PERFORMANCE PERSPECTIVES
with David Spaulding

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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 Patrick Fowler at

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http://www.SpauldingGrp.com

WHY THE HANDCUFFS?

Handcuffing clients

A number of firms have expressed interest in switching their verifications to The Spaulding Group. There are several reasons for this, including:

- We only use senior level verifiers (avoiding clients from having to teach their verifiers about GIPS and performance measurement).
- We avoid turnover (meaning clients won't have to answer the same questions every year).
- We do remote verifications (meaning they're much more efficient).
- We get the job done in a timely manner (our preliminary reports are typically delivered on the last day we're at our client's offices, or very shortly thereafter).
- We provide our clients with a proprietary GIPS Orientation Kit, to assist them with both achieving and maintaining compliance.

But, their verifier has *handcuffed* them with a contract of one or more years, which restricts their ability to change verifiers.

The Spaulding Group does not *handcuff* our clients: they are not obligated to retain us if they choose to discontinue our services. We feel that if they want to leave, they should be able to, no strings attached.

Handcuffing employees

We are currently thinking of hiring a new verifier. And, it only makes sense to consider someone from a competitor. However, some verification firms handcuff their employees with non-compete agreements, which restrict their ability to work for another verifier.

In reality, these agreements typically are not defendable. The main reason is it's a restraint of trade: they restrict someone from continue to work in a profession they've developed expertise in.

As I understand it, some states (e.g., California) prohibit them and others (e.g., Massachusetts) are considering doing the same.

That said, the verification firm usually has deeper pockets than the employee, meaning that if the individual leaves and joins a competitor and is then sued by their former employer, they will have to hire an attorney. And even if they win, the court costs and attorney fees can be high.

But is this fair? We think not. We do not have non-compete agreements with our staff.

The Journal of Performance Measurement®

And so, simple question: why?

- Why do some verification firms resort to handcuffing their clients and employees? As noted above, we do neither! Are we being foolish or fair?
- Why do the clients agree to sign such documents? Why do employees?

Okay, the answers to these last two questions are probably pretty obvious, but, it's still unfortunate.

The Spaulding Group will not handcuff its employees or clients. We think it's unfair to both. If a client wants to sign a long-term agreement (as a few have), that's fine. But even with these, our clients are free to terminate at their will.

Are we being foolish? I think not. I think we're being fair.

GROWING QUITE TIRED OF THE FABLED BENCHMARK CRITERIA

You may have noticed that the CFA Institute issued a draft guidance statement on benchmarks.[1] I failed to comment on this earlier. I did submit my comments,[2] and you're welcome to have a look.

For the most part, I thought the document was quite good. However, it seems as if the benchmark criteria that was developed a couple decades ago had to be included. And I, for one, am not a fan.

Here they are, as they appear in the GS:

- <u>specified in advance</u>. Although this may not always be the case, firms should select a composite benchmark prior to the evaluation period.
- <u>relevant</u> (formerly known as "relevant"). The benchmark reflects the investment mandate, objective, or strategy of the composite.
- <u>measurable</u>. The benchmark is quantifiable.
- <u>unambiguous</u>. The constituents of the investable universe can be clearly identified and priced.
- <u>representative of current investment opinions</u>. The firm has current knowledge of the investable universe.
- <u>accountable</u> (formerly known as "owned"). The firm selects the benchmark and is accountable for any deviations from the benchmark.
- <u>investable</u>. The benchmark offers a passive alternative that is a realizable and alternative opportunity genuinely open to the investor.
- <u>complete</u>. The benchmark provides a broad representation of the sector of the market to which it pertains.

1 https://www.gipsstandards.org/standards/Documents/Guidance/exposure_draft_public_comment_benchmarks.pdf

2 https://www.gipsstandards.org/standards/Documents/Guidance/benchmarks_spaulding.pdf

The first seven were the original ones, as many of us have become familiar with; the eighth is new.

What's my objection? Well, they are a bit biased. Consider the following table:

		Benchmarks			
	Criteria:	Absolute	Market Indexes	Peer Groups	Custom
1	Unambiguous	Yes	Yes	No	Yes
2	Investable	No	Yes	No	Yes
3	Measurable	Yes	Yes	Yes	Yes
4	Appropriate	Yes	No	No	Yes
5	Reflective of opinions	No	Yes	No	Yes
6	Specified in advance	Yes	Yes	No	Yes
7	Owned	No	Yes	No	Yes

This comes from our firm's *Fundamentals of Performance Measurement* course, that includes a section on benchmarks, that in turn includes references to the criteria. We see the original seven criteria, and how the four major types of benchmarks stack up.[3] You'll notice that only one, "custom," manages to achieve a perfect score. And note that peer groups fail miserably, with absolute not too far behind. Even market indices, something that is quite common, fails when it comes to being "appropriate."[4]

Would you not think that if something only gets a score one out of seven, it would be deemed a <u>totally</u> and <u>completely</u> unacceptable benchmark, never to grace the pages of a client report or marketing brochure? Or, shouldn't one that fails three out of seven times also be deemed unac-ceptable?

Well, chances are you are completely aware that both absolute and peer group benchmarks are employed quite a bit.

I was told, by whom I cannot recall, that the creators of this criteria also offered custom bench-marks; I have no way of validating this. Perhaps it's apocryphal. I only point this out as perhaps a reason why it ranks so high. In reality, custom are not used to the degree that market indexes are, are they?

Why is it that these criteria achieved an almost sacrosanct level in our industry?

My response to seeing them: *what's the point?* Do they have any real value? If they do, why aren't they actually resulting in the elimination of types that fail, at times miserably?

Is it time to *toss out* these criteria, or perhaps come up with better ones that truly result in assessing a benchmark's true value?

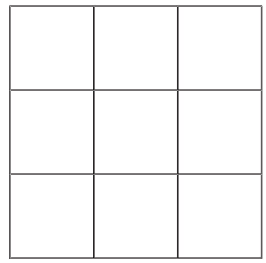
3 The scoring comes from the CFA Institute's CIPM program: these are the answers they expected as part of the exam.

4 The reason is that a benchmark's definition of "style" and "market cap" may not align precisely with that of the manager, and so one might question its true appropriateness.

PUZZLE TIME!

December 2017 Puzzle[5]

Three squares are chosen at random from the 3 x 3 grid below, and a cross is placed in each chosen square.



What is the probability that all three crosses line in the same row, column, or diagonal?

A. 1/28
B. 2/21
C. 1/3
D. 8/9

This seems like a simple exercise in probability. There are three rows, three columns, and two diagonals, which totals eight. However, in placing the cross in each, there are 3! (3 × 2 × 1, or 6) ways to place the cross (that is, the order in which you choose to insert the cross).[6] And so, our "starting"[7] numerator is actually 8 × 6 or 48.

What is the total number of possible ways to place the cross in three squares? Well, for the first box there are nine; once that's selected, then there are eight; and once that is picked, it's seven. We multiply these values together (9 × 8 × 7) and get 504. This is the number of possible ways to insert three crosses into the matrix, and is our "starting" denominator.

Our answer is therefore 48 / 504. And, this value can be reduced to 2 / 21, which is our option "B."

There are other ways to solve this. For example, Joel Bursma offered this:

There are eight ways the crosses could be in a line (three rows + three columns + two diagonals). There are 84 different combinations (C(9,3)) of cross placements. 8/84 reduces by 4 to 2/21.

Hans Braker offered this:

*The total number of ways to select 3 squares from the 9 available squares is 84: (9 over 3) = (9*8*7) / (3*2*1).*

There are only 8 solutions in which the three squares lie on a row, column or diagonal: 3 rows + 3 columns + 2 diagonals.

So the probability is 8/84 = 2/21.

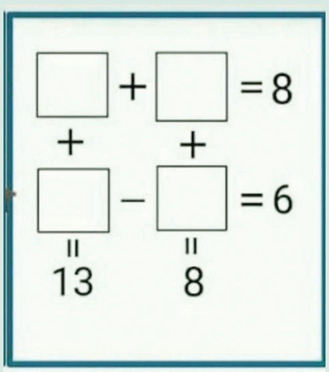
Anthony Howland also got this one correct.

November 2017 puzzle

I failed to notice that Daniel Kempf also got the correct answer!

January 2018 puzzle

Fill in the boxes in the accompanying puzzle to solve the equations.



5 Taken from the I Love Mathematics Facebook page.

6 For example, consider the first row. You could put the first cross in the box on the left (left box), the second in the middle (middle box), and the third in the right (right box). Or, you could put the first in left box, second in right box, and third in center box. Or, you could put the first in middle box, second in right box, and third in left box. And so on. Hopefully, you'll see that there are six ordered ways to place the squares in these three boxes.

7 We'll be able to reduce it.

KEEP THOSE CARDS & LETTERS COMING

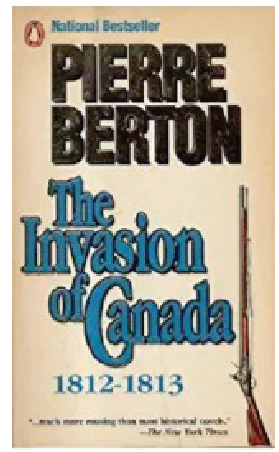
We appreciate the emails we receive regarding our newsletter. Mostly, we hear positive feedback while at other times, we hear opposition to what we suggest. That's fine. We can take it. And more important, we encourage the dialogue. We see this newsletter as one way to communicate ideas and want to hear your thoughts.

Some feedback

Daniel Kempf offered the following comments on the November 2017 issue on social media:

I just finished reading the newsletter and I thought your comments on tweeting were interesting. I'd be curious to know how regulation and the SEC are affecting the financial industry's adoption of Twitter. You mentioned that a lot of performance professionals are not yet on it, but I know that there are increasingly onerous guidelines that many of us in the industry now have to pay attention to that almost make it not worth the effort to sign up. For example, we have to worry that any tweet we "like" or "thumbs up" could potentially be considered an endorsement. I wonder if others avoid it for the same reason.

BOOK REVIEW



Moral: if you give me a book to read, be patient, as it may take me awhile.

Back in August 2002 (yes, 15+ years ago), Carl Bacon gave me Pierre Berton's *The Invasion of Canada: 1812-1813* to read. Pierre, who is now deceased, was a Canadian. And so, Carl thought reading a book that covered the War of 1812 from a foreigner's (i.e., non-American's) perspective might be fun.

Well, the book has sat for quite some time, but I finally picked it up. And, I found it to be excellent! While it is nonfiction, it reads very much like an historical novel.

The author is quite balanced in his writing. He points out the mistakes of all combatants, which includes the Americans, Canadians, British, and American Indians.

I don't recall reading about this war before, and so really didn't know a whole lot. I recommend it.

www.spauldinggrp.com/bacon-vs-spaulding

THE SPAULDING GROUP'S 2018
INVESTMENT PERFORMANCE MEASUREMENT CALENDAR OF EVENTS

DATE	EVENT	LOCATION
February 20-21, 2018	Fundamentals of Performance Measurement	Boston, MA
February 22-23, 2018	Performance Measurement Attribution	Boston, MA
March 13-14, 2018	Fundamentals of Performance Measurement	San Francisco, CA
March 15-16, 2018	Performance Measurement Attribution	San Francisco, CA
April 25, 2018	Asset Owner Roundtable	Denver, CO
April 26-27, 2018	Performance Measurement Forum	Denver, CO
May 15-16, 2018	PMAR North America	Philadelphia, PA
May 17, 2018	Bacon vs. Spaulding	Philadelphia, PA
June 11-12, 2018	PMAR Europe	London, England
June 13, 2018	Spaulding vs. Bacon	London, England
June 14-15, 2018	Performance Measurement Forum	Dublin, Ireland
July 16-20, 2018	Performance Measurement Boot Camp	New Brunswick, NJ
August 14-15, 2018	Fundamentals of Performance Measurement	Chicago, IL
August 16-17, 2018	Performance Measurement Attribution	Chicago, IL
October 15-16, 2018	Fundamentals of Performance Measurement	San Diego, CA
October 17-18, 2018	PMAR West Coast	San Diego, CA
November 15-16, 2018	Performance Measurement Forum	Luxembourg
November 28, 2018	Asset Owner Roundtable	Orlando, FL
November 29-30, 2018	Performance Measurement Forum	Orlando, FL
December 5-6, 2018	Fundamentals of Performance Measurement	Mumbai, India
December 11-12, 2018	Fundamentals of Performance Measurement	New Brunswick, NJ
December 13-14, 2018	Performance Measurement Attribution	New Brunswick, NJ

For additional information on any of our 2018 events, please contact Patrick Fowler at 732-873-5700

TRAINING…

Gain the Critical Knowledge Needed for Performance Measurement and Performance Attribution

TO REGISTER:

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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:

- February 20-21, 2018 – Boston, MA
- March 13-14, 2018 – San Francisco, CA
- August 14-15, 2018 – Chicago, IL
- October 15-16, 2018 – San Diego, CA
- December 11-12, 2018 – 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.

CE Qualified Activity — 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:

- February 22-23, 2018 – Boston, MA
- March 15-16, 2018 – San Francisco, CA
- August 16-17, 2018 – Chicago, IL
- December 13-14, 2018 – 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.

CE Qualified Activity — 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.

WORKING ON YOUR 2018 BUDGET?

Don't forget to make room for conferences. And why not the Trifecta of Performance Measurement Conferences?

The Journal of Performance Measurement® Sixteenth Annual International PMAR Performance Measurement, Attribution & Risk Conference — May 15th - 16th, 2018

The Journal of Performance Measurement® Ninth Annual International PMAR IX Performance Measurement, Attribution & Risk Conference EUROPE — 11 - 12 June 2018 – London

The Journal of Performance Measurement® Second Annual – West Coast PMAR II Performance Measurement, Attribution & Risk Conference WEST — October 17 & 18, 2018

PMAR, Performance Measurement, Attribution & Risk, is the #1 performance measurement conference. If you've never experienced it, you owe it to yourself and your firm. And if you have, then you know the great value it is. And now, there are three to choose from!

So please set aside funds in your 2018 budget to participate in PMAR!