PERFORMANCE PERSPECTIVES

with David Spaulding

VOLUME 8 – ISSUE 7 **MARCH 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

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TRANSACTION VS. HOLDINGS BASED ATTRIBUTION

There was a time when vendors challenged one another as to what approach is better: transaction- or holdings-based attribution. This no longer seems to be the case, as most vendors today appear to be prepared to offer both. And why is this? Probably because segments of the market want to see one or the other. Therefore, in order to not limit the prospects they can reach, they offer both.

The main difference is that holdings based does not adjust its beginning weights for activity that takes place across the period being measured, while transaction-based takes this activity into consideration. Consequently, we tend to see the holdings-based approach often unable to fully reconcile to the excess return, while the transaction-based is able can.

Research we did a few years ago found that some firms preferred holdings-based because of either (a) having a very large client base to support or (b) a lack of confidence in the interim data, which might have introduced errors which otherwise wouldn't have been present. Over the years systems have become faster, so I am curious how many still avoid the move to transaction-based because of volumes. In addition, many firms that use holdings based do so on a daily basis; this isn't necessary with the transaction-based method, so there is an advantage with the latter in a savings on disc storage.

I will be addressing this topic at our upcoming Performance Measurement, Attribution and Risk (PMAR) conferences. Currently I am doing some research to build a case study, which will be expanded upon in my dissertation. If you have any thoughts, ideas, case studies, "horror stories," insights, etc. that you'd like to share on this topic, please pass it along.

ONE SIZE DOESN'T FIT ALL WHEN IT COMES TO PERFORMANCE MEASUREMENT

I have been invited by DST Global Solutions to give an address in Asia next month (in Beijing, Shanghai, and Singapore), where my topic will be "Performance Measurement: One Size Doesn't Fit All." I am excited by this opportunity for a few reasons. One being that although it will be my third trip to Asia, it will be my first to Beijing and Shanghai. Also, the topic is something that I will very much enjoy addressing, since I have been hinting at this for some time. For example, in a couple recent blog posts,[1] I point out that the GIPS® (Global Investment Performance Standards) standards do not hold the answer to all of our return questions (nor is intended to do so).

If you have any thoughts, ideas, or suggestions on this topic, please share them!

1 See http://investmentperformanceguy.blogspot.com/2011/03/lets-stop-celebrating-gips-as-only.html and http://investmentperformanceguy.blogspot.com/2011/02/is-gips-at-center-of-investment.html.

The Journal of Performance Measurement®:

UPCOMING ARTICLES

Refining Core-Satellite Investing
– Ronald J. Surz

An Advanced Methodology for Fund Rating
– Noel Amenc and Veronique Le Sourd

The Journal Interview:
– James Edmonds

Life Settlements: Valuation and Performance Reporting for an Emerging Asset Class
– Darwin M. Bayston, Douglas R. Lempereur, and Anthony Pecore

The Characterstics of Factor Portfolios
– Jose Menchero

Tailoring Manager Allocation to Market Conditions Using Alpha Optimization: Part 1
– Eric A Stubbs and Enrique Jaen

DEALING WITH CHANGES IN RETURN METHODS

In a recent blog post I touched on two scenarios: one, where firms change formula methods over time and the second, the concurrent and simultaneous use of two or more methods. Both are allowed.

Let's consider the first case. We of course would expect firms to transition from one method to another over time, as they strive to achieve greater degrees of accuracy. For example, the following is no doubt an evolution that many firms have gone through:

Original Dietz	Modified Dietz	Revalue for large flows	True Daily

Today, any firm that claims compliance with the GIPS standards, who are required to use time-weighting,[2] must revalue for large cash flows. Many firms establish thresholds (e.g., 10%) while an increasing number are moving to daily performance, which is essentially revaluing for all cash flows. What we would not expect to see, however, is:

Modified Dietz (w/ revaluation)	True Daily	Modified Dietz (w/ revaluation)	True Daily

as such dynamics would suggest the attempt to optimize returns based on the formula that produces the better result.

It is also possible that as a firm progresses they may adjust how they treat cash flows. We are on the record supporting start-of-day treatment for inflows, and end-of-day treatment for outflows, and we are finding more and more firms doing this. And so, we often see something like:

Start-of-day for all flows	Start-of-day for inflows / End-of-day for outflows

As to the second point, if firms manage separate accounts as well as mutual funds, it is highly common to see something like this:

Modified Dietz (w/ revaluation) [for separate accounts]
True Daily [for mutual funds]

It's important that the firm document their approach to calculating returns, as well as any changes to their methods.

2 I make the distinction because in some cases (*e.g.*, private equity) money-weighting (via the internal rate of return) is required.

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.

RISK…WHY CAN'T WE ALL JUST GET ALONG

Okay, so perhaps Rodney King's memorable words aren't a perfect fit here, but my point is that we can't agree on very much when it comes to risk. I recently interviewed someone for *The Journal of Performance Measurement®* and when it got to talking about risk, the first thing he pointed out was that we cannot agree on what risk even is, so how can we agree on how to measure it?

By no means do I expect to see agreement nor do I necessarily want to, since risk is very much an emotional topic.

What is very important is that we all do agree that there are different views on what risk is, as well as different views as to what is the best measure. What is important is that we have a plethora of methods to choose from. And it is also important that we understand what they mean, what they purport to measure, what their shortcomings and strengths are, and how to interpret what they produce. It is also important that the right measure(s) are given to the right people (getting back to the "one size" issue noted above). For example, giving a retail brokerage client who makes their own investment decisions tracking error or a Sharpe ratio to me makes no sense. There may not even be an ideal measure for these individuals, but I know what isn't ideal.

Carl Bacon and I have often debated the merits of time- versus money-weighting, and arithmetic versus geometric attribution. Debates (not necessarily involving Carl and me) are worthy on the merits of the different risk measures, too, so that we can hopefully get some insights into their strengths, shortcomings, and appropriateness. An interesting topic worthy of greater attention.

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

DATE	EVENT	LOCATION
May 16-17, 2011	Fundamentals of Performance Measurement Training	New Brunswick, NJ (USA)
July 12-13, 2011	Fundamentals of Performance Measurement Training	Toronto, Ontario
July 14-15, 2011	Performance Measurement Attribution Training	Toronto, Ontario
August 22-23, 2011	CIPM™ Principles Exam Preparation Class	New Brunswick, NJ (USA)
August 24-26, 2011	CIPM™ Expert Exam Preparation Class	New Brunswick, NJ (USA)
September 13-14, 2011	Fundamentals of Performance Measurement Training	San Francisco, CA (USA)
September 15-16, 2011	Performance Measurement Attribution Training	San Francisco, CA (USA)
October 11-12, 2011	Fundamentals of Performance Measurement Training	Chicago, IL (USA)
October 13-14, 2011	Performance Measurement Attribution Training	Chicago, IL (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)

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

TRAINING…

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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 Introduction to Performance Measurement on these dates:

May 16-17, 2011 – New Brunswick, NJ
July 12-13, 2011 – Toronto, Ontario
September 13-14, 2011 – San Francisco, CA
October 11-12, 2011 – Chicago, IL
December 6-7, 2011 – 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:

July 14-15, 2011 – Toronto, Ontario
September 15-16, 2011 – San Francisco, CA
October 13-14, 2011 – Chicago, IL
December 8-9, 2011 – 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, 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 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).

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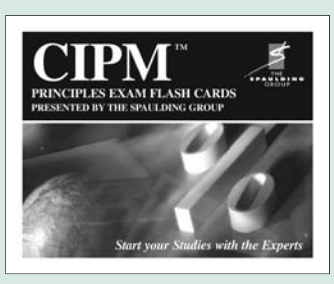

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