

Metropolitan City Teachers' Retirement Fund Performance Appraisal

Topic: Pension Funding

Characters: John Spence, portfolio analyst for Metropolitan City Teachers' Retirement Fund
Mary Trenkler, newly hired investment director
Bill Fredericks, external stock portfolio manager

John Spence is a portfolio analyst for Metropolitan City Teachers' Retirement Fund (MCTRF), where he works under the newly hired investment director, Mary Trenkler. MCTRF is a defined benefits plan for all the municipal workers. Recently, Mary asked John to prepare a performance analysis of one of the pension fund's external growth stock portfolio managers, Bill Fredericks. Mary wants John to return with an analysis and recommendation either to retain Bill's firm or replace them with Growth Unlimited (GU), a firm which Mary has mentioned to John on two occasions as having "impressive results in growth stocks."

In the past, John has performed many such analyses by comparing risk and return performance over a three-year period and has to a large extent let the numbers determine his recommendations. This time, however, he is hesitant to do so. Although Bill's performance (Exhibit I) is well below GU's over the last three years, John does not want to see Bill's firm terminated. Bill has become a close personal friend to John, largely through their close working relationship. Bill's firm has given John help on various projects from time to time apart from growth stock investing and has provided John and other staff members the opportunity to attend educational seminars sponsored by his firm at no cost to MCTRF.

As an aside, John has calculated that Bill's performance is nearly equal to that of GU's over a seven-year period and is actually slightly better in the latest quarter. Additionally, from an efficient markets perspective, he can easily make the argument that relying on historical results is a very suspect way of evaluating future performance. In making his analysis, John is weighing the fact that he and MCTRF have historically placed a great deal of emphasis on the prior three-year performance, against his commitment to Bill, who has helped John's professional development and made him look good in front of his boss, Mary's predecessor.

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Exhibit I

Portfolio Returns, Net of Fees and Commissions

	Bill Fredericks	Growth Unlimited	Growth Stock Universe
Last quarter	11.2%	10.3%	9.9%
Most recent year	12.8%	18.1%	18.4%
Two years (annualized)	11.9%	15.2%	12.5%
Three years (annualized)	13.1%	16.7%	13.7%