VOLUME 15 – ISSUE 9 JUNE 2018

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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.

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WHY WE DON'T CARE ABOUT THE LENGTH OF THE TIME PERIOD WHEN LINKING RETURNS

<u>Let's begin with some background: what time-weighting means</u>

Ask just about any, <u>any</u>, performance measurement professional that holds the CFA, CAIA, CIPM, etc. this simple question, and in all likelihood you will get the wrong answer:

"What does the term time-weighting mean?"

The term derives from the now 50-year old Bank Administration Institute standard on performance measurement: *Measuring the Investment Performance of Pension Funds*.

The BAI created a "working group" to develop a standard on calculating rates of return. This was a group of some "heavy hitters," including Nobel Prize winner Eugene Fama, PhD. As Fama explained to me, they didn't actually "meet," but rather did their work remotely, coordinating and communicating periodically.

This arose as a result of the work of Peter Dietz, who published his doctoral dissertation in 1966, and called for a measure that would eliminate or reduce the effect of cash flows, since it's usually clients who control external flows. He referred to his measure (which today we call the "mid-pont Dietz" or "Original Dietz") as an "average return."

The BAI came up with three ways to calculate returns:

- exact method, where you revalue the portfolio whenever a cash flow occurs
- linked-IRR (today typically referred to as the "Modified BAI"), where you calculate the internal rate of return at regular intervals (e.g., monthly or quarterly), and link the results
- regression, which no one does.

A problem arose: how <u>should</u> you link the subperiod returns? Let's say you used the exact method over a year, and have results covering a few days and a few months and you want to come up with the return for the full year: what do you do?

Today, of course, we use geometric linking. But, at that point this idea apparently didn't come to mind. And so, *what to do?, what to do?*

The Journal of Performance Measurement®

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– João Sousa Dias, Eagle Investment Systems

GIPS 20/20
– Carl R. Bacon, CIPM, StatPro

The Journal Interview
– Nick Sharp, Ph.D., MSCI

Net-of-Fee Performance Calculations
– Andre Mirabelli, Ph.D., Opturo and Krista Harvey, CFA, CIPM, TIAA

A Measure for Evaluating the Distributions of Ex-Ante Forecast Returns
– Masahito Shimizu, Tokyo Institute of Technology

Confronting the Challenges of Multi-Level Attribution
– David Spaulding, DPS, CIPM, The Spaulding Group

Well, they struck upon a method they called "time-weighting." And here's how they explained it:

"The recommended rate is called 'time-weighted' because it is simply the ***weighted average*** of internal rates of return ***for the subperiods between cash flows with each weight being only the length of its corresponding subperiod***."

Doesn't this make sense? If you think about it, shouldn't returns for longer periods count for more than those for shorter periods? To me, this is just so very obvious. And, it's something that is often brought up in our Fundamentals of Investment Performance Measurement classes. If, for example, in a year you have just two returns: one for five days and the other for 360 days, shouldn't the one for 360 days have greater weight?

Brilliant, simply brilliant!

But, the reality is that NO ONE, NO ONE does this. Not a soul within the universe.[1]

And why, because it does not make sense. No, you should NOT give greater weight to longer periods.

But why not? Why DOESN'T the length of period matter?

Good question.

Well, let's take this example of the two returns. Our return for the five days is 0.50 percent, and the return for the 360 days is 3.18 percent. We geometrically link these returns together:

$$R_{Year} = (1 + r_{5\,Days})\left(1 + r_{360\,Days}\right) - 1 = (1.0050)(1.0318) - 1 = 3.70\%$$

As you can see, the return for 360 days is treated exactly the same as the 5-day return: there's no "weighting."

Day 1	0.03%
Day 2	0.01%
Day 3	-0.02%
Day 4	0.12%
Day 5	0.00%
Day 356	0.13%
Day 357	0.00%
Day 358	0.00%
Day 359	0.40%
Day 360	0.03%
360 Days	3.18%

Let's consider how we might have gotten that 360 day return: by linking the 360 days individually (see accompanying graphic). We just string the days together, right?

The 3.18% 360-day return was derived by linking individual days:

$$r_{360\,Days} = (1 + r_{Day1})(1 + r_{Day2})\ldots(1 + r_{Day360}) - 1$$

We are, in this example, simply linking five more days to a return that is based on 360 individual days, as shown above, or link to the prior 360 days:

$$R_{Year} = (1 + r_{Day1})(1 + r_{Day2})\ldots(1 + r_{Day360})(1 + r_{Day361})\ldots(1 + r_{Day365}) - 1$$

Mathematically, isn't this the exact same thing? We can multiply the first 360 days together and get our 360-day return, and then link the additional five days, or simply link all 365 at the same time (see graphic on the next page).

I hope this makes sense to you; if not, send me a note and I'll try again.

1 Well, perhaps someone on Jupiter, because being the biggest planet, size matters to them.

Back to time-weighting

And so, as you can see we do not "weight time." But then why do we refer to our returns as being "time-weighted"? I suspect that at some point a mistake was made; that the term "time-weighting" was thought to refer to the returns the BAI suggested, rather than the linking method (which, again, no one uses).

Time-weighting means a return method that reduces or eliminates the effect of cash flows. There is no "weighting" of time. Just another example of a way to cause confusion!

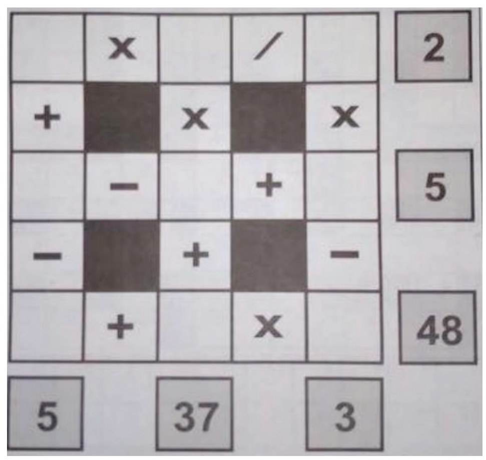
And now you know!

Day 1	0.03%
Day 2	0.01%
Day 3	-0.02%
Day 4	0.12%
Day 5	0.00%
Day 359	0.40%
Day 360	0.03%
Day 361	0.01%
Day 362	0.02%
Day 363	-0.03%
Day 364	0.03%
Day 365	0.02%
Year	3.70%

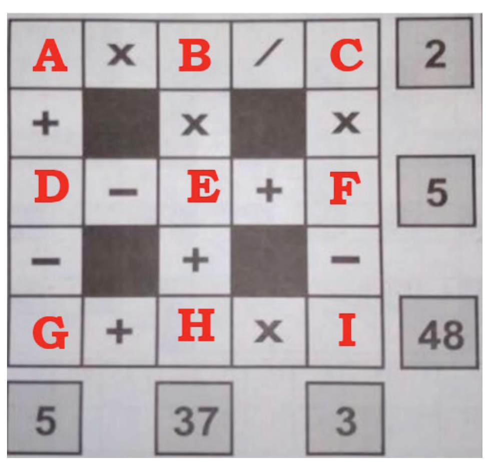
PUZZLE TIME!

May Puzzle

Fill in the nine empty boxes in the accompanying chart, using the numbers one to nine (1-9). That is, you will use each number, from one to nine. Good luck!



To make it easier to reference the various cells, I've inserted letters for the squares we're trying to find solutions to:



At first one might think that the solution would be by using simultaneous equations, but I think that would be quite difficult. And so, perhaps it's best just to try to use some logic. Let's start with the first row. We have values of 1-9 to choose from. What numbers work?

1 × 2 won't (since we cannot divide 2 by anything to get to 2)
1 × 4 will, since we can divide by 2
1 × 6 will, since we can divide by 3
1 × 8 will, since we can divide by 4
2 × 3 won't (since we'd need to reuse the 3 to get to 2)
3 × 4 will, because we then divide by 6 (12/6=2)
3 × 6 will, because we then divide by 9 (18/9=2)
3 × 8 won't (because the result (24) is too large)
4 × 6 won't (again, too large)
5 × 2 won't (we'd need to divide by 2)
5 × 4 won't (too large)
7 × 4 won't (too large)

Looks like we have five (actually, 10) possible solutions for the first row.

A: 1 4 2
B: 4 1 2
C: 1 6 3
D: 6 1 3
E: 1 8 4
F: 8 1 4
G: 3 4 6
H: 4 3 6
I: 3 6 9
J: 6 3 9

Which is the right one?

I found it easier to third column (where the box shows a 3) to start. Here, there are only four possible solutions for the top rightmost square, "C" (2, 3, 4, 6, 9), and so by solving this, we'll narrow down our options.

Let's start with "9." [from the I and J potential solutions]

9 × F − I = 3

We could have 9 × 1 − 6, but the 6 is already used, so that won't work. And 9 × 2 is too large, so we can scratch out I and J.

What about 6? [G & H]

6 × F − I = 3

We rule out 1, since we'd have to subtract 3, which isn't available.

6 × 2 − 9 = 3. And so, this is a possible solution.

Any other number multiplied by 6 would be too large, so we will move on.

Now let's try 4 [E & F]

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.

$4 \times 2 - 5 = 3$. That works. Another possible solution.

$4 \times 3 - 9 = 3$. Works. Another possible solution.

That's it for "4," since any other number is too large.[2]

Now it's 3's turn [C & D]

$3 \times F - I = 3$

$3 \times 4 - 9 = 3$. Works.

And finally, we have "2." [A & B]

$2 \times F - I = 3$

$2 \times 5 - 7 = 3$. Works.

$2 \times 6 - 9 = 3$. Works.

And so, we have several options for Box C; more than perhaps I was hoping for:

C1: $6 \times 2 - 9 = 3$
C2: $4 \times 2 - 5 = 3$
C3: $4 \times 3 - 9 = 3$
C4 $3 \times 4 - 9 = 3$
C5 $2 \times 5 - 7 = 3$
C6 $2 \times 6 - 9 = 3$.

Meaning of our original 10 overall options, we have 8 that are still alive!

A: 1 4 2
B: 4 1 2
C: 1 6 3
D: 6 1 3
E: 1 8 4
F: 8 1 4
G: 3 4 6
H: 4 3 6

Let's try to solve for box A. Here, we're looking to solve this equation: $A + D - G = 5$.

We know that A and B are possible solutions, so we'll start there. Box A can either be 1 or 4.

If 1, then $1 + D - G = 5$. What are D and G?

$1 + 9 - 5 = 5$ works, but will eliminate C5 above, since the 5 is taken.

$1 + 7 - 3 = 5$ works

For $4 + D - G = 5$

$4 + 6 - 5 = 5$ won't work, because the "5" is taken in C5 and the "6" in C6.

2 I'll stop pointing out the upper limits.

June puzzle

Imagine that you have an infinite table with a checkerboard pattern. In the bottom leftmost corner you put a 0. For every other cell, you insert the smallest non-negative integer that hasn't been used neither in the same row, to the left of the cell, nor in the same column, below it. So, for example, the first row will have the numbers 0,1,2,3,? What is the number that appears in the 1997th row, 2018th column?

Two hints:

#1 The key is in understanding that the 1997th row and the 2018th column have nothing special.

#2 Write down a small board and fill it in following the rule of the problem statement. Look for patterns.

Good luck!

Now let's consider C and D. Here, we are using either a 1 or 6 for Box A.

1 + D − G = 5

1 + 9 − 5 = 5. Won't work, since the 9 is taken in C4, so this eliminates both C4 and C and D.

Now we'll try E and F (1 and 8 as possibilities for square A).

1 + D − G = 5

1 + 9 − 5 = 5. Won't work, as C3 uses the 9.
8 + D − G = 5

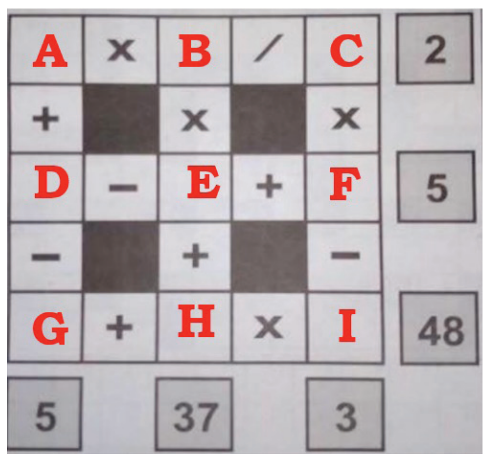
8 + 2 − 5 = 5. This will cause C2 to not be eligible. But C3 works, so this is an option.

And last we have G and H (3 and 4).

3 + D − G = 5

3 + 4 − 2 = 5 won't work.
3 + 7 − 5 = 5 works.

Anyway, hopefully you get the idea. If you continue this process of seeing what works and what doesn't (a bit painful, but it gets easier as you move along, you will get this as the solution:



Well, several folks worked through this (and perhaps did it in a more efficient manner than I did): Brett Bloemendaal, Mark Rothermel, Hans Braker, James Damian, Neil Riddles, Daniel Kempf, Anthony Howland, Dean Altshuler, and Karen Chiu. Note that a few of these folks hadn't previously submitted solutions, so we welcome them to the fold!

A special supplement provided by CFA Institute

DECIPHERING MISCONCEPTIONS ABOUT GIPS® COMPLIANCE

The United States Investment Performance Committee (USIPC) serves as an official Country Sponsor of the Global Investment Performance Standards (GIPS®) in the United States. The USIPC is a standing committee of CFA Institute. The purpose of the USIPC is to promote the adoption, and implementation and development of the GIPS standards throughout the United States as the common method for calculating and presenting investment performance.

Introduction

When it comes to compliance with the Global Investment Performance Standards (GIPS®), there are many misconceptions that may lead a firm to the conclusion that becoming GIPS compliant will be extremely difficult and potentially even impossible. This paper is intended to address some of these misconceptions, provide clarity, and eliminate perceived barriers to claiming GIPS compli-ance.

All references to the GIPS standards throughout the paper are to the 2010 edition of the Global Investment Performance Standards, which became effective on January 1, 2011.

Misconceptions that are barriers to entry for a firm pursuing compliance

Misconception: GIPS compliance is expensive

When firms consider pursuing GIPS compliance, a common impediment is the perception that GIPS compliance is expensive. In some cases, this isn't a misconception at all. For firms with data integrity issues, or procedures that differ significantly from the requirements of the GIPS standards due to the complexity of the firm, achieving GIPS compliance can actually be an expensive proposition - both in terms of dollars and human capital. However, this is not always the case. For firms that have at least a couple of the following characteristics, GIPS compliance may not be as expensive as expected:

- Knowledgeable personnel with capacity to manage the project
- A relatively short performance track record
- A limited number of portfolios
- Limited product offerings (i.e., resulting in a small number of composites)
- Established technology resources that can be used for composite construction
- Sound books and records retention policies

Misconception: GIPS compliance increases a firm's regulatory risks

Compliance with the GIPS standards is not required by any law or regulation. However, once a firm makes the decision to claim compliance, it becomes a responsibility of the firm to ensure that all requirements of the GIPS standards are being met on a firm-wide basis. Essentially, maintaining an accurate claim of compliance becomes a de facto regulatory requirement. On face value, this would appear to create additional regulatory risk for the firm. In reality though, if a firm is presenting investment results and not at least adhering to the principals of the GIPS standards (even if not actively claiming compliance), then the firm already has a heightened level of regulato-ry risk. The GIPS standards are the industry accepted standard for calculating and presenting investment performance results to prospects - not following the GIPS standards means the firm has chosen to deviate from industry norms, which will often pique the interest of regulators.

Misconception: Firms must have a 5-year track record before they can comply

A common area of confusion relates to the length of track record required in order to claim GIPS compliance. Some believe that in order to claim GIPS-compliance their entire track record must be compliant regardless of its length. Conversely, others believe that they can just comply prospec-tively without doing anything to ensure that their history is compliant. While still others think that they must have a 10-year compliant track before claiming compliance. In reality, a firm must apply the GIPS standards retroactively for the last 5 calendar years or since inception of the firm, whichever is shorter. That means that if a firm was recently established and has a very short performance track record (less than 5 years), it can still achieve compliance and present compliant information - there is no need for the firm to wait. Additionally, if a firm has been around for 30 years, it does not have to ensure its entire performance track record back to inception is in line with the GIPS standards. The firm needs only to initially present the most recent five years of its performance history that adhere to the GIPS requirements in order to claim compliance. After the firm presents a minimum of five years of GIPS-compliant performance, the firm must add an additional year of performance each year, building up to a minimum of ten years of GIPS-compliant performance. However, doing so would limit the firm's ability to show their full track record in GIPS-compliant presentations, as only compliant information can be included in a GIPS-compliant presentation from 2000-forward.

Misconceptions about the value of GIPS compliance

Misconception: GIPS compliance is only valuable as a marketing tool

GIPS compliance has clear value to prospective clients, such as increased transparency and comparability of performance presentations. However, compliance with the GIPS standards also creates many benefits to the firm making the claim. Maintaining the required policies and proce-dures strengthens internal controls across many departments within the organization. The team(s) responsible for GIPS compliance typically serve a quality control function for both back-office and front-office. This may result in the early identification of client mandate breaches, trading errors, portfolio style drift, corporate action mishandling, or an accounting transaction being booked incorrectly, to name a few.

Maintaining compliance with the GIPS standards is a team effort. It requires many stakeholders across the firm working together, typically including personnel in marketing, legal, compliance, accounting, portfolio management, and performance measurement. Each team member provides different perspectives and inputs necessary for the firm to maintain compliance, and this increased communication can benefit the firm in many ways by helping eliminate departmental silos and encouraging interdepartmental collaboration.

Firms complying with the GIPS standards also benefit from the standardized framework and internal controls that ensure consistent and directly comparable investment information. Complying with the standards ensures a consistent process for composite construction and presentation of investment results. Additionally, it sets a baseline that ensures relevant performance disclosures are included in marketing materials.

Another benefit for the firm is that the standards provide a set of guidelines for employees to follow if differences of opinion arise across departments, or if pressured by senior members. The employees responsible for maintaining the firm's claim of compliance have to look no further than the GIPS standards to ensure the right decisions are being made when it comes to composite construction, calculation, and presentation of performance.

Lastly, these concepts are supported by the fact that asset owners are now claiming compliance with the GIPS standards at an increased rate, even though they don't market to prospective clients. They recognized that complying with an industry standard like GIPS demonstrates its commitment to best practices in calculating and presenting performance.

Misconception: Clients don't understand or know what GIPS compliance is

While this may have been true in the past, sophisticated investors (particularly institutional investors) have become increasingly knowledgeable about the GIPS standards and what it means to claim compliance. Through the due diligence process, clients will often ask pointed questions of their investment advisors that will challenge the accuracy of their GIPS-compliance claim. For example, a firm may be asked if their composites include all discretionary accounts managed to the strategy, if terminated accounts are included in their performance track record, or if composite results include hypothetical or back-tested results. The first two are explicit requirements of the GIPS standards, while the third item is expressly prohibited. A wrong answer would clearly indicate that the firm is not actually compliant.

Misconceptions about the scope of GIPS compliance

Misconception: The GIPS standards are performance calculation standards

The GIPS standards are thought of by many as performance calculation standards. Although performance calculations are certainly an important aspect of GIPS compliance, the standards are much more than just a series of calculation methodologies. A firm may calculate returns in a manner that perfectly aligns with the GIPS standards, but if they fail to construct composites and create presentation materials that include all of the disclosures and statistics required by the GIPS standards, then the firm would not be compliant. Further, if the firm does not implement a process for ensuring that GIPS-compliant presentations are provided to all of the firm's prospective clients, then, again, the firm's claim of compliance would not be accurate.

Misconception: Composites can be GIPS compliant

The claim of compliance is at the firm level, not at the composite or strategy level. Firms cannot state that they are GIPS compliant for one composite but not another. Additionally, firms cannot claim they are complying with some provisions (e.g., composite construction) and not other provisions (e.g., policy to revalue for large cash flows). Firms are not permitted to state they are in partial compliance. Technically, if a firm claims compliance with the GIPS standards, then each of the firm's composites would fall under the umbrella of that claim of compliance and would, therefore, be compliant as well. However, the claim of compliance should not be expressed at any level other than by the firm as a whole.

Misconception: Only marketed strategies need to have a composite

There are several misconceptions around performance presentations and GIPS. Firms may have strategies and, therefore, composites they may not market or that they market selectively. Perhaps it is a strategy that the firm still has one portfolio managed to, but they have decided to discontinue selling the strategy. Regardless, if there is a portfolio managed to the strategy, the firm must create a composite for this portfolio, include the composite on their list of composites, and be able to provide a composite presentation in a timely manner, if requested.

Misconception: A firm claiming compliance must be a legal entity

Many organizations may be hesitant to pursue GIPS compliance because the project may appear to be a huge undertaking particularly for a very large and complex asset management company. In some instances, a company would not necessarily have to apply the GIPS standards to the entire legal entity. If there is an arm of the company that can be held out as a distinct business entity, that entity can claim compliance independent of the company as a whole. Further, any part of the company that is held out to clients as a distinct business entity can claim compliance. Because of this, many investment companies today have more than one "firm" that claims compliance within their overall organization, while also potentially maintaining certain divisions or business units that do not claim compliance. However, when dissecting an organization in this manner, it is important to keep in mind how the firms are held out to the investing public and maintain consistency across all materials disseminated by the organization (websites, pitch books, RFP responses, etc.). While defining the firm more narrowly may seem like a path to expediting compliance, it often leads to more complications for the company in the long run.

Misconception: Software can make a firm GIPS compliant

While they may use methodologies that are acceptable under the GIPS standards, software systems that calculate portfolio returns and/or composites - as well as the underlying calculation methodolo-gies themselves - cannot claim to be GIPS compliant. Additionally, the use of a particular accounting or composite management system cannot automatically make a firm GIPS compliant. Systems can help to facilitate compliance, but they cannot achieve compliance for a firm on their own.

Misconceptions about composite construction

Misconception: All discretionary portfolios must be included in composites

The GIPS standards require all fee-paying, discretionary portfolios managed by the firm to be included in at least one composite. This requirement often creates confusion though, particularly as it relates to the term "discretion." Firms that claim compliance with the GIPS standards often do not realize that this one term has one definition commonly used by regulators - the authority to decide which securities to purchase or sell - and a different definition established by the GIPS standards - the ability of the firm to implement its intended strategy. While a certain portfolio may meet the regulator definition of discretion, it may not satisfy the GIPS definition and, therefore, would not be appropriate to include in composites.

Misconception: A composite must include more than one portfolio

A common misconception related to composite construction is that a composite must consist of multiple portfolios when, in fact, a composite may only include one portfolio. This is often evident when a composite is first created, as a composite will often include only one portfolio at inception. The firm should not wait to create the composite until multiple portfolios are managed to the strategy. Under the GIPS standards, firms do not have to present dispersion for composites that contain less than 5 portfolios. This is provided as an option because dispersion may not be as meaningful in those cases, but this should not be confused with suggesting that composites containing less than 5 portfolios are themselves not meaningful or do not need to be created. A firm must create a composite for a single portfolio if it is fee-paying and deemed to be discretionary based on the GIPS-compliance policies documented by the firm. The firm must include all actual fee-paying, discretionary accounts in a composite, even if an account is the only one being managed to a particular strategy.

Misconception: A portfolio can only be included in one composite

There is also a common belief that accounts can only be included in one composite during any particular time period. While this may be the practice at some firms, it is not the rule. Composites must include all portfolios that meet the composite definition; therefore, if a firm has similar composites with overlapping definitions, then accounts may be included in multiple composites. Firms may create a broadly defined composite that includes all accounts managed to a particular strategy and then a more narrowly defined composite of accounts managed to the same strategy but that have specific investment characteristics (e.g., the ability to use derivatives). If an account meets both composite definitions, it must be included in both composites. An example of this concept would be a firm that wants to be able show the performance of all their Large Cap Equity accounts in one composite, but they also choose to create more narrowly defined composites segregating Large Cap Growth and Large Cap Value accounts. In this scenario, the accounts included in the Large Cap Growth and Large Cap Value composites would also be included in the overall Large Cap Equity composite.

Misconception: Composites must include a minimum account size threshold
Firms often think that they need to establish a minimum account size that must be met before an account is in a composite. In reality, establishing a minimum account size is a recommendation, not a requirement. Further, when firms do implement composite minimums, they often do so with a focus on their marketing approach and the size of account they would typically accept. When establishing minimums for composite inclusion, the emphasis should be on the amount of assets required in order to implement the intended strategy. In practice, this level may be different from the firm's marketing minimum. For firms that manage portfolios of highly liquid assets, there may be no material limit on the amount of assets needed to implement the strategy.

Misconceptions about GIPS policies

Misconception: Policies and procedures are the same thing
The GIPS standards require firms to document their policies and procedures used in establishing and maintaining GIPS compliance. However, when compiling this documentation, firms often make the mistake of focusing more on the policies and not so much on documenting procedures. Documenting the policies - describing "what" the firm does in order to maintain compliance - is generally fairly straightforward. On the other hand, the procedures - "how" compliance is maintained - is often more difficult, customized, and firm specific. While the firm's policies and procedures do not need to provide step-by-step procedures outlining how daily tasks related to composite maintenance are performed, they should provide enough general information about the process that would allow a reader to understand what tasks are being performed.

Misconception: "Large" cash flow and "significant" cash flows are the same thing
The terms "large" and "significant" can seem to mean the same thing in certain contexts. When discussing cash flows within GIPS, however, they mean two completely different things and that can be a bit confusing.

A large cash flow is defined as the level at which the firm determines that an external cash flow may distort performance if the portfolio is not revalued. When portfolios are valued infrequently (e.g., monthly) portfolio returns become less accurate when there are cash flows during that period. The more frequent the portfolio is revalued and performance is calculated within those periods, the closer the return is to a true time-weighted return. A true time-weighted return provides a return that reduces or eliminates timing of cash flows that are not normally in the control of the portfolio manager. With the exception of private equity and real estate assets, firms must value all portfolios on the date of all large cash flows (with "large" defined as a fixed percentage of the portfolio's asset value or in terms of the value of the flow).

A significant cash flow is defined as the level at which the firm determines that an external cash flow may temporarily prevent the firm from implementing the strategy. This is not the same as a large cash flow. Large cash flows have more to do with calculating a more accurate return whereas a significant cash flow pertains more to the inability to implement the strategy. When a significant amount of cash enters or exits the portfolio, the portfolio manager may be forced to initiate trading activity that they normally would not have, causing the portfolio to perform different than undisrupted portfolios managed to the same strategy. If an account triggers a significant cash flow policy, it must be temporarily removed from the composite as it is not considered discretion-ary during that time period. The account must be re-included in the composite once it has met the firm's policy for re-inclusion. A significant cash flow policy is composite specific and not required.

Misconceptions about disclosures and compliant presentations

Misconception: All advertisements and composite materials must reference GIPS compliance
The GIPS standards require that firms make every reasonable effort to provide a GIPS-compliant presentation to all prospective clients. However, firms are not limited to providing composite information only in GIPS-compliant presentations. Firms can present composite performance in other materials, including advertisements, and not make any reference to GIPS compliance. That being said, once the firm decides to make reference to the firm's claim of GIPS compliance and the materials are distributed through websites, magazines or any written or electronic material

addressed to more than one prospect, it would be considered an advertisement under the GIPS Advertising Guidelines. It is up to the firm to decide if they want to limit referencing their claim of GIPS compliance to just the GIPS-compliant presentation or if the claim should also be included in other materials. Any mention of GIPS compliance outside of the GIPS-compliant presentation must include all necessary disclosure as outlined in the GIPS Advertising Guidelines. Firms should refer to local laws and regulations to ensure the presentation meets advertising requirements beyond those prescribed by the GIPS standards.

Misconception: GIPS-compliant presentations must include all required disclosures, even if they aren't applicable to the composite being presented

To comply with the GIPS standards, firms must disclose certain information in all GIPS-compliant presentations regarding their performance and the policies adopted by the firm. Firms are not required to make negative assurance disclosures (e.g., if the firm does not use leverage in a particular composite strategy, no disclosure regarding the use of leverage is required). In an effort to limit compliant presentations to a one or two-page concise document it is advantageous to ensure the most important information is displayed. Space can become limited as the GIPS standards evolve and new disclosures are required, and with each additional year of composite history another line of data is presented. Common negative assurance disclosures that are not required include: stating the composite does not have a minimum market value, stating that the composite does not include non-fee-paying portfolios, and stating that the composite does not have a significant cash flow policy. While these pieces of information can be disclosed, it is paramount to ensure the most important information is provided to prospective investors in a digestible format.

Misconception: Composite creation date and composite inception date are the same

One of the disclosures required by the GIPS standards that often creates confusion is the compo-site creation date. The natural assumption is that the creation date for a composite should reflect the date when the performance track record starts (i.e., the inception of the composite). This is not necessarily the case. The composite creation date is the date when the firm made the decision to construct the composite. A composite may be constructed at a later point than when the first portfolios managed to the strategy opened, so the firm may have some benefit of hindsight in how the composite is built. The potential for this benefit of hindsight is conveyed through the composite creation date.

Misconceptions about GIPS verification

Misconception: Verification is required

Another common misperception is that a firm needs to be verified in order to claim compliance. This is not the case. Just like claiming compliance is voluntary, so is receiving a third-party verification. Verification is highly recommended and gives validity to a firm's claim of compliance. It is also expected by investors in many markets, so not receiving a verification can result in lost business opportunities. Further, verification can also give the firm's management a higher level of comfort with the accuracy of their claim of compliance. As a result, many firms choose to go through the verification process, even though it is not mandatory.

Misconception: Verification ensures compliance

There is also some confusion related to the scope of verification and the assumption that it validates the accuracy of the firm's performance track record. In reality, a verification does not ensure the accuracy of any specific composite presentation. Verification is only designed to assess two things: 1) whether the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and 2) whether the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. As a result, there could be errors in the performance presentation for a particular composite that are not caught by the verification process. In order to try to identify such issues, a firm can also receive a compo-site-specific performance examination. A performance examination is a detailed examination of a specific composite's GIPS-compliant presentation by an independent verifier. A performance examination report can only be issued simultaneous to, or after a verification report has been issued. A firm that claims compliance with the GIPS standards should also maintain a detailed, ongoing internal review process related to their GIPS-compliance program, regardless of whether the firm is verified. Ultimately, compliance is the responsibility of the firm making the claim, not their verifier.

THE SPAULDING GROUP'S 2018
INVESTMENT PERFORMANCE MEASUREMENT CALENDAR OF EVENTS

DATE	EVENT	LOCATION
July 16-20, 2018	Performance Measurement Boot Camp	New Brunswick, NJ
August 14-15, 2018	Fundamentals of Performance Measurement	Chicago, IL
August 16-17, 2018	Performance Measurement Attribution	Chicago, IL
October 15-16, 2018	Fundamentals of Performance Measurement	San Diego, CA
October 17-18, 2018	PMAR West Coast	San Diego, CA
November 15-16, 2018	Performance Measurement Forum	Luxembourg
November 28, 2018	Asset Owner Roundtable	Orlando, FL
November 29-30, 2018	Performance Measurement Forum	Orlando, FL
December 5-6, 2018	Fundamentals of Performance Measurement	Mumbai, India
December 11-12, 2018	Fundamentals of Performance Measurement	New Brunswick, NJ
December 13-14, 2018	Performance Measurement Attribution	New Brunswick, NJ

For additional information on any of our 2018 events, please contact Patrick Fowler at 732-873-5700

TRAINING…

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October 15-16, 2018 – San Diego, CA
December 11-12, 2018 – New Brunswick, NJ

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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.

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The Journal of Performance Measurement® Second Annual – West Coast
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