

# PERFORMANCE PERSPECTIVES

with David Spaulding



VOLUME 12 – ISSUE 6

FEBRUARY / MARCH 2015

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](mailto:CSpaulding@SpauldingGrp.com)

## A FIRST...BUT HOPEFULLY NOT TO BE REPEATED TOO OFTEN

Since we began publishing this newsletter, we've managed to get an issue out each month. And would have done so for February and March, too, save for the limited amount of time I had to prepare them. Not only has this been our perennial "busy season" for verifications, we've had a few consulting assignments tossed in as well, which have taken much of my discretionary time away. And so, this issue is for February AND March. Hopefully we'll be *back on schedule* with April.

## A BIT MORE ABOUT TIME- AND MONEY-WEIGHTING

In 1966, the birth of performance measurement, as we know today occurred, with the publication of Pension Funds: Measuring Investment Performance, by Peter O. Dietz. This work was so well received<sup>1</sup> that in 1968 the Bank Administration Institute (BAI) of America published its seminal *Measuring the Investment Performance of Pension Funds*: the first standard on performance measurement. This was followed in 1971 by the Investment Counsel Association of America's<sup>2</sup> (ICAA) standard.<sup>3</sup>

Peter's research uncovered three main things:

- Not all pension funds bothered to revalue their portfolios, opting to keep them at book value
- There were a variety of ways that institutions measured the performance of their plans
- Often, the internal rate of return was used to evaluate managers.



Peter encouraged institutions to regularly mark-to-market (i.e., revalue) their portfolios. In addition, he pointed out how the internal rate of return was not a good measure to evaluate managers, as it allowed external cash flows, which the clients typically controlled, to influence the results. Instead, he recommended that a measure be used that would eliminate or reduce the impact of cash flows. While he referred to this as an "average" return, BAI gave it the name we know it as today: time-weighting.

### A bit of overselling?

*There's a story I like to tell about a young Catholic girl who began dating a Protestant boy. After a few dates, it appeared they were getting serious, and so the girl's mother reminded her that she wanted her daughter to marry a Catholic. "But Mom, I think I'm*

1 Probably helped along by the articles he also wrote on the topic.

2 Now the Investment Adviser Association.

3 The differences between the two works are extreme. The BAI's is a book, significantly longer, and much more in depth, while the ICAA's is really a brief pamphlet. But they serve similar roles: to establish rules on how to calculate performance.

# The Journal of Performance Measurement®

## UPCOMING ARTICLES

### Fixed Income Attribution with Carry Effect

– Tianci Dai, CFA, CIPM  
Mark Elliott

### The Associative Property of Attribution Linking

– Yindeng Jiang, CFA  
Joseph Sáenz, Ph.D.

### New Look at Multi-Period Attribution: Solving Rebalancing Issue

– Dmitry Cherkasov, CFA, CIPM

### Visualization, R, ggplot2, and Applied Finance in Performance Measurement

– Rodolfo Vanzini

### Contribution Fundamentals

– David Spaulding, DPS, CIPM

*falling in love with him!” The mother responded with a suggestion: “Perhaps you could have him join you at Mass each week. If he experiences the beauty of our service, I’m sure he’ll fall in love with our faith and will want to convert.” And so, the daughter decided to try.*

*After a few weeks the daughter reported that her boyfriend had, indeed, come to love her faith, and had agreed to convert. And so, a wedding was planned.*

*However, after a few months the daughter called her mother in tears: “Mom, the wedding’s off.” Why?,” asked the mother; is he not going to convert?”*

*“Oh, he’s converting,” reported the daughter. “And he’s going to become a priest!”*

This is an example of overselling: the daughter sold her faith a bit too much.

The same occurred with time-weighting, though it was no one’s intention. In fact, several individuals went out of their way to point out that the IRR was an effective way to measure the performance *of the fund*, while time-weighting would be used to measure the performance *of the manager*. For whatever reason, it apparently became quite common for firms to only use the latter.

Today, there’s greater appreciation for the need and desire to understand “how my portfolio is doing.” Thus, the need to use a different measure than what’s used to evaluate the managers; one that take the cash flows into consideration.

**“We must say that we congratulate you on your simplicity,  
but do not envy you on your folly”**

**Thucydides**

The Melian Dialogue; *History of the Peloponnesian War*

Peter Dietz pointed out the need to eliminate the affects of cash flows, which the manager didn’t control. Some say that to judge the performance of the client, we also need to eliminate the affect of cash flows. Really? This translates into the following illogical logic:

- In order to judge the manager, we need to eliminate the effect of cash flows, which the client controls.
- In order to judge the account, we need to eliminate the effect of cash flows, which the client controls.

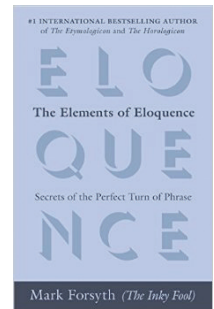
And so, when do we not want to eliminate the effect of cash flows? The answer to these thinkers is quite simple: never!

### **More and more are “getting it”**

We’re beginning to see the institutionalization of money-weighting, with the Government Accounting Standards Board (GASB) in the United States and in Canada. As with any change, there’s bound to be some discomfort, disagreement, and denial that it’s a good thing. I’m pleased that in my efforts to get folks to embrace money-weighting

## BOOK REVIEW

I love to read and do in two ways: the traditional way we were all taught and also by listening. I subscribe to [www.Audible.com](http://www.Audible.com), which I find to be an invaluable resource for all kinds of books. And so, I normally have two or three paper books going at the same time, as well as listening to one (while driving and exercising, primarily).



While it's rare, I will occasionally both listen to and actually read a book. This happened recently with *The Elements of Eloquence: Secrets of the Perfect Turn of Phrase*, by Mark Forsyth. It's excellent (that's probably obvious, if I went through it two times).

Forsyth discusses over thirty writing techniques, most of which I was unaware of. While most people know about alliteration, these other methods are most likely foreign to them.

Here are just a few:

- **Polyptoton:** “the repeated use of one word as different parts of speech or in different grammatical forms.” An example is the Beatle’s *Please Please Me*.

Shakespeare (who the author frequently references) was a fan of the technique; e.g.,

Let me not to the marriage of true minds  
Admit impediments. Love is not love  
Which alters when it alteration finds,  
Or bends with the remover to remove.

- **Antithesis:** “first you mention one thing; then you mention another.” Oscar Wilde was apparently a master of this technique; for example, “The well-bred contradict other people. The wise contradict themselves.”
- **Enallage:** a deliberate grammatical mistake. Apparently, these can work quite well. T.S. Eliot employed it in “The Love Song of J. Alfred Prufrock”: Let us go then, you and I.” Also, Dylan Thomas: “Do not go gentle into the good night.”

What the author conveys are techniques that many authors and songwriters have employed, which end up being memorable or striking to us, even though we don’t know exactly why.

As a reader, it makes one more alert when they see them employed; and, as a writer it provides techniques we may want to try ourselves.

The book is short and well worth your investment, especially if you enjoy writing and/or reading.

Malcolm Smith	UK
Hans Braker	Netherlands
Dorian Young	US
Tom Stapleton	UK
Gerard van Breukelen	Netherlands
Anthony Howland	UK

## PUZZLE TIME

### January Puzzle<sup>4</sup>

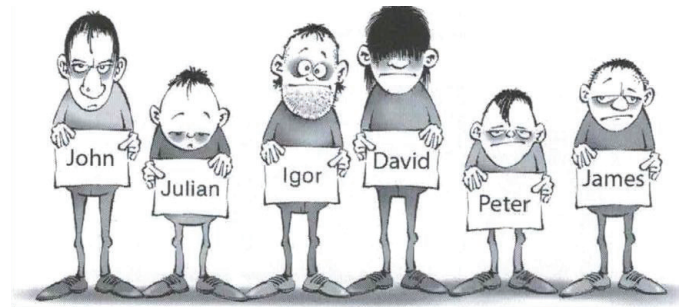
This puzzle is one that involves *deductive reasoning*. We did a puzzle like this more than ten years ago, which proved to be very popular.



The police have arrested six criminals and are trying to identify the boss. The police inspector made the suspects to form a line-up, in the same order as the following table, and has asked each of them four questions, as shown in the table, along with their answers.

#	Questions	John	Julian	Igor	David	Peter	James
1	Are you the boss?	NO	NO	NO	NO	NO	YES
2	Is the boss standing to your left?	NO	YES	NO	NO	YES	NO
3	Is the boss standing to your right?	NO	YES	YES	NO	YES	NO
4	Is the boss standing next to you?	YES	YES	YES	YES	NO	NO

Each criminal lied exactly two times. On the basis of this information, identify who the boss is. Just to clarify, David is to the left of Igor, while Julian is to Igor's right (i.e., it's from *their* perspective).



**Julian:** I think Julian is a key person to start with, since he gave contradictory responses (that the boss is standing both to his left and right), so one of those has to be wrong. Why? Can't they both be false? I don't think so, because if they were both lies, then his other answers (that he's not the boss and that the boss is standing next to him) would have to be true, which they can't be. And so, we can conclude that the boss is either to his left or right, but not next to him. So, we can rule out John, Igor, and Julian as the boss. And so, we can say that these are "not the boss," which is a good start, since that would mean that one of the other three has to be. Because his statement that the boss isn't standing next to him, then his statement that the boss is standing to his right has to be wrong, since only John is standing to his right, and he's also standing next to him. And so, the boss has to be to his left. And so, we know the following so far:

<sup>4</sup> Source: *100 Math Brainteasers*, by Zbigniew Romanowicz and Bartholomew Dyda.

#	Questions	John	Julian	Igor	David	Peter	James
1	Are you the boss?	NO (true)	NO (true)	NO (true)	NO	NO	YES
2	Is the boss standing to your left?	NO	YES (true)	NO	NO	YES	NO
3	Is the boss standing to your right?	NO	YES (false)	YES	NO	YES	NO
4	Is the boss standing next to you?	YES	YES (false)	YES	YES	NO	NO

**Peter:** He's helpful, I think. He, like Julian, gave contradictory responses: that the boss is both to his left and right. If he's lying both of these times, then he would have to be the boss. However, he answered "no" to that question," which has to be true, since he's only allowed two lies, and if we conclude that he was lying for the second and third questions, he'd have to be telling the truth when he says he's not the boss. And so, it's true that the boss is either to Peter's right or left and that he's not the boss. We also know that his answer to #4 has to be a lie, since he's only lied once so far (that the boss is both to his left and right), so the boss must be standing next to him. Meaning, that the boss is either David or James; I think that's progress!

#	Questions	John	Julian	Igor	David	Peter	James
1	Are you the boss?	NO (true)	NO (true)	NO (true)	NO	NO (true)	YES
2	Is the boss standing to your left?	NO	YES (true)	NO	NO	YES	NO
3	Is the boss standing to your right?	NO	YES (false)	YES	NO	YES	NO
4	Is the boss standing next to you?	YES	YES (false)	YES	YES	NO (false)	NO

**Igor:** Now, let's consider Igor. We are able to conclude that he's not the boss, since he's not standing next to Peter. And so, he's was telling the truth when he told us that. When asked if the boss is to his left, he lied by saying "no" (we know it's true from the other two criminals). He also lied when he said the boss is to his right, meaning he was telling the truth when he said the boss was standing next to him.

#	Questions	John	Julian	Igor	David	Peter	James
1	Are you the boss?	NO (true)	NO (true)	NO (true)	NO	NO (true)	YES
2	Is the boss standing to your left?	NO	YES (true)	NO (false)	NO	YES	NO
3	Is the boss standing to your right?	NO	YES (false)	YES (false)	NO	YES	NO
4	Is the boss standing next to you?	YES	YES (false)	YES (true)	YES	NO (false)	NO



## KEEP THOSE CARDS & LETTERS COMING

*We appreciate the emails 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.*

Meaning...David's the boss.<sup>5</sup>

We can further demonstrate this by analyzing the other answers:

#	Questions	John	Julian	Igor	David	Peter	James
1	Are you the boss?	NO (true)	NO (true)	NO (true)	NO (false)	NO (true)	YES (false)
2	Is the boss standing to your left?	NO (false)	YES (true)	NO (false)	NO (true)	YES (false)	NO (true)
3	Is the boss standing to your right?	NO (true)	YES (false)	YES (false)	NO (true)	YES (true)	NO (false)
4	Is the boss standing next to you?	YES (false)	YES (false)	YES (true)	YES (false)	NO (false)	NO (true)

I'll confess that I found the wording *not so clear*, and perhaps you did, too. Take for instance Julian. When I first attempted this I knew that the boss couldn't be both to his left or right, so one of those statements has to be a lie. Since he said he's not the boss, I concluded he must be telling the truth. But then how could the boss not be standing next to him? My failure was to think that questions 2 and 3 meant *immediate* right or left, but that's really not what's being asked: just *to* your left/right. Once that was overcome, the solution wasn't far away.

### February/March Puzzle

Somewhere off the beaten track lie three villages: Aden, Baden, and Caden, which share a fire brigade located outside these places. The inhabitants of Aden always tell the truth, while the locals in Baden begin their conversation with a true statement, which is invariably followed by a pack of lies. The villagers in Caden embark on their conversation with a true sentence and then alternately lie and tell the truth. One day the duty officer in the fire station received a call from an inhabitant of one of the villages:

"A fire has broken out in one of the villages!"

"In which village?," demanded the officer.

"In ours!"

"Ours?...and more precisely" asked the officer.

"In Caden!"

At that moment the line went dead.

Which village was the call from? And where should have the duty officer sent the fire engine?



<sup>5</sup> I rarely attempt the puzzle before posting it, so didn't know until now that I'm (or my namesake) is the boss of this crime syndicate. Hans included the following with his response: "As we would expect from The Spaulding Group, David is the boss." And Tom offered "David is the boss (of course!)." And Gerard wasn't left out, either: "David is of course the boss!!" It's merely a coincidence, though a funny one, and I appreciate the jabs.

## Laura Soehl, CIPM

Analyst  
HGK Asset Management

### Bio:

Laura Soehl is the Performance Analyst on the Client Service Team responsible for performance measurement, analysis, and evaluation for the firm's equity and fixed income departments. Laura has been with the firm since 2008.

Laura earned a Bachelor of Arts in Communication with a minor in Spanish, Business, and Cultures from the University of Maryland. She holds the CIPM designation.



## CLIENT'S CORNER

### *1. How long have you been involved in performance?*

I have been with HGK since 2008. In 2009, I began assisting the performance department

and am now the lead Performance Analyst at the company. I attained the CIPM designation in 2012.

### *2. What do you enjoy most about it?*

There are many aspects of the performance role that I enjoy and find desirably challenging. My job is quantitative in nature but also involves interaction with departments across the entire firm and with clients. It challenges me to be analytical in my thought processes, yet not at the sacrifice of my communication skills, which is frequently in use and always developing. The coupling of analytical skills with communication skills is very important to me in a role.

### *3. What role does The Spaulding Group play at your firm?*

The Spaulding Group has been useful at HGK in more ways than one. We are currently undergoing our first annual GIPS verification with the Group, and could not be happier with the choice thus far. Beyond this, several coworkers and I have taken the CIPM examination and attended the Group's classes for exam preparation; we all felt the classes were excellent. The in-class instruction and materials, coupled with the blog posts and webinars they provided, supplemented my studies and prepared me well for both tests. Their expertise and support is remarkable and we at HGK look forward to continuing to working together.

## THE SPAULDING GROUP'S 2015 INVESTMENT PERFORMANCE MEASUREMENT CALENDAR OF EVENTS

DATE	EVENT	LOCATION
April 22	Asset Owner Roundtable Meeting	Chicago, IL (USA)
April 23-24	Performance Measurement Forum	Chicago, IL (USA)
May 12-13	PMAR North America	Philadelphia, PA (USA)
May 14-15	Fundamentals of Performance Measurement	New Brunswick, NJ (USA)
June 15-16	PMAR Europe	London, England
June 18-19	Performance Measurement Forum	Dubrovnik, Croatia
July 14-15	Fundamentals of Performance Measurement	Chicago, IL (USA)
July 16-17	Performance Measurement Attribution	Chicago, IL (USA)
August 24-25	CIPM Principles Prep Class	Chicago, IL (USA)
August 26-28	CIPM Expert Prep Class	Chicago, IL (USA)
September 16	Portfolio Risk	San Diego, CA (USA)
October 20-21	Fundamentals of Performance Measurement	Los Angeles, CA (USA)
October 22-23	Performance Measurement Attribution	Los Angeles, CA (USA)
November 5-6	Performance Measurement Forum	Prague, Czech Republic
November 18	Asset Owner Roundtable Meeting	Phoenix, AZ (USA)
November 19-20	Performance Measurement Forum	Phoenix, AZ (USA)
Nov. 30 – Dec. 4	Virtual PMAR – An online conference event	
December 8-9	Fundamentals of Performance Measurement	New Brunswick, NJ (USA)
December 10-11	Performance Measurement Attribution	New Brunswick, NJ (USA)

*For additional information on any of our 2015 events, please contact Christopher Spaulding at 732-873-5700*



## 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](mailto: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](http://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:

May 14-15, 2015 – New Brunswick, NJ

July 14-15, 2015 – Chicago, IL

October 20-21, 2015 – Los Angeles, CA

December 8-9, 2015 – New Brunswick, NJ

#### 15 CPE & 12 PD Credits upon course completion

CFA Institute has approved this program, offered by The Spaulding Group, for 12 CE credit hours. If you are a CFA Institute member, CE credit for your participation in this program will be automatically recorded in your CE tracking tool.



#### 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 16-17, 2015 – Chicago, IL

October 22-23, 2015 – Los Angeles, CA

December 10-11, 2015 – New Brunswick, NJ

#### 15 CPE & 12 PD Credits upon course completion

CFA Institute has approved this program, offered by The Spaulding Group, for 12 CE credit hours. If you are a CFA Institute member, CE credit for your participation in this program will be automatically recorded in your CE tracking tool.



#### 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.

**UPDATED CIPM Principles and Expert Flash cards are now available on our web store. Please visit [www.SpgShop.com](http://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.

