

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.

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When you think about it, what does the asset owner's overall TWR mean?

For quite some time I have preached that the return should answer a question. To determine, for example, whether to use a time- or money-weighted return, I'll ask "what question are you asking?"

For example, if you want to know your own performance, as an investor, money-weighting is what you want. Vanguard and other mutual fund companies now provide investors with the ability to see their "personal rate of return." This is a money-weighted return that takes cash flows into attention.

If you ask "how did my manager perform?," I'd want to know what that manager was investing in.

If it was public equities or bonds, then the time-weighted return would apply, as we do not want cash flows to influence the results (since the manager does not control the flows, the investor does). On the other hand, if it's a private equity manager, we'd want to use the internal rate of return, the "true" money-weighted return, because we want to capture the impact of flows, since in this case the manager controls the flows.

If an asset owner only invests in public equities and bonds, then the time-weighted return would tell them how well their managers performed, overall, collectively, in aggregate. This would, I believe, have some value. They can also use the TWR for each manager individually, to see how they did.

However, many, if not most, public pension funds, as well as many other asset owners, now have an allocation to private equity. We would never evaluate an individual private equity manager using the time-weighted return, because it would remove the impact of their cash flow decisions, and the result would have zero meaning: it answers no question at all: zilch, nada.

And so, if we combine the asset owners private equity funds with their publicly traded assets, what does the time-weighted return tell us?

Well, that's quite simple, it answers the question "how did ??? perform."

That is, it doesn't answer any question whatsoever. It has zero meaning. It means nothing.

And yet, the Global Investment Performance Standards (GIPS®) requires asset owners who choose to comply to report the time-weighted return for their composites. Why? Well, the answer, I think, is pretty simple: because that's what GIPS always requires. Until the 2020 version, it seemed to generally abhor the use of the IRR, limiting its use quite a bit. The Standards recommend that asset



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owners report the IRR (sorry, money-weighting, since the rules have [sadly] broadened what is allowed).

Asset owners are used to reporting the time-weighted return; they've been doing it for decades. Despite the United States Government Accounting Standards Board (GASB) requiring the IRR on an annual basis, most asset owners seem to like the time-weighted return.

But I believe that's just a habit that has taken root. More understanding of what the returns deliver, what they actually mean, is necessary.

If someone can provide the answer to what the fund's TWR means, what question it actually answers, that would be great. I'm "all ears."

Please feel free to share your thoughts.
More to follow on "best practices."



THE SPAULDING GROUP'S 2022
INVESTMENT PERFORMANCE MEASUREMENT CALENDAR OF EVENTS

DATE	EVENT	LOCATION
November 10-11, 2022	EMEA Meeting of the Performance Measurement Forum	London, England
November 15-16, 2022	Fundamentals of Performance Measurement Training Class	San Diego, CA
November 16, 2022	Asset Owner Roundtable Meeting	San Diego, CA
November 16, 2022	Broker/Dealer Symposium – First Meeting	San Diego, CA
November 17-18, 2022	North American Meeting of the Performance Measurement Forum	San Diego, CA

For additional information on any of our 2022 events, please contact Patrick Fowler at 732-873-5700.

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It's hard to find such focused training around the topic of performance measurement along with experienced instructors who can get into the details of various calculations. I recommend this two-day training course for firms looking to provide a good foundation on this topic." – Rajiv Mathur, Kaiser Permanente

TO LEARN MORE, PLEASE CONTACT:

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