



## Performance Report FAQ

Upon request, PMI can prepare a performance report (what we call our “Perf Rep”) containing graphical and statistical measures that managers may find interesting or useful. Note that there are a number of rules, regulations, and interpretations that address the proper disclosure of performance information to current and prospective investors. **Accordingly, if Perf Reps are to be used for marketing or investor communications, you must contact your attorney to determine if a Perf Rep is appropriate for your fund and to review and draft desired changes to the boilerplate disclosures and notes.** All fund sales materials should be reviewed by qualified persons to assess compliance with the anti-fraud provisions of the Investment Advisers Act of 1940 plus any state or other rules that may apply.

The following is a compilation of our most frequently asked questions about “Perf Reps.”

**Q: How do I change the notes on the Perf Rep?**

A: Ask your administrator for “Perf Rep Disclosures.doc,” a file you can use to edit the boilerplate notes and then return to PMI. If your counsel wants to substantially increase the volume of disclaimers, you should submit those on a second page that can be attached as page 2 (plus let us know what should be dropped from the Perf Rep itself).

**Q: How is fund performance determined?**

A: Fund “official” performance is that of a hypothetical unrestricted (with regard to new issues) participant who invested at inception, has made no capital additions or withdrawals, and who is charged fees and incentive compensation as set forth in the offering documents, without fee reductions or waivers. Monthly results are reported on a “contingent net basis” – as if the incentive compensation, if any, had been charged – even though the actual incentive compensation may not be allocated or paid until a later date.

**Q: If I waive fees, will that increase my reported performance?**

A: No. The tracking account is still charged manager compensation as set forth in the offering documents. Since prospective investors will presumably pay full fees, it could be considered deceptive to show a track record without them.

**Q: What if I have more than one fee arrangement?**

A: A Perf Rep can show only one return for a fund, and the tracking account limits us to one Perf Rep per fund. Standard practice is to show returns after the manager compensation at the highest rate set forth in the offering documents. If some investors have hurdle structures, while some do not, “highest” may only be apparent in hindsight; accordingly, it is best to use the highest non-hurdle rate structure and create a note that indicates that another compensation rate may apply to some investors.

**Q: What if my fee rates change?**

A: In most cases, you should ask legal counsel to prepare a note explaining the change (such as: “This report reflects a management fee rate change from 1% to 2% as of January 1, 2006. Results prior to that date reflect the earlier fee rate.”). For some funds with shorter track records, PMI may be able to go back and adjust the tracking account to the new rate so that the Perf Rep reflects current fees over the entire period. While this may be preferable from a disclosure perspective, it will change prior official numbers, which may not be desirable. You should consult your attorney for guidance.

**Q: Can you explain the statistics?**

A: Yes. Please ask for a copy of our “Notes on Statistical Ratios” if you have not already received one. You may distribute that publication to anyone who is shown a Perf Rep.



**Q: May I choose which statistics to display?**

A: Yes, but, once added, statistics should be considered more or less permanent. Changing statistical comparisons (or benchmarks – see below) can decrease the value of the Perf Rep as well as delay its delivery.

**Q: Why do cumulative return graphs come in two styles?**

A: PMI can prepare cumulative performance graphs showing “cumulative return” in percent or “growth of \$1000.” While cumulative percent return graphs may be appropriate in the first few years of a fund’s life, we recommend shifting to “growth of \$1000” once returns of the fund and/or benchmarks approach 100%. The reason is that the “growth of \$1000” graphs permit logarithmic scales. If a fund is already up 100% (\$1000 has grown to \$2000), a 10% return is equal to \$200, which translates to 120% cumulative. On a linear scale, that change will be twice the size of a similar return at fund inception. Consequently, the apparent volatility becomes misleading. Log scales are not used with percent returns because the start point is zero and the possibility of negative numbers.

Note that log scaling requires that PMI manually create the horizontal gridlines. You can help us by inspecting the Perf Reps carefully and letting us know if we’ve missed one.

**Q: What indexes are available for comparison?**

A: We keep most common equity indexes, plus a number of debt indexes as well. Our principal requirement is that the index be published and publicly available. Not only does that facilitate our independent acquisition of the data, but it eliminates obscure or private indexes that investors can’t find or verify themselves. Ask or email your service team if you’d like to see a list.

**Q: How do I choose an index?**

A: There are two major considerations in an index choice:

1. The legal question relates to what inferences may exist in the choice of an index. Would a comparison solely to T-bills and bonds imply that the fund has a similar risk profile? In an always hedged long-short equity fund, does the use of the S&P 500 imply something that could be misleading? What is the relevance of a small cap benchmark for a large cap fund? These are questions that you should discuss with your attorney. For added context about this issue, note the following disclaimer that is suggested in the notes for a Perf Rep:

“Market indexes are included in this report only for comparative purposes and as context reflecting general market results. The Fund does not seek to replicate the composition, or mirror the performance or volatility, of any such index, and can be expected to have investments that differ substantially from the securities or other instruments included in any such index. Accordingly, no representation is made that the performance or volatility of the Fund will track or otherwise reflect any particular index.”

2. Investors use statistical comparisons to evaluate investments. Reporting a beta or correlation versus an obscure index may not be of much value. On the other hand, comparing a market-neutral portfolio to the S&P 500 is probably valuable because the statistics help measure the extent to which the fund is affected by the market. In other words, if the intent is to be different from the market, it’s a good idea to show what the market did over the same time period.

We suggest that most funds compare against the S&P 500 with dividends reinvested. Regardless of whether the S&P 500 is what you consider your “benchmark,” it is a universal yardstick for statistical measurements, and most investors will want to understand your fund’s statistical relationships to the “market” as a whole. For a second index, funds which invest in the broad market often include the Russell 2000 or NASDAQ, and some funds may choose other indices which they view as “benchmarks.”



Keep in mind that the choice of an index is semi-permanent. When managers decide to change a benchmark, it can raise questions from investors. Accordingly, it is important to predict what you will want as index comparisons 2 years from now and to get the choices approved by your attorney. While PMI provides boilerplate notes on Perf Reps that attempt to disclaim any performance inferences due to index choice, you should have your attorney review and approve that section as well.

**Q: May I specify a blended benchmark – a mix of several indexes?**

A: We have discontinued support for blended benchmarks due to the regulatory concerns mentioned in point #1 of the immediately preceding question. When a manager sculpts a custom index, the promissory implications of a benchmark become even more problematic, as we believe there is a clear suggestion that the blended benchmark was created in the image of the fund. Accordingly, the statement that “*no representation is made that the performance or volatility of the Fund will track or otherwise reflect any particular index*” would ring somewhat hollow and there would be possible added liability due to failure to match the risk and return characteristics of the blend.

**Q: Why shouldn't we compare to an index of hedge funds or fund-of-funds?**

A: While we have access to some of the commercial hedge fund indexes, we don't use them on Perf Reps. In addition to survivorship bias, the low volatility of these indexes makes them unsuitable for comparisons. Unlike an unmanaged equity index, each hedge fund monthly result reflects a unique set of market and security exposures. The average of these will usually display a fraction of the volatility of the majority of hedge funds separately. Accordingly, the statistical ratios that use volatility will not be realistic. Keep in mind that it may be appropriate to use hedge fund indexes in graphs or other non-statistical materials that you create for your own marketing materials.

**Q: What about comparing to the price return of an index, without dividends?**

A: The GIPS (formerly AIMR) guidelines plus SEC Rule 205-1 both characterize benchmarks as total-return indexes. Accordingly, they should be used if publicly available.

**Q: When can I start getting a Perf Rep?**

A: The PMI Perf Rep Creator program requires at least 3 months of data (plus, all displays involving annualized numbers are suppressed until there are at least 12 months of results). Also, note that even the non-suppressed statistics are not particularly useful until the number of data points becomes significant.

**Q: Can a Perf Rep start from a date other than the Fund's inception date?**

A: If there is a desire to include pre-fund investment results or to start the Perf Rep at some date after actual fund inception, the fund manager needs to consult legal counsel to address the potential legal issues (if it were not clearly stated that the displayed track record was not actually within the fund or excluded an existing prior track record, there would seem to be potential legal issues regarding disclosure). If approved, counsel needs to draft appropriate legal notes for inclusion on the Perf Rep. A Perf Rep including pre-fund data might include, for example, a disclaimer such as “*Results for the period prior to fund inception on 1/1/2005 are those of a general partner managed account, net of estimated manager compensation, but with no provision for third-party expenses.*” A start date later than inception might include a disclaimer such as “*Results on this report commenced on 1/1/2005. Results from fund inception (1/1/2004) are available from the general partner.*”

Note that, since Perf Reps require a minimum of 3 data points, a start date after inception would further delay the production of the first Perf Rep.

**Q: Why is the PDF locked?**

A: This provides the reader with greater assurance that PMI created the report. (Note that it is not absolute assurance – PDF locking is not totally secure.)



**Q: Can you modify the colors for us?**

A: No. Part of the purpose of a PMI “branding” of the report is to emphasize that it is created by your third-party administrator.

**Q: May I use the statistics from the Performance Report in my other materials?**

A: That is a question for your attorney. Please keep in mind that our numbers may be revised in later periods, so any materials using PMI-created numbers should be periodically reviewed for changes. Note the disclaimer we include in Performance Reports as an example: *“Based on information believed to be correct, but subject to revision and audit adjustment.”*

**Q: Why do the Perf Reps use monthly instead of quarterly data?**

A: There are several practical reasons. One is that investors today nearly always ask for monthly data, so if PMI prepared a quarterly Perf Rep, it’s inevitable that a monthly would also be needed (keep in mind that, while Perf Reps are highly automated, they do require staff time to prepare). Secondly, Perf Reps utilize monthly data not only in the displays, but within all of the statistical comparisons. PMI’s Sharpe and Sortino ratios, for example, are run using true monthly excess returns, not a period-overall estimate of excess return. So conversion to quarterly would be a non-trivial undertaking. Lastly, the more data points, the more valid the statistics – 5 years of quarterly numbers is only 20 data points. Accordingly, all Perf Reps are formatted for monthly data.

**Q: Do I have to use the Perf Reps?**

A: No, Perf Reps are created solely for your discretionary use. Although many managers use the Perf Reps with current investors and prospects, many do not. As noted above, Perf Reps are considered advertisement materials under federal and state investment adviser laws. Accordingly, Perf Reps, as with all marketing materials, should be carefully scrutinized by counsel. For alternative report styles, you may wish to investigate statistical/marketing vendors such as PerTrac to see the presentations possible within their offerings.

**Q: May I include the Performance Report within my marketing materials?**

A: If your attorney permits it, yes. Keep in mind that it may be best to attach the Perf Rep as a separate file – its value to you may be increased when it is obvious that your third-party administrator created it. If you wish to insert it within a presentation, the “lock” requires that you make an image of the Perf Rep using an image printer such as Microsoft Office Document Image Writer. The steps using that program are:

- Open the file in Acrobat
- File / Print
- Select "Microsoft Office Document Image Writer" as your printer
- Choose a file name and location
- Open the file (with Microsoft Office Document Image Writer)
- Edit / Select All
- Edit / Copy image
- This image can be pasted into a PowerPoint or another document.

One benefit of using Microsoft Office Document Image Writer is that the image can be stretched to fit your page.

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