Twenty years ago, the idea of a standardized approach toward investment performance measurement was just that—merely an idea.

Motivated by what he saw as a critical need for standardized and transparent performance presentation measures, Frederick L. (Ted) Muller, CFA, incoming chairman of the Financial Analysts Federation, asked Claude N. Rosenberg, Jr., to assemble a blue-ribbon committee to recommend specific procedures for investment managers to follow when presenting performance records. Committee members Robert H. Jeffrey, Robert G. Kirby, Dean LeBaron, CFA, and John J. F. Sherrerd, CFA, joined Claude Rosenberg and began their work in the summer of 1986. After a year of intensive work, the committee completed an outstanding report and submitted it to the FAF Board for discussion and evaluation. Subsequently, the final report was published in the September/October 1987 issue of the *Financial Analysts Journal*.

“The *FAJ* article proved to be the basic foundation document for moving forward in a long process towards what we recognize and celebrate today as the Global Investment Performance Standards (GIPS®),” Mr. Muller recently said. “Sponsored by over 27 countries worldwide, the GIPS standards carry on the objective outlined two decades ago—the creation of consistent standards that ensure fair and full disclosure of performance presentation measures throughout the broad professional investment community.”

While the commitment to better performance presentation disclosures remains, CFA Institute offers this reprint of the landmark *FAJ* article in recognition of the accomplishments made over the past twenty years.
Editorial Viewpoint

The FAF Board wishes to emphasize the requirement for full disclosure in the presentation of portfolio performance and considers misrepresentation on this issue to be prohibited under the joint FAF/ICFA Code of Ethics and Standards of Professional Conduct, Standard III E (Prohibition Against Misrepresentation of Services).

The FAF Board endorses the basic approach recommended by the Committee for Performance Presentation Standards to be used by investment management organizations and consultants. Adoption of full disclosure standards for performance presentation is considered by the FAF Board to be in the best interest of the investing public.

Comments are invited and should be addressed to the Committee on Performance Presentation Standards, the Financial Analysts Federation, P. O. Box 3726, Charlottesville, VA 22903. An FAF-sponsored seminar on performance is planned for spring 1988.

A Report on Setting Performance Presentation Standards

From The Committee for Performance Presentation Standards (CPPS):
Claude Rosenberg, Jr., Chairman (Rosenberg Capital Management)
R. H. Jeffrey (Jefflion Investment Co.)
Robert Kirby (Capital Guardian)
Dean LeBaron (Batterymarch Financial)
John J. F. Sherrerd (Miller, Anderson & Sherrerd)

I. The Committee for Performance Presentation Standards (CPPS) strongly recommends that the Financial Analysts Federation (FAF) approve, and then disseminate and attempt to place into force, standards for investment management performance presentation. Up to now, this all-important subject has been given little attention; as a result, investment advisers (despite registration with the Securities and Exchange Commission) have been left to their own standards, which have been varied, uneven and, in many instances, outright irresponsible and dishonest. If the investing public is to be treated fairly, and if the investment management industry is to represent the highest ethical and moral standards, a fair and understandable policy must be developed. The CPPS sincerely hopes that the following report provides reasonable guidelines for FAF approval.

II. Those affected by standards
A. This report focuses on standards for “investment managers,” which obviously includes all registered investment advisers.
B. We hope that other organizations and individuals might also be included in this thrust, and urge the FAF to encourage appropriate regulatory authorities to use the standards recommended by the CPPS as a basis for their compliance. The following groups fit into this category:
   1. stock brokers acting as “portfolio managers” for clients, particularly those who charge separate (from normal commissions) fees for their management services;
   2. mutual funds, where certain presentation practices are very deceptive, but which exist under different jurisdictions;
   3. consultants.

III. Performance calculation
A. Time-weighted calculation is the natural method; perhaps the FAF should recommend one preferred formula.
B. Total return, including income and capital appreciation, is of course recommended.
C. To allow for the most efficient judgment of manager efficiency, the CPPS recommends that results be presented before fees, but with this omission always noted when presenting data. As indicated in V. A. 11., we recommend that pertinent fee information be included with performance presentation.
D. Manager and client should agree in advance on the starting date for calculation of account performance.

1. This starting date should be part of the management agreement, and managers must therefore abide by such date.

2. Because the precise starting date for managed funds is not always definite (owing to legal problems, delay of receipt of funds, etc.), it is recommended that a specified period (e.g., 30 days) be set as inception for performance calculation. Again, the time period will vary from manager to manager, depending on manager style or client preference; but agreement in advance solves the “fairness” problem.

E. Managers may calculate performance results for equities only (excluding cash), but performance with cash should accompany these results, along with the statement that results with cash are more representative of management results. Fixed income results should always include cash.

F. Exclusions from account performance calculation and presentation to clients might include such items as the following:

1. special category investments, such as assets not carrying manager discretionary power within a manager business in which other accounts are normally discretionary;

2. client assets not being charged the manager’s normal fee. As a matter of policy, the CPPS recommends that all assets be included somewhere in a manager’s performance measurement and presentation.

G. Convertible securities should be included in equity performance, not fixed income, unless there exist specific reasons for the contrary. Such reasons should be explained in advance to clients.

H. Balanced accounts, with both equity and fixed income assets, should be separated into two distinct (equity and fixed income) categories. Each such category should be assigned its own cash balances so that the performance of each will include returns on cash as allocated. Cash should never be “unallocated.”

1. Assuming that the balanced account manager’s assignment is to change asset mix, managers are encouraged to alter the ratios between equities and fixed income by bookkeeping transfers of cash from one category to another. The clear statement of asset mix changes and of

Table 1: XYZ Actual and Annualized Tax-Exempt Equity Performance vs. S&P 500

| Year | Actual Return (%/Yrs.) | 2 Yrs. | 3 Yrs. | 4 Yrs. | 5 Yrs. | 6 Yrs. | 7 Yrs. | 8 Yrs. | 9 Yrs. | 10 Yrs. | 11 Yrs. | 12 Yrs. | 13 Yrs. | 14 Yrs. | 15 Yrs. | 16 Yrs. |
|------|-----------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|

FINANCIAL ANALYSTS JOURNAL / SEPTEMBER-OCTOBER 1987
current status is an aid to manager-client communications; and the
distinct "pots" of fixed income and equity
assets, each with its own and separate
cash position, provide the most pristinelinear and meaningful performance cal-
culation of each asset. The end result
is a vast improvement in client under-
standing of performance results from
each of the categories.

2. Performance results from bal-
anced accounts should, therefore, in-
clude the following:
a. equities, including cash designat-
ed for potential investment in equ-
ities,
b. fixed income, including cash des-
ignated for potential investment in
fixed income, and
c. total account.

3. Results for 3.a. and 3.b. should be
compared with their respective, com-
parable indexes, as if they were sepa-
rate accounts.

4. Results for 3. c. should be com-
pared with a combination of the same
indexes used in 3. above, according
to the average proportions of the account held
in each (equity and fixed income) category
in each given year. A legitimate excep-
tion would be when the client sets the
specific ratio between bonds and stocks, in which case the set ratio
should constitute the index for per-
formance comparison.

Assume, for example, that Balanced
Account XYZ held an average of 60 per
cent of its total portfolio in its separate
equity component and 40 per cent in
its fixed income for 1986. The compar-
ative index for equities (say, the S&P
500) should be weighted at 60 per cent,
while the appropriate fixed income
index (assume the Shearson/Lehman
Corporate/Government index) should
be weighted at 40 per cent, producing
a number against which the total ac-
count performance return should be
compared.

IV. Indexes for performance compari-
sions
A. Managers should explain any in-
dexes to be used for performance com-
parisons, in advance, to clients. These
indexes should parallel the risk ele-
ments or investment styles the client
account is expected to track.

B. Comparisons with specific mea-
sures (e.g., real returns adjusted for
inflation, riskless returns from Treas-
ury bills) can be used when requested
by clients.

V. Formation and presentation of
composite performance results
A. We strongly recommend that all
managers construct and present accurate
composites of investment performance. We
recommend the following rules for
constructing and presenting such
composites.

1. Managers should include results
for as long a period of time as accurate
accounting can be accomplished, no
less than 10 years if possible and up to
20 if practical.

2. Management organizations in
business for less than 20 years should
include results from the very first full
calendar year since their inception.

3. Each and every year of such re-
sults should be presented to prospec-
tive clients, unless requests delineate
shorter periods.

4. Results should be shown both for

<table>
<thead>
<tr>
<th>Year</th>
<th>Composite Assets ($000)</th>
<th>% of Total Equity Assets Yr.</th>
<th>% of Total Firm Equity Assets Yr.</th>
<th># of Clients Yr.</th>
<th>Avg. Acc. Size ($000)</th>
<th>Avg. Fee Yr.</th>
<th>Avg. Mkt Cap. of Eq. Held ($ millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2/28/87</td>
<td>3,748,237</td>
<td>76</td>
<td>52</td>
<td>101,811</td>
<td>0.55%</td>
<td>2.02</td>
<td></td>
</tr>
<tr>
<td>1986</td>
<td>3,176,472</td>
<td>72</td>
<td>52</td>
<td>72,081</td>
<td>0.55%</td>
<td>1.55</td>
<td></td>
</tr>
<tr>
<td>1985</td>
<td>2,413,366</td>
<td>73</td>
<td>51</td>
<td>61,086</td>
<td>0.55%</td>
<td>1.90</td>
<td></td>
</tr>
<tr>
<td>1984</td>
<td>2,330,854</td>
<td>71</td>
<td>49</td>
<td>47,321</td>
<td>0.55%</td>
<td>1.87</td>
<td></td>
</tr>
<tr>
<td>1983</td>
<td>1,871,740</td>
<td>70</td>
<td>49</td>
<td>47,568</td>
<td>0.55%</td>
<td>1.87</td>
<td></td>
</tr>
<tr>
<td>1982</td>
<td>1,500,152</td>
<td>65</td>
<td>42</td>
<td>44,565</td>
<td>0.55%</td>
<td>1.86</td>
<td></td>
</tr>
<tr>
<td>1981</td>
<td>1,000,236</td>
<td>65</td>
<td>40</td>
<td>37,504</td>
<td>0.45%</td>
<td>1.85</td>
<td></td>
</tr>
<tr>
<td>1980</td>
<td>557,876</td>
<td>55</td>
<td>32</td>
<td>31,257</td>
<td>0.45%</td>
<td>1.84</td>
<td></td>
</tr>
<tr>
<td>1979</td>
<td>316,431</td>
<td>55</td>
<td>28</td>
<td>19,924</td>
<td>0.45%</td>
<td>1.80</td>
<td></td>
</tr>
<tr>
<td>1978</td>
<td>286,700</td>
<td>55</td>
<td>22</td>
<td>14,383</td>
<td>0.45%</td>
<td>1.74</td>
<td></td>
</tr>
<tr>
<td>1977</td>
<td>304,256</td>
<td>55</td>
<td>20</td>
<td>14,335</td>
<td>0.45%</td>
<td>1.72</td>
<td></td>
</tr>
<tr>
<td>1976</td>
<td>105,856</td>
<td>49</td>
<td>17</td>
<td>17,897</td>
<td>0.45%</td>
<td>1.69</td>
<td></td>
</tr>
<tr>
<td>1975</td>
<td>88,346</td>
<td>50</td>
<td>15</td>
<td>7,057</td>
<td>0.45%</td>
<td>1.54</td>
<td></td>
</tr>
<tr>
<td>1974</td>
<td>106,364</td>
<td>50</td>
<td>13</td>
<td>6,796</td>
<td>0.40%</td>
<td>1.52</td>
<td></td>
</tr>
<tr>
<td>1973</td>
<td>122,893</td>
<td>49</td>
<td>13</td>
<td>8,182</td>
<td>0.40%</td>
<td>1.50</td>
<td></td>
</tr>
<tr>
<td>1972</td>
<td>96,296</td>
<td>48</td>
<td>13</td>
<td>9,493</td>
<td>0.40%</td>
<td>1.45</td>
<td></td>
</tr>
<tr>
<td>1971</td>
<td>80,000</td>
<td>45</td>
<td>12</td>
<td>8,025</td>
<td>0.40%</td>
<td>1.39</td>
<td></td>
</tr>
</tbody>
</table>

This performance presentation of XYZ Capital Management conforms to the standards set by the Financial Analysts Federation (standards dated 1987). In addition to the information presented herein, such standards include:
1) Returns from all cash reserves are included in performance calculations.
2) Figures include accounts under our management from their respective inception dates, including those clients no longer with the firm.
3) No selective periods of performance have been utilized. Results from all accounts have been continuous from their inception to the present or to the cessation of the client relationship with this firm.
4) The composite calculation has been appropriately weighted for the size of each account.
5) Results are presented before management and related custodial fees. The average fee charged for each period appears in the presentation.
individual years and cumulative periods, as indicated in Table I.

5. All client accounts should be included for whatever period such accounts were under management; portions of periods under management (i.e., managers choosing inclusion of portions) should be prohibited.

6. Clients' accounts no longer under management will be included in the composite(s).

7. Changes in a manager's organization should not lead to an altering of composite results. Results achieved by an organization are the organization's responsibility; gains and losses of personnel do not constitute a reason to alter reported performance figures.

8. Managers are encouraged to construct separate composites where valid reasons exist for doing so. We thus encourage a differentiation between, say, taxable and non-taxable accounts, fully discretionary and non-discretionary accounts and other categories that entail varied investment styles, controls or risks. As indicated in 9.e. below, managers should list all their composites, with figures and other pertinent information on each, whenever performance results are presented. Any and all exclusions from any presentation of performance results must be clearly stated.

9. Composite performance calculations should be factored for dollars managed, not calculated as a median or as an unweighted average of such performance. Thus each account within a composite grouping should be factored by that account's asset size. Managers should also clearly delineate the following:
   a. the number of client relationships included in each (and all) composite(s);
   b. the total size of the composite for the beginning (January 1) and end of each year;
   c. the range of account sizes included;
   d. the weighted average size of accounts constituting the composite;
   e. information on all assets excluded from the composite.

10. Fixed income and equity portions of balanced accounts should be included in their respective composites, provided they conform to section III. H. above on balanced account calculations.

11. Because performance results will be reported to individual clients before fees (as per III. C.), the CPPS recommends that composite figures also be presented before fees. A complete listing of manager fees should, however, accompany such performance data; and an average fee actually incurred by clients whose accounts are included in the composite should be clearly stated.

B. Any comparative indexes utilized for any accounts included in a composite should be presented along with such composite figures for all such periods shown. In other words, if accounts combined into a composite are being compared with different indexes (see IV.A.), all such indexes should be presented for comparative purposes.

C. As indicated in III. E., managers should never present performance figures, in individual accounts or composites, without including returns on cash resulting from portfolio management.

D. A range of total returns, from low to high, included in any composite should accompany the presentation of such figures.

E. Other pertinent information for use in performance analysis may be added to requirements indicated above. For example, managers may include (for each period) average market capitalization of stocks held, beta, average quality and duration of bond holdings, etc.

F. Table II provides a sample recommended format for performance presentation.

VI. Verification of composites

A. Audited figures should not be required, because of the onerous potential costs involved. Full disclosure of assets included in and excluded from composites will alert prospective clients to the representative nature of these figures.

B. Veracity of the figures included in any composite remains an unresolved problem. We have not completed a study of alternatives. One alternative that has been suggested, however, is that manager organizations state at least annually that all performance calculations have been made in accordance with the (proposed) FAF recommended formula (see II.B.) and in accordance with other rules laid out in section V. on composites. Such statement should always accompany presentation of performance results.

VII. As mentioned, CPPS strongly recommends that the FAF attempt to impose performance standards on all investment management firms (including banks, insurance companies, mutual funds, brokers acting for a fee as managers). We also encourage a corresponding set of rules for consultants, who should be urged to utilize composites of (manager) composites, along with composites of actual accounts they are monitoring. We strongly discourage consultant compilation of manager accounts that are not true composites and that are selected by managers themselves.
The Financial Analysts Federation, founded in 1947, is a non-profit professional organization consisting of 53 Financial Analysts societies located in the major cities of the United States and Canada. These societies have an aggregate of about 14,500 members who are engaged in security analysis, portfolio management, and executive direction of the investment function. The affiliated Institute of Chartered Financial Analysts awards the professional designation of “Chartered Financial Analyst” to qualified members upon successful completion of three examinations.