

FROM THE FOUNDER



The man answered, "You must love the Lord your God with all your heart, all your soul, all your strength, and all your mind." And, "Love your neighbor as yourself." Luke 10:27

I'm trying to create the best workplace environment for First Rate—the best experience possible. Where should I look for help to have the greatest chance of success? Yes, I listen to employees and customers. Yes, I read the great business practitioners' books. Yes, I meet with other entrepreneurs and business people. However, all the best ideas and practices hang off the basic principles taught in the Bible. That's why I use the Bible as my primary business manual.

We say that First Rate is the Heart of Performance. It's true, but that's not the whole picture. The Bible says it's not *just* the Heart that's important, but it's also our Soul, Mind and Strength. That's why I think a first-rate workplace engages the whole person - my heart, my soul, my mind and my strength. I also think a first-rate workplace has God at the center. I have found that if I love God first, then my love increases for all my relationships. Ideally, I can be fully engaged with work and appropriately aligned with God to produce the best results for clients, friends and family—a First Rate experience!

The first best practice is 'Bring my God to Work Day—Every Day.' If I can work with the knowledge that God is in my presence, then I'm going to think, speak and act better - not perfect, but better. The way I deal with others will improve, especially during tough, stressful circumstances. Every relationship benefits from my improving my relationship with God.

The second best practice is that when I go to work, I bring my heart, soul, mind and strength to the job. Let's say my mind comes up with a clever solution to a complex, long standing problem. Before others will follow my lead, they want to know if my heart is in it. They want to know if I have the strength to see the solution implemented and people want to know that I'm not selling my soul to the devil to get the work done. I think it's only natural to work with my heart, soul, mind and strength.

With those two best practices, I can 'love the LORD my God' with all of myself in the workplace. That's First Rate Living for me. May this year be filled with your best practices!

Dave

MEET A FIRST RATE EXPERT



Dr. Brian Thompson is a recognized authority in the field of performance measurement and is a member of the Advisory Board of *The Journal of Performance Measurement*. Dr. Thompson acquired a vast amount of knowledge during his years at National FSI, where he held senior positions serving as the Director of Investment Performance Systems. More recently, he has worked as an institutional investment consultant for companies like Dain Rauscher, Mercer Consulting, Buck Consultants and Principal Financial Securities. Presently, Dr. Brian Thompson serves as the Senior Research Consultant of First Rate.

Dr. Thompson received his Bachelor of Science degree in industrial engineering at the University of California, Berkeley. Dr. Thompson also received his Master's in system engineering and his Ph.D. in operations research from Southern Methodist University, with a focus in pension fund asset allocation. He is a graduate of the Wharton Executive Program and the Trust Program at Northwestern University. In addition, Thompson is a registered professional engineer.

Risk Adjusted Performance Measurement Issues in a Bear Market

This material is expanded on in a white paper available on the First Rate website, www.firstrate.com/Partner/Library/White_Papers.htm. The white paper includes examples of the computational issue with negative excess returns and the application of an adjusted Sharpe ratio that can be used to rank portfolios in a bear market.

Overview

Today's bear market requires investment professionals to re-evaluate the methods used to assess risk adjusted return measures. Most risk-adjusted return measures are reward-to-risk ratios. These ratios generally consist of a reward that is an excess return in the numerator and a risk in the denominator. The excess return is the average portfolio return, less the average risk free return for many risk adjusted measures. The metric for risk varies between measures as shown in Table 1 on the following page. Although these measures have proven effective in a bull market, there are computational and interpretation issues with these measures in a down market when excess returns are negative.

In a bull market, average portfolio excess returns would be positive and the risk adjusted return measure would decrease as risk increased. However, in a bear market, average portfolio excess returns would generally be negative and the risk adjusted measure would become less negative (or increase) as risk increased. This anomaly occurs in a wide range of measures impacted by the bear market. It also occurs in a measure such as the information ratio, in which the reward is the excess return of the portfolio over the benchmark. The information ratio is more impacted by relative performance than market direction. However, the information ratio has the same problem as other ratios when the average excess return of the portfolio versus the benchmark is negative.

Risk Adjusted Measures

The following is a list of frequently used measures in which higher ratios are generated when the rewards are negative and the risk measure increases.

Measure	Reward	Risk	Comment
Sharpe Ratio	$R_p - R_f$	Excess Return Standard Deviation	Widely used for relative ranking of portfolios or funds
Treynor Ratio	$R_p - R_f$	Portfolio Beta	Well known tool for ranking portfolios or funds
Sortino Ratio	$R_p - R_f$	Downside Risk	Measure receiving more interest since focus on downside
Calmar Ratio	$R_p - R_f$	Maximum Drawdown	Used by hedge funds and alternative investments
Information Ratio	$R_p - R_b$	Tracking error of portfolio vs. benchmark	Widely used to show value added while tracking benchmark

where R_p =Portfolio Return R_f =Risk Free Return and R_b =Benchmark Return

Approaches in Practice

There are a range of approaches used when dealing with negative rewards as numerators in risk adjusted performance measures. These approaches include the following:

Avoid using the measures since the results are counterintuitive. An argument can be made that clients would not be interested in accepting less than the risk free rate (or less the benchmark) for performance while taking on risk.

Reinterpretation of results. It has been argued that results are meaningful when negative rewards with high volatility have a higher probability of achieving positive returns. The benefit of high volatility is very questionable and would depend on the probability distribution of returns favoring positive performance. However, portfolio volatility is generally a drag on performance and it is more likely that negative performance will outweigh positive performance.

Measure modification to always reward higher performance and lower risk. Craig L. Israelsen has published a modification of the Sharpe ratio and the Information ratio that provides rankings more consistent with reward volatility measures. This was published in the January 2003 and May 2004 issues of the *Financial Planning Magazine*. An adjustment is made to the denominator of the Sharpe ratio when the average excess return is negative.

There would be no adjustment for portfolios if the average excess return were positive.

Conclusion

The computation and interpretation of risk adjusted performance measures requires special consideration when the excess returns computed are negative. There are several different measures that are impacted. These risk adjusted performance measures provide a method of ranking portfolios based on one metric for each portfolio. In bear markets, several of these measures may provide questionable rankings.

Initial reviews of technical publications have only provided an adjustment approach for the Sharpe Ratio and the Information Ratio. Future research will expand the search for adjustment methods to support more accurate portfolio rankings. Until validated methods for adjustment are available for handling negative excess returns, we recommend focusing on the components of risk adjusted measures such as returns, volatility and tracking errors.

“The computation and interpretation of risk adjusted performance measures requires special consideration when the excess returns computed are negative.”

2009 Performance Conference set for March 23 - 25!

Register by February 10, 2009



Please join the First Rate family on March 23-25, 2009 for the Annual Performance Conference. The two-and-a-half-day conference will be held at the Four Seasons Resort and Club Dallas in Las Colinas.

We hope that you will gain new perspectives on the capabilities and the scope of resources that First Rate provides. It is our goal to forge strong relationships with each of you so that we might better understand your needs. As your partner in the performance measurement industry, we are determined to help you and your institution provide a service that is truly First Rate.



Photos from the 2008 Performance Conference

There is no cost to attend the conference, but attendees are required to register to allow for better event planning. Registered attendees will receive meals on all three days. The conference program will consist of sessions centered on running your business, serving your clients, growing your business and personal growth. Topics that will be presented include the following:

- ◆ Why we need and how to benchmark constituents, global benchmarks and peer universe data
- ◆ How to report on separately managed accounts
- ◆ Best practices and new features of First Rate performance
- ◆ The future of GIPS
- ◆ Risk returns
- ◆ Total portfolio attribution
- ◆ First Rate Application Service Provider (ASP)



**Support
First Rate's
Green
Initiatives**

Understanding the importance of supporting environmental sustainability, First Rate has extended its solution-centric partnership to include the environment. First Rate will be implementing several “green” initiatives throughout the year aimed at reducing our impact on the environment. The first phase of our “going green” initiatives includes reducing the number of printed paper-based newsletters distributed. We are asking all of our friends to support our efforts by signing up to receive our quarterly newsletters via e-mail. **Please visit us at www.FirstRate.com or call 817-525-1843 to sign up to receive a copy of First Rate's free quarterly e-newsletter.** Stay tuned for other ways you can join First Rate in preserving the environment!

Chaplain's Corner

Happy New Year! by Jud I. Stone

"Happy New Year!" sounds hollow to many investment professionals as 2009 begins. "Horrible New Year!" sounds a lot more like it for other people. By contrast, with a new administration taking office this month, many people are saying, "Hopeful New Year!" Hollow, horrible or hopeful — which is it for you?

It's important for us to be honest about how we feel about things. But it's also important to remember that other people are not obligated to embrace our emotional weather. So if Happy New Year sounds hollow or horrible to you, decide today to address the matter in a constructive way. Three important action steps I've used when I'm feeling down is to pray, do something physical and network with a group of friends who can help me repair my hope and remind me that I'm not alone.

Some ancient wisdom states "Is any one of you in trouble? He should pray." (James 5:13) We might dismiss that counsel, but Chaplain Patrick McLaughlin, CDR, USN, in his book *No Atheists in Foxholes: Prayers and Reflections from the Front* includes this quotation from Hannah Whitall Smith: "A feeling of real need is always a good enough reason to pray."

"...if 'Happy New Year' sounds hollow or horrible to you, decide today to address the matter in a constructive way."

Living on the front of the economic crisis can easily create the feeling of a real need. It's not a bad idea to pray foxhole prayers.

Combining prayer with physical activity is like soup and sandwiches. They go together. I walk, jog, shoot baskets, work in the yard or even do housecleaning! I try to find something that is constructive and gets my heart pumping. As a child, if I complained about being bored, Mom would say, "Go outside and play!" Physical activity is good for the body as well as the soul.

Networking with others is also an avenue to replace emptiness or hollowness with meaning and significance. A wise man declared, "It's better to have a partner than go it alone. Share the work, share the wealth. And if one falls down, the other helps, but if there's no one to help, tough! By yourself you're unprotected. With a friend you can face the worst. Can you round up a third? A three-stranded rope isn't easily snapped." (Ecclesiastes 4:10, 12, *The Message*)

Whatever your emotional weather might be at the start of 2009, it's my prayer to God that we'll be praying diligently, working our hearts frequently and networking enthusiastically! God bless you and yours in 2009.

Welcome to First Rate!



Harry Aliwarga
Service Bureau



Nathan Skinner
Service Bureau



Brian Puerschner
Channel Marketing



Teyren Brown
Marketing

ABOUT FIRST RATE

First Rate develops and supports investment analysis and performance measurement software for many of the largest financial service providers. The First Rate Performance Suite of applications provides complete portfolio tracking and reporting solutions specific to the client's needs. First Rate's performance measurement tools help investment managers communicate the value of their investment strategies. Starting in 1991, the Texas based First Rate was one of the first performance measurement systems available in a web-based environment, and is used by more than a third of the top trust institutions. For more information about First Rate, visit www.FirstRate.com.



Post Office Box 200877
Arlington, Texas 76006

www.FirstRate.com