

Do we need performance presentation standards for performance attribution? - A practitioners note.

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by Dr. Stefan J. Illmer;

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Kontaktadresse
Illmer Investment Performance Consulting AG
Weinbergstrasse 28
CH – 8200 Schaffhausen
Email stefan.illmer@iipc-ag.com

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By Dr. Stefan J. Illmer

In performance measurement seminars about the Global Investment Performance Standards (GIPS™) people always ask about the future of these standards.¹ This note fits into this discussion and explains why we need standards for presenting performance attribution figures. To follow the arguments it is best to refer at an example for a performance attribution report.

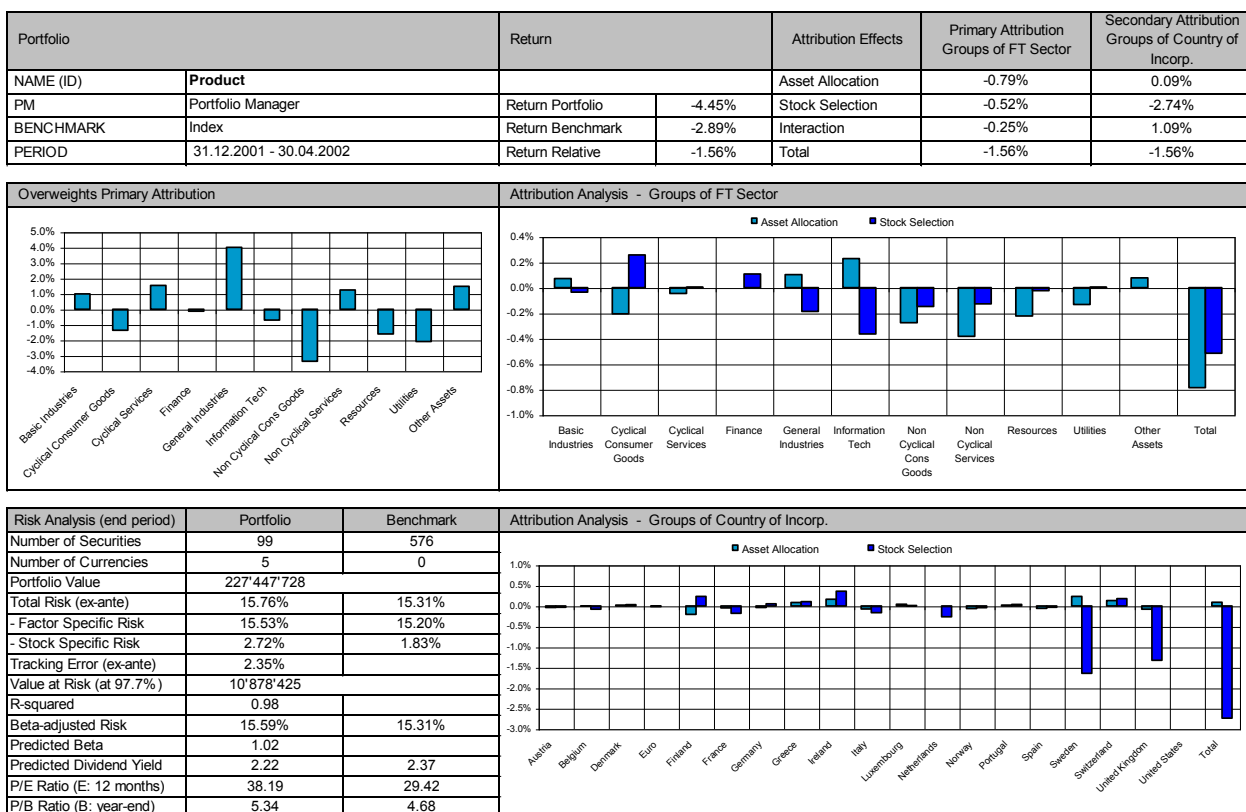


Figure 1: An example for a performance attribution report

Like in the early days with performance reports, without appropriate disclosures presenting a performance attribution report can also lead to misinterpretations and to a lot of unanswered questions. Here are some of the most important questions one may have:

- What is analyzed? A composite, a representative portfolio, a strategy or a model portfolio?
- Does the performance attribution analysis follow the investment decision process of the asset manager?

- Does the performance attribution analysis mirror the investment style of the asset manager?
- Is the benchmark appropriate to the investment strategy?
- Is the investment universe covered by the benchmark? Are investments outside the benchmark allowed and if yes, is this effect allocated to the stock picking or asset allocation effect?
- Are derivatives included in this analysis and if yes how?
- Is leverage considered in this analysis and if yes is the return calculated on a cash basis?
- Which methodology is used to calculate the returns?
- Is the performance attribution system buy-and-hold or transaction based?
- Is the analysis done on a daily or monthly basis?
- Are there differences between the presented returns and the official return calculation of the custodian?
- What time period is shown and why has this period been chosen?
- Are transaction costs included within the stock selection or asset allocation effect?
- Are the results presented gross or net of management fees?
- Do the management effects vary over time - what is the dispersion?
- Is the interaction effect shown separately or allocated to a specific management effect?

These questions illustrate that a performance attribution report can easily lead to misinterpretations and consequently to wrong decisions on future investment activities. Saying this, answers to the above questions are essential in order to assess the quality of the investment process of an asset management company.

Most of the above questions are well known to all people that deal with GIPS and GIPS compliant performance presentations, like performance analysts, asset management companies, regulators, auditors, clients, consultants and so on. The spirit of GIPS and its targets like full transparency and disclosure as well as fair representation illustrate its future direction towards performance presentation standards for performance attribution.

Until performance presentation standards are available for performance attributions asset management companies should follow the spirit of GIPS. This means that they should present the performance attribution analysis in a fair and comparable format that provides full disclosure. Or in other words, they should present the performance attribution results in a way that the report has not the potential to mislead and do not contradict or conflict with the information provided in a GIPS report. Additionally it should be stated that it is also the responsibility of the clients and especially of the consultants to ask the relevant questions to fully understand what is shown by an asset management company.² Not doing this may lead to misinterpretations and to a misjudgment of the performance quality of an asset management company.

From a practitioners point of view there is a clear answer to the question whether we need performance presentation standards for performance attribution: Yes we do!

Endnotes

- ¹ This note summarizes the conclusion of a presentation "Pitfalls in using Performance Attribution" held by the author on the Spaulding Performance Measurement Forum in Oslo this year. The presentation is available from the author (email: stefan.illmer@csam.com).
- ² A good starting point for a clients' questionnaire to asset management companies could be the EIPC working paper "Guidance for users of Attribution Analysis" or the different surveys on performance attribution done by The Spaulding Group, PriceWaterhouseCoopers and other audit or consulting firms.