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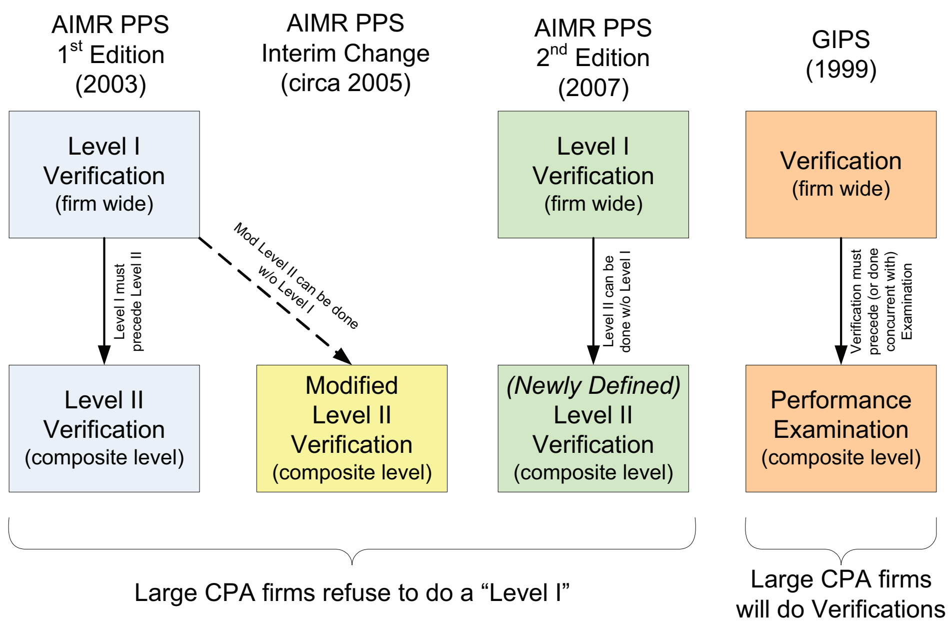
UNDERSTANDING *WHY* WE DO WHAT WE DO

Earlier this month, I posted about the subject "Understanding the why" in my blog.[1] I mentioned how in reading a David Baldacci book (sorry, listening to a David Baldacci book) I learned why folks in the UK drive on the left, rather than the right-hand side of the road.

I used this as a pick-up point to discuss why so many U.S. firms that claim compliance with the Global Investment Performance Standards (GIPS®) have performance examinations done, while firms elsewhere (e.g., Europe) do not (it stems from the practice of large CPA firms unwilling-ness to conduct "Level I" verifications under the AIMR-PPS®, thus their clients not having Level Is done; this changed with GIPS, where these same firms will now do Performance Examinations (which are equivalent to Level IIs)).



This past weekend the Roman Catholic church introduced a new version of the Mass in English. The basis behind this is apparently due to the criticism of the original translation, which occurred as part of Vatican II (i.e., the translation could have arguably been better). And so, we know the "why," but this doesn't necessarily make the changes any easier. The admonition "do it because I said so!" doesn't cut it with children, or many adults for that matter. We often want to know "why."

1 http://investmentperformanceguy.blogspot.com/2011/11/understanding-why.html

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I guess in the end one might ask "does it matter?" In some things, perhaps not. But in trying to understand why most firms use time-weighting, why standard deviation "rules" when it comes to risk, and why certain changes were made to the GIPS Standards do affect us, and we should take into consideration "the why." We may discover that the basis for a rule (or change to a rule) is unfounded, or at least something we take exception to.

WHO'S THE CLIENT?

I want to pick up on another topic I addressed earlier this month in my blog: that is, who the client is, for GIPS purposes.[2] This is a topic which has been discussed at various times, but for which there is little written. The following graphic should prove helpful in our discussion.

We'll take each type of client separately.

Institutions. Here we speak of pension funds, endowments, foundations, etc. It is typical for a manager to establish a direct relationship with these institutions (although gaining access to them may be through an investment consultant). These accounts are managed separately, and have separate accounts established, usually at a custodian, that the manager has access to. When the manager makes a purchase, the institution owns the securities or asset. Thus, from a GIPS perspective, *these* are clients and prospective clients, that call for the firm to *make every reasonable effort* to get them the appropriate composite compliant presentation(s).

2 http://investmentperformanceguy.blogspot.com/2011/11/whos-client-revisited.html.

Upcoming Events:

First Rate 2012 Performance Conference

March 26-27, 2012

Four Seasons Resort and Club Dallas – Irving, Texas

Conference Website:

http://www.firstrate.com/investmentperformanceconference2012

High Net Worth Individuals. Many managers will serve the need of high net worth (or ultra high net worth) individuals. And as with institutional clients, separate accounts are established directly with each client, the manager makes purchases specifically for these clients, and the clients own the underlying assets. Therefore, these individuals are, from a GIPS perspective, clients and prospective clients.

Mutual Funds: In the case of a mutual fund, the manager makes purchases for the fund, not the individual shareholders. Some countries have rules established as to what the prospective clients are to be given (e.g., fund prospectuses) and how returns can be shown to them. The *mutual fund* is the client or prospective client; not the individual shareholders. Therefore, for GIPS purposes the firm is not obligated to provide these individuals with GIPS presentations.

Wrap Fee (SMA) Accounts. This is a bit of an "odd ball" situation. The GIPS guidance statement[3] permits firms to treat the wrap fee sponsor as the client or the individuals who invest in it. Given that it is typical for the manager to make their "sales pitch" to the sponsor, not the individuals who will invest, treating the sponsor as the client (prospective client) makes a lot of sense. But again, you have some flexibility here.

Hedge Funds, Limited Partnerships. Is there really any difference between a limited partnership, such as a hedge fund or private equity fund, or a mutual fund? In both cases, the individual investors are purchasing shares in the fund or partnership, and don't own the underlying assets; these belong to the partnership. The manager does not make individual investments. Conse-quently, the hedge funds or partnerships are the clients or prospective clients.

Note that when high net worth individuals or institutions invest in partnerships or mutual funds, they no longer are the "client" or "prospective client" for GIPS purposes.

You can probably glean from this summary that the criteria for the individual or institution being a "client" for GIPS purposes being:

- purchases of securities or assets are made specifically for the individual or institution
- the individual or institution owns the underlying assets
- the individual or institution has a separate account established, often at a custodian, where the assets are held.

Please let me know your thoughts on these characterizations. I happen to think clarity is needed, and I hope that I have provided some (and also hope that my views are generally accepted on this subject).

3 http://www.gipsstandards.org/standards/guidance/develop/pdf/gs_wrap_fee_clean.pdf.

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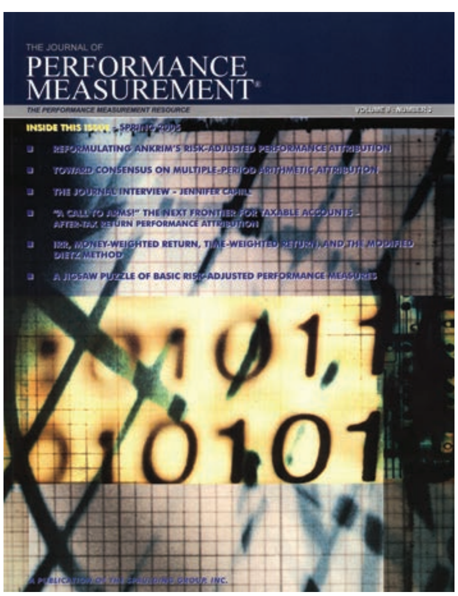

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December 1-2, 2011	Performance Measurement Forum	Orlando, FL (USA)
December 6-7, 2011	Fundamentals of Performance Measurement Training	New Brunswick, NJ (USA)
December 8-9, 2011	Performance Measurement Attribution Training	New Brunswick, NJ (USA)
February 7-8, 2012	Fundamentals of Performance Measurement Training	Los Angeles, CA (USA)
February 9-10, 2012	Performance Measurement Attribution Training	Los Angeles, CA (USA)
March 13-14, 2012	Fundamentals of Performance Measurement Training	Boston, MA (USA)
March 15-16, 2012	Performance Measurement Attribution Training	Boston, MA (USA)
March 19-20, 2012	CIPM Principles Prep Class	Chicago, IL (USA)
March 21-23, 2012	CIPM Expert Prep Class	Chicago, IL (USA)

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

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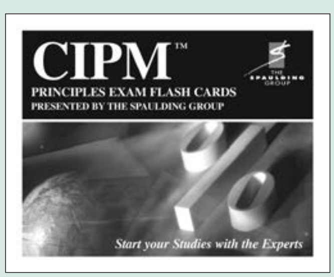

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