Investigating the Future of Global Performance Measurement

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In this article we investigate:

- What happened in the last ten years?
- What are the current trends and hot topics?
- What will happen in the next ten years?
- What is the biggest challenge in mastering the future?
- Final remarks

What happened in the last ten years?

Here we make some general observations about the typical circumstances of the profession around ten years ago:

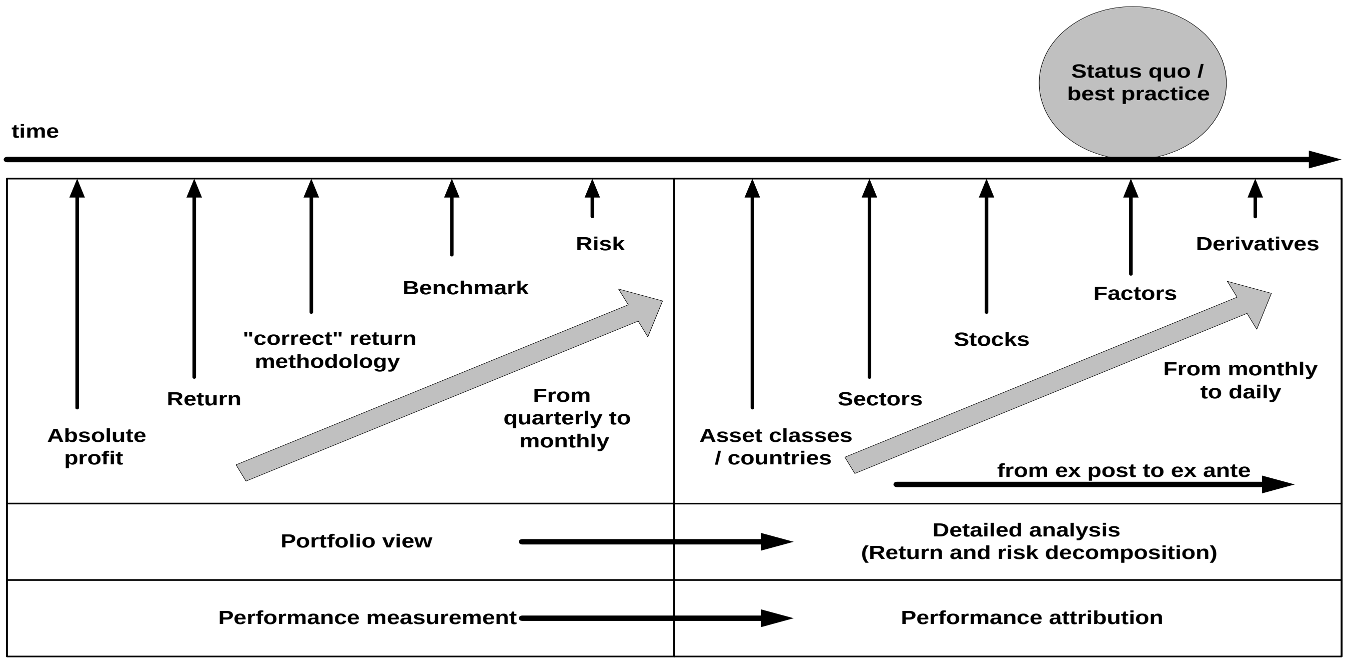
The first comment is that there were hardly any performance databases established and little in the way of dedicated performance reporting tools.

Few asset management houses were in a position to provide return attribution or risk attribution that reflected the investment decision process. The return calculation itself was predominantly a monthly calculation at the total portfolio level using the original Dietz method. Settlement date accounting treatment remained the norm and accrual accounting for dividends was rarely undertaken.

Outside of the USA, the AIMR-PPS was hardly known and even fewer had undertaken the task of implementation. Those at the forefront of the profession that were thinking about a performance monitoring or risk management framework had either just started or only partly implemented a solution.

Training for the industry was much more limited; there was no educational program for performance specialist. Most learned their profession by way of on-the-job training.

The following diagram provides an illustration of how the performance / risk attribution framework has evolved in the past ten years.



We now provide a summary into some of the instrumental changes in the industry

- Introduction of the Global Investment Performance Standards (GIPS)
- Formation of performance (ex post) and risk (ex ante) monitoring frameworks
- Creation of the CIPM from the CFA Institute
- Information flows and communication benefits from the world wide web
- Better software and functionality from software vendors and advances in information technology

What are the current trends?

We now begin to track the current trends:

Performance databases are now established and performance reporting tools have been routinely implemented.

We find that return attribution for equity and fixed income portfolios is common practice. However, risk attribution for equity and fixed income portfolios is still evolving and is only established in part.

Efforts to provide specific performance analytics for specific products have begun. An example of this is contribution to tracking errors on high alpha products.

We find that most managers are well on the road towards daily return calculation on portfolio, as well as, stock level and the trade date accounting and accrual accounting for dividends is routine.

It is very widely accepted that GIPS is the global PPS (Performance Presentation Standard). GIPS are broadly known and implemented. The CIPM Program has been initiated as the first certification program for Performance specialists.

Asset Managers have come a long way down the road of Performance monitoring and/or Risk management frameworks. Many have partially implemented their strategic solutions. These functions are seen as important support mechanisms for marketing and as control / compliance monitoring. Thus the Performance / Risk function is seen as a value added function.

We have witnessed a very definite move towards a united approach of Performance, Risk, Data Management and Client Reporting. These previously disparate functions are now moving in the same direction and many are combining efforts in a effort to improve the client experience.

We now fund a mature scene of industry organizations addressing performance measurement seminars and forums along with the regulators starting to look at performance measurement and presentations.

Our next step is to look at some of the hottest topics facing us today:

- Increasing needs of asset managers: increased level of detail, desire for better data and therefore reporting quality, better coverage of the managed portfolios, including multi-asset class portfolios, hedge funds, derivatives, etc
- increasing reporting needs: more detailed information, more flexibility on analytics and report design, higher frequency of report delivery, more reports available online
- increasing pressure to provide analytics also from the client's point of view: client return versus portfolio manager analytics, addressing the absolute and less the relative analytics, especially for private clients
- increasing pressure to provide analytics also for client's total assets: including external assets (real estate, private equity, assets held with other custodians, advisory accounts)
- providing more reporting and analytics to clients to meet their own Management Information Statistics (MIS) and data needs
- increasing regulations by the European authorities: UCITS or MiFID, more protection of the investors by requiring more transparency and through addressing performance presentations and risk measurement aspects
- further development of the performance presentation standards: GIPS 2010, new areas to be covered (performance attribution, client reporting, valuation, etc.), other performance presentation related standards (mutual funds, private equity, real estate, etc.)
- Increasing need for guidance on performance related issues: hedge funds, risk measurement methods, illiquid assets, performance fees, structured products, fixed income attribution
- Increasing need for education and training: broader acceptance and use of educational training programs like the CIPM program; integration of performance analytics or performance monitoring in portfolio management training as part of the investment process and the quality assurance process; more training programs for the (end-)investors rather than only tailored to a portfolio manager perspective
- increasing technical discussions: debates on the shortcomings and the appropriateness of certain calculation methodologies; development of a comprehensive return and risk calculation framework; economical interpretation of calculation techniques, increasing needs for developing risk models to better reflect existing products or investment processes and to better address the risk view from clients; increasing pressure on software vendors to provide the necessary tools for the performance analytics;

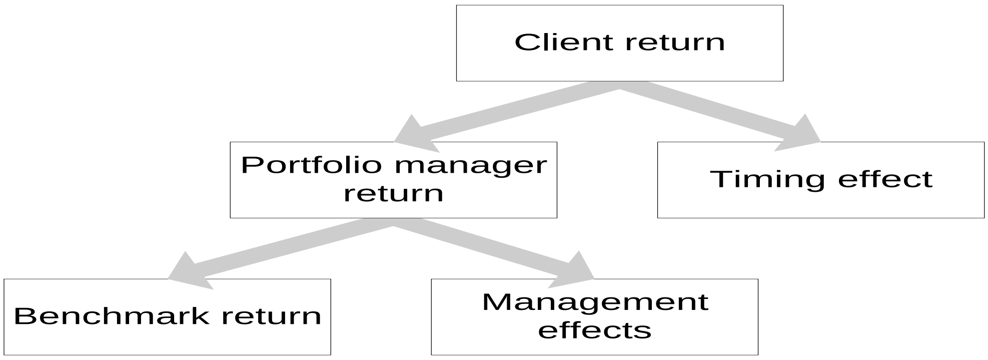
increasing need for daily security and benchmark data; reference data as well as prices; look-through for indirect investments or structured products

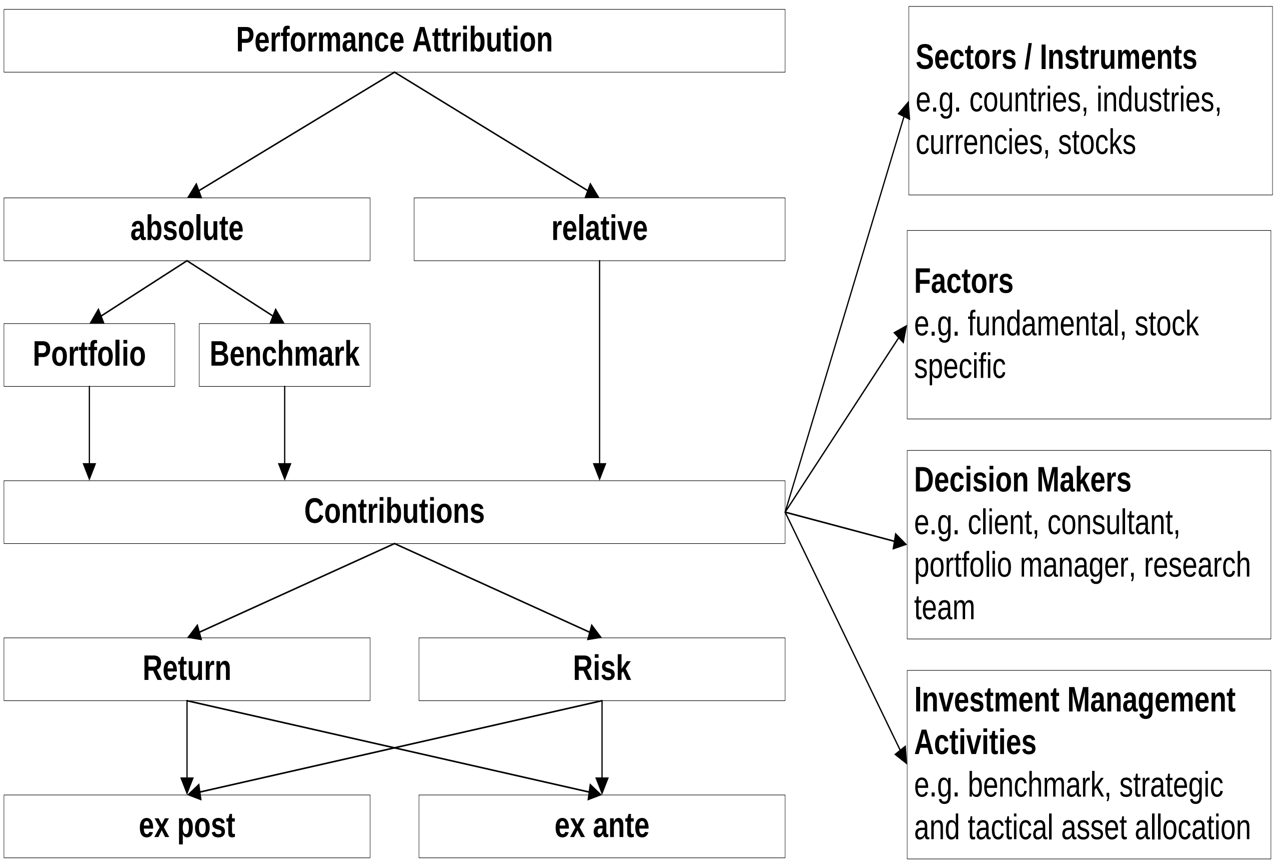
- increasing need for integrated solutions: consistent use of calculation methodologies and consistent data throughout all systems and analytics

What will happen in the next ten years?

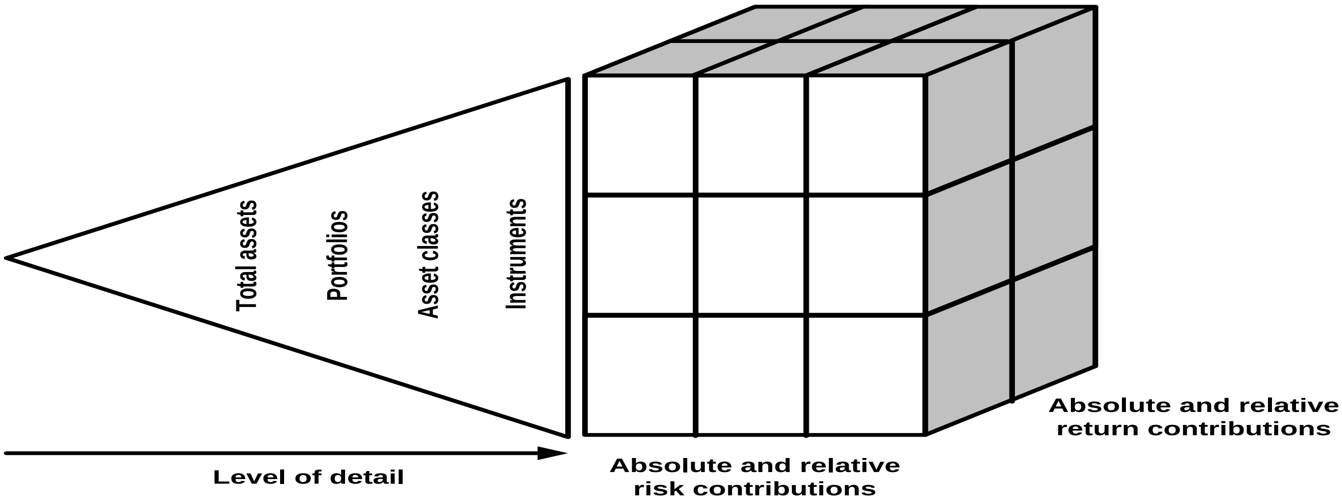
We begin to turn our attention to anticipated developments in the coming decade, given the rapid pace of change in the preceding ten years:

Firstly we would expect that a comprehensive performance measurement framework will be developed and firmly established. Equally we anticipate all kinds of performance analytics will become routine. These points are illustrated in the following diagrams:





Practitioners will be able to “slice and dice” their analytics in all manner of ways, as illustrated below.

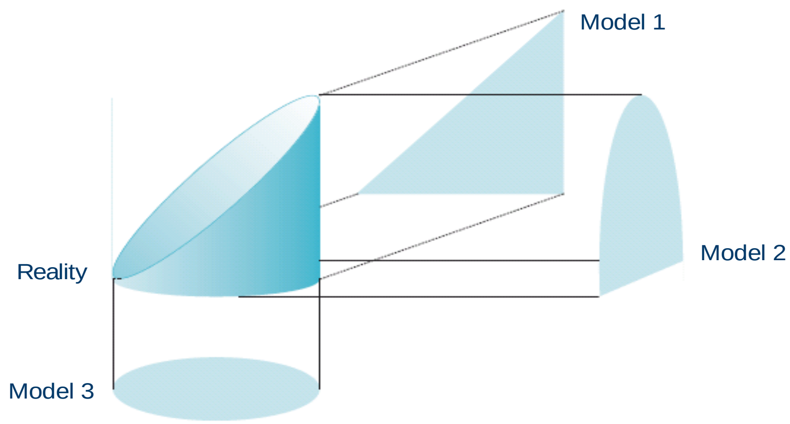


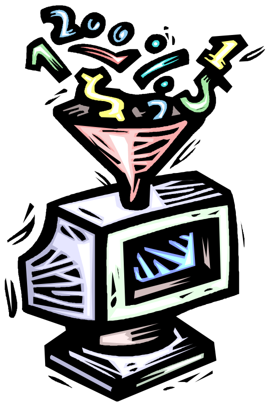
Risk attribution will have further evolved and will be able to reflect the full investment universe and the whole investment process; all securities can be mapped; impacts of liabilities and leverage can be analysed; all risk factors will be relevant to the asset managers; all risk factors are empirically significant; risk models have a high degree of accuracy and very small estimation errors.

Risk Model : Global	Portfolio	Benchmark
Number of Securities	67	1'550
Number of Currencies	8	0
Portfolio Value	84'334'091	
Total Risk (ex-ante)	18.81%	18.21%
- Factor Specific Risk	18.66%	18.18%
- Stock Specific Risk	2.39%	1.02%
Tracking Error (ex-ante)	2.57%	
Relative Value at Risk	3'570'469	
R-squared	0.98	
Beta-adjusted Risk	18.64%	18.21%
Predicted Beta	1.02	
Predicted Dividend Yield	1.86	2.01
P/ E Ratio (E: 12 months)	28.39	26.00
P/ B Ratio (B: year-end)	2.58	2.56

Risk Model : Global	Portfolio	Tracking Error
Total Risk (ex-ante)	18.81%	2.57%
Factor Specific Risk	18.66%	1.50%
- Region	11.50%	0.18%
- Country	6.98%	0.83%
- Industry	2.64%	0.77%
- Fundamental	1.44%	0.78%
- Currency	8.42%	0.27%
- Covariance (+/ -)	9.35%	0.52%
Stock Specific Risk	2.39%	2.08%

The Risk models will be able to provide contributions to risk for the entire reality of the investment process:

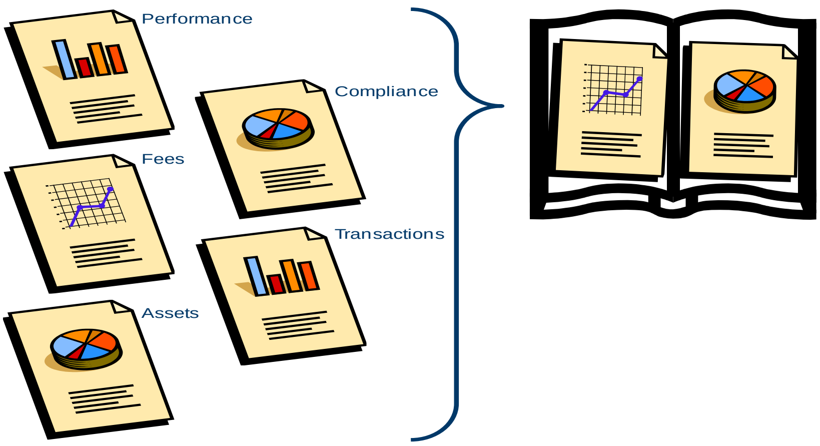




Data Management: all reference data is available for securities in the portfolio and the same for benchmark constituencies - on a daily basis. We would expect that "look-through" analysis is common practice. Common platforms, sources and languages have been developed allowing custodians and banks share the necessary data and information. We anticipate that standard interfaces have been developed and implemented for sharing data and information.

In summary, all required data is readily available.

In the coming years we predict that asset managers and software vendors continue to work together to develop integrated solutions for client reporting to clients, covering all aspects of Performance and Risk reporting.

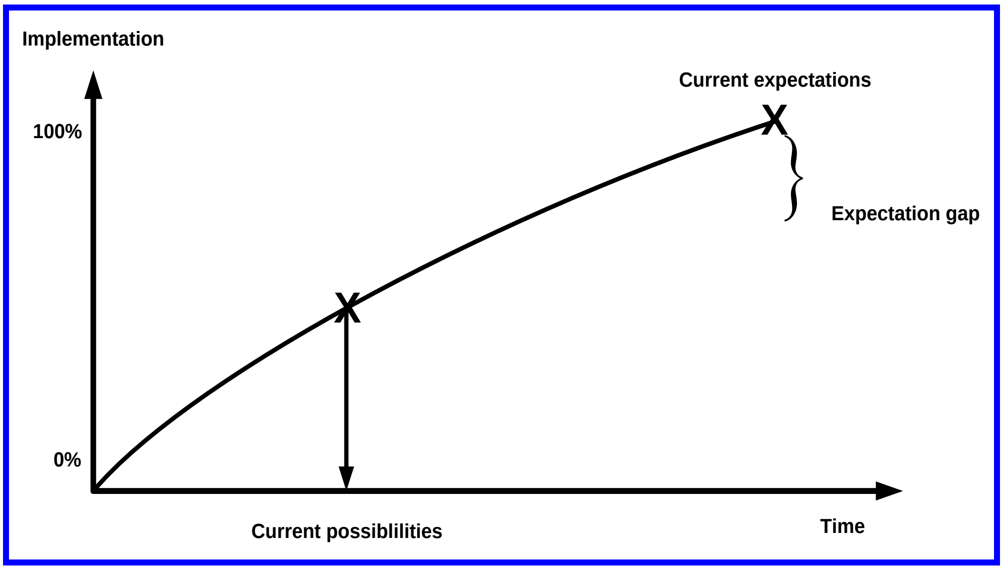


It is likely that Operations departments will become more integrated with their stakeholders and more standardisation follows. Outsourcing continues to be on the agenda and the outsource providers are consistently delivering to their clients' expectations.

In this vision of the next ten years, the certification of the investment profession, via the CFA and CIPM programs, continues and there is more self-regulation by the industry. The Regulators are more active in the industry and develop robust but practical frameworks. broader acceptance of external / independent verifications or certifications.

What is the biggest challenge in mastering the future?

That is easy! Much of what precedes this page is nascent. The biggest challenge is how do we manage the gap in expectations!



Final remarks

Practitioners may like to think about investing more time in identifying and defining the needs of the asset managers and of the clients. It is very important that we accept that clients have specific needs with respect to performance analytics. We must address not only the possibilities but also the limits of performance measurement and consequently create realistic expectations. Consider increasing transparency and present necessary disclosures. Those with line management responsibilities and strategic roles must ensure that appropriate resources are available whilst being aware of the cost-drivers and their impact on the total costs. Finally, I advocate that more and more emphasis is put on education as risk / performance measurement and attribution is not as easy as it often appears!

This article has been derived from a presentation given at Performance Attribution Risk Management 15 (PARM15).