.

² *The Journal of Performance Measurement*. “The Journal Interview.” Spring 2009.

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Such extreme language might get one attention, but surely doesn't help advance their cause. The CFA Institute deserves a tremendous amount of credit for the work they've done and the ideas they've fostered. Many will rightly find such a suggestion offensive.

I am slowly making it through Triana's book and must confess that I'm much less impressed than I expected to be: I will no doubt offer a formal review at a later date.

JUDGMENT AND THE STANDARDS

I was recently conducting a verification for a client that has a policy regarding temporary removal of accounts from composites, where they indicate that there may be cases where it "may no longer be reasonable to keep an account in a composite." This, to me, suggests that the situation is reviewed and someone decides if the account should be removed. Sorry...not permitted. Your rules should dictate whether the account comes out. The criteria should be clear enough that it's essentially "an automatic" action, without human judgement playing a part. Once you allow judgement in, games can arise. Sorry.

GIPS 2010

The CFA Institute held its annual GIPS conference in Boston this month, where many of the changes planned for GIPS (effective January 1, 2011) were announced. We will disclose these in detail in our October issue. In addition, we will host a webinar in November to discuss them, so stay tuned!

THE SPAULDING GROUP'S 2009 INVESTMENT PERFORMANCE MEASUREMENT CALENDAR OF EVENTS

DATE	EVENT	LOCATION
October 20-21, 2009	Introduction to Performance Measurement Training	San Francisco, CA (USA)
October 22-23, 2009	Performance Measurement Attribution Training	San Francisco, CA (USA)
November 12-13, 2009	Performance Measurement Forum	Rome, Italy
November 19, 2009	Trends in Attribution Symposium (TIA III)	New Brunswick, NJ (USA)
December 3-4, 2009	Performance Measurement Forum	Orlando, FL (USA)
December 8-9, 2009	Introduction to Performance Measurement Training	New Brunswick, NJ (USA)
December 9-10, 2009	Performance Measurement Attribution Training	New Brunswick, NJ (USA)

For additional information on any of our 2009 events, please contact Christopher Spaulding at 732-873-5700

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TRAINING...

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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:

October 20-21, 2009 – San Francisco, CA

December 7-8, 2009 – New Brunswick, NJ

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:

October 22-23, 2009 – San Francisco, CA

December 9-10, 2009 – New Brunswick, NJ

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, over 2,000 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 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.

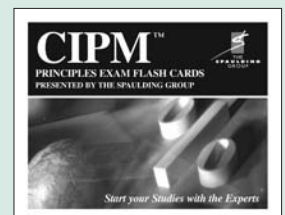
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THE JOURNAL OF PERFORMANCE MEASUREMENT'S
THIRD ANNUAL INTERNATIONAL

TRENDS IN ATTRIBUTION SYMPOSIUM

THE HELDRICH HOTEL, NEW BRUNSWICK, NJ
NOVEMBER 19, 2009

Attribution is the **hottest** area in performance measurement today

On November 19, 2009 we will hold our Third Annual International Trends in Attribution Symposium (TIA). This is an entire day focused on the important topic of attribution.

We have assembled notable speakers with excellent topics to provide you with the conceptual as well as practical information you require to better address the expanding realm of attribution. This focused event will provide important information that is essential to you and your firm. Attend and you will gain greater insights, discover opportunities and methodologies, and learn of the latest theories about this hugely important topic.

Space is limited, please take advantage of our discounted pricing by calling us today at 732-873-5700, or complete and fax back the back of this form to 732-873-3997 or simply visit us online at www.SpauldingGrp.com.

As an added incentive, we are giving away The Spaulding Series' latest book: *Classics in Investment Performance Measurement* to the first 10 paid registrants.

CONFERENCE SPONSORS

Special Thanks To Our Sponsors...



AGENDA: THURSDAY, NOVEMBER 19, 2009

7:15 - 8:15 AM	REGISTRATION: CONTINENTAL BREAKFAST
8:15 - 8:30 AM	WELCOME <i>David D. Spaulding, CIPM, The Spaulding Group, Inc.</i>
8:30 - 9:30 AM	RISK ATTRIBUTION FOR PORTFOLIOS WITH STRATEGIC ASSET ALLOCATION <i>Philippe Grégoire, Ph.D., Orfival</i> <ul style="list-style-type: none">• Tactical asset allocation• Diversification and allocation effect• Selection effect
9:30 - 10:15 AM	PERFORMANCE ATTRIBUTION FOR YIELD CURVE INSENSITIVE DEBT SECTORS <i>Timothy P. Ryan, The Hartford Investment Management</i> <ul style="list-style-type: none">• Introduce the concept of return neutralized weight analysis• Apply this attribution approach to yield curve insensitive debt sectors• Quickly extend this approach to yield-curve sensitive markets• Present, by example, the material and compelling benefits this analysis has over the standard attribution formulas

10:15 - 11:00 AM	MORNING BREAK
11:00 - 11:45 AM	FAST ATTRIBUTION <i>John D. Simpson, CIPM, The Spaulding Group, Inc.</i> <i>Timothy R. Ryan, The Hartford Investment Management</i> <i>Stephen Campisi, CFA, Intuitive Performance Solutions</i> <i>David D. Spaulding, CIPM, The Spaulding Group, Inc.</i> <ul style="list-style-type: none">• This innovative panel approach of attribution experts and practitioners will tackle a host of topics in an exciting lightning round, which is sure to provide you with insightful perspectives, ideas and opinions



11:45 - 12:45 PM	LUNCH BREAK
12:45 - 1:45 PM	GLOBAL ATTRIBUTION <i>Ed Rackham, Ph.D., Wilshire Analytics</i> <ul style="list-style-type: none">• Construction of a global multi-factor attribution model• Attribution of portfolio returns using a multi-factor model• Analysis of global portfolio returns
1:45 - 2:45 PM	FACTOR VS. DECISION BASED ATTRIBUTION <i>Stephen Campisi, CFA, Intuitive Performance Solutions</i> <ul style="list-style-type: none">• Contrasting the two major approaches to attribution• How factors are handled• Why decisions-based may make more sense

2:45 - 3:15 PM	AFTERNOON BREAK
3:15 - 4:00 PM	ASSET OWNERS AND ATTRIBUTION: A CASE STUDY <i>Greg Stewart, BNY Mellon Asset Servicing</i> <i>Frances Barney, BNY Mellon Asset Servicing</i> <ul style="list-style-type: none">• How asset owners use attribution at all levels• Quantify the impacts of fund level versus manager level decisions• How to use attribution as an investment manager monitoring tool
4:00 - 4:45 PM	BALANCED ATTRIBUTION <i>David D. Spaulding, CIPM, The Spaulding Group, Inc.</i> <ul style="list-style-type: none">• Why is it so hard? (it isn't!)• Understanding what we are truly measuring• Getting the numbers to make sense
4:45 - 5:00 PM	CONFERENCE WRAP-UP & CONCLUSION <i>David D. Spaulding, CIPM, The Spaulding Group, Inc.</i>

EASY REGISTRATION

CONFERENCE COSTS

Register for TIA III by August 31 and pay \$895 – Rate increases to only \$995 after that!
(If you have more than three attendees, please call 732.873.5700 for special group pricing.)

Total: _____ attendees at a cost of: \$ _____

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MONEY BACK GUARANTEE

Any attendee who is not satisfied with the conference at the end of the day, will receive a full refund.

TERMS & CONDITIONS

Conference Fee: Includes all sessions, lunch and documentation.

Cancellations: Cancellations received in writing before November 1, 2009 will be subject to a service charge of \$159.00. After this date, the full conference fee will be charged and no refunds given.

It may be necessary for reasons beyond the control of the organization to alter the content and timing of the program or the identity of the speakers. This contract is subject to United States Law.

Are you registered? You will always receive an acknowledgement of your registration. If you do not receive a confirmation, please call 732.873.5700 to ensure that we have received your registration.

HOTEL RESERVATIONS

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