Rethinking Performance Reporting in a Down Market

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"In business, words are words, explanations are explanations, promises are promises, but only performance is reality." – Harold S. Geneen

Everything is relative, especially when it comes to reporting investment results. I recently spoke to my financial advisor and he informed me that I was down about 20% for the year. I thanked him and told him to 'keep up the good work.' An actively managed equity portfolio down that much in 2008 seems pretty good in relative terms.

The global financial market we've been experiencing this year is unprecedented. Bear Stearns is gone. Lehman Brothers is gone. Merrill Lynch, Goldman Sachs, and Morgan Stanley are undergoing significant transformations just to stay in business. The Bush Administration is proposing a $700 billion U.S. government bailout to "save" our economy. Then there's the socialization of the largest insurer in the world AIG… I'm sure you're weary of the headlines so I will stop here, but as you know, there are several other worries in financial markets that we all have to deal with everyday as investment professionals (for more info see CNBC, oil, and short-selling).

As a performance measurement practitioner, I don't claim to know where we're headed; my area of expertise focuses on reporting the past. The only constant today on Wall Street is uncertainty and volatility. One fact that is clear of debate is that **money is on the move**, as evidenced by the re-allocation of assets into "safe" investments as investors search for peace of mind. Investors who must stay invested, (i.e. institutions and individuals requiring investment income) will be taking a closer look and re-evaluating their investment advisor mandates.

It is widely known that clients examine their reporting packages much more closely during down markets than they do when times are good. Investment results reporting will play a critical role in their decision-making process during this time of insecurity. **In a down market, performance reporting provides a foundation of rationality when investor emotions are highly irrational.**

Investment management firms who have the ability to demonstrate acceptable relative performance through accurate, detailed, and timely client reporting will have a distinct advantage over those who cannot. There is a direct correlation between asset levels and trust levels and solidifying client confidence and understanding is at a premium in this environment. Performance reporting can be utilized to prove to clients that the agreed upon investment policy is being followed and that risks are being adequately addressed.

How can your firm leverage performance measurement reporting to retain and even attract assets under management in a down market? The following recommendations are a few tried and proven approaches that build trust and confidence: GIPS Compliance & Verification, Attribution Reporting, and Ex-Post Risk Reporting.

Advantages & Benefits

• GIPS Compliance & Verification

If your firm is not claiming compliance with GIPS (Global Investment Performance Standards), you should certainly be considering it as the global client demand for consistent performance is steadily increasing. It is the one and only standard in the industry for ensuring that investment managers are calculating and presenting their investment results responsibly and accurately. It strengthens your marketing power by inspiring your clients and prospects with confidence in your track record. **In a down market, above average performance results will be met with skepticism if you're not compliant.** Further, having your claim of compliance verified by an independent and objective third-party legitimizes your track record and provides corroborative evidence that your firm has appropriate policies and procedures in place for calculating and presenting performance. An additional benefit of compliance and verification is the comfort in knowing that your performance measurement operations are more bulletproof because returns are continuously being reviewed at regular intervals.

• Attribution Reporting

Decomposition of investment results relative to an appropriate benchmark is the single most effective method of proving to clients and prospects that your firm is adhering to its various investment objectives. Attribution is an invaluable resource for portfolio managers to write their market commentaries which take on even more significance during down markets. During a bad market, competition is fierce for assets and some portfolio managers have a tendency to stray from investment guidelines as they struggle to add value. A way of distinguishing your firm from competitors is by providing proof through attribution analysis to clients and prospects that regardless of market conditions, you are staying the course. An underappreciated benefit of attribution analysis is the reassurance that results are accurate. Dissecting the portfolio into smaller pieces magnifies operational errors such as pricing discrepancies or mishandled corporate actions that may have gone undetected if only the total level is analyzed. Attribution analysis catches these errors and allows for their resolution prior to clients receiving their reports. **Precise client reports generate confidence** which, as discussed earlier, is crucial during down markets. Finally, attribution analysis that is truly reflective of the investment process contributes to a portfolio manager's increased understanding of the portfolios they are managing allowing them to fine-tune their methodology to yield better results.

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• Ex-Post Risk Reporting

Managing risk is what investment managers are hired to do. Historical risk measurement statistics, or ex-post risk, indicate how well the portfolio manager has managed risk relative to a market index. In simplest terms, a good manager produces a higher return at a lower level of risk than the benchmark. Risk must be actively monitored by investment managers at all times; **during a down market, it's no revelation that risk reporting is paramount to investors.** There are several measures of risk that can easily be reported to clients and prospects. Reporting risk will bolster your firm's credibility and display valuable transparency to clients and prospects.

In addition to the traditional measures (Standard Deviation, R2, Info Ratio, Sharpe, etc.), I recommend incorporating downside deviation, shortfall risk, and expected downside value. An added bonus to ex-post risk reporting is it is extremely easy to implement because you already have the required returns data.

Invest the time to educate your clients about these value-added investment performance measures and they will thank you with their confidence and their assets.

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