

# PERFORMANCE PERSPECTIVES

*with David Spaulding*



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Since 1990, The Spaulding Group, Inc., an employee-owned business, has had an increasing presence in the money management industry.

The Spaulding Group, Inc. is the fastest-growing verification firm, serving clients around the globe, with assets ranging from less than \$100 million to more than \$1 trillion. We provide an array of other performance measurement services and products, including consulting, publishing (The Journal of Performance Measurement®), research, and training. We also host the Performance Measurement Forum, the Asset Owners' Round Table, and the Annual PMAR™ Conferences.

We are actively involved as members of the CFA Institute and other industry groups. The Spaulding Group has also led the charge for the industry in the handling of error correction, attribution guidelines/ standards, and Investment Performance Measurement Analyst Certification (since handed over to the CFA Institute and now called the CIPM program).

Several of our senior staff regularly speak at and/or chairs industry conferences. Our founder and CEO, David Spaulding, is a frequent author and source of information to various industry publications. Our firm continues to make huge contributions to our industry, in terms of valuable content, innovative ideas, and volunteer activities.

Our clients appreciate our industry focus and understanding of their business, their needs, and the opportunities to make them more efficient and competitive.

## WHAT A HIATUS

It's definitely not for lack of material that we've (I've) fallen behind. The past few months have brought with it a combination of health and technological challenges, as well as a load of work. I'm hoping that we'll be more timely for the balance of this year.



## NET-OF-FEE RETURNS ...CHALLENGES APLENTY

I had a conversation with the president of one of our GIPS® verification clients recently regarding the presentation of their wrap fee composite reports. External advisors typically use these reports when meeting with their clients, and there were two issues of great importance:

- They use the maximum 300 basis points as their fee for the net-of-fee returns, even though many clients are paying much less
- If the advisor subtracts the annual net returns from gross, the result will not equal 3.00%, which can often be confusing.

I promised to write an article on this, which I have (hoping it will be in the next issue of The Journal of Performance Measurement®). I'll offer a summary here.

As for the first issue, an alternative would be to show the net-of-fee returns net of the actual fees, which is quite common. The problem is that the result is virtually meaningless, since we have no idea what the number represents.

The downside of using the max fee is that the resulting net-of-fee return is probably a bit lower than it would be had actual fees been used. However, we at least know what the number represents.



# The Journal of Performance Measurement®

## UPCOMING ARTICLES

Finding and Retaining Quality  
Performance and Risk Talent  
- Frances Barney, CFA, BNY Mellon

Driving Force: How Performance  
Evaluation is Becoming an Engine  
of Investment Industry Growth  
- CFA Institute

The Journal Interview  
- Todd Juillerat, CFA,  
The Spaulding Group

2020 GIPS Standards survey #1  
Detailed Results  
- David Spaulding, DPS, CIPM,  
The Spaulding Group

Python in the Performance Team  
- Jonnathan De Jesus Luna, CFA,  
Members Trust Company

LANDMARK ARTICLE:  
Performance Measurement  
and Attribution with  
Leverage and Derivatives  
- Damien Laker, CIPM

A “compromise,” sort of, would be to introduce the apparently long forgotten asset-weighted fee, that the AIMR-PPS® required. If we include it with the net-of-fee return derived from actual fees, the number has some meaning. Consider this table:

| Fee Mix | AWF    | $R_G^Y$ | $R_N^Y$ |
|---------|--------|---------|---------|
| 1       | 0.601% | 2.289%  | 1.678%  |
| 2       | 0.645% | 2.289%  | 1.634%  |
| 3       | 0.649% | 2.289%  | 1.630%  |
| 4       | 0.669% | 2.289%  | 1.610%  |
| 5       | 0.754% | 2.289%  | 1.524%  |

They are from a composite with five accounts, each with a different annual fee, ranging from 40 to 100 basis points, with the fees charged quarterly.

The gross-of-fee returns are identical, as we would expect; but, the net-of-fee returns vary quite a bit. By including the asset-weighted fee (AWF), the net-of-fee returns now have some meaning. And, we can see that as the AWFs increase, the net returns decrease.

I encourage firms that report net-of-fee returns using actual fees to introduce the asset-weighted fee as supplemental information. The formula is quite simple:

I should add that I have never (or at least don't recall) seen a formula to derive this value, but came up with this, which seems to work well. I would explain the notation, but believe it's probably pretty clear.

$$AWF^{Composite} = \sum_{i=1}^n w_i fee_i^{Account} = \sum_{i=1}^n \left( \frac{w_i}{\sum_{j=1}^n w_j} \right) fee_i^{Account} = \frac{\sum_{i=1}^n w_i fee_i^{Account}}{\sum_{j=1}^n w_j}$$

As for the problem with the annual fee not equaling the difference between the annual gross and net returns, this is simply a matter of compounding.

For more on this topic, please read my upcoming article!<sup>1</sup>

## IN HOUSE DEVELOPED RETURN METHODOLOGIES

As you might expect, we often run into situations where firms calculate their returns internally, typically with spreadsheets. While there is nothing really wrong with this (other than that spreadsheets are time-consuming and error prone), problems do arise when the firm creates their own return methodology.

Rarely does a creatively developed internal system work properly, even though it may seem quite logical.



<sup>1</sup> If you're not already a subscriber, simply go here to sign up: it's free! <https://spauldinggrp.com/free-journal-of-performance-measurement/>

## 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 recall a few years ago when someone called, wanting us to review and certify<sup>2</sup> their system. The prospect explained their system to me over the phone, and I quickly explained some of its problems. He insisted it was an acceptable approach, as his clients agreed that it was quite logical. And I, too, agreed it was quite logical. It was simply flawed. I regret not retaining these details so that I could share them with you.

There is really no need for a firm to derive a new way to calculate returns: they are well documented and easily available.

## PUZZLE TIME

### November 2019 puzzle

This puzzle was posted by a friend on FaceBook. I thought it interesting, so am using it here. Good luck!

A suitcase weighs 44 pounds plus half its own weight.

How much does it weigh?

This puzzle was a "teaser" for an "Impossible IQ Test From The 1980's, which "Only 1 in 50 people can pass." I generally try to avoid click bait, so was not going to try the test. But, this single puzzle intrigued me.

I initially found the wording a bit unclear, and I ended up pondering it for several minutes before deciding it was worth pursuing.

The Nobel prize winner in Economics, Daniel Kahneman, wrote the best seller, "Thinking Fast and Slow," to explain how we respond to various settings. The fast brain wants to say  $44 + 22 = 66$ , but that would be wrong.

The wording seems tricky, but it actually isn't. One merely need think in terms of an algebraic equation. The suitcase's weight,  $W$ , equals 44 plus half of its weight or  $44 + (1/2 \cdot W)$ . Once solved, we may realize we actually over thought it, as logic, a different though related field, should suffice.



<sup>2</sup> One of our consulting services is software certification. Several firms and organizations have passed the rather rigorous evaluation, most recently Archer Investment Management Solutions:

**PMAR NORTH AMERICA  
HAS MOVED TO  
NOVEMBER 12-13, 2020, BUT  
WE WILL HOLD A REMOTE  
VIRTUAL MINI-PMAR  
THE WEEK OF MAY 11TH  
FOR ALL REGISTERED  
ATTENDEES.**

**Agenda:**

**Monday, May 11, 2020 – 11:00 am (EST):** Arithmetic vs Geometric – Explaining the difference in a crisis, *Dr. David Spaulding, CIPM*

**Tuesday, May 12, 2020 – 11:00 am (EST):** A New Era in Risk Management: Answering the big question, what is a sustainable withdrawal rate? *Steve Campisi, CFA*

**Wednesday, May 13, 2020 – 11:00 am (EST):** *GIPS Panel: Ashley Reeves, CIPM*  
*Todd Juillerat, CFA, and Jennifer Barnette, CIPM*

**Thursday, May 14, 2020 – 11:00 am (EST):** Geometric vs. Attribution – Explaining the Differences to Clients. *John D. Simpson, CIPM*

**Friday, May 15, 2020 – 11:00 am (EST):** Virtual Roundtable – submit your questions and our panel of experts will answer them.



<https://spauldinggrp.com/product/pmar-north-america-2020/>

Don't miss out, the virtual conference is FREE to all attendees. Register for PMAR North America, PMAR Europe, or PMAR West and receive your complimentary online pass.

Let's walk through the solution:

$$W = 44 + \left(\frac{1}{2} \times W\right)$$

$$2W = 88 + \left(\frac{2}{2} \times W\right) = 88 + W$$

$$2W - W = 88$$

$$W = 88$$

A point that Kahneman made was that if you check your work, you'll be able to confirm your solution. If we had gone with the "fast brain's" answer of 66, we could easily check, right? The suitcase weighs 44 + half the weight; if the weight is 66, half is 33, so 44 + 33 = 66; but it doesn't.

However, 44 + half the suitcase's weight of 88 yields 44, and 44 + 44 = 88.

Thinking logically, we know that the suitcase's weight is made up of two parts: 44 and half its weight. Well, if there are two parts to it that together yields the weight, and we know that one part is half, it should follow that the other part has to equal the same half, meaning that it's 44 and 44.

**March Puzzle**

The product of two numbers is 32 and their difference is 4. What are the two numbers?



THE SPAULDING GROUP'S 2020  
INVESTMENT PERFORMANCE MEASUREMENT CALENDAR OF EVENTS

| DATE                  | EVENT                                   | LOCATION                   |
|-----------------------|---|----------------------------|
| May 19-20, 2020       | Fundamentals of Performance Measurement | Boston, MA                 |
| May 21-22, 2020       | Performance Measurement Attribution     | Boston, MA                 |
| June 18-19, 2020      | Performance Measurement Forum           | Amsterdam, The Netherlands |
| July 21-22, 2020      | Fundamentals of Performance Measurement | Montreal, QC               |
| July 23-24, 2020      | Performance Measurement Attribution     | Montreal, QC               |
| August 11-12, 2020    | Fundamentals of Performance Measurement | Chicago, IL                |
| August 13-14, 2020    | Performance Measurement Attribution     | Chicago, IL                |
| September 15-16, 2020 | PMAR Europe                             | London, United Kingdom     |
| November 11-12, 2020  | Performance Measurement Forum           | Porto, Portugal            |
| November 12-13, 2020  | PMAR North America                      | Philadelphia, PA           |
| November 19-20, 2020  | PMAR West Coast                         | San Diego, CA              |
| November 16, 2020     | Asset Owner Roundtable                  | Orlando, FL                |
| November 17-18, 2020  | Performance Measurement Forum           | Orlando, FL                |
| December 8-9, 2020    | Fundamentals of Performance Measurement | New Brunswick, NJ          |
| December 10-11, 2020  | Performance Measurement Attribution     | New Brunswick, NJ          |

For additional information on any of our 2020 events, please contact Patrick Fowler at 732-873-5700

# TRAINING...

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

### TO REGISTER:

Phone: 1-732-873-5700

Fax: 1-732-873-3997

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

**May 19-20, 2020 – Boston, MA**

**July 21-22, 2020 – Montreal, QC**

**August 11-12, 2020 – Chicago, IL**

**December 8-9, 2020 – 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:

**May 21-22, 2020 – Boston, MA**

**July 23-24, 2020 – Montreal, QC**

**August 13-14, 2020 – Chicago, IL**

**December 10-11, 2020 – 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.