

# 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 [PFowler@SpauldingGrp.com](mailto:PFowler@SpauldingGrp.com)

## RECOLLECTIONS OF A FUN ALL-DAY WORKSHOP “DOWN UNDER”

For the past several years I've been invited to participate in the annual iPARM conference in Sydney, Australia. Just about any excuse to make the roughly 25-hour journey is fine, given my affection for this country, its people, and its food. Over the years I've made friends with several folks there, and enjoy reconnecting when I return. I've also conducted all-day workshops while there, covering a variety of performance measurement topics.



This year it struck me that it'd be fun to do something quite different: to explore some performance measurement's trivia and oddities.

At first glance it might seem to be something that is intended to entertain, with no real value. However, such a perception would, in my view, be in error. Performance measurement professionals should, in my book, understand:

- why we do the things we do, so they're better able to interpret results and explain the information to others
- what the terms we use actually mean, so as to avoid confusion
- how alternative approaches really are different.

Over the years I've observed, way too often, mistakes and misconceptions about such things as:

- what time-weighting means
- why we geometrically link returns
- the true advantages and disadvantages of the alternative approaches to attribution
- how we frequently do calculations that are in conflict with the model designer's intentions.

Shouldn't, for example, a performance measurement professional be able to:

- explain why a portfolio had a positive return, even though it lost money?
- explain why subtracting the year's net-of-fee return from its gross-of-fee return may be higher or lower than the annual fee?
- what residuals mean and where they most likely come from?
- discuss what risk-adjusted returns represent?

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# The Journal of Performance Measurement®

## UPCOMING ARTICLES

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### Residuals on Duration-based Fixed Income Attribution

– *João Sousa Dias,  
Eagle Investment Systems*

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### GIPS 20/20

– *Carl R. Bacon, CIPM, StatPro*

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### The Journal Interview

– *Nick Sharp, Ph.D., MSCI*

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### Net-of-Fee Performance Calculations

– *Andre Mirabelli, Ph.D.,  
Opturo and Krista Harvey,  
CFA, CIPM, TIAA*

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### A Measure for Evaluating the Distributions of Ex-Ante Forecast Returns

– *Masahito Shimizu,  
Tokyo Institute of Technology*

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### Confronting the Challenges of Multi-Level Attribution

– *David Spaulding, DPS, CIPM,  
The Spaulding Group*

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When I was in the Field Artillery branch of the U.S. Army, senior enlisted men could explain, in great detail, specifics about the weapons they used. This would have included things like the inside and outside diameters of the artillery piece they were responsible for, the weight of the various rounds they might use, and the differences between various shells. Such knowledge signaled a high degree of knowledge, as well as their passionate interest in their job. While some of this information might not appear practical, in reality, all such information can have benefits.

Our annual PMAR (Performance Measurement, Attribution & Risk) conferences include Performance Jeopardy at the end of the first day. These events, just like the hit TV show for which its based, bring together three performance measurement professionals to demonstrate their knowledge and expertise.

Clearly, we don't expect all of the individuals to be able to answer all of our questions, and many of the questions can be challenging. However, when we post certain formulas, we expect them to know at least a few of them. Likewise, when we ask for the first names of such luminaries as Sharpe, Treynor, Dietz, Brinson, Campisi, and Menchero, we expect at least one of them to respond to each with the correct response (William, Jack, Peter, Gary, Steve, and Jose).

The reality is that many don't score very high on certain parts of the game. And that's okay, because we also use this session as an education period. Not only will I, the host, provide the answers, I'll often offer a bit of an explanation, so that our attendees will increase their knowledge.

My guess is that 95% of the individuals who've obtained the CIPM cannot correctly answer most of these questions:

- what does the term "time-weighting" actually mean?
- explain why it took more than 30 years after its birth for the exact method to begin to catch on.
- contrast the internal rate of return, linked IRR, and exact method, in terms of valuations and treatment of cash flows.
- differentiate the major risk-adjusted measures and explain how they do or do not adjust returns for risk.
- provide an example to demonstrate what compounding means, so that a layman will understand why subperiod returns aren't simply added together in order to extend the result across time.
- explain what the numerator of the Sharpe and Treynor ratios represents.
- discuss the two general approaches to the Sharpe ratio: Sharpe's original method vs. what is commonly done in the industry.
- contrast arithmetic and geometric attribution, to include the benefits and drawbacks of each.
- identify the organization that first published rate of return standards.
- explain why order dependence doesn't matter when it comes to linking rates of return.
- explain why, when linking returns rates of return, no provision is necessary to account for differences in each return's time period, though they may vary considerably.



## LONG-AWAITED ATTRIBUTION BOOK TO END ALL ATTRIBUTION BOOKS IS DUE IN EARLY 2018!

I am putting the finishing touches on my second book on performance attribution (the first was published by McGraw-Hill in 2003: 15 years ago next year! It holds the distinction of being the first book dedicated to performance attribution.

I've been working on my revision for way too long, and am committed to getting it done. But, I need your help in picking a title. Please select the one you like best from the following list, or come up with a fourth.

- A. The Complete Guide to Performance Attribution
- B. The Handbook of Performance Attribution
- C. Investment Performance Attribution Revisited
- D. Other (please offer an alternative title)

Please send your response directly to me: [DSpaulding@SpauldingGrp.com](mailto:DSpaulding@SpauldingGrp.com). Thanks!!!

- why we annualize rates of return.
- discuss the two types of attribution residuals and their likely causes.
- contrast the Brinson-Fachler and Brinson-Hood-Beebower methods.
- explain why it is not possible for an investor in a multi-currency strategy to report an overall "local" return.
- explain why, when we subtract a portfolio's net-of-fee return from its gross-of-fee return the result may be higher than the annual fee. Might this mean the client is being overcharged?
- explain what the aggregate method to asset-weight a composite's return represents (in contrast to the other approaches, which you should also be able to explain).

I could go on a bit further, but this is sufficient.

Is it unreasonable to expect performance measurement professionals to have sufficient expertise to answer such questions? I think not.

And so, the class I taught in Sydney isn't just "fun and games." It has a great deal of practical benefits, as it enhances the knowledge and expertise of the students, making them more appreciative of the methods we employ, and able to respond to questions as well as do a better job of analysis, when necessary.

Because the class was so well received we've decided to make it an all-day webinar. It will be held on Tuesday, November 28, from 10 AM to 4 PM EST. To learn more, please visit this page on our firm's website: <http://www.spauldinggrp.com/product/pm-trivia-oddities-webinar/>.

## A BETTER UNDERSTANDING OF RISK

One of the highlights of the recent iPARM event in Sydney was a talk that my friend, Kyle Ringrose, gave. Not only is Kyle a great presenter, his command of PowerPoint's presentation capabilities is quite good (he, like I, prepares his own slides).



But what really made the difference this year was his challenge of the typical risk measures all firms employ. As Kyle pointed out, for the most part they measure volatility. But is volatility risk?

This wasn't news to me; in fact, we touch on it in our Fundamentals of Performance Measurement class.<sup>1</sup> Risk is not meeting one's objectives. E.g., for a retiree, it can be defined as running out of money!

Kyle went beyond this, to demonstrate how investments in high volatile securities would typically do a much better job than the alternative, low volatility approach.

He will most likely speak at one of our events in 2018: which one we don't yet know. In addition, he has submitted an article on this topic, which will appear in a future issue of *The Journal of Performance Measurement*.

<sup>1</sup> I'll also be addressing this at the next meeting of the European Performance Measurement Forum in Rome, Italy.

## 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.*

## I LIKE TO TWEET!

I've become a fan of Twitter, and there are some good reasons for this. It's quite a bit different than LinkedIn, which I'm also a frequent user of. Twitter is quite a bit more open and there seems to be a lot more "energy" here. And although we find that most performance measurement professionals are not yet using it, we encourage them to start to.

I follow a variety of people, including:

- investors
- news sources
- political people
- sports people (not because of their athletic skills, but because of their character)
- religious people.

I recently discovered a Catholic nun, Sr. B. (Brittany Harrison), "a real Salesian Sister," who is quite funny. It just so happens that she is located not far from me in New Jersey, so perhaps we'll meet some day. From her I discovered Sr. Theresa Aletheia, who recently posted this:

"What people really mean: 'Your analysis of this doesn't fit neatly with my particular political allegiances so please stop making me think.'"

I considered this not from a political perspective, but rather from an industry standpoint. There are folks in our industry who won't be persuaded to alter their views, because they are so locked in with their beliefs, beliefs that were formed decades ago. And despite the evidence, won't budge. Okay, so perhaps you might think that I fall into this category myself. I would beg to differ, however, since I have altered my views on multiple occasions, when presented with sound arguments. And so, despite my advanced age, I seem to be much more flexible than individuals much younger than I. A willingness to consider, truly consider, the arguments posed would help advance much of what we're doing.

## IS IT 2018 CALENDAR YEAR BUDGET TIME FOR YOU?

If yes, hopefully you're putting aside funds for training and conferences.

We encourage you to have funds for our annual Performance Measurement, Attribution & Risk conferences: where there once were only two, now there are three!

Last month we launched PMAR West. We started with a single day, just to see how it would go, and have decided that, like PMAR North America (or just "PMAR") and PMAR Europe, PMAR West in '18 will have two days. The accompanying graphic provides the dates. Please join us for a unique experience that is filled with opportunities for growth, engagement, and fun!

**It's 2018 Budget Time**  
Remember to make PMAR your conference choice!

<b>PMAR</b> Performance Measurement, Attribution & Risk Conference May 15th - 16th, 2018	<b>PMARIX</b> Performance Measurement, Attribution & Risk Conference EUROPE 11 - 12 June 2018 - London	<b>PMAR II</b> Performance Measurement, Attribution & Risk Conference WEST October 17 & 18, 2018
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**October puzzle**

Our friend and colleague, Jed Schneider, a fellow Jeopardy fan, offers this month's puzzle: what is the highest possible score in Jeopardy? Of course, this assumes you know the show; if you don't, I'm guessing you can find an example on YouTube to gain some understanding as to the rules and derive the answer.

**August puzzle**

I failed to report that Neil Riddles got this puzzle correct.

**July puzzle**

I failed to report that Hans Braker also got this puzzle correct.

**PUZZLE TIME!****September puzzle**

Three consecutive numbers multiplied together equal 54,834.

Can you find them?

This puzzle, to me, seems fairly straight forward. We have the product of three consecutive numbers. What might they be? Well, why not X, X+1, and X+2? Okay, so we therefore know that:

$$X(X + 2)(X + 3) = 54,834$$

We can take this further:

$$X^3 + 5X^2 + 6X = 54,834$$

How does one solve this? I think it's massively difficult, though am sure that an algebraist would have no difficulty giving us an answer. However, we can take the "easy man's solution," as Neil Riddles did, by simply plugging in different numbers and getting the answer.

Now, to do this completely manually might prove to be QUITE a challenge. However, with Excel, not so difficult. I think one can use the "bisection" approach, favored by many lovers of the IRR, to quickly find the solution

In my "Formula Result" column I simply point to the "X" column, and use the very simple formula expressed above (e.g., =(A2)\*(A2+1)\*(A2+2)). And it really doesn't take long to get the answer:

	A	B
1	X	Formula Result
2	25	17,550
3	50	132,600
4	37	54,834

And so our answer is 54,834, 54,835, and 54,836.

An alternative would be to assume that  $X^3 = 54,836$ . We can solve this with Excel, too. We simply ask Excel to tell us what  $54,834^{(1/3)}$  equals; we get the answer 37.9681173. We can then strip the decimal portion away and see if 37 works, which we've already established that it does.

Tricia Bailey used this and offered the following explanation:

Unless I'm missing something, I thought September's puzzle was quite simple. I solved it by trial and error at first but then thought of taking the cube root of 54,834 to more quickly narrow down the three consecutive numbers: 37, 38, 39.

Anthony Howland, Hans Braker, and Tom Stapleton solved it this way, too!

Oh, and Matthew Rayner, Dan Kempf, and Dan Lehrer got the correct answers, too!

## THE SPAULDING GROUP'S 2017 INVESTMENT PERFORMANCE MEASUREMENT CALENDAR OF EVENTS

DATE	EVENT	LOCATION
November 9-10, 2017	Performance Measurement Forum	Rome, Italy
November 15, 2017	Asset Owner Roundtable	Orlando, FL
November 16-17, 2017	Performance Measurement Forum	Orlando, FL
December 2017	Performance Measurement for Non-Performance Professionals Webcast	
December 11-12, 2017	Performance Measurement Training	Mumbai, India
December 11-12, 2017	Fundamentals of Performance Measurement	New Brunswick, NJ
December 13-14, 2017	Performance Measurement Attribution	New Brunswick, NJ

*For additional information on any of our 2017 events, please contact Patrick Fowler at 732-873-5700*

### A WORD ABOUT PERSONAL GROWTH

I'm a committed life-long learner. Consequently, I dedicate a substantial amount of my free time to personal growth. While this is mainly through reading, I do it in other ways, too.

I am also a regular listener of Joel Osteen on Sirius Radio when I drive. He's very much like the motivational speaker, Anthony Robbins, providing positive and uplifting messages.

His message #388 was one dedicated to personal growth; I suggest you have a watch or listen.<sup>2</sup>

Because this newsletter is already kind of long, I'll cut this section short, but refer you to a recent blog post where I expounded on this subject a bit more.<sup>3</sup>



<sup>2</sup> It's available on YouTube.

<sup>3</sup> <http://www.spauldinggrp.com/bit-personal-growth-adopting-life-long-learner-philosophy/>

## TRAINING...

### *Gain the Critical Knowledge Needed for Performance Measurement and Performance Attribution*

#### TO REGISTER:

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E-mail: [info@SpauldingGrp.com](mailto:info@SpauldingGrp.com)



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#### 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 11-12, 2017 – 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:

December 13-14, 2017 – 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.

#### WORKING ON YOUR 2018 BUDGET?

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



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!