

PERFORMANCE PERSPECTIVES

with David Spaulding



VOLUME 11 – ISSUE 10

JUNE 2014

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

MONEY MANAGER RUNS AFOUL OF THE SEC

By now you've probably heard that "ZPR Investment Management, Inc. (ZPRIM) violated Sections 206(1), 206(2), and 206(4) of the Investment Advisers Act of 1940 (Advisers Act) by misrepresenting compliance with Global Investment Performance Standards (GIPS) in magazine advertisements and investment report newsletters, and violated Advisers Act Sections 206(2) and 206(4) and Advisers Act Rule 206(4)-(a)(5) by making misrepresentations to Morningstar, Inc. (Morningstar), resulting in two false Morningstar reports on ZPRIM."¹



As I understand it, ZPRIM has been fined a not insignificant amount of money as a result of this infraction. Very serious stuff, yes?

What does it mean to *misrepresent compliance with GIPS*? Well, if the firm isn't actually compliant but claims to be, clearly that's a misrepresentation. This can be quite tricky, though. What if you have an advertisement which fails to comply with the GIPS Advertising Guidelines; does this put you out of compliance with the Standards? Some might respond "yes." I do not know how the SEC would respond.

In my Internet travels, I frequently come upon asset manager websites and often find them not to meet the GIPS advertising rules. When I do, I normally send someone at the firm a note, explaining the problem. Here are a few recent examples:

- "XYZ Advisors has prepared and presented this report in compliance with the Global Investment Performance Standards (GIPS®)."
- "ABC Asset Management meets the compliance standards for the CFA Institute's Global Investment Performance Standards (GIPS) for performance measurement and reporting."
- "PDQ Investment Management claims compliance with the U.S. and Canadian version of the Global Investment Performance Standards (GIPS)."

All three of these firms make reference to the Standards on their website, and are therefore obligated to comply with the GIPS advertising guidelines, which require the following wording: "[Insert name of firm] claims compliance with the Global Investment Performance Standards." I should also point out that the guidelines also require (a) the firm definition and (b) how a prospect can obtain a compliant presentation and/or the firm's list of composite descriptions.

One of the firms I recently contacted sent me a response:

The Journal of Performance Measurement®

UPCOMING ARTICLES

**Operational and IT
Consequences of
Performance Reporting**
– Bruce Russell

**Measuring Performance
in the Presence of Deposits
and Withdrawals**
– Thomas Becker

The Journal Interview
– Richard Mitchell

**Cumulative Frongello-
Equivalent Attribution**
– Tim Svenson

**Milestone – Risk-Adjusted
Performance Attribution**
– Jose Menchero

**A Simplified Fixed Income
Attribution Model**
– Peter Simmons,
Anton Karadakov

Hi Dave,

Thanks for the note. We consulted with [our verifier] on this and they made two points. One was that since the statement that follows makes reference to the attached appendices, we are meeting the disclosure requirements and do not need to comply with the Advertising Guidelines. Their second point was a recommendation to consider removing the language in question in order to avoid the risk that someone reads the statement and doesn't follow along to the appendices. In other words, [our verifier] disagreed that we need to comply with the Advertising Guidelines and thought that no action was necessary, although removing the statement could be helpful.

As you might have suspected, I replied to this note:

Dear Mary,

Thanks for your note and for sharing the response you got from your verifier. The following comes from the Advertising Guidelines:

The screenshot shows a document titled "III. GIPS ADVERTISING GUIDELINES" with a page number of 29. Section A is titled "A. PURPOSE OF THE GIPS ADVERTISING GUIDELINES" and states: "The GIPS Advertising Guidelines provide FIRMS with options for advertising performance when mentioning the FIRM'S claim of compliance. The GIPS Advertising Guidelines do not compliance in an advertisement MUST follow the GIPS Advertising Guidelines or include a COMPLIANT PRESENTATION in the advertisement." Below this is a section titled "Definition of Advertisement" which states: "For the purposes of these guidelines, an advertisement includes any materials that are distributed to or designed for use in newspapers, magazines, FIRM brochures, letters, media, websites, or any other written or electronic material addressed to more than one PROSPECTIVE CLIENT. Any written material, other than one-on-one presentations and individual client reporting, distributed to maintain existing clients or solicit new clients for a FIRM is considered an advertisement."

The key as to whether these guidelines must be followed is whether you reference GIPS; in the absence of such a reference, you can do anything you want, pretty much, as long as it meets the requirements of the regulator (i.e., the SEC in your case). And so, my logic is pretty straightforward:

- websites fall within the definition
- you reference GIPS on your website
- therefore, you're obligated to follow the rules.

Your wording doesn't fall within the requirements:

B. REQUIREMENTS OF THE GIPS ADVERTISING GUIDELINES

All advertisements that include a claim of compliance with the GIPS standards by following the GIPS Advertising Guidelines MUST disclose the following:

1. The definition of the FIRM.
2. How a PROSPECTIVE CLIENT can obtain a COMPLIANT PRESENTATION and/or the FIRM'S list of COMPOSITE DESCRIPTIONS.
3. The GIPS compliance statement for advertisements:
 "[Insert name of FIRM] claims compliance with the Global Investment Performance Standards (GIPS®)."

©2010 CFA INSTITUTE

III - GIPS ADVERTISING GUIDELINES

To me, the solution is quite simple: change your wording. Why [your verifier] would find your wording acceptable is beyond me; it's from the 2005 edition, and has been replaced. Plus to amend it is very simple.

There are two forms of the advertising rules:

1. *without numbers*
2. *with numbers.*

As I recall, your page has no numbers, so the requirements are extremely simple: do the three things noted above.

That's it! I imagine this can be done pretty quickly.

Why, one might wonder, would a verifier (a fairly large one at that) tell their client that their wording is acceptable and that what they have is outside the realm of the Advertising Guidelines?

If a "compliant firm" has an advertisement that fails to meet the needs of the Standards, does this invalidate their claim of compliance? As I noted above, I believe so; I wouldn't want to test it, though. Better to make sure your advertisements are, in fact, compliant.

Upcoming webinar!

We will host a webinar with Michael S. Caccese, Esq; a partner with K&L Gates LLP, to discuss this case, most likely in August. Details will be made available once they're firmed up.

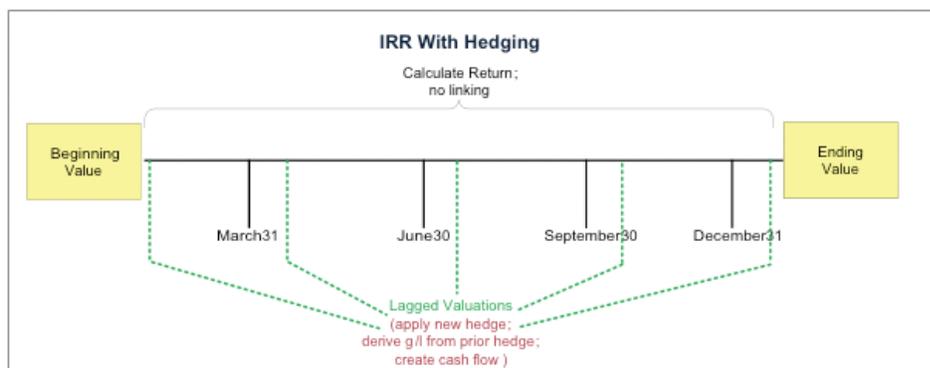
HEDGING AN INTERNAL RATE OF RETURN

A question recently arose as to how one would apply hedging to an internal rate of return. In this case, the portfolio for which the IRR is being generated isn't hedged; rather, an overlay is applied to the entire account, and this is just one of the portfolios which make up the entire account. And so, this is a hypothetical hedge, though the same issues would arise with actual hedging.

This happens to be a private equity portfolio, which introduces its own challenges. The organization wants to have as "perfect" a hedge as possible. There would be no point to do hedging more often than quarterly, however, since these portfolios are typically

valued only once a quarter. And this valuation is usually lagged by 30 to 45 days!

The following graphic summarizes my thinking as to how this could be done:



The simulated hedging would be done on a lagged basis, to coincide with the quarterly valuations. At these instances, the prior hedge is closed out, and the gain/loss computed, resulting in cash flows. In addition, a new hedge is applied, based on the valuation and allocation across currencies.

I found this to be an interesting subject, and welcome your thoughts, insights, inputs; thanks!

PUZZLE TIME

May Puzzle

Last month's puzzle comes from, of all places, Facebook! If you're a member (or even if you're a member of LinkedIn) you'll see these puzzles once-in-awhile, where the poster claims that only a few folks are able to solve it, and if you are, you must be a genius. Well, I think solving them hardly makes one a genius (some nice stroking, I guess), but this one is one that seems to have two possible solutions, but only one that's correct.

There are two possible solutions; first, the wrong one.

If you work from left to right, you get the following:

- $7+7 = 14$
- $7 = 14 \div 7 = 2$
- $+7 = 2 + 7 = 9$
- $\times 7 = 7 \times 9 = 63$
- $-7 = 63 - 7 = 56$.

As one respondent pointed out, if you enter the numbers in this sequence into a calculator, you'll get this (incorrect) answer.

The second is to follow the order that I was taught a very long time ago, using this handy mnemonic:

WHAT IS THE ANSWER?

$$7 + 7 \div 7 + 7 \times 7 - 7$$

unfortunately most will get this WRONG!

Please My Dear Aunt Sally, where

- P = parentheses
- M = Multiply
- D = Divide
- A = Add
- S = Subtract.

There are no parentheses, so we begin with multiplication and division, followed by addition and subtraction. Perhaps I'm a bit overly detailed, but the accompanying box shows how we arrive at the correct answer.

I was a bit surprised (can't say why) that even Excel orders the process properly.

My colleague, John Simpson, pointed out (as I do) that there are two

possible solutions. He refers to the second as the algebraic method, which is probably appropriate, and the first as the "chain method," mentioning, too, that some calculators handle math this way. To me, there is only one correct way. If your calculator uses the "chain method," then you need to take advantage of its parenthesis capabilities to ensure you force it to do the math correctly. I don't believe that this method would be deemed acceptable by mathematicians.

June Puzzle

This month's puzzle comes from the book I reviewed, *How Not to Be Wrong*, by Jordan Ellenberg.

During World War II, the Statistical Research Group (SRG), a classified program in the United States, was asked to help in an effort to safeguard American planes. The military provided the SRG with data they felt would be useful. It turned out that when planes returned from engagements over Europe, they were covered in bullet holes, but the damage wasn't uniform in its distribution across the planes: there were more holes in the fuselage and not much in the engines:

Plane section	Holes / square foot
Engine	1.11
Fuselage	1.73
Fuel system	1.55
Rest of the plane	1.80

If they added more armor throughout the plane, the weight would be problematic. And so, the thought was to redistribute the armor, concentrating on places with the greatest need.

Question: you're a member of the SRG and have to make a decision. Where would you place the armor? Of the four places in the table, where would you reduce and where would you increase the armor?

Jed Schneider	USA
Debi Rossi	USA
John Simpson	USA
Hans Braker	Netherlands
Tom Rumore	USA
Brian Teitelbaum	USA
Neil Riddles	USA
Gerard van Breukelen	Netherlands

$$\begin{array}{r}
 7 + 7 \div 7 + 7 \times 7 - 7 \\
 \underbrace{\quad\quad\quad}_{1} \quad \underbrace{\quad\quad\quad}_{49} \\
 7 + 1 + 49 - 7 \\
 \underbrace{\quad\quad\quad}_{8} \quad \underbrace{\quad\quad\quad}_{42} \\
 \underbrace{\quad\quad\quad}_{50}
 \end{array}$$



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.

BEHIND THE SCENES AT TSG

Patrick Fowler



What do you do? I am President and COO of The Spaulding Group, I am also the Managing Editor of *The Journal of Performance Measurement*. I am responsible for the day to day operations of the company as well as coordinating all of our training, conferences, Forums, newsletters, webcasts, surveys, web conferences and much of our vendor relationships.

How long you've been with the firm? I just celebrated my 16th anniversary with the company on June 1st, having joined right after college graduation.

What you like about working for us: What I most enjoy about working for The Spaulding Group is the camaraderie of the team, the challenge of trying something new and the satisfaction in seeing a project grow from seed to fruition. When I was hired, Dave had a clear vision of what he wanted (he still does). In our first meeting he discussed a Forum, training, conferences and more to come. All of these things have been implemented since coming on board and much much more.

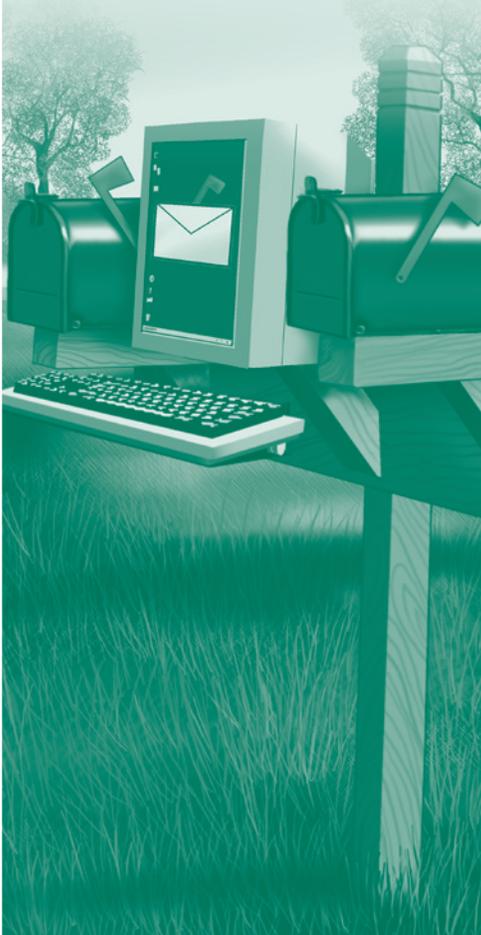
Personal info

Family: I come from a large family with four brothers and one sister (who happens to be our Event Planner). I have been married for twelve years to my college sweetheart, and we have two beautiful children named Isabella and Michael.

Education: I started off my collegiate career playing soccer for East Stroudsburg University before transferring to Rutgers University, Cook College. I received my degree in Communications with a minor in Environmental Business Economics. I also completed a mini-MBA program through the Rutgers Business School on Business Essentials and continue to further my education through reading and online training courses.

Hobbies / past times: I've played soccer my entire life and continue to. I've just started coaching my son's soccer travel team and am excited to see the passion for the sport being passed to the next generation. I am also an avid golfer and compete in several family "tournaments" a year.

Miscellaneous: I was also a member of the NJ Army National Guard, and found it to be an incredible experience.



Bob Leaper

Head of Business Development,
North America
DST Global Solutions NA, LLC

Bio:

Bob Leaper brings more than 30 years of experience in financial services and technology organizations. His areas of expertise include cloud computing, data management, accounting, performance, analytics, and business intelligence. In his role at DST, he is responsible for driving business development in North America for the award-winning Anova suite of products. Prior to joining DST Global Solutions, Bob served as head of sales and marketing at Eagle Investment Systems. He has also held critical leadership roles at several information technology firms serving the investment industry, including Data Agent, InvestTech Systems Consulting and Thomson Financial.



CLIENT'S CORNER

1. How long have you been involved in performance?

I have been involved in performance measurement for the last 23 years out of 33 years in the financial industry.

2. What do you enjoy most about it?

Performance measurement is the culmination of the investment management, operations, data management and technology processes: anomalies in any of those aspects will typically be revealed in the returns, risk and attribution analysis.

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

The Spaulding Group is a valuable thought leader in the performance measurement space, and brings together many like-minded people to share and learn from each other.

**THE SPAULDING GROUP'S 2014
INVESTMENT PERFORMANCE MEASUREMENT CALENDAR OF EVENTS**

DATE	EVENT	LOCATION
July 15-16	Fundamentals of Performance Measurement	San Francisco, CA (USA)
July 15-16	Fundamentals of Performance Measurement	Sydney, Australia
July 17-18	Performance Measurement Attribution	San Francisco, CA (USA)
July 17-18	Performance Measurement Attribution	Sydney, Australia
July 22-23	Fundamentals of Performance Measurement	New York, NY (USA)
July 22-23	Fundamentals of Performance Measurement	Hong Kong
July 24-25	Performance Measurement Attribution	New York, NY (USA)
July 24-25	Performance Measurement Attribution	Hong Kong
August 18-19	CIPM Principles Prep Class	Chicago, IL (USA)
August 20-22	CIPM Expert Prep Class	Chicago, IL (USA)
September 17	Portfolio Risk Class	Boston, MA (USA)
September 23-24	Fundamentals of Performance Measurement	Los Angeles, CA (USA)
September 25-26	Performance Measurement Attribution	Los Angeles, CA (USA)
October 14-15	Fundamentals of Performance Measurement	Chicago, IL (USA)
October 16-17	Performance Measurement Attribution	Chicago, IL (USA)
November 11-12	Fundamentals of Performance Measurement	Dallas, TX (USA)
November 13-14	Performance Measurement Attribution	Dallas, TX (USA)
December 9-10	Fundamentals of Performance Measurement	New Brunswick, NJ (USA)
December 11-12	Performance Measurement Attribution	New Brunswick, NJ (USA)

For additional information on any of our 2014 events, please contact Christopher Spaulding at 732-873-5700

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:doug.spaulding@spauldinggroup.com) (732-873-5700) with your suggestions.

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:

July 15-16, 2014 – San Francisco, CA

July 15-16, 2014 – Sydney, Australia

July 22-23, 2014 – New York, NY

July 22-23, 2014 – Hong Kong

September 23-24, 2014 – Los Angeles, CA

October 14-15, 2014 – Chicago, IL

November 11-12, 2014 – Dallas, TX

December 9-10, 2014 – 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 17-18, 2014 – San Francisco, CA

July 17-18, 2014 – Sydney, Australia

July 24-25, 2014 – New York, NY

July 24-25, 2014 – Hong Kong

September 25-26, 2014 – Los Angeles, CA

October 16-17, 2014 – Chicago, IL

November 13-14, 2014 – Dallas, TX

December 11-12, 2014 – 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.

CIPM PREP TRAINING: August 18-19, 2014 – Principles Level–Chicago, IL
August 20-22, 2014 – Expert Level–Chicago, IL

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.

