

Main Takeaways

- ▶ **Barry Knapp**, Barclays' equity strategist, sat down with us to discuss the circuitous route of his career and life. *p12*
- ▶ **Entry-level finance** hopefuls are increasingly looking to the CFA program to gain an edge in the tough job market. *p6*
- ▶ **Every day** is different for a wealth manager; but client relationship-building and communication always remain priorities, as told by Dean Civitello. *p7*
- ▶ **The hedge fund** panel discussion detailed what it takes to be successful in starting up a hedge fund. *p5*
- ▶ **Culture** is the latest competitive advantage high-performing investment firms are exploiting. *p10*
- ▶ **Eurozone debt crises** and US economic softness dominated headlines and markets in 2010. *p1*
- ▶ **Shareholders must** decide how to fairly compensate financial professionals. *p19*
- ▶ **The reputation** of finance professionals did not have a positive 2010. *p1*
- ▶ **Peter Thiel's book** on the lack of diversity at Stanford proved to be thought-provoking. *p12*
- ▶ **CFA candidates** should be aware that a deeper skill set is needed to pass Level II & III. *p16*
- ▶ **Pension accounting** is becoming a key area in assessing the quality of a company's earnings. *p5*

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Where's the Risk?

2010 Markets in Review - by Irina Torelli, CFA

Pundits have widely defined 2010 as a risk-on-risk-off year; however it would be more accurate to christen it the *where's the risk?* year. The markets were and still are in the process of identifying the after effects of the great leverage era (*and its subsequent deleveraging*) and attempting to correct misperceptions of risk throughout practically every asset class. Significant conclusions realized this year were that countries in the Eurozone were more highly levered than expected (*even concealing indebtedness through suspect currency swaps*), the financial conditions and prospects of developed and developing countries have inverted to a high degree, and the dollar is gradually losing its place as the

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The Free Lunch

Thank God That's Over! - by Jeff Uken

Faster than you can say, "Bankers deserve bail—not bail-out!" it was apparent that 2010 would be yet another year's worth of sullyng the finance profession's reputation. Less than two weeks into the new year Phil Angelides, political grandstander nonpareil, likened a well-respected financial leader to a used car salesman "selling a car with faulty brakes and then buying an insurance policy on that car." This not only displayed a complete inability to grasp the concept of market making but also marked the beginning of another open season on our reputation. From Pres. Obama deriding our compensation practices as "obscene," to Barney Frank telling us that "people really hate you," to Tea Partiers calling for our blood, bashing bankers

was one of 2010's few truly bipartisan concepts.

How are we responding to this public flogging? Responding implies action -

I'd wager that we're more coping than defending ourselves. They say humor is one of life's greatest coping mechanisms, so it only made sense for us to invoke Patch Adams as our patron saint and try to laugh it off. We've foregone carousing in Vegas in favor of 'icing' our coworkers (*icing, v: the strange practice of*

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President's Message



A lot has occurred in the investment management industry since our last newsletter. Investment professionals both locally and abroad continue to experience both consolidation in the workplace and increased workloads. However, some are finding new opportunities and taking the challenge to learn from this tumultuous period.

In this environment, the CFA Society of San Francisco recognizes that it has an important role to play in supporting members where they need it. As the job market continues to get more competitive, there are a number of things that members can do:

- **Stay abreast of current issues via continuing education (CE):**
 - In 2010, we hosted 32 events with 1,200 attendees. The panel on, "So, you wanna start a hedge fund?" In September was sold out with 160 people. Our Portfolio Manager Series has also been very popular with speakers covering a wide range of current issues. We are finalizing our 2011 CE event calendar and will have more information soon on the website.
- **Stay connected and make new connections with industry peers:**
 - The society is increasing opportunities for members to connect with each other. We always make time at educational events for members to catch up over a bite to eat or drink. We've also hosted a number of purely social events. Again, please watch our website for upcoming social events.
- **Utilize career services that are available:**
 - In light of the current economic environment, the career development committee has been established for the role of driving career services for members. We have an established job-line for society members and employers. There are several career based events and services that we have planned over the coming months.

Our society held its annual New CFA Charterholder Ceremony on November 18th. I want to congratulate everyone who passed CFA Level III last June and welcome those of you who have chosen to join CFA Society of San Francisco. A few facts about our society: Our membership is now approaching 3,200 and in size we are ranked 4th nationally and 7th globally. It was established in 1929 and is the second oldest of all societies. Worldwide, there are 135 CFA societies with over 100,000 CFA Charterholders.

In December, we had the inaugural 'Strategic Advisory Board' (SAB) meeting in which we had several high level executives from the Bay Area investment community join us to discuss a wide range of issues in the investment management industry. With the help of the SAB, we will strive to become the voice of the Bay Area investment community.

The society's Sixth Annual Forecast Dinner is coming up on February 3rd, 2011 and will be held at the Ritz Carlton in San Francisco. The Forecast Dinner has evolved into a marquee event for investment professionals on the West Coast. This year's panel features Nobel Prize winner Myron Scholes, Hedge Fund Manager and Venture Capitalist Peter Thiel and Head of US Equity Strategy for Barclays Capital, Barry Knapp. The event is going to be moderated by Cris Valerio of Bloomberg TV.

We couldn't have undertaken any of these initiatives without the devoted 'leaders' on the society board and the many volunteers. In closing, I want to encourage you to attend and participate in our many upcoming events. We are always looking for volunteers to help serve on any of our many committees. Communicate with us and let us know if we are headed in the right direction! Happy New Year and best wishes for 2011.

Sincerely,

Satish Swamy, CFA
President



SOCIETY PROGRAMS

February 3, 2011 4:30 - 8:30 PM

“Sixth Annual Economic Forecast Dinner”

Ritz Carlton Hotel

600 Stockton Street, SF

Members: \$120

Non-Members: \$160

February 15, 2011 3:00 - 4:30PM

Continuing Education Program

“Succession Planning at Investment and Wealth Managers”

CFASF Program Center

300 Montgomery Street, SF

Members: \$20

Non-Members: \$30

February 22, 2011 6:00 - 8:00PM

Continuing Education Program

“The State of the Economy: Perspectives of the Federal Reserve Bank EVP John Williams”

University Club

800 Powell Street, SF

Members: \$35

WORD FROM THE EDITOR

It's only fitting that the start of the new decade would coincide with a new approach (and a new name) to our venerable newsletter - we're making big changes within these pages! Quite simply, we want to move from merely being a recount of the club's activities to a magazine-style publication that addresses the needs and interests of an otherwise unserved niche: the Bay Area finance professional. We want this to be a publication that adds value to your life and when you're sorting the daily mail, that doesn't find itself sadly relegated to the Junk Mail pile.

Of course, we'll still cover our events, include a few words from our President, provide Committee Chair updates, and list our scheduled events, but now we're going to do a little bit more. For example, in this issue, to help you get the most out of the Annual Economic Forecast Dinner, we dove a little deeper to give you a better understanding of our presenters with an interview with Barry Knapp and a book review of Peter Thiel's critique of Stanford's lack of diversity. There's even a new personal interest section we call CFA Living, which will include completely original content that aims to explore finance career trends/events in depth, foster community within our organization, and, if nothing else, just be an interesting read.

So, kick back, give it a read, and be happy we made it to 2011.

- Jeff Uken

Career Development Programs

February 17, 2011

Art of the Interview Workshop

March 24, 2011

Investment Industry Entrepreneurship

April 21, 2011

Investment & Finance Career Fair

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ACKNOWLEDGEMENTS

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Design and Layout: KATIE L. PIZZIO, LOTUS MANAGEMENT COMPANY

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NEXT DEADLINE FOR SUBMISSIONS IS MARCH 15TH 2011.

Markets in Review - Continued from page 1

world's reserve currency. The PIIGS (Portugal, Italy, Ireland, Greece, and Spain) debt crises, unexpected deterioration of the US economy, and Fed Quantitative Easing (QE) programs dominated financial markets and news throughout 2010 and resulted in another roller coaster year. In January, US interest rates were at 3.5%, markets up, dollar down. As the Greek problem and signs of softening in the US economy started to emerge, stocks lost all the gains for the year, 10-Year Treasuries reached all the way down to 2.5% and the dollar went up. A reversal of this trade emerged as the Fed announced its intention to start the QE program. During these ups and downs, the one asset that seemed to sidestep the market's tumultuous conditions has been gold,

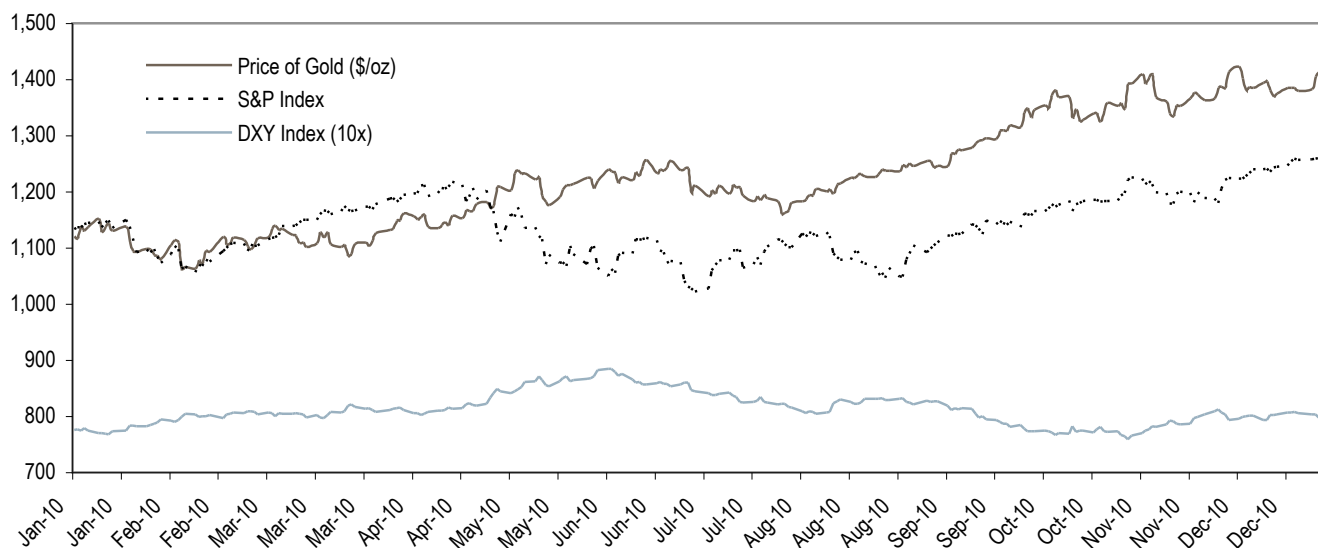
which ended the year up around 30%. In the absence of a strong global currency, as most central bankers climbed over each other to devalue their respective currencies, gold seemed to emerge as the only asset acting as a reliable store of value. Still, most would agree that returning to a gold standard would not be ideal. Developing countries continued to exhibit strong growth and their equity markets concluded the year on a positive note.

Stocks correlations were elevated for the year as macro events dominated risk. Macro investing has emerged this year a fashionable theme in the investment community (*which makes our macro-focused Annual Forecast Dinner more relevant than ever*).

In 2011, we can expect the

old worries and new surprises to continue to weigh on the markets. The Eurozone's sovereign debt issues have not been solved; rather the problems have just been kicked down the road to buy time for Europe's leaders to lethargically search for politically feasible solutions. In the US, signs of an economic recovery are surfacing; however, the housing market is still mired in dismal conditions and 10% unemployment is just too high for anyone to get excited. Emerging markets will probably continue to have good growth, but enthusiasm should be tempered as their share of the global economy is limited.

2011 will be a bumpy ride, so buckle up... the seatbelt light is still on!



What it Takes to Start a Hedge Fund

by Mac Furst, CFA

Chances are good that you've at least briefly entertained the idea of starting a hedge fund and making out like John Paulson. You've heard they're exciting, glamorous, and very lucrative. If you attended the CFASF panel discussion on hedge funds, you would've found that reality doesn't really match up to that perception. In fact, it's tough as nails and intensely competitive. If you weren't able to make it to the event, here's what you missed:

- **Investment strategy** - It is absolutely imperative to be able to convincingly articulate a hedge fund's investment strategy that reflects the specialized expertise of the manager (*and leave it up the investor to diversify*). An undifferentiated strategy such as "long/short U.S. large cap" probably won't win you investors, but a more differentiated strategy such as "long/short U.S. financial services stocks based on a quantitative model that heavily emphasizes insider buy and sell signals" might.
- **Investment performance** - With investors clamoring for consistent returns, various strategies need to be employed to smooth out volatility of returns (*through the use of options and other derivatives, among other strategies*).
- **Team** - A team approach reduces, but doesn't completely eliminate the key person risk in the eyes of potential investors.
- **Service providers** - When picking the necessary hedge fund service providers, such as a lawyer, accountant, administrator, prime broker, and custodian, the focus

should not be on collecting a list of impressive names, but on finding a good match. In many cases, it is preferable to select a less well-known firm that is inclined to give the hedge fund the necessary attention.

- **Cost** - The cost to start a hedge fund is at a minimum \$100,000 and operating expenses for the vast majority of hedge funds clock in at a minimum of \$120,000 per year.
- **Break-even** - Depending on the investment strategy employed and the number of personnel involved, most hedge funds reach break-even at \$3 to 10 million in assets under management.
- **Money-raising** - The sources of funds include friends and family (*often the only way to start out*), high net worth individual investors, seeders, third-party marketers, fund of funds (that often insist on a three year track record), and institutional investors (*the choice for more mature hedge funds once assets under management exceed \$100 million*). Batting averages in investor meetings will likely rise no higher than a paltry .020, and the sales cycle can drag on for up to a year (*with multiple meetings with each prospective investor*). Money-raising can be extraordinarily frustrating.
- **Success rate** - 80 to 90% of start-up hedge funds fail to ever get off the ground.

Flash Review

Don't Forget About Pension Accounting! - by Michael Ellis, CFA

Pension accounting – one of the most dreaded topics of Level II of the CFA Program. Exam takers likely cram in details about expected returns on plan assets, mortality rates, discount rates, and then relish in forgetting these items as quickly as possible. As the fiscal year-end approaches for many companies, and we get our annual peek at pension assets & liabilities when companies file their 10-K, I think it's a worthwhile time to revisit some of the basic topics of pension accounting and how these tools can be implemented given the current economic environment.

Pension accounting is a key area in assessing the quality of a company's earnings because management estimates for discount rates, expected returns, and other items, are all used in determining the annual pension expense and funded status. Significant changes in management estimates, or overly aggressive estimates, may indicate that the pension accounts are being used to manage earnings. I encourage readers to focus on the expected return on plan assets as they read the notes to various 10-K's over the next couple of months. In general, companies were reluctant to cut their estimated returns on plan assets through the economic downturn. As such, pension expenses and funded status may not accurately reflect economic reality. If we are in an extended period of low interest rates, the fixed income portion of pension portfolios may be in store for very low single-digit returns, placing a heavy burden on the equity & other portion of the portfolio to meet the high return hurdle for the overall portfolio (currently an average estimated return of 8% across corporate pension plans). It will be interesting to see if companies make downward revisions to expected returns, or have significantly shifted the weightings of various asset classes as of December 31, 2010. Instead of taking it for granted that these portfolios will rack up 8% returns every year, an investor should ask whether or not management's estimates are realistic given the outlook for various asset classes. It may also be useful to conduct a sensitivity analysis on pension portfolios in order to derive your own view of pension liabilities and expenses given your expectation of the future returns for various asset classes.

CFA: Basic Qualification? - by Hunter Patterson

As a sophomore majoring in economics at the University of California at Berkeley, Even Ke had already decided he was going to take Level I of the CFA program his senior year. Ke knew he wanted to work in finance and had been told by a family friend in the industry that passing Level I while in college might give him an edge when it came time to apply. So that's what he did. In the fall of his senior year, between studying for upper division economics exams and participating in the campus investment club, he chipped away at the CFA Candidate Body of Knowledge and sat for Level I in December of 2009. He passed the exam, graduated and now works for a mutual fund company in San Francisco.

While Ke may have an unusually high level of motivation, he is also part of a trend among CFA candidates who are taking the exams earlier in their careers, often before they start working in the industry or even graduate from college. Several dozen undergraduates from around the Bay Area planned to take Level I this year and many students from graduate programs like USF's M.S. in Financial Analysis are signed-up as well.

While information provided by the CFA Institute shows that most candidates have historically been between the

ages of 26 and 30, those under 26 accounted for 34% of all candidates in 2009. Specific data showing an increase in young candidates was not available, but Professor John Veitch, CFA who chairs the economics department at USF and is the director of the CFA review program here at CFASF said he has observed an increase in the number of young people planning to sit for the exams.

Taking the Level I exam while in college has benefits as well as drawbacks. Passing the first level of the program can give entry level candidates an edge when applying, especially since the economic downturn has increased competition among young college graduates where the unemployment rate is 8%, nearly double the 4.5% unemployment rate among all college graduates. A director of recruiting at a large asset manager said that there have been instances when passing or even just registering for Level I has mattered when differentiating junior level candidates for positions at the company. Entering the CFA Program demonstrates motivation and a commitment to continuing education which is valued by hiring managers in the investment industry, the recruiter indicated.

Studying for the exams while in college can also be easier. Ke said the material in the Level I exam was not as in depth as what was being covered in his classes at Berkeley and that overlap between the two programs made studying for Level I easier. Nicolas Ciobanu,

a graduate student in the USF M.S. FA program, tended to agree, saying that while he had not benefited from full-time work experience in the field, his coursework was preparing him for the exams.

However, taking the exam while in college also means there is no employer to foot the \$1035 bill for program enrollment, exam registration and books. Passing Level I before landing a full-time position might also mean forgoing a bonus, promotion or other perks that some employees receive for passing the exams.

But at the end of the day, if it helps job-seekers differentiate themselves, candidates like Ciobanu say they're happy to double down on a shot at an entry-level job by working toward their degree and the CFA Charter at the same time. "At the end of the day, I just want to get the CFA out of the way as quickly as possible and focus on my career and investments," Ciobanu said.

CFA
CFA Society of San Francisco has been helping Bay Area Candidates prepare for the CFA® exam since 1992. CFASF offers an extensive program of review classes, study groups and workshops to assist candidates with their studies.

To learn more or register for our classes visit

www.CFASanFrancisco.org

EXAM REVIEW

A Day in the Life of a Wealth Manager - by Dean Civitello, CFA

My day-to-day experiences as a wealth manager may not be typical, for the main reason being that there isn't a "typical" wealth manager schedule, which is one of the profession's primary benefits: flexibility in the management of one's time.

My wealth management practice primarily oversees the assets of twenty-five core clients comprised mainly of families and individuals. Ninety percent of the assets under our management belong to those core clients and the remainder belongs to our non-profit organization clients. We also manage a discretionary equity portfolio for several clients and offer consulting services to institutional investors.

There are essentially two parts to a good wealth management practice, in my opinion:

- Providing advice: taking what you know about your clients and combining it with what you believe about markets in order to manage customized strategies.
- Practice management: efficiently managing your business so that no client is neglected and you are able to maintain awareness of the investment environment, but so that you are also free to continue growing your business.

Communication between the members of my three-person team is critical to the success of our business. My partner's office is directly next to mine and our assistant sits directly outside of our typically open doors. We find that the open door environment works extremely well to service

our group of core clients, ensuring that nothing critical is overlooked.

What My Day Looks Like: Reading

An investment advisor (not at my firm) once told me to never read the paper or any research. His rationale: there's too much information and you'll never be able to make good use of it, so such activities just get in the way of making phone calls and raising assets. That rationale might be appropriate for some, but it's not right for me. My preference is to be informed and opinionated. As a result, I spend the first couple hours of each day reading (except today, since I'm scrambling to meet this article's deadline).

Specific Projects

There are often time-sensitive tasks that must be completed specifically for a client or several clients: raise cash, invest new cash, prepare for a meeting, keep a new client on-track in the process of getting initially invested, respond to an inquiry, etc. We address these by coordinating responsibilities among team members and executing as needed.

Know Your Client (not just a compliance requirement)

Although "knowing our clients" is not necessarily a specific daily activity, it is an aspect of wealth management that cannot be understated. We speak to clients regularly and only make recommendations when we believe we fully understand a client's goals.

When a person or family hires a wealth manager, they are essentially saying, "I have these assets, these goals, these

expectations and these unique circumstances – please advise me on how to manage all of these." There are plenty of questionnaires designed to gather the pertinent information (goals, time horizon, willingness to take risk, etc.) and we use these to some degree. But to truly know someone enough to manage their entire net worth requires an ongoing conversation, which goes beyond any questionnaire I've seen.

Investment Strategies & Tactics

We customize long-term investment strategies for each client based on our ongoing communications with our clients and our beliefs regarding markets. These customized strategies serve as long-term target allocations that will guide us and our clients over the years. We find these targets particularly useful during periods when markets are very volatile to the downside. While these are not static targets that we refuse to alter, they are carefully planned long-term strategies that should be respected throughout market cycles.

We then attempt to add value by tactically managing portfolios over time. For example, my senior partner and I could discuss introducing a new asset class/style or overweighting one style versus another. My responsibility would be then to perform research to either confirm or reject our initial thoughts. If confirmed, I must then examine our options for implementation and select

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A Day in the Life... Continued from page 7

the option I believe is most attractive. I would present my conclusions to my senior partner for further discussion and an ultimate conclusion.

We base both our long-term strategic allocations and our mid-term tactical decisions on a combination of top-down and bottom-up analyses. From the top-down we attempt to identify current macro themes and the risks and opportunities they present. From the bottom-up we attempt to examine the expected returns of various asset classes in an effort to determine which offer attractive risk-adjusted compensation and which do not.

When we identify a theme we believe calls for action, we review each client's portfolio to build a specific understanding of how the theme should be implemented. Any recommendations we make will be based on a combination of our investment conclusions and each client's situation.

Investment Manager Research

My partner and I believe active management can add value to a total investment portfolio. We are aware of opposing points of view, but philosophically we see tremendous value in having highly experienced specialists manage portions of our clients' assets. Of course, identifying such people is a difficult task, and even then there is no guarantee of success since even the brightest people make mistakes.

Therefore, a portion of each day is spent meeting or speaking with managers, reviewing historical activity and performance, analyzing current positioning, or discussing the manager with a colleague. Our goal is to get a strong understanding of a manager's methods and philosophy so that we can learn what to expect. Typically, we will study a manager for several quarters and sometimes for over a year prior to making any commitment of capital. We prefer to view our relationships with managers as long-term partnerships, even with those managers we are hiring for tactical, mid-term investment themes.

Recently, we met with one of our core equity managers, who we have worked with since early 2004, but who has performed poorly, relative to his index, over the past several years. This meeting was primarily conversational, with minimal focus on numbers since we all already knew the story the numbers told. But by allowing the manager to speak about his portfolio, the rationale for each position, and his forecast from a macro standpoint, we were able to retain the confidence that initially attracted us to this manager. We are convinced that the manager is fully dedicated to the portfolio and focused on protecting and growing capital. Our approach allows us to stick with talented managers, even if performance is temporarily poor.

Ongoing Client Communication

It is important that our clients be kept up-to-date on their portfolios and on our thoughts. On a regular basis, we provide our clients with customized reviews of performance

and allocations, accompanied by commentary from our team on our results.

This exercise actually accomplishes a good amount. First, it keeps an open dialogue with our clients – we inform them of our thoughts and they have a chance to let us know what's on their minds. Second, it keeps our clients educated, which is important because we don't want any of our clients to ever wonder what we really do for them or whether or not they're prepared for some macro event they heard about on the news. Third, it forces us to remain consistently aware of how our clients' portfolios are positioned versus our outlook and allows us to efficiently take action if needed.

Wrapping up the Day





I've always felt it's important to remind yourself why you show up to work in the first place. For me, it's the great pride I have in being the trusted advisor to successful families and institutions and the satisfaction of being part of an exceptional team.



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on upcoming society
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The Lineup - by Hunter Patterson

<p>Faces of San Francisco Finance</p>	 <p>Michael Faust, CFA</p>	 <p>David Burkart, CFA</p>	 <p>Martin Kemnec, CFA</p>	 <p>David Allen, CFA</p>
<p>Where'd you grow up?</p>	<p>Wisconsin</p>	<p>The Bay Area - I'm a local!</p>	<p>Bennett Valley - Santa Rosa</p>	<p>Valley Forge, PA</p>
<p>Favorite CFASF event in 2010...</p>	<p><i>The Stakes Go Up in Social Investing</i></p>	<p>Hedge fund event (I was a panelist) - brutally honest discussion, lots of good questions and follow-up.</p>	<p>I earned my charter in 2010, so without a doubt the Charter Award Ceremony - great event to top a lot of hard work.</p>	<p>The Forecast Dinner was outstanding. The CFASF does an amazing job lining up great talent and powerful content.</p>
<p>Most exciting thing you did in 2010...</p>	<p>Rose Bowl</p>	<p>Dramatically expanding my business and seeing my friends succeed in starting up new funds.</p>	<p>Snorkeling with spinner dolphins and green sea turtles in Maui during Christmas was amazing.</p>	<p>You wouldn't want to print it.</p>
<p>How do you spend your Saturdays?</p>	<p>Chasing after my two young kids and dog.</p>	<p>Spending time with my wife.</p>	<p>Enjoying all that San Francisco has to offer.</p>	<p>Exploring Point Reyes, sailing, and learning tennis with my son.</p>
<p>Favorite financial markets commentator...</p>	<p>Too many to pick one.</p>	<p>David Rosenberg (Gluskin Sheff), John Hussman (Hussman Funds), and Barry Ritholtz (FusionIQ).</p>	<p>David Rosenberg, admittedly one of the most bearish economists on the street.</p>	<p>James Grant is as brilliant as his newsletter is expensive.</p>
<p>Last book you read...</p>	<p><i>Hero Found</i></p>	<p><i>Inside Out</i> (Barry Eisler) and <i>No One Would Listen</i> (Harry Markopolos)</p>	<p><i>The 48 Laws of Power</i> (Robert Greene)</p>	<p><i>A Voyage for Madmen</i> (Peter Nichols)</p>
<p>If you had a week off how would you spend it?</p>	<p>Return to New Zealand.</p>	<p>Sleeping. Oh! I get a week off when I'm running my own firm? Okay, travel: Japan or France.</p>	<p>Traveling. I have never ventured past Europe so I'd like to explore the Far East next.</p>	<p>I'd like to crew on a big, blue-water ocean crossing...</p>

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Volunteer@CFASanFrancisco.org

Keene on Culture

Culture as a Competitive Advantage - *by Jim Keene, CFA*

A scan of the business literature reveals a plethora of information on factors impacting the value of a firm. In the investment management and wealth management businesses, some of the obvious ways are 1) increasing revenues by expanding the client relationship, 2) diversifying revenues sources across more clients and types of clients, 3) reducing client turnover by institutionalizing the client relationship, 4) outsourcing non-core functions to specialized companies, and 5) minimizing financing costs. The solutions tend to be functionally-focused (e.g., sales, service, operations, marketing, and finance).

The investment and wealth management industries are knowledge-based. Intellectual capital, along with relational capability, is what differentiates firms. Underlying all these “obvious” ways of increasing firm value is the ability of the organization and its leaders to effectively make decisions. Recent research by Focus Consulting Group¹, based in Chicago, reports key characteristics of top investment organizations whose culture supported effective decisions include:

1. As an organization, we have the ability to attract top talent,
2. We are free from silos in our organization,
3. We have strong talent management which includes career pathing and succession planning,
4. We have an ownership mentality, our employees think like owners of the business,
5. We are good at executing plans, and
6. Our senior team communicates well (clear and transparent).

Additionally, the cultures of the top ten percent of firms in the study of sixty firms (the Focus 6) supported the following attitudes and behaviors to a statistically significant degree over the average firm:

1. Full engagement and employee development,
2. Initiative and risk taking,
3. Competition and high performance,
4. Efficiency and loyalty,
5. Clarity, order and good communication, and
6. Effective decision making.

Top organizations believe there is a connection between strong culture and effective decision making. The top five differentiating factors of the Focus 6 firms vs. the Industry average are as follows:

1. **I feel fairly compensated for my contributions.** In the book “Drive,” authored by Dan Pink, the three key motivating factors driving knowledge workers are autonomy, mastery and purpose. He also states that firms need to get the money right and take it off the table. While compensation is a factor, they are not ultimately driven or obsessed by it at the top firms.
2. **We have the right team members to accomplish our goals.** This was a key piece differentiating “good” from “great” firms in Jim Collins work in “Good to Great.” Organizational research shows that teams hiring “A” players have a positive performance influence on the remainder of the team.

¹Crisis Lessons from “Thrivers, Divers and Survivors: Research on Investment Leadership and Culture”; September 2010; authored by James Ware, CFA.

3. **There is a high level of trust among team members.** The level of trust impacts the speed and efficacy of decision-making in an organization. With trust, people don't worry about other's agendas for empire-building, looking good and political maneuvering.
4. **Our team openly debates issues.** Effective decision making is best made through vetting ideas. Complex decisions and decisions with significant consequences are better made with input from many, rather than one or a few. Great ideas surface in an open debate atmosphere.
5. **As a team we value and appreciate one another.** Research shows that a 5 to 1 ratio of positive/supportive exchanges to criticisms must occur to maintain high levels of engagement and goodwill in a relationship. The positive comments have to be genuine and not mere "atta boys."

The investment management and wealth management business are in more competitive environments than they have ever seen. Defined benefit plans are slowly becoming a dinosaur. Many more entrepreneurial wealth management firms have started up over the last several years increasing competition. The recession has had a lingering impact on asset values and, hence, revenues for asset-based fee revenue firms. This doesn't even address the changed risk management environment in which we live today. Increasingly, top firms are moving from "people as a competitive advantage" to "culture as a competitive advantage," recognizing the impact of the behaviors and beliefs of a firm in a complex system.

However, in order for the culture advantage to be sustainable it has to be practiced and built upon on a continuous improvement basis. While good firms will continue to focus on improving sales, service, operations, marketing and finance, the great firms will actively improve their culture with a focus toward more effective decision-making.



Jim Keene, CFA, is a Consulting Partner with Focus Consulting Group which, in turn, helps investment leaders leverage their talent. He can be reached at jkeene@focuscgroup.com.



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Barry Knapp: The Circuitous Route

Barclays' Strategist Discusses Career, Pro Soccer, Family

Interview by Michael Bodnyk, CFA and Jeff Uken

CFASF will be hosting its sixth annual economic forecast dinner on February 3, 2011 featuring guest speakers Myron Scholes, Peter Thiel, and Barry Knapp. In anticipation of this event, CFASF interviewed Barry Knapp, head of equity research at Barclays Capital, uncovering some valuable advice and entertaining anecdotes.

Financial Standard: How did you become global head of equity strategy for Barclays?

Barry Knapp: It was a circuitous route to be sure. I started working at Lehman brothers in 1989 after I finished my MBA, which I did in two years at night at Fordham University. I originally came to New York in 1984 when I finished undergrad. I was an econ major with a finance minor at the University of Rhode Island. In reality, I thought I was going to be a professional soccer player

Multiculturalism Doesn't Mean Diversity

"The Diversity Myth" By David O. Sacks and Peter A. Thiel

Article by Evelyn Lawson, CFA

No matter what images the word multiculturalism evokes within you, Sacks and Thiel's book, "The Diversity Myth", will be a thought provoking read to help you maneuver through America's changing society.

The authors take us through the history of 1980's Stanford University, and its experiment mainlining multiculturalism into campus life. They use the Stanford experience to springboard into a more general discussion of what multiculturalism has come to mean, and provide a stern warning about the risks of using the veil of multiculturalism to suffocate intellectual diversity and repress self expression.

The first half of the book provides a detailed history of Stanford's efforts to expunge all traces of western culture from its curricula, information sources and dormitory life. In its place, a flavor of multiculturalism reminiscent of that purported by 1960's activists was embraced by the university's administration. As graduates from Stanford in the 80's, both authors draw from personal experience. The last half of the book is devoted to a consideration of the concept of multiculturalism. The authors suggest that by identifying specific subgroups based on factors such as race, gender and sexual preference, multiculturalism suggests that all minorities are alike in that they share a common bond of being victims. Their later chapters, with titles such as 'Welcome to Salem' and 'Stages of Oppression' step the reader, by argument and example, through a world of intellectual intolerance and subjugation of free thought. They do provide some thoughts for a better future. However, the main purpose of the book appears to be in pointing out the failures of the past, leaving the reader to consider for themselves the best path ahead.

FS: [Laughs] I didn't know you played soccer?

BK: I did. I was captain back in 1983 at Rhode Island. We were in and out of the top 10 DI. You laugh about it, but at the time it was a consideration. The old NASL, the league the Cosmos were in and the like, folded about a week after my senior season ended. I would have starved as a professional soccer player, so it worked out fine for me, but nonetheless that was part of what I was doing as an undergrad. But, you know, I was really interested in economics and finance, and so I came down to work on the street.

FS: What was your experience on Wall Street like?

BK: I worked at Merrill for a couple years. Then I worked at Fidelity Investments while I did my MBA and wound up at Lehman Brothers in '89. Initially I was in the equity derivatives area and wound up running a chunk of the equity derivatives business. I was in various roles within that business for 14 years. Then for the next four years, I was in a principal trading role trading a macro book across asset classes. Along the

way I was doing a lot of internal strategy work and writing to help manage the risk of the equity division. I kept getting asked in one form or another whether I would consider a strategist role within research. Because I had this brilliant foresight that the Volcker rule was coming back in May of 2008, I acquiesced and agreed to do that. Again, I'm being tongue in cheek about the whole thing, but I did agree to become the strategist in May of 2008. By September, when Lehman Brothers went bankrupt, I had not yet begun publishing, so I was the strategist for a short period of time but never actually published anything until we were taken over by Barclays and I started publishing in October of 2008. So it's a little bit of a different background from the typical strategist who may have come out of research. I had actually been a trader with a book and sweated out positioning, mark-to-market, VaR, and all that other stuff.

FS: Has it been challenging to transfer from a short term trading role to a longer term strategy role?

BK: The way I came at trading was from very much of a macroeconomic perspective – for example, Fed policy and how that would impact the capital markets. What the capital markets said about the economy and policy and what policy and economics said about the capital markets. So it wasn't that difficult really. Actually, I enjoyed the process.

FS: Do you have any words of encouragement or advice for young CFA charterholders or candidates?

BK: I came into the business in a very similar time frame as all of the younger people who are entering the business now. I graduated in 1984, two years after the end of a vicious recession, the worst one we had seen in quite some time. The unemployment rate went to 10.8%. Two years later it was still quite problematic. There weren't a lot of jobs on the street. I took what I could get. In retrospect, the first job that I had was not something that I wanted to do, but I slowly moved towards a better outcome. I went and did my MBA at night and struggled through it. Anybody who has completed the CFA program has essentially done the same thing. To keep educating yourself is one of the keys. Quite frankly one of the things I guess that's characteristic about my career is that I've remade myself on a number of occasions. I held a number of different jobs at Lehman Brothers. When I first came into it the equity derivatives area was a very nascent growing area and that took me all the way to becoming a managing director at Lehman, but then that business was becoming more competitive and wasn't holding the same challenges for me so I went and did something else for a few years and saw another opportunity and took that one as well. So, I don't know what to say about that other than definitely keep educating yourself and don't be

afraid to make some changes in your career when you see opportunities.

FS: Any other characteristics about you or your career that you would like to share with us?

BK: One of the characteristics that has been true of me for my whole life and is still true of me is that I'm a voracious reader. I just plow through it. Today for example I saw the San Francisco Fed put out a note on "skin in the game in mortgage back securities" and they've done a little analysis on that. I read that. I'm going through a number of different internal research reports. I read all weekend. If I go skiing, I log onto Bloomberg when I'm sitting on the chair lift and see what's going on in the markets. If you have a true love for the markets and you're really interested in all the macroeconomic factors then that will carry you a long way. It's not a question to me of just developing a toolset that you then refine over time, it's really a question of constantly educating yourself and being able to reinvent yourself when the need develops.

FS: Any interesting books you've read recently?

BK: I read a book on Vanderbilt, who was quite

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East Meets West

CFA Singapore Opens its Arms to CFASF Member

by Lynne Gravelle Mosier, CFA, CAIA



From Left to right: Lynne Gravelle Mosier, CFA, CAIA; Clara Lim, NUS; Professor Tan; Chorh Chuan, NUS President; Jim Rogers

As a globally minded CFA Charterholder, I was already thrilled at the opportunity to visit Singapore last November, but then was floored when I

had the good fortune to meet and discuss finance with legendary investor Jim Rogers. I've been a devoted follower of his since the 80's and his book, *Investment Biker*, is simply a must read if you love adventure travel, economics and investing!

In preparation for my trip, I checked in with the local CFA chapter as I wanted to maximize my career development opportunities, global investment perspective and get the low down on the local scene. My outbound email got back a lovely response from the Singapore CFA Director, Francis Er. We had an excellent email chat on networking and CFA topics leading up to an invitation for me to speak at one of their luncheons, which would be hosted by the University of Chicago office on the topic of global asset allocation from a US investor's perspective.

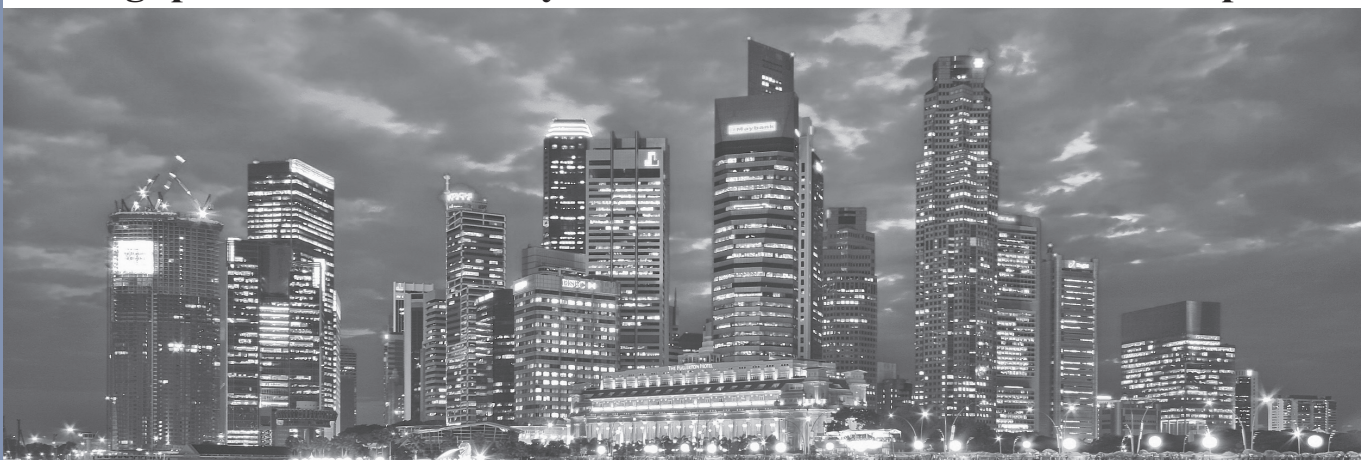
I was excited to discuss one of my favorite topics, Dynamic Global Asset Allocation, especially in the House of Markowitz (and Modern Portfolio Theory). This would prove to be both a special highlight and an etiquette challenge; as a dynamic allocator,

I believe in Post Modern Portfolio Theory and certainly did not want to offend University of Chicago with my differing opinion. In defense of Markowitz though, his theories were established in the 50's/60's before computer ubiquity. A major challenge, in my opinion, is that many traditional asset allocation models are steeped in the past and overly reliant on average historical performance.

In addition to my aforementioned love for asset allocation, I have a particular affinity for discussions on the China/Emerging Markets Asia Growth Story. I was absolutely giddy about engaging the audience in a "Devil's Advocate" debate on the China growth story. I am personally overweight Asian markets, so I wanted to ensure that I wasn't missing any ominous signs. I endeavored to create a presentation as interactive as possible and was able to overcome cultural obstacles that prize reserve to foster a lively debate on the subject. During our debate, Jim Rogers made a celebrity cameo and he and I engaged in a bit of the Jim Chanos/Jim Rogers debate; it certainly was a personal highpoint.

As always, diversification is the word, but I'm still a big believer in the Asia Growth story. My revisit to Singapore (I had lived in Asia during the 90's) was a true delight and I now know what they mean when they say that Singapore is the "Switzerland of Asia."

"Singapore: beautiful City and home to a fantastic CFA chapter"



... Interview continued from page 13

fascinating to read about. A liquidity crisis would take place every fall when the farmers' crops came in and the money got drawn out of the banks to pay for those crops. That would happen virtually every fall. In those days, there was no central bank. Because of Jacksonian politics, they had abolished the Bank of the United States back in the 1830s or so. So you would have these liquidity crises on Wall Street every fall. Ultimately, those sorts of things were what led to the formation of the central bank. I constantly go back and re-read about history to try and understand the current situation by re-learning lessons of the past.

FS: What do you think of Ron Paul's proposal to abolish the Fed altogether?

BK: When you realize why the Federal Reserve came into being, the real catalyst was the panic of 1907 and the fact that J.P. Morgan had to act essentially as the central bank. The capital markets got too big for any one bank to provide that level of stability or liquidity in the time of a crisis. Paul Warburg who was the son-in-law of Jacob Schiff who was the patriarch of Kuhn, Loeb, the predecessor firm to Lehman Brothers, J.P. Morgan's biggest rival on the street in those days, was really the driving force

behind forming the central bank. The idea was really to deal with a crisis situation. Going back to the Vanderbilt situation, every fall you would have a liquidity crisis where money got drawn out of the banks to pay for the crops. Guys like Vanderbilt would take advantage of it and cause stock market crashes every fall because of that liquidity at the banks because margin would get drawn down on margin accounts. You realize that the central bank was critical to smoothing the various bumps in the road that are almost inevitable. I think it's really more a question of looking at what the Fed has evolved into and whether the scope has gotten too great as opposed to abolishing it altogether. To abolish the Fed altogether in an environment where we have such an activist government that wants to pull strings all the time would leave us in a really crippled position.

FS: Outside of finance what keeps you busy?

BK: I skied 25 days in Colorado each of the last two winters, so I do quite a bit of skiing. I still play soccer all the time. I ran a youth soccer club that had 2700 kids in it for seven years, so that was my volunteer work to run one of the biggest local soccer clubs in the state of New Jersey. Other than that I guess I'm a typical family guy. Two kids in college, one is a senior one is a freshman and a thirteen year old who is going to be in a heavy metal band some day apparently [laughs].

FS: Now, how do you feel about that?

BK: I don't know. His mother and I were Led Zeppelin fans back in the day and still are but we're not sure how we feel about Metallica and Motörhead and the like.

FS: Have you heard his work?

BK: Yeah, he's good! He's good.

FS: What does he play? Is he the guitar player? The screamer?

BK: He's the guitar player, no screamer. We were discussing it last night, took him out to dinner, and he had me on this serious 'liquid metal' station. And I said, "Here's the problem, Ian: a well-placed scream like Robert Daltrey in *Won't Get Fooled Again* is effective. A scream that carries through the entire song, to me, isn't as effective." We had a laugh about that.



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Mastering the CFA Levels II & III Tests

by James Stoner-Holk, CFA

Passing Level I is an accomplishment, but passing Levels II & III exams require a deeper skill set. Let's review the required skills common across all three exams:

Memorizing facts - Those little bits of information make up a large part of Level I, but never disappear from levels II or III.

Doing the math - Each exam level requires rigorous mathematical ability. Memorizing, but not understanding the formulae can work for Level I, but not at Levels II & III. Focus on understanding why a formula is built. Understanding how formulae are derived and recognizing common roots in formulae dramatically helps with passing Levels II & III.

Managing your time - Time management gets harder in the next two exams, especially at Level III. It tends to be the norm that no one finishes the Level III morning constructed answers section.

Mastering Level III

The main organizational change from Level I to Level II is that the questions are grouped as item sets, not single questions. Item sets are vignettes of info with 6 questions per set. Level II requires two additional skills to be successful: reading speed and reading comprehension.

Reading speed - According to Wikipedia, an average native English-speaking adult reads at a 200 words/minute pace during analytical reading. The chart below shows word counts from a Level II mock exam vignettes and calculates how long the average adult would take to read the vignettes.

CFA Level 2 Mock Exam – Morning Session (2009)

Item Set	Subject	Word Count	Time
1	Ethics	629	3.15
2	Quantitative Methods	286	1.43
3	FSA	417	2.09
4	FSA	322	1.61
5	Corporate Finance	441	2.21
6	Economics	513	2.57
7	Equity	574	2.87
8	Fixed Income	450	2.25
9	Derivatives	612	3.06
10	Portfolio Management	294	1.47
	(Word counts include numbers)	Total	22.69

That's about 13% of the total exam time just for reading, assuming you achieve full comprehension on the first pass. If you have any difficulty reading English, then reading speed improvement should be a priority.

Reading comprehension- Reading quickly isn't enough though, you also need to understand what you read. The vignettes will not try to trick or deceive you, but their structure makes it very easy to miss a relevant piece of information.

Suggestions:

Time yourself - Break out the watch when practicing vignettes. Better yet, considering filming your test taking so you can see how long it takes you to do each part of the item set. Note which sections take you the most time.

Practice - Practicing item sets helps you become accustomed to the way that pertinent information for certain styles of questions are embedded into the vignette. The more familiar you are with the patterns of questions, the less you will have to adapt on the day of the test.

Learn key words - The text of the vignette can jump out at you when you know what to look for.

Mastering Level III

The morning session - Level III's afternoon session follows the same format as Level II, but the constructed answer format for the morning session is a different beast. Worth a total of 180 points, this section has between 10 to 15 vignettes, each with 1 to 7 or more required responses. Each question is assigned a specific number of points. The loose rule of thumb is that each point is equal to one minute, so a 30-point question should take a half hour to read and answer.

The unpredictable nature of the Level III morning session makes studying difficult. To earn full credit, you need to learn every LOS in the Level III curriculum. While technically true of the other exams, the constraints of the multiple choice format allow candidates to narrow their focus. At Level III you must understand the LOS command words so you know the extent to which you must learn the material. If asked to "Calculate" an answer, write down the formula, show your work and give your answer. If asked to "Calculate", "Determine", and "Justify", then your answer must be significantly more involved. One valuable test-taking strategy is to fully answer the question, but not do any more.

The tough truth about Level III is that it requires a more thoroughly comprehensive and integrated understanding of the material than either of the other exams. Memorization, while still important, is not sufficient to pass this test. You must be able to synthesize a valid answer from the stated and implicit information in the vignette and the relevant material in the Body of Knowledge, with nothing more than a prompt.

Suggestions:

Keep it short, legible and concise - No extra points are earned for tangential answers which aren't a direct response to the question. You are graded solely on the validity of your answer. Likewise, graders do not care how nicely you write. As long as you write the correct response in a legible manner, you'll receive credit. Bullet points are encouraged.

Prioritize the questions - If you're a normal test-taker, you won't have time to answer all the questions in the morning session as fully as you'd like. Don't spend too much time on a question in your weak area at the expense of others in your strong areas. Within the questions, answer select parts and not others to receive partial credit.

Answer with confidence - You lose points for straddling two answers, even if one is right. Write your answer and defend it as strongly as you can, given the circumstances. Graders are working from model answers; however, graders will consider non-model answers on their own merits and, if the answer is valid given the information provided, will give credit for such alternative answers.

...The Free Lunch - continued from page 1

forcing one's chosen target to drop to one knee and rapidly drink a lukewarm, moderately unpalatable malt beverage – sometimes even on the trading floor). Imagine my shock and amusement when I opened an inter-office mailing envelope to find that I was the cruel victim of a transcontinental icing; it even helped me forget for a moment that normal, everyday Americans hate me. In the year of humor, we traded in BankersBall.com, “where investment bankers come to party,” for the aptly named SadGuysOnTradingFloors.com, which, with its pictorials of dejected men losing large sums of other people’s money, helped us to find the humor in, and rise above, the despair of this downtrodden year. These comedic antics, however juvenile, made up our stand in 2010 or, as Conrad Hyers suggested, our “stubborn refusal to give tragedy... the final say.”

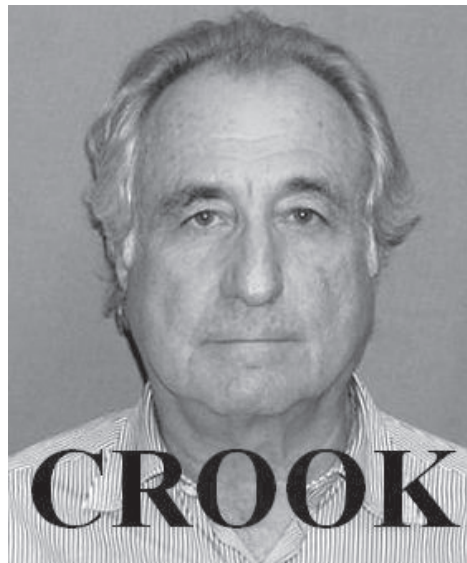
Mere subsistence isn't our way of life though, as clearly evidenced by a recent Bloomberg headline, “Half of Bankers May Quit If Bonuses Disappoint.” We expect year-end cash windfalls, thank you very much. Our grin-and-bear-it approach has even led to the sacrilegious cancellation of Christmas (or at least our boondoggle Christmas parties). This is particularly troubling, given that we're the practitioners of God's work (well, at least Goldman is). It wasn't always like this though: at one point, it was completely appropriate for John Thain, Merrill Lynch's now-former CEO, to run up a \$1.2mm tab decorating his office and later apologize by rationalizing, “The expenses were incurred over

a year ago in a very different environment.” You may be asking yourself, “How could he possibly have thought it was okay to use company funds on an \$87k area rug?” But you'd be missing the point – the right questions is, “How do we get back to that ‘very different environment?’”

Unfortunately, there are a few serious impediments to us turning back the clock, cranking up the music, and getting up and dancing, not the least of which is the aforementioned public that hates us: over 70% of Americans want the government to ban our bonuses, contract law be damned. This may seem like a formidable obstacle at first glance, but I'm not ready to throw in the towel just yet. After all, for a community that could transform so-called toxic waste (sub-prime mortgages) into cold, hard cash for the better part of a decade, nothing is impossible. We could say we're sorry and try to move on, but that would be too simple. Or we could go completely the other way and give the not-so-contrite Madoff response: “F--- my victims. I carried them for twenty years, and now I'm doing 150 years.” Bernie, however, lives in a 6'x6' windowless box and regularly sports an orange jumpsuit, so that can't be the right answer.

Perhaps we could pack up and tell America that we're taking our talents to... hmmm... But where would we go? I doubt we're a high priority for the International Rescue Committee. So, what should we do?

I'll think about that in 2011. After all, 2011 is another year!



“To most Americans, this might as well have been our collective portrait”

The Bonus Conundrum - by Damon G. Krytzer, CFA

“So, what do you do for a living?” asked my London cab driver. “I work in finance” I replied, which apparently surprised him, since, as he explained, most financial professionals seem more comfortable to just say they drive a truck or paint houses.

In this holiday (*bonus*) season, it seems fitting to weigh in on compensation in the financial services sector, specifically on the effectiveness of regulation. On one hand, financial compensation practices have led to misaligned incentives and excessive risk-taking, and thus have contributed to instability in the financial markets. On the other hand, punitively restricting the pay of finance professionals based on a simplistic populist notion that ‘bankers’ are just paid too much would likely not lead to a desirable outcome either. For a productive outcome on reform, all stakeholders including regulators, directors and executives have a role to play in eliminating unsafe compensation structure without destroying the entrepreneurial spirit that drives the US financial system.

The pure interest of the shareholder is broadly covered by the setting of incentives for the employee to succeed. That is the entire point – pay-for-performance practices encourage activities in the best interest of shareholders. For that to happen, the compensation structure must correctly measure and reward performance, and should avoid unintended risk consequences.

This puts compensation committees in a tough spot; making compensation “fair”, as defined by the general population, while still rewarding (*and retaining*) top traders and bankers. Over the past few years, many firms have reigned in the percentage of net revenue paid out in response to hostile public opinion, but the pay numbers distributed to many professionals are still large enough to appear as if the financial crisis never happened.

Until recently, the actual distribution of this asset pool was completely opaque, and the trend towards greater transparency is only continuing. Andrew Cuomo of New York has gone so far as to demand total distribution transparency; who and how many are at the top of the pay scale, rather than simply the total pool divided by the number of recipients. This leads me to believe that taxes are in mind as a deterrent, with lawmakers proposing bonus taxes as high as a 75%, or even suggesting a complete elimination of the bonus pool altogether. This seems to be a veiled populist response, as simply ascertaining the names of the recipients and the amounts received does not consider the shareholder value created by the recipients as a result of earning those bonus incentives.

Many financial firms contend that the real cause of financial system instability was a political response to rising income disparity. Policymakers kept interest rates low and Fannie & Freddie kept churning out mortgages so that

the voting public would feel richer (*on funds borrowed from their phantom home equity*) and more optimistic when it came time to go to the polls. While it would be wrong to absolve the banks of all wrongdoing, it is hard to argue that they paid back the TARP, generated a profit for taxpayers and shareholders alike, and should now pay the people that made it happen. While banks probably owe taxpayers more considering that so many programs, such as bank-issued debt backed by taxpayers, and the \$1 Trillion+ that the Fed has infused into system, have clearly benefitted bank profitability, it is hard to see why employees driving the positive results should simply be punished.

With the interests of financial professionals and lawmakers at odds, it is ultimately the shareholders that are best equipped to decide efficient and sustainable structure; this stakeholder understands more clearly than regulators how the underlying business works. Shareholders are in the best position, through the appointed board of directors, to govern compensation in the best interest of a sustainable business. In a capitalist society, they are intended for the job.