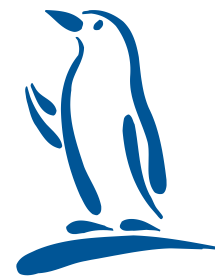


Excess Returns

Monthly insights for investment marketing and sales professionals



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Investment management is a competitive field where small things can make a big difference. This issue of *Excess Returns* examines a potential competitive advantage that is sometimes oversimplified or misunderstood by many investment firms.

With best wishes,

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Alpha Partners is an investment marketing firm specializing in research and presentation strategy. Our goal is to create alpha (excess returns) by helping investment firms win, keep and diversify assets under management.

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The Right Kind of Proof

“Managing money is about one thing: performance.”

— Barton Biggs, *Hedgehogging**

I live in a paradoxical world. The CIO of an alternative asset management company told me that he would like investment performance emphasized more heavily in the front of his company’s sales presentation. “You asked for proof, Liz,” he said, “isn’t performance the only proof that really matters?” Meanwhile, later that same afternoon, a marketing professional for another firm argued vehemently against providing any information about performance up front. “I do not want to spend any time on performance,” he said. “Performance is the reason we’re in the finals and it’s the reason our competitors are in the finals, too. It’s a waste of time to talk about performance.”

Both of these firms had enviable long-term track records in the strategies I was hired to market. And this was true by any measure: absolute, index-relative, peer group-relative and risk-adjusted. Both firms also had good stories about *why* their numbers were consistently strong over time.

But one firm wanted to mention performance decisively up front while the other insisted that it be relegated to the back near the appendices. Go figure.

* I am indebted to David Spaulding for this reference to *Hedgehogging*.

Beyond Performance: Other Forms of Proof

As regular readers of *Excess Returns* already know, I agree with Mr. Biggs. I believe it is vitally important to ensure there is one concise yet descriptive statement about strong performance up front in any sales meeting — a statement not only about the numbers but also about the story behind the numbers. What I often find, however, is that a primary focus on the numbers overshadows other compelling forms of proof such as portfolio composition, performance attribution, patterns of performance and examples of the investment philosophy and process.

Portfolio composition. When one buys the services of an investment manager, one also buys a portfolio. What that portfolio looks like, how it has changed over time and how it is changing now in response to new opportunities is a fascinating aspect of many manager strategies that, weirdly, receives relatively little air time in new business presentations. Maybe this is because the portfolio, like performance, customarily is relegated to the back of the book and material in the back of the book sometimes is covered at the end in a rush (if it is covered at all).

Performance attribution. Performance attribution provides valuable context, indicating awareness of what is going on in the portfolio and a high level of commitment to client communications. Firms that systematically provide clear attribution with explanatory detail are firms willing and able to document sources of performance. In other words, they can prove that performance reflects skill as opposed to luck (or fraud). But performance attribution is still hard to come by, especially in asset classes outside of public equity.

Patterns of performance. As with attribution, this form of proof sets the stage for understanding when times are tough. Clients who understand when and why the strategy may underperform are more likely to remain patient when the numbers are weak.

Examples and case studies. I can count on one hand the firms that consistently provide fresh, relevant buy and sell examples consistent with their stated investment philosophy and process. Virtually all examples across asset classes sooner or later somehow or other degrade into what quantitative managers contemptuously refer to as “stock stories” — stories about why the investment team likes the holding *without any reference whatsoever to the investment philosophy and process*.

Sources. I recently read a long, interesting white paper by an investment company. The paper was filled with interesting insights, brought to life with extensive qualitative as well as quantitative detail. There was just one rather large problem. Very little of this information was sourced. My enjoyment of the paper and positive view of the manager were compromised as I kept wondering, “Where did they get that?” Or, “Really? Based on what?” The problem, I believe, was that the authors were so close to their subject that they took as established truth information that required defined sources.

Facts. Facts are a form of proof, and facts always trump adjectives. “An investment team with an average of 15 years of experience with 10 years of tenure at this firm,” for example, is much more convincing than “a highly experienced investment team.”

So yes, managing money is about one thing, and that one thing is indeed performance. But performance is only one form of proof, and investment firms can strengthen their marketing, sales and client service by providing proof in all its different forms.

For more about presenting performance, in good times and bad, you also may wish to read:

[When Last Should Come First](#)

[Insulation Against Poor Performance](#)

[How to Stay Up When Your Numbers Are Down](#)

Reality Check

To elevate the amount of proof in your firm's presentation(s), ask yourself the following questions:

- ✓ What do we mean, exactly, by this statement?
- ✓ Does this statement or number require a source?
- ✓ Can we factually substantiate this and, if not, why are we making this claim?
- ✓ Does this presentation (paper, story) capture what we really do in executing this strategy? And if not, what's missing that would make our strategy come alive?



Investment Performance Handbook

I did not expect to find myself laughing out loud while reading [*The Handbook of Investment Performance: A User's Guide*](#), by performance measurement guru David Spaulding of [The Spaulding Group](#). But laugh I did as Mr. Spaulding uses military personnel performance reviews to remind readers how subjective performance evaluations can be. “This young lady has delusions of adequacy,” one review notes, while another comments that “This man is depriving a village somewhere of an idiot.” Subjective assessments like these make one want to run headlong back into the quantitative, objective world of investment performance measurement.

My favorite part of the book, though, was not these examples of subjectivity run amok, but what I think of as “the Shockers”:

- Shocker #1** A firm where one of the managers did her own performance measurement calculation rather than rely on what came out of the company’s system.
- Shocker #2** The portfolio manager who significantly overstated returns owing to a data entry error (numbers that should have been entered as a minus that were instead recorded as a plus).
- Shocker #3** The mutual fund firm that advertised superior numbers relative to the index for a 12-month period based on only two months of performance during that same 12 months.

Who should read this book? Consultants, managers of managers, investment company professionals and anyone concerned with presenting investment performance. Mr. Spaulding provides a straightforward, scholarly consideration of performance measurement, performance attribution, risk measurement and related controls, policies and procedures. A final chapter addresses performance measurement as a growing profession in the investment industry. Those who find this book useful may also be interested in [Classics in Investment Performance Measurement](#) and [Readings in Fixed Income Performance Attribution](#).

