



# Retooling Risk Management

## IAFE Conference

December 1, 2009

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# Client's Reactions: Portfolio Construction

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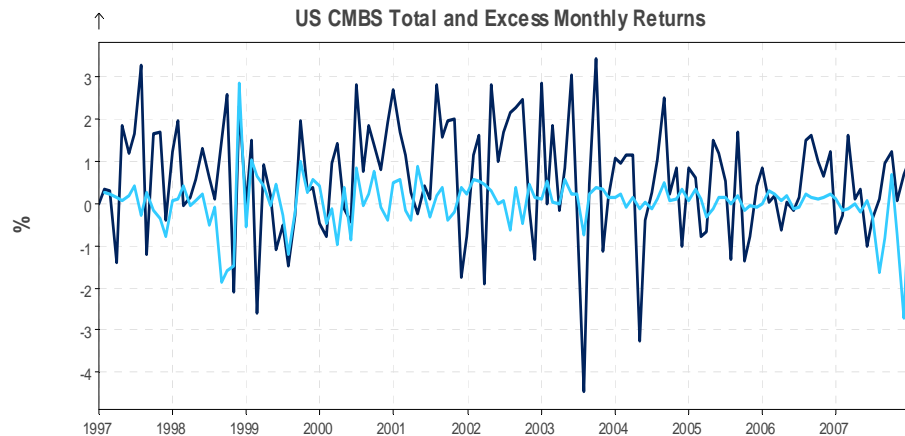
POINT Portfolio Modeling

- Return
  - ▶ Question the sources of “alpha”
  - ▶ Looking into correlated exposures
  - ▶ Liquidity and cost-to-close: The absolute major overlook
  - ▶ Discretion on over-ruling quantitative models
    - For example, hard-to-measure exposures, such as oil
- Risk
  - ▶ Intensive use of the models
  - ▶ Different spin on the use of risk models
    - Know the models, assumptions, and their conditional nature
    - Know the people
      - Breadth of research
      - State-of-art modeling – Bounce back ideas
      - Track record of implementing and communicating model changes
      - Close to the market

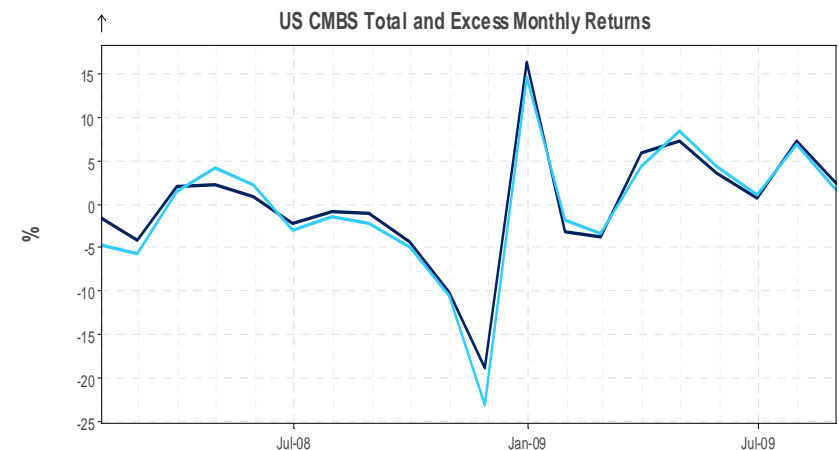
# Risk Models: What Went Wrong

POINT Portfolio Modeling

- Correlations: Basis risk and hedges
- Traditional Scenario Analysis: Worries with the unknown
- Total collapse of issuer/sector-concentration constraints
  - ▶ Systemic macro risk, not idiosyncratic
- Volatilities: For example, securitized investment grade products
  - ▶ CMBS volatility: From “agencies” to equities



Key	Axis	Name	Last	Minimum	Maximum	Mean	SD
—	Left	Inv Grade CMBS - Total Return	1.10	-4.46	3.44	0.57	1.32
—	Left	Inv Grade CMBS - Excess Return	0.91	-2.70	2.84	0.03	0.59



Key	Axis	Name	Last	Minimum	Maximum	Mean	SD
—	Left	Inv Grade CMBS - Total Return	2.49	-18.80	16.45	-0.07	6.96
—	Left	Inv Grade CMBS - Excess Return	1.72	-23.19	14.66	-0.59	7.58

Source: Barclays Capital

# Risk Models: What Went Right

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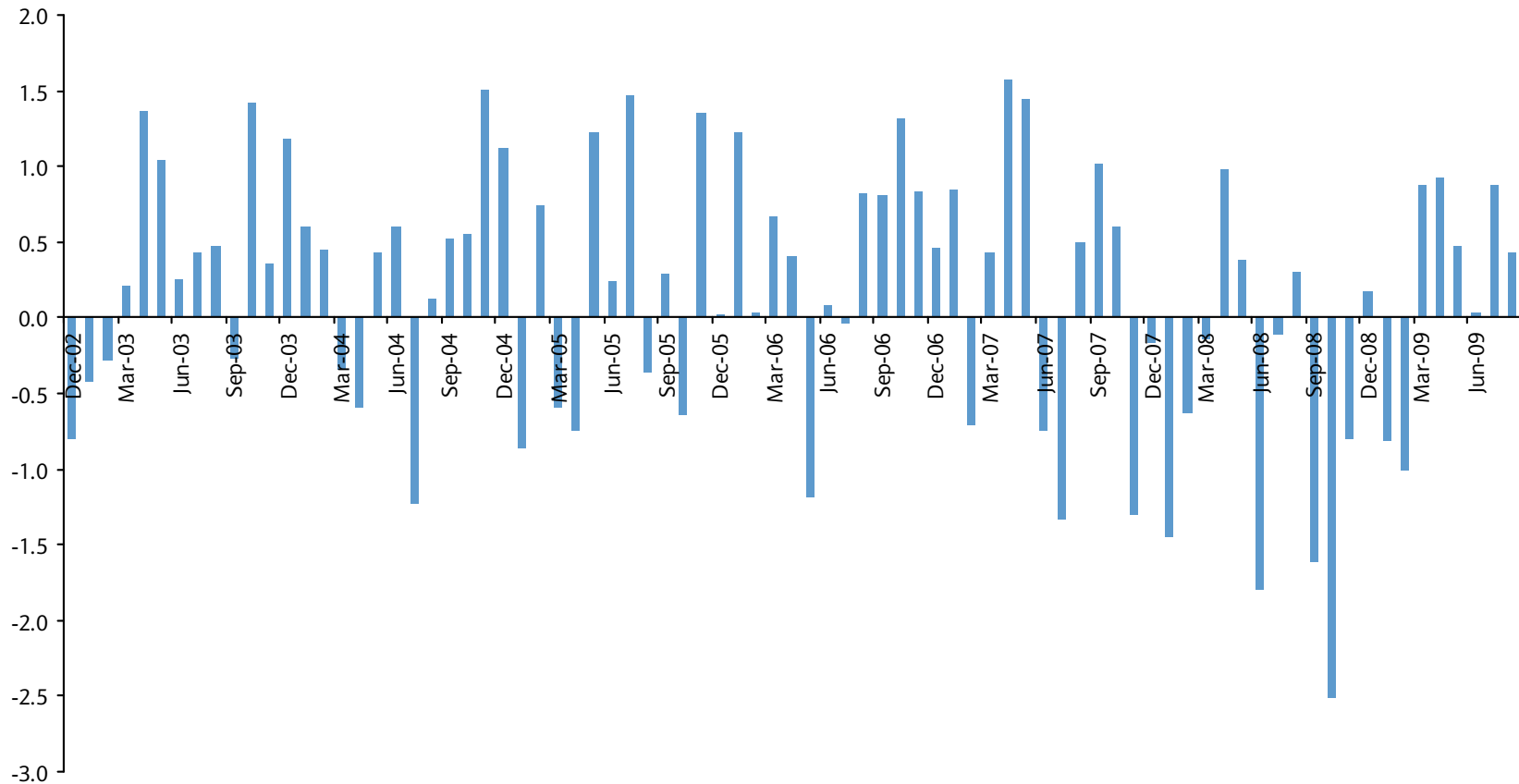
POINT Portfolio Modeling

- Conditional models
  - ▶ More invariant factors
  - ▶ Frequent updates of conditioning variables
  - ▶ *Judicious* use of high/mixed frequency data
- Also faring well in recovering from the markets' volatility highs
- Cross-markets loops/feedback
  - ▶ From the equity markets in what regards default probabilities
  - ▶ Distress in equities coming from the credit market
  - ▶ Good description of the sources of risk

# What Went Right: Example I

POINT Portfolio Modeling

## Standardized Returns for the US Market Portfolio

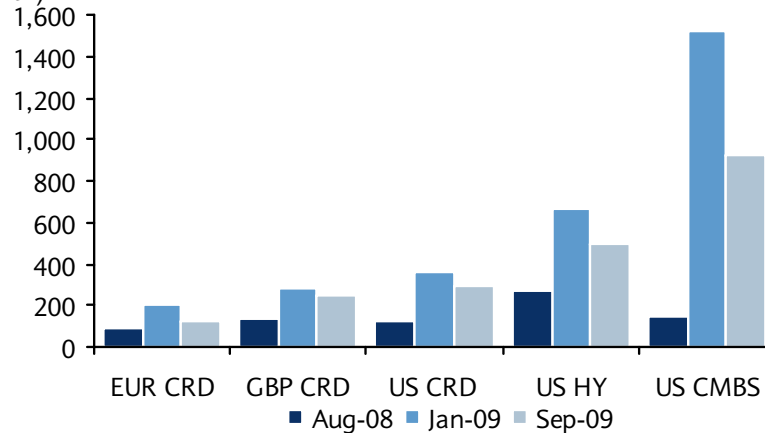


Source: POINT, Barclays Capital

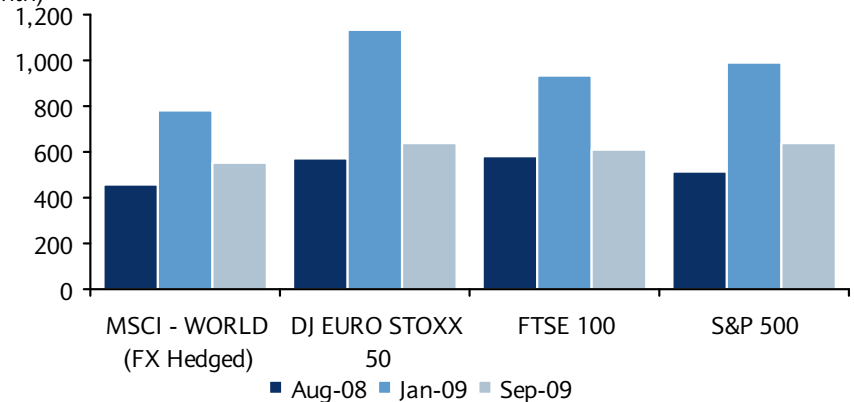
# What Went Right: Example II

POINT Portfolio Modeling

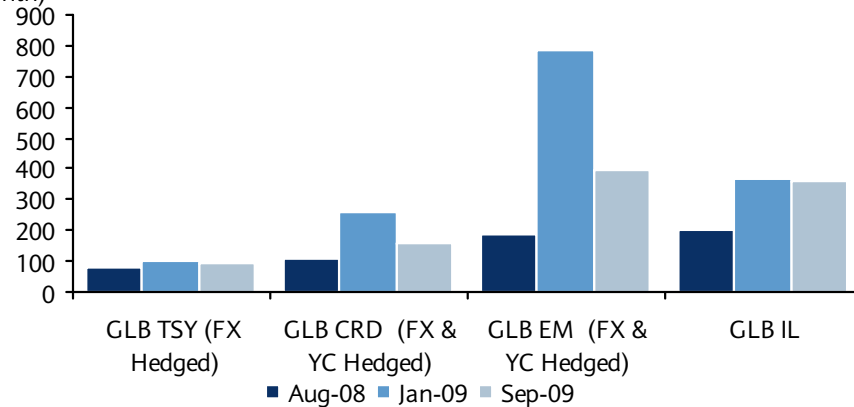
TEV Forecast  
(bp/month)



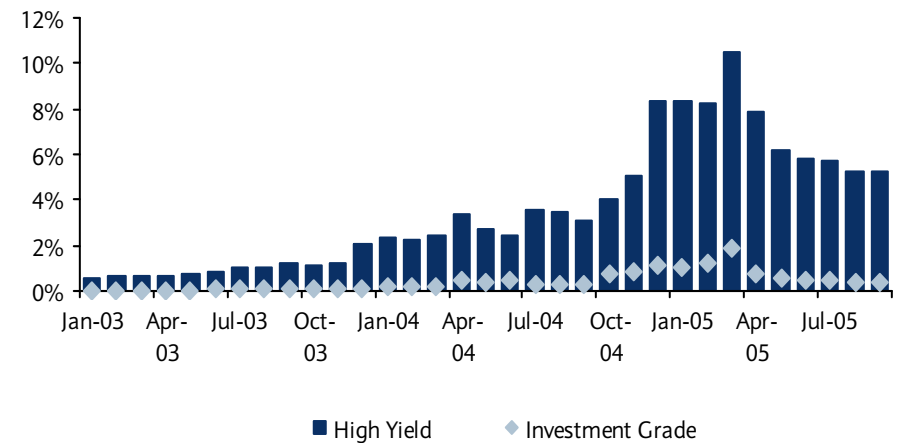
TEV Forecast  
(bp/month)



TEV Forecast  
(bp/month)



POINT Corporate Default Probability (1 year)



Source: POINT, Barclays Capital

# Going forward

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POINT Portfolio Modeling

- What clients are asking for:
  - ▶ Scenario analysis and stress-testing
  - ▶ Risk models:
    - Are they overshooting?
    - Conditional dynamic correlations across asset classes
    - Independent risk assessments at different frequencies
    - Volatility and higher moments: For example, skewness
    - New alpha/risk factors? Government, skewness, short interest
- Other interesting research points and challenges:
  - ▶ Cross-asset class dependencies:
    - Putting together data of very different nature
    - Model synchronization
    - Availability of *good* data versus rich conditional models
  - ▶ Correlation: Asymmetric nature and tail clustering

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