

PERFORMANCE PERSPECTIVES

with David Spaulding



VOLUME 10 – ISSUE 3

NOVEMBER 2012

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

WHAT'S A REASONABLE AMOUNT OF DISPERSION

We are frequently asked by GIPS® (Global Investment Performance Standards) verification clients for guidance as to what a reasonable amount of dispersion would be. This is quite difficult for two reasons.

But before I proceed, I want to remind you that GIPS requires firms to provide a measure of dispersion for composites that have at least six accounts present for the full period. There are several available measures, including:

- Standard deviation (probably the most common method)
- Asset-weighted standard deviation (sadly, probably the second most common method)¹
- High/Low (i.e., the highest and the lowest returns in the distribution)
- Range (the distance between the high/low (i.e., high minus low)).



Most firms that use standard deviation run it against the group of accounts that are present for the full period. However, this technically measures the standard deviation around the average of this group, NOT the actual composite return! To measure it against the composite return would be more difficult, and the difference in results is probably not material, so it shouldn't be a problem; I merely consider this a technicality.

Now, to the difficulty noted above:

First, it's relative to what the average return is. That is, if we have the same standard deviation for two composites, but one with, for example, a rather low average return and the other with an average that's much higher, we might draw two conclusions.

Consider Table #1. Here we see two portfolios that have the identical standard deviation (1.86%).² However, I would suggest that while for Portfolio #1 the standard deviation isn't an indication of wide dispersion, it is for Portfolio #2.

To consider this another way, their ranges are quite close. However, while the range may not be considered unreasonable when the average is 12.93%, it does look suspicious when the average is 3.25 percent.

1 This measure was championed by the Association for Investment Management & Research (i.e., the CFA Institute's prior moniker) for use in the AIMR Performance Presentation Standards (AIMR-PPS®). It apparently seemed logical to someone at the time that since returns are asset-weighted, that the standard deviation should be, too. This is a great example of the failure of what some think is logical, without going to the trouble of really analyzing it. While we can easily interpret standard deviation (i.e., the more common equal-weighted approach (that roughly two-thirds of the distribution falls within plus or minus one standard deviation from the mean)), there is no easy way to interpret what the asset-weighted variety means. We strongly discourage its uses and encourage our clients to drop it. Interestingly, although it was a favorite measure in the AIMR-PPS, it doesn't get any such support in GIPS, although it is permitted.

2 Note that I used the "population" version of standard deviation.

The Journal of Performance Measurement®

UPCOMING ARTICLES

Venture and Private Equity Performance Update: One Cheer for FAS157

– Susan Woodward

A New Choice in Multi-period Investment Performance Attribution: Effective Return versus Geometric Smoothing

– Ronald J. Surz

Analyzing Diversification Effects, Sector Allocations, Market Conditions, and Factor Tilts in Advanced Equity Beta Strategies: The Case of Efficient Indices

– Felix Goltz and Dev Sahos

Flows and Woes: The True Cost of Spot Trading Policy

– Matthew Lyberg and
Alexander Dunegan

Rethinking Portfolio Risk in Asset Management

– Charles T. Hage

The second problem is that standard deviation isn't always sensitive to outliers. That is, it doesn't provide much insight into their presence or degree.

Portfolio #1					Portfolio #2				
10.00%	11.05%	12.21%	13.49%	14.90%	1.00%	1.51%	2.27%	3.41%	5.13%
10.05%	11.10%	12.27%	13.56%	14.98%	1.02%	1.54%	2.31%	3.48%	5.24%
10.10%	11.16%	12.33%	13.62%	15.05%	1.04%	1.57%	2.36%	3.55%	5.34%
10.15%	11.22%	12.39%	13.69%	15.13%	1.06%	1.60%	2.41%	3.62%	5.45%
10.20%	11.27%	12.45%	13.76%	15.20%	1.09%	1.63%	2.46%	3.70%	5.57%
10.25%	11.33%	12.52%	13.83%	15.28%	1.11%	1.67%	2.51%	3.78%	5.68%
10.30%	11.38%	12.58%	13.90%	15.36%	1.13%	1.70%	2.56%	3.85%	5.80%
10.36%	11.44%	12.64%	13.97%	15.43%	1.15%	1.74%	2.61%	3.93%	5.92%
10.41%	11.50%	12.70%	14.04%	15.51%	1.18%	1.77%	2.67%	4.01%	6.04%
10.46%	11.56%	12.77%	14.11%	15.59%	1.20%	1.81%	2.72%	4.10%	6.17%
10.51%	11.61%	12.83%	14.18%	15.67%	1.23%	1.85%	2.78%	4.18%	6.29%
10.56%	11.67%	12.90%	14.25%	15.74%	1.25%	1.88%	2.84%	4.27%	6.42%
10.62%	11.73%	12.96%	14.32%	15.82%	1.28%	1.92%	2.89%	4.36%	6.56%
10.67%	11.79%	13.03%	14.39%	15.90%	1.30%	1.96%	2.95%	4.45%	6.69%
10.72%	11.85%	13.09%	14.46%	15.98%	1.33%	2.00%	3.02%	4.54%	6.83%
10.78%	11.91%	13.16%	14.54%	16.06%	1.36%	2.04%	3.08%	4.63%	6.97%
10.83%	11.97%	13.22%	14.61%	16.14%	1.39%	2.09%	3.14%	4.73%	7.12%
10.88%	12.03%	13.29%	14.68%	16.22%	1.42%	2.13%	3.21%	4.83%	7.26%
10.94%	12.09%	13.35%	14.76%	16.30%	1.44%	2.17%	3.27%	4.92%	7.41%
10.99%	12.15%	13.42%	14.83%	16.38%	1.47%	2.22%	3.34%	5.03%	7.56%
	Average	12.93%				Average	3.25%		
	Standard Deviation	1.86%				Standard Deviation	1.86%		
	High	16.38%				High	7.56%		
	Low	10.00%				Low	1.00%		
	Range	6.38%				Range	6.56%		

Table #1

Consider Table #2.

Here we again see our earlier Portfolio #1, along with Portfolio #3. Their averages are quite similar, and their respective standard deviations aren't very different. However, their high/low and range values are notably different. In Portfolio #3 we have extreme values of 1% and 25%, and yet the dispersion fails to give them much attention.

This is one reason that as a verifier, while we *do* look at standard deviation, we also want to look at the high/low values, to identify outliers which may represent accounts that don't belong in the composite.

Is there a problem with a large standard deviation? Not necessarily. These can arise for various reasons. They are, however, an indication of a potential problem. They're intended for the prospective client, to gain an understanding of the *consistency* in which the management is done.

Again, as verifiers we are more concerned with the outliers.

The Journal of Performance Measurement has begun a series on performance measurement professionals, and we need your help to identify the folks we should include. We focus on one or two people in each issue, with the list driven by input from other PMPs.

And so, please contact our editor, [Doug Spaulding](mailto:DougSpaulding@SpauldingGrp.com) (732-873-5700) with your suggestions.

PERFORMANCE MEASUREMENT HALL OF FAME

The recently published Summer issue of *The Journal of Performance Measurement*[®] announces that we are seeking nominations for the Performance Measurement Hall of Fame. We credit our friend and colleague, Tim Ryan, for this suggestion.

Please submit names to Douglas Spaulding (DougSpaulding@SpauldingGrp.com), the Journal's editor. The Journal's advisory board will vote on membership. We expect the "inaugural class" to consist of five to ten names. The inductees will be announced in our Winter issue.

We thank Tim for thinking of this idea and for suggesting that we create the Hall.

Your suggestions and ideas are also invited.

Portfolio #1					Portfolio #3				
10.00%	11.05%	12.21%	13.49%	14.90%	1.00%	10.99%	12.15%	13.42%	14.83%
10.05%	11.10%	12.27%	13.56%	14.98%	10.00%	11.05%	12.21%	13.49%	14.90%
10.10%	11.16%	12.33%	13.62%	15.05%	10.05%	11.10%	12.27%	13.56%	14.98%
10.15%	11.22%	12.39%	13.69%	15.13%	10.10%	11.16%	12.33%	13.62%	15.05%
10.20%	11.27%	12.45%	13.76%	15.20%	10.15%	11.22%	12.39%	13.69%	15.13%
10.25%	11.33%	12.52%	13.83%	15.28%	10.20%	11.27%	12.45%	13.76%	15.20%
10.30%	11.38%	12.58%	13.90%	15.36%	10.25%	11.33%	12.52%	13.83%	15.28%
10.36%	11.44%	12.64%	13.97%	15.43%	10.30%	11.38%	12.58%	13.90%	15.36%
10.41%	11.50%	12.70%	14.04%	15.51%	10.36%	11.44%	12.64%	13.97%	15.43%
10.46%	11.56%	12.77%	14.11%	15.59%	10.41%	11.50%	12.70%	14.04%	15.51%
10.51%	11.61%	12.83%	14.18%	15.67%	10.46%	11.56%	12.77%	14.11%	15.59%
10.56%	11.67%	12.90%	14.25%	15.74%	10.51%	11.61%	12.83%	14.18%	15.67%
10.62%	11.73%	12.96%	14.32%	15.82%	10.56%	11.67%	12.90%	14.25%	15.74%
10.67%	11.79%	13.03%	14.39%	15.90%	10.62%	11.73%	12.96%	14.32%	15.82%
10.72%	11.85%	13.09%	14.46%	15.98%	10.67%	11.79%	13.03%	14.39%	15.90%
10.78%	11.91%	13.16%	14.54%	16.06%	10.72%	11.85%	13.09%	14.46%	15.98%
10.83%	11.97%	13.22%	14.61%	16.14%	10.78%	11.91%	13.16%	14.54%	16.06%
10.88%	12.03%	13.29%	14.68%	16.22%	10.83%	11.97%	13.22%	14.61%	16.14%
10.94%	12.09%	13.35%	14.76%	16.30%	10.88%	12.03%	13.29%	14.68%	16.22%
10.99%	12.15%	13.42%	14.83%	16.38%	10.94%	12.09%	13.35%	14.76%	25.00%
Average		12.93%			Average		12.87%		
Standard Deviation		1.86%			Standard Deviation		2.47%		
High		16.38%			High		25.00%		
Low		10.00%			Low		1.00%		
Range		6.38%			Range		24.00%		

Table #2

PUZZLE OF THE MONTH

First, let's recall last month's puzzle, which was submitted by my colleague, Jed Schneider.

You are a prisoner. There are two doors. Behind one is a man-eating tiger, and behind the other is freedom. A guard stands in front of each door. One guard always lies while the other always tells the truth. You must choose one door to exit. You are allowed to ask one and only one question to one of the guards (both guards know what's behind each door).

What question do you ask to guarantee choosing the door to freedom?

This one stumped me; I had to ask Jed for the answer (though I regret not being able to figure it out).

The answer: Go to either guard and ask the following question: "If I asked the other guard what door has the tiger behind it, what would he say?" Whatever the guard's answer is, you would choose the opposite door.

Explanation: Let's say that the tiger is behind Door A; freedom is behind Door B. If the one you speak to is the liar, he will say that the other guard would say it's behind Door B (because HE (the liar KNOWS it's behind Door A, but has to lie, so will tell you (untruthfully) that the other guard would say "B") If the one you speak to is the honest one, he knows that the other is a liar, and that he (the liar) will say "Door B."

Phil Butler	UK
Gerard van Breukelen	Netherlands
Anthony Howland	UK
Max Moltchanov	USA
Nadir Chaudhry	Canada
Akash Mehta	India
Tommy Cronin	Ireland
Andrew Peakman	Switzerland
Saili Natu	USA

We had only a few folks who got it right, so I wasn't the only one stumped.

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.

November's Puzzle

Again, I'm using one submitted by Jed.

There are four people who need to cross a bridge in the middle of the night. The bridge is structurally weak and can only hold two people at a time. There is only one flashlight amongst the four people and it is impossible to cross the bridge without one since it is so dark outside. Each person can cross the bridge at different speeds as follows:

Person A can cross the bridge in 1 minute.

Person B can cross the bridge in 2 minutes.

Person C can cross the bridge in 5 minutes.

Person D can cross the bridge in 10 minutes.

The group decides to have two people go over, have someone come back with the flashlight (you can't throw it back), two more go over, etc. until all four get to the other side safely. When a pair goes over, they can only go as fast as the slowest person in that pair.

How fast can all four men get over the bridge and how should they be paired to do so?

I haven't tried it yet, but am hopeful I'll succeed. Good luck!



*Save
the
dates!*

The Journal of Performance Measurement®
Eleventh Annual International

PMAR

Performance Measurement,
Attribution & Risk

Conference

May 16th - 17th, 2013

The Journal of Performance Measurement®
In Association with RIMES Technologies

PMAR IV

Performance Measurement,
Attribution & Risk Conference

EUROPE

11 - 12 June 2013 - London

THE SPAULDING GROUP'S 2012/2013 INVESTMENT PERFORMANCE MEASUREMENT CALENDAR OF EVENTS

DATE	EVENT	LOCATION
December 4-5, 2012	Fundamentals of Performance Measurement Training	New Brunswick, NJ (USA)
December 6-7, 2012	Performance Measurement Attribution Training	New Brunswick, NJ (USA)
January 15-16, 2013	Fundamentals of Performance Measurement Training	Chicago, IL (USA)
January 17-18, 2013	Performance Measurement Attribution Training	Chicago, IL (USA)
January 28, 2013	Fundamentals of GIPS Workshop	Los Angeles, CA (USA)
February 11-12, 2013	Fundamentals of Performance Measurement Training	Los Angeles, CA (USA)
February 13-14, 2013	Performance Measurement Attribution Training	Los Angeles, CA (USA)
March 11-12, 2013	Fundamentals of Performance Measurement Training	Boston, MA (USA)
March 13, 2013	Portfolio Risk	Boston, MA (USA)
March 14-15, 2013	Performance Measurement Attribution Training	Boston, MA (USA)
March 18-19, 2013	CIPM Principles Exam Preparation	New Brunswick, NJ (USA)
March 20-22, 2013	CIPM Expert Exam Preparation	New Brunswick, NJ (USA)
April 15, 2013	Fundamentals of GIPS Workshop	Toronto, ON, Canada
April 16-17, 2013	Fundamentals of Performance Measurement Training	Toronto, ON, Canada
April 18-19, 2013	Performance Measurement Attribution Training	Toronto, ON, Canada
May 14-15, 2013	Fundamentals of Performance Measurement Training	Philadelphia, PA
May 15, 2013	Fundamentals of GIPS Workshop	Philadelphia, PA
May 25, 2013	Performance Measurement For Non-Performance Professionals	San Francisco, CA (USA)
June 10, 2013	Fundamentals of GIPS Workshop	London, England
June 13-14, 2013	Fundamentals of Performance Measurement Training	London, England
July 16-17, 2013	Fundamentals of Performance Measurement Training	San Francisco, CA (USA)
July 18-19, 2013	Performance Measurement Attribution Training	San Francisco, CA (USA)
July 22, 2013	Fundamentals of GIPS Workshop	Sydney, Australia
July 23-24, 2013	Fundamentals of Performance Measurement Training	Sydney, Australia
July 25-26, 2013	Performance Measurement Attribution Training	Sydney, Australia
August 19-20, 2013	CIPM Principles Exam Preparation	Chicago, IL (USA)
August 21-23, 2013	CIPM Expert Exam Preparation	Chicago, IL (USA)
September 18, 2013	Portfolio Risk	Boston, MA (USA)
September 23, 2013	Fundamentals of GIPS Workshop	Vancouver, BC, Canada
September 24-25, 2013	Fundamentals of Performance Measurement Training	Vancouver, BC, Canada
September 26-27, 2013	Performance Measurement Attribution Training	Vancouver, BC, Canada
October 21, 2013	Fundamentals of GIPS Workshop	London, England
October 22-23, 2013	Fundamentals of Performance Measurement Training	Chicago, IL (USA)
October 24-25, 2013	Performance Measurement Attribution Training	Chicago, IL (USA)
November 18, 2013	Fundamentals of GIPS Workshop	Boston, MA (USA)
November 19-20, 2013	Fundamentals of Performance Measurement Training	Boston, MA (USA)
November 21-22, 2013	Performance Measurement Attribution Training	Boston, MA (USA)
December 10-11, 2013	Fundamentals of Performance Measurement Training	New Brunswick, NJ (USA)
December 12-13, 2013	Performance Measurement Attribution Training	New Brunswick, NJ (USA)

For additional information on any of our 2012-2013 events, please contact Christopher Spaulding at 732-873-5700

TRAINING...

Gain the Critical Knowledge Needed for Performance Measurement and Performance Attribution

TO REGISTER:

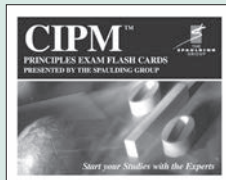
Phone: 1-732-873-5700

Fax: 1-732-873-3997

E-mail: info@SpauldingGrp.com



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



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:

December 4-5, 2012 – New Brunswick, NJ
 January 15-16, 2013 – Chicago, IL
 February 11-12, 2013 – Los Angeles, CA
 March 11-12, 2013 – Boston, MA
 April 16-17, 2013 – Toronto, ON, Canada
 May 14-15, 2013 – Philadelphia, PA
 June 13-14, 2013 – London, England

July 16-17, 2013 – San Francisco, CA
 July 23-24, 2013 – Sydney, Australia
 Sept. 24-25, 2013 – Vancouver, BC, Canada
 October 22-23, 2013 – Chicago, IL
 November 19-20, 2013 – Boston, MA
 December 10-11, 2013 – 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:

December 6-7, 2012 – New Brunswick, NJ
 January 17-18, 2013 – Chicago, IL
 February 13-14, 2013 – Los Angeles, CA
 March 14-15, 2013 – Boston, MA
 April 18-19, 2013 – Toronto, ON, Canada
 July 18-19, 2013 – San Francisco, CA

July 25-26, 2013 – Sydney, Australia
 Sept. 26-27, 2013 – Vancouver, BC, Canada
 October 24-25, 2013 – Chicago, IL
 November 21-22, 2013 – Boston, MA
 December 12-13, 2013 – 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 of transporting their staff to our training location and limits their time away from the office. With the discounted 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).

UPDATED CIPM Principles and Expert Flash cards are now available on our web store. Please visit 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.