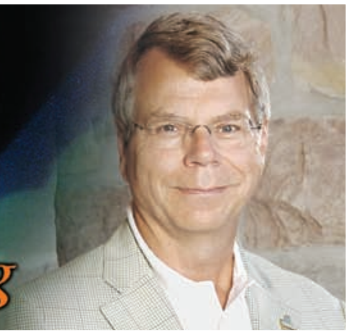
PERFORMANCE PERSPECTIVES
with David Spaulding



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GIPS 2010…SOME IDEAS GOOD, SOME NOT SO

Change we can not believe in

Those who know my political leanings will find it somewhat incredulous for me to paraphrase the incoming U.S. President. However, the gravity of some of the proposed changes to our beloved GIPS® standards necessitates such action.

At the recent Fall (Autumn) meeting of the European chapter of the Performance Measurement Forum (which was held in Amsterdam this year) we were brought up to date on some of the planned changes. And while many of the proposed changes were already known to me, some caught me a bit *off guard* and were (to put it mildly) not well received by me and a few others who were present.

In the coming months we will provide much more detail on what is planned. We will hold a variety of seminars, both in person and via the web. We will also make my formal comments available to you. In the mean time, we'd like to address a few of the *less welcome* (at least by me) planned changes. We will touch on a couple at a time, so as not to overwhelm you with these details.

Crossing into new territory: Client Reporting

We've heard rumblings for some time about wanting to have the standards address aspects of client reporting. And our response is a simple one: why?

Recall that the presentation standards were originally introduced because of the problems with the way some firms were advertising their performance. Beginning with the original FAF standards in the mid '80s, to the AIMR-PPS® in the early 90s, and onto GIPS, we've seen a concerted effort to provide the industry with standards on how firms should report and advertise their returns to prospective clients.

For years many of us (including the CFA Institute) have worked to stymy the confusion that seemed to surface when the standards were discussed, with many thinking they were either "calculation" or "client reporting" standards. We have consistently made it clear that they apply to prospects. And so why is there now felt a need to move into the client reporting arena?

There are several proposed changes that will cause this to happen, from slight wording changes to a recommendation that compliant firms "provide a compliant presentation to current clients on an annual basis." And while I'm grateful that this isn't being proposed as a requirement, even as a recommendation I find it disturbing. One must be aware of the ever present "slippery slope" which could transform any recommendation into a requirement.

During our discussion in Amsterdam one member said that a client of his (a German-based asset manager) decided to distribute GIPS reports to their clients a few years ago; they stopped almost immediately. And why? Well, just think about it:

The Journal of Performance Measurement®:

UPCOMING ARTICLES

- roughly half of your clients will have returns below average, yes? After all, that's what an average is, yes? And so you can expect to hear from these clients wondering why their returns are below average.[1]
- the result of these inquiries will be that you will have to (a) have staff to answer them, (b) have the ability to do the necessary research to answer the questions, (c) respond to your clients satisfaction, (d) hope that your explanation is satisfactory, and on and on.

This recommendation brings additional costs to compliant firms. Compliance is costly enough (staff, software, verification) without adding yet more costs and another administrative burden.

During our recent Forum meeting someone pointed out that "recommendations" are supposedly "best practice." Well, who is doing this today? It doesn't appear to be "common" practice, and so why would we think it would be "best" practice?

I oppose any move of the standards into the domain of client reporting but am open to hearing why the committee feels it's necessary.

Proprietary portfolios

I had never heard this term before, but it's being used to reference cases where managers establish new strategies with their own (seed) money. Their definition: "a proprietary portfolio is a portfolio that is funded by the firm itself; there is no third party." While I'm aware that many firms utilize such actions, the term (proprietary portfolios) is new. Seeding is often done to try out an investment idea. Those ideas that seem to have promise are eventually introduced to the marketplace; those that don't are either modified in hopes that they might eventually work or are abandoned.

I recall this topic being addressed at another session and voiced opposition to any requirement for reporting of such efforts; I thought I had received assurance that this wouldn't occur, but I was mistaken or there was a change in direction. The planned change: "A firm will be required to disclose the percent of the composite that is composed of proprietary portfolios." <emphasis added> This applies to strategies that are tried and abandoned, as well as those that become legitimate offerings. I consider this to be unnecessary and without justification.

Many asset mangers "seed" new ideas, sometimes several at a time. These are often done in a clandestine manner, so as not to alert their opposition of what they're up to. To require that these details be made public is simply incredible. What is to be possibly gained from this?

And why must a firm be required to disclose the percentage on an ongoing basis, even for those strategies that become actively marketed? Additional burdens on the effort to maintain compliance and for reporting. And will this become an area that will be within the scope of the verifier's domain? One would think so, yes? So, perhaps even more costs added on?

1 The first time I encountered such an inquiry was in the mid 1980s, when I worked for a NYC-based asset manager. One of our sales reps complained that half of his clients had below average returns; I guess he felt that as with the residents of Lake Wobegon, everyone should be above average.

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Such details are providing answers to questions that aren't being asked. What possible reason can there be to add such a burden to compliant firms. This change may serve as a deterrent for firms that are considering compliance or the basis for a decision to abandon compliance.

I hope to develop more eloquent explanations as to why I find these two proposed changes quite unwelcome. These are far from "changes I can believe in." I suspect that these (and other items we'll address next month) will be met with a strong "push back" from the market. It's very important for compliant firms to become familiar with all aspects of what's planned. We will summarize all the planned changes in the January edition. We will also continue to let you know what we think about them. For the most part, we're either supportive or agnostic about them; however, in those cases where we object, you will definitely be informed.[2]

As always, your thoughts are welcome, too.

SHOWING "STANDARD DEVIATION" ON A PRESENTATION… RISK MEASURE OR DISPERSION MEASURE?

While conducting a GIPS verification for a client I realized something: if they are using standard deviation as their measure of dispersion, and simply label the column "standard deviation," how do we know if it's (a) a dispersion measure or (b) a risk measure? Standard deviation can be both.

It's a risk measure if we look at a time series of returns (e.g., the past 36 months) and calculate the dispersion across them. This would show how volatile the manager's performance has been.

It's a dispersion measure if we use it to compare the returns of the accounts within the composite vis-à-vis the composite's return.

Risk

Month	1	2	3	…	33	34	35	36
Composite Return	1.00%	-1.07%	2.14%		-0.80%	-0.70%	1.25%	1.77%

Account	Annual Return
A	12.70%
B	12.65%
C	13.01%
D	12.99%
E	13.07%
…	
X	12.73%
Y	13.08%
Z	13.25%
Composite	13.04%

Dispersion

The role of standard deviation

To avoid confusion, it probably makes sense to label the column "Dispersion" and then explain what it means in the disclosure section. Yes?

2 As I've done in the past, I want to emphasize that these opinions are solely mine. That they do not represent the views of any of the committees I'm a member of.

Are You Currently Facing Staffing Issues?

Can't find enough qualified help? Need an extra hand to roll out quarter end/ year end numbers?

As firms realize the enhanced function that performance teams now play in the overall investment process, the market for qualified staff has become more and more competitive. The Spaulding Group can help your staffing needs with our "***just-in-time***" staffing resources for all of your performance needs.

TYPES OF ASSIGNMENTS

The Spaulding Group can help your firm in many ways including:

- GIPS® Related work
- Performance Analysis and Numbers Preparation
- Operational Issues
- Data Issues
- System Implementations
- System Design

Advantages of utilizing The Spaulding Group's staffing resources:

Cut Benefit Costs – Given the rising cost of benefits and the fact that workers comp and disability continue to rise, the hourly cost for a consultant or temporary staff figures in substantially below that of a full time worker of comparable skill set.

Eliminate Training Costs -Our staff comes ready to roll up their sleeves and help you as soon as they walk in the door.

Eliminate Hidden costs of Overtime - There is substantial evidence that despite the short-term benefits that make overtime attractive to employers, a growing body of research shows that working long hours over long periods of time is not necessarily cost-effective because of diminished quality, increasing mistakes and reduced productivity.

Reduce Costly Hiring Mistakes - Using The Spaulding Group employees eliminates the cost of mistakes in hiring and using marginally productive workers because employers get temporary professionals with the right skills and the best personality for the job. In fact The Spaulding Group assumes the risk for the firm, that is, if our staff does not perform the work is free.

Staff Up and Down at your Convenience - Have to get those quarter-end numbers done? Staff out on vacation or maternity leave? Bring us in for a day, a week, a month, or a year – our staff is ready to assist whenever you need us.

The Spaulding Group arrives ready to work, focused on doing the job and meeting project goals.

For additional information, please contact Chris Spaulding at **732-873-5700** or **CSpaulding@SpauldingGrp.com**

EX ANTE RISK MODELS

"Beware of geeks bearing models"
– Warren Buffet

We invite anyone who has an *ex ante* (forward looking) risk model that accurately predicted or warned of the huge drop in the stock market to let us know, so we can acknowledge them. We suspect that at the beginning of the year, few (if anyone) had a model that predicted huge losses. And why not? Because we're encountering (once again) events that aren't supposed to happen, at least statistically. They're "black swans," as best selling author Nassim Nicholas Taleb calls them.

A recent *Wall Street Journal* article[3] discussed the model AIG used for their credit-default swap business. The model was developed by not just a PhD, but a Yale professor, so a lot of "cred" comes with such a model, yes? And, they paid upwards of $1 million a year for this individual's counsel. And while they were apparently aware of some of the model's deficiencies, they relied on it nevertheless. And the result was losses in the "hundreds of billions of dollars."

And so, how is your model doing? Should we be putting much "cred" into models that (a) rely on statistical assumptions that are more often wrong than right or (b) rely on past events which have no way of predicting future ones? Again, your thoughts are always welcome.

The current market's volatility is no doubt stretching much of what we do, including our assumptions. There's much to be gained from such markets. Perhaps a review of the notion of *ex ante* risk is one of them. While there is value to measuring these statistics, caution <u>must</u> be exercised in interpreting and reporting them. References to them should reflect the underlying assumptions as well as the "risks" in assuming they're "gospel."

VERIFIER CORNER

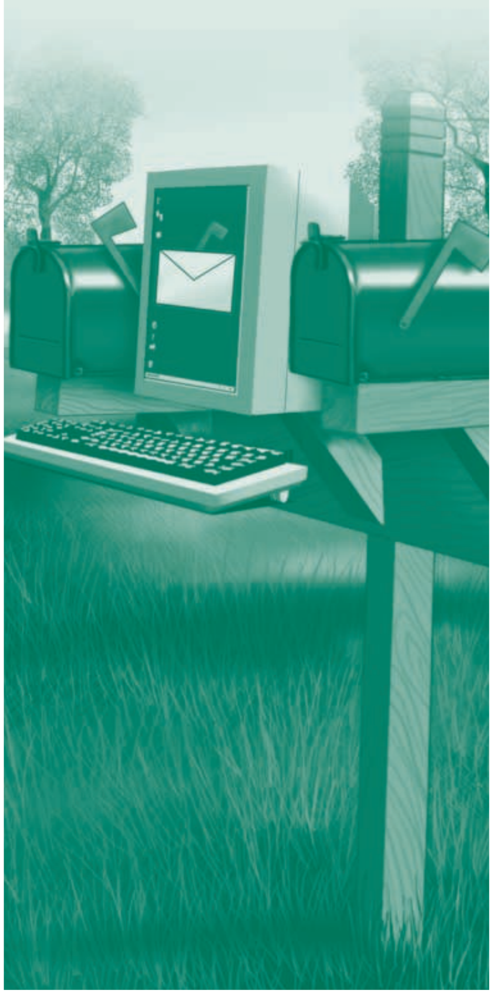
Someone recently asked the following: "we're showing annualized and cumulative returns: must we label them 'supplemental'?"

I want to go "on the record" and say that I never liked the idea of mandating that supplemental information be labeled as such. I don't see any benefit in doing it. But, the requirement is here, and so we have to live with it. But what IS supplemental information? Essentially, it's any return or risk related information that is neither (a) required nor (b) recommended by GIPS. In this case, both annualized and cumulative returns ARE recommended; therefore, we would not label them.

3 "Behind AIG's Fall, Risk Models Failed to Pass Real-World Test." October 31, 2008.

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.



TSG NEWS

We're pleased to report that next month we will achieve a new milestone: the Performance Measurement Forum will be ten years old! Our group has grown in many ways, from our increase in members to our group's influence. Our retention rate is quite high; and we've turned to having a waiting list for firms wishing to join. Our meetings are always lively, with much dialogue and debate. We're pleased with the success we've had and look forward to it continuing.

REMINDER!

We're doing our 7th survey on the presentation standards. Please join in!!! All participants will be entered into a raffle for a chance to win a Nintendo Wii or Ipod Shuffle.

Visit our website at:
http://www.spauldinggrp.com/gipssurvey2008.htm to download your copy today.

THE SPAULDING GROUP'S 2008-2009 INVESTMENT PERFORMANCE MEASUREMENT CALENDAR OF EVENTS

DATE	EVENT	LOCATION
December 4-5	Performance Measurement Forum (North America)	Orlando, FL (USA)
December 8-9	Introduction to Performance Measurement Training	New Brunswick, NJ (USA)
December 10-11	Performance Measurement Attribution Training	New Brunswick, NJ (USA)
February 17-18, 2009	Introduction to Performance Measurement Training	Los Angeles, CA (USA)
February 17-18, 2009	Introduction to Performance Measurement Training	London, England
February 19-20, 2009	Performance Measurement Attribution Training	London, England
March 17-18, 2009	Introduction to Performance Measurement Training	Boston, MA (USA)
March 19-20, 2009	Performance Measurement Attribution Training	Boston, MA (USA)
April 21-22, 2009	Introduction to Performance Measurement Training	New York, NY (USA)
May 12-13, 2009	Introduction to Performance Measurement Training	Chicago, IL (USA)
May 14-15, 2009	Performance Measurement Attribution Training	Chicago, IL (USA)
May 20-21, 2009	PMAR VII Conference	Philadelphia, PA (USA)
July 20-24, 2009	Investment Performance Measurement Bootcamp	New Brunswick, NJ (USA)
September 15-16, 2009	Introduction to Performance Measurement Training	Boston, MA (USA)
October 20-21, 2009	Introduction to Performance Measurement Training	San Francisco, CA (USA)
October 22-23, 2009	Performance Measurement Attribution Training	San Francisco, CA (USA)
November 18, 2009	Trends in Attribution Symposium (TIA III)	Philadelphia, PA (USA)
December 8-9, 2009	Introduction to Performance Measurement Training	New York, NY (USA)
December 10-11, 2009	Performance Measurement Attribution Training	New York, NY (USA)

For additional information on any of our 2008 events, please contact Christopher Spaulding at 732-873-5700

Save The Date!

The Journal of Performance Measurement®
Seventh Annual International

PMAR

Performance Measurement, Attribution & Risk

Conference

May 20th - 21st, 2009

TRAINING…

Gain the Critical Knowledge Needed for Performance Measurement and Performance Attribution

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:

December 8-9, 2008 – New Brunswick, NJ
February 17-18, 2009 – Los Angeles, CA
February 17-18, 2009 – London, England
March 17-18, 2009 – Boston, MA
April 21-22, 2009 – New York, NY
May 12-13, 2009 – Chicago, IL
September 15-16, 2009 – Boston, MA
October 20-21, 2009 – San Francisco, CA
December 8-9, 2009 – New York, NY

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.

CFA INSTITUTE PROFESSIONAL DEVELOPMENT QUALIFIED ACTIVITY 12 CREDIT HOURS

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 10-11, 2008 – New Brunswick, NJ
February 19-20, 2009 – London, England
March 19-20, 2009 – Boston, MA
May 14-15, 2009 – Chicago, IL
October 22-23, 2009 – San Francisco, CA
December 10-11, 2009 – New York

15 CPE & 12 PD Credits upon course completion

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CFA INSTITUTE PROFESSIONAL DEVELOPMENT QUALIFIED ACTIVITY 12 CREDIT HOURS

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 2,000 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 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.

TO REGISTER:

Phone: 1-732-873-5700
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E-mail: info@SpauldingGrp.com

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