VOLUME 4 – ISSUE 9 MAY 2007

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

WHERE ARE THE ADVERTISING POLICE?

While I'm quite pleased that so many firms now advertise their claim of compliance with GIPS® (actually, far more than I recall doing so with the AIMR-PPS®), I'm a bit disheartened by the regular failure of many of these firms to actually comply completely with the advertising standards. Who monitors this stuff?

When I see an ad that's technically non-compliant, I will usually attempt to contact the firm to make them aware of their shortcomings. On a few occasions, the firms have taken corrective action; but not in all cases, however. Granted, I have no regulatory authority or any power to assess a penalty, but my motives are strictly professional: to try to insure that all advertisers adhere to the rules. One of my fears has been that if one firm violates the rules and gets away with it, others will follow, and that's what appears to be happening.

A common feature to include in ads is a chart showing period returns (see, for example, *Figure 1*).

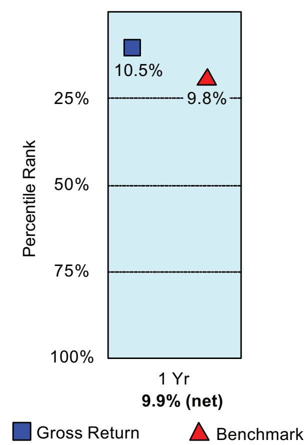

Figure 1

The problem I have with this type of chart is that I believe it violates an SEC rule that gross-of-fee returns can be shown in an advertisement provided their shown with "equal or lesser prominence." How can we say that the net-of-fee return is shown with equal prominence when it's not even in the chart! Granted, the gross-of-fee return is the same font size as net, but it gets a special figure and is shown relative to the index. How can this be considered equal prominence? If anything, gross (again, in my opinion) is getting greater prominence than net. But these charts are appearing in ever greater regularity because no one has formally said that they are inappropriate.

The SEC isn't the GIPS Advertising Police. But shouldn't someone be? Perhaps the GIPS Help Desk? Couldn't they, when they become aware of ads like this, simply send a formal letter to the company informing them that their ad is violating the rules?

When we realize that it was an advertisement that many attribute to the birth of the AIMR-PPS, shouldn't we all be wanting to insure that any performance-related advertisement is correct?

The Journal of Performance Measurement®:

UPCOMING ARTICLES

First-time-right Ratio: Measuring the Measures
– Timothy P. Ryan

First Steps in Foreign Exchange Transaction Cost Analysis
– Michael DuCharme, CFA

The Journal Interview
– Jose Menchero, Ph.D., CFA

On the Robustness of Performance Measures in Fund Persistence
– Yin-Ching Jan and Su-Ling Chiu

Transaction-based Performance: a Framework for Evaluating Measurement and Attribution Methodologies
– Mark R. David, CFA

Accurate Benchmarking is Gone but Not Forgotten: The Imperative Need to Get Back to Basics
– Ronald J. Surz

Oh, and speaking of gross- versus net-of-fee returns, if an advertisement shows statistics which are based on returns (e.g., alpha, tracking error, information ratio), shouldn't these statistics indicate whether they're based on net- or gross-of-fee results? And, presumably, ***have*** to be based on net?

TIME-WEIGHTING OR MONEY-WEIGHTING? THE ANSWER: WHAT'S THE QUESTION?

When trying to decide whether to use money-weighting (aka "dollar weighting") or time weighting, I suggest you ask, "what's the question?" This should be the basis for the decision.

I had a conversation recently with someone from a large ($80 billion) public pension fund, who inquired into which they should use. I asked her if she wanted to know how they (i.e., the pension fund) is doing? She said "yes," so I said "money-weighting." Later, I spoke with their custodian who pointed out that often the fund wants to compare their returns with other funds. In this case the question would be "how did we do versus other funds" and the answer would be "time-weighting." Make sense?

NEW ORLEANS COMMUNITY SERVICE

PERFORMANCE MEASUREMENT FORUM
RECONSTRUCTION TEAM
NEW ORLEANS 2007

In the April newsletter we mentioned that members of the Performance Measurement Forum, along with two general contractors, participated in a community service project in New Orleans. Recall that New Orleans is still recovering from Hurricane Katrina. We thought you might like to see a few photos from the event. To access them go to http://www.spauldinggrp.com/neworleanspictures2007.htm

SIGNIFICANT CASH FLOWS...AN EASY REQUIREMENT TO OVERLOOK

I discovered something recently while doing a pre-verification for a client: all the required disclosures aren't listed in the standards!

Because this client takes advantage of the option to temporarily remove accounts from composites because of significant cash flows but had failed to indicate this in their presentation, I wanted to provide a reference. However, as I read through the list of disclosures in the standards (pages 12 and 13), I didn't see it listed. If we go to the guidance statement we find "If a firm wishes to make use of the option to remove portfolios when Significant Cash Flows occur, then it must disclose the following items **in each presentation**:..."

I think this is very easy to overlook. I've suggested that the next edition of the standards incorporate this. Hopefully it will!

SHORT POSITIONS – KEEP THEM SHORT

When firms engage in short selling, they want to know their return. First, there are varying opinions on how to do this. Jose Menchero wrote a great piece that discusses this at length.[1] A much simpler approach (which I think is probably more widely used) is to change the denominator in the Modified Dietz formula to an absolute value.

Now, I could go into more detail here on calculating these returns, but this isn't my point for referencing them. Perhaps I'll take the broader subject up in a future issue. My point is: don't net your positions. *i.e.,* if you are sometimes *long* and sometimes *short*, don't net them!!! Netting them makes calculating the returns, I believe, virtually impossible!

I know how to calculate a return when we have a starting long position and end with a long position; I know how to calculate a return when we have a starting short position and end with a short position. However, I don't know how to calculate a return if we start long and end short, or start short and end long! If you do, let me know. But I don't think it's possible.

So, if you go short, keep these positions separate from your longs.

FROM OUR READERS

I had planned to have this note from Steve Campisi in our April issue, but forgot to include it:

Just FYI. It's a common mistake - one that many CFA charterholders make. According to the ethical standards of the CFA Institute, the term "CFA" is always to be used as an adjective, never a noun. So, you are making a minor ethical slip when you refer to someone as "a CFA" rather than the approved term "a CFA charterholder." Admittedly, I have a hard time keeping a straight face when I teach this in the Ethics course for the CFA exam preparation course. However, rules are rules.

On a serious note, your piece on the independence of verifiers was great. This is an important topic that still does not get the attention it deserves. Your persistence in staying engaged with this topic is a real service to the industry.

This was supposed to be in April, too. (*Sorry Jason*)

Dave,

I hope all is well with you and everyone at the Spaulding Group.

With regards to "Verifying the Verifiers," what about a system similar to the American Institute of CPAs' peer review process? The system of peer review has worked well for CPAs for years.

Of course if an attorney general wants to make a name for him/herself, there is not much we can do, but this system has allowed for more trust from the public. CPAs are still rated very high in terms of public trust.

Please let me know if you have questions and/or need further information.

Thank you,
Jason Inman, CPA

I think this is an excellent idea and passed it along to one of the Verification Subcommittee members.

1 "Performance Attribution With Short Positions." The Journal of Performance Measurement: Winter 2002/2003. Pages 39-50.

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

DATE	EVENT	LOCATION
June 14-15	Performance Measurement Forum	Helsinki, Finland
July 23-27	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)
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)
October 23-24	Introduction to Performance Measurement Training	New York, NY (USA)
October 25-26	Performance Measurement Attribution Training	New York, NY (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

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PERFORMANCE MEASUREMENT BOOT CAMP

Experience a full week of intensive, real world training, designed to saturate new hires and staff in various situations and arm them with the tools of the performance trade. The Spaulding Group, Inc. invites you to attend Investment Performance Measurement on this date:

July 23-27, 2007 – New Brunswick, NJ

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:

September 17-18, 2007 – Los Angeles, CA
October 8-9, 2007 – Boston, MA
October 23-24, 2007 – New York, NY
December 3-4, 2007 – New Brunswick, NJ

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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 10-11, 2007 – Boston, MA
October 25-26, 2007 – New York, NY
December 5-6, 2007 – 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 10 PD credit hours as granted by CFA Institute.

ADVANCE PERFORMANCE MEASUREMENT

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.