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Comment file submitted to the SEC on the value of including gap attribution in quarterly performance reports from investment managers and financial advisers.

Definitions;

Return expectations = a probability distribution of return expectations

Investment manager risk = risk relevant to assessing investment managers over time
= the difference between ex-post results at the end of an investment and ex-ante returns at the start investment period

Gap attribution = ex-post versus ex-ante return gap attribution
= explaining the gap between end of period investment return results and beginning of investment period return expectations
(so gap attribution explains investment manager risk)

The beginning of period portfolio composition reflects the history of investment manager actions and those actions cannot be changed, that is, they are beyond the control of the investment manager. The beginning of period composition reflects the portfolio positioning the investment manager needs to be accountable for going forward. Investment manager accountability has to focus on their actions in the current performance period which they control. Investment manager accountability has to focus on the portfolio's beginning of period positioning and how it evolves over the current performance review period. If return and return risk define the results of investment managers then investment manager's actions need to be explained in terms of return and return risk. The best way to define risk when assessing investment managers is to define risk in a way the investment managers themselves have control over in order to make investment managers accountable for the portfolio risks they manage in pursuit of returns. One way to define return risk for investment managers is a measure of the degree of return uncertainty the investment manager will confront in the latest performance review period. A way to define this risk is the difference between the investment manager's end of period actual return performance, that is their period ex-post returns and beginning of period return expectations, that is their beginning of period ex-ante return expectations. This definition of investment manager return risk should be the focus of quarterly performance reviews and explaining it to investors will be referred to as gap attribution.

With respect to the SEC's notion of 'layered disclosure' ; gap attribution offers the most straight forward, informative and consistent assessment of how investment managers manage investment return risks and return potential. Given that most investment managers do not provide gap attribution, it is no surprise that most retail and institutional investors do not trust the investment managers, how can investors trust investment managers that do not communicate

essential risk management information ?¹ The ex-post returns provided in quarterly performance reports by investment managers provide no accountable measure of portfolio risk other than historic returns. Defining portfolio returns relative to a benchmark inadequately accounts for the complete risk the investors face and if investors are provided inadequate information, how can investors make smarter investment decisions ? Gap attribution in quarterly performance reports over time also provides an excellent way to assess the degree that the returns generated came from skill or luck. The closer ex-post returns are to ex-ante returns, the more confidence investors can have that skill generated those returns.

Those that argue that ex-ante return expectations are proprietary are in effect telling investors that the investment manager has chosen not to inform the investors about their investment process risk control. How can investors develop any trust in their investment managers if this is the case ? Note that gap attribution does not require any information about the investment process itself, only the beginning of period return expectations it generated and the results from it. Without the investment process risk insights provided by reconciling gap attribution over time, investors will continue to not trust investment managers.

Those that argue that return expectations can be gamed by competitors are ignoring the prevalence of efficient markets despite its frequent departures from efficiency. Who is to say that what is being gamed isn't noise ? Gap attribution presented by all investment managers over time would provide a data set with which this concern could be scrutinized.

Those that argue implementing gap attribution would be too costly ignore the opportunity to grow the number and size of their investors that could arise due to adopting gap attribution in their quarterly performance reports. Why would investors appreciate gap attribution ? Gap attribution provides a more efficient, consistent communication of investment return results than most quarterly performance reports now with their focus on what holdings did well and not so well which provide little or no explanation of return expectations for risk consideration.

Investment manager risk as defined here is not the only risk facing investors. Reviewing historic return variability allows investors to assess their own tendency to sell at bear market troughs. In general, this historic return review can highlight how conscious or unconscious trend following makes investment decision making more cyclical than it should be. Investment managers could help investors manage these behavioral biases by sharing their own return expectations. Having

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Reference; CFA Institute Future of Finance 2020 publication;

Earning Investors' Trust How the desire for information, innovation and influence is shaping client relationships.

said that, regardless of the degree myopic loss aversion and other investment biases influence investor behavior, the best way to assess the degree investment managers are helping investors in this way would be through a review of gap attribution over time.

The issue of forward-looking statements and related safe harbor rules are beyond the scope of this comment file yet could impact its implementation.

A practical guide to implementing gap attribution as part of quarterly performance reports follows.

Require all financial advisers & fund managers to accumulate a minimum of three years of quarterly performance reviews which include gap attribution. Gap attribution needs to be framed in terms of the financial advisor's or fund manager's selected investment horizon such that each quarter the fund manager's actual ex-post (let's say 3-year return) would be compared with the ex-ante expected 3-yr return arrived at three years earlier. Each quarterly return performance review could be for any time horizon the manager desires; with the minimum being one quarter, the time since last review but with no upper limit; for example, each quarter the manager could review the quarter to quarter 3-yr actual rolling return performance and reconcile that with the ex-ante call made three years earlier . The chosen investment horizon would have to be used for a minimum of 10 years for consistency's sake.

The result here is an on-going quarter to quarter reconciliation of the latest 3-yr ex-post returns with the manager's ex-ante return expectations 3 years earlier. Over time this reconciliation should help investors understand how the manager adds value and offers an explanation of return uncertainty which in turn should foster greater trust in the manager's investment approach.

Illustration:

At the end of Q4 2021, ex-post results of 3-yr total pre-tax nominal return on a benchmark index can be compared with ex-ante 3-yr total pre-tax nominal return expectation the start of Q1 2019. Refer to the ex-post return as $x_p\%$ and the ex-ante return as $x_a\%$. The manager could then provide investors with an explanation for $x_p\% - x_a\%$.

An example of the possible assessments;

Over time a systemic negative result for ex-post less ex-ante returns ($x_p\% - x_a\%$) would frame discussion as to why the fund manager consistently over estimated returns (to entice potential clients?) or under estimated ex-ante return risk. For example, if the investment manager thought the equity risk premium would be lower at the start of the period than it turned out to be at the end of the period. While a systematic positive result would frame a discussion of a manager prone to risk aversion or one missing stronger than expected earnings growth or one simply managing expectations to under promise and over deliver. Gap attribution would clarify what is going on here for investors.

The details of ex-ante ex-post return gap attribution;

If at every quarter's start from Q1 2019 onward, the manager's ex-ante 3-yr return expectation is logged then starting at the end of Q4 2021, investors can see and compare the manager's actual returns with each quarter's beginning of quarter return expectations. Allowing investors to verify the historic ex-ante returns logged would be crucial. Note that this is the manager's baseline return expectation for their chosen benchmark and need not reflect any client portfolios which are influenced by the specific client's preferences. The point of this is to hold the manager accountable for a benchmark return expectation that should guide and influence all client portfolio recommendations regardless of their unique circumstances whether the motivation is tracking benchmark exposure or in active management to outperform said benchmark.

Implementation wrap up;

Requiring this to be completed for a minimum of three years provides investors with enough gap attribution history to gain a level of understanding in the investment managers approach to return and risk.

Those that meet these performance reporting requirements for 12 quarters would then be certified to have met performance credibility standards. Note that there is no need to divulge proprietary investment processes, if the managers choose not to, all that is required is posting of ex-post results and ex-ante expectations each quarter along with some descriptions/explanation for the differences in terms of the assumed drivers of performance and uncertainty at the end of the quarter. An added benefit here is that investment managers with different approaches can be assessed within a common accountability framework.

Yes, current GIPS requires five years of performance but none of it is required to be ex-ante and it lacks a common performance attribution approach. The current GIPS ex-post returns need to be linked to ex-ante return expectations in order to allow investors to glean the substance of the investment process being used in terms of accountable risk control and the return being pursued. Investors deserve that.