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July 2019

Article of the month:

An efficient portfolio loss model

July 2019. Christian Fenger (Quant at Danske Bank since 2005)

We propose a new parsimonious model for valuating portfolio credit derivatives dependent on aggregate loss. The starting point is the loss distribution, which is constructed to be time dependent. We let the loss be beta distributed, and, by implication, the loss process becomes a stochastic jump process, where a jump corresponds to losses appearing simultaneously. The model matches empirical loss data well with only two parameters in addition to expected loss. The size of the jump is controlled by the clustering parameter, and the temporal correlation of jumps is controlled by the autocorrelation parameter. The full model is relatively efficient to implement, as we use a Monte Carlo at portfolio level.

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Variance Premium, Downside Risk, and Expected Stock Returns

June 2019. Bruno Feunou (Bank of Canada), Ricardo López (Syracuse Univ.), Romeo Tedongap (ESSEC Business School), Lai Xu (Syracuse Univ.)

We decompose total variance into its bad and good components and measure the premia associated with their fluctuations using stock and option data from a large crosssection of firms. The total variance risk premium (VRP) represents the premium paid to insure against fluctuations in bad variance (called bad VRP), net of the premium received to compensate for fluctuations in good variance (called good VRP). Bad VRP provides a direct assessment of the degree to which asset downside risk may become extreme, while good VRP proxies for the degree to which asset upside potential may shrink. We find that bad VRP is important economically; in the cross-section, a onestandard-deviation increase is associated with an increase of up to 13% in annualized expected excess returns. Simultaneously going long on stocks with high bad VRP and short on stocks with …

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A Step Ahead of Crisis

June/July 2019. Kelly Hennigan and Martin Snow (The Actuary Magazine)

While more than 10 years have passed since the Sept. 15, 2008, collapse of Lehman Brothers and the last full-blown international banking crisis, the qualitative and quantitative risks affecting our industry and the way we work have never been greater. The pace of regulatory, technological, operational and environmental change is quicker than ever before. Innovation is moving forward and affecting us in ways we would not have imagined a few years ago.

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Risk Factors, Macroeconomic Context And Forecasts

July 2019. Didier Borowski (Head of Macroeconomics Res.),Philippe Ithurbide (Global Head of Res.)

Risk Factors: The table within the article presents risk factors with judgmental probabilities (i.e. not market based). It also develops the possible market impacts.

Macroeconomic Context: Our convictions and our scenarios. This section provides a reminder of our central scenario and alternative scenarios.

Macroeconomic picture by area: An overview of the macroeconomic outlook for world's major economic regions.

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Why a cashflow-conscious approach is increasingly important for liability mgmt strategies

July 2019. Mark Humphreys (Head of Invesco Investment Solutions EMEA)

Over recent years, the improvement in funding levels for defined benefit (DB) pension plans has amplified the importance of implementing de-risking strategies to hedge liabilities and ultimately bringing plans closer to their goal of securing benefits. This can be via the transfer of risk in the form of an annuity or buy-out with an insurer, or in a 'self-sufficient' state. Liability driven investment (LDI) is generally thought of as enabling schemes to bridge the gap in funding levels via the use of leveraged derivatives for hedging and growth assets to close deficits.

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Resampling slashes credit risk VAR underestimates – research

July 2019. Alexander Campbell (Editor at Risk.net)

It's a perennial dilemma for credit risk managers: how do you gauge an accurate picture of risk exposure on loan portfolios where data is thin or discontinuous? If available data only covers a few years, a lender could be significantly underestimating its credit risk value-at-risk. But, according to new research, judicious use of resampling techniques can remove most of this risk, where banks are applying one of the most commonly used interest rate risk models.

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Swaptions face valuation hit on discounting switch

July 2019. Lukas Becker (derivatives desk editor for Risk.net)

Investors in euro and US dollar swaptions could see widespread gains and losses when the discounting and collateral rates for cleared swaps are changed as part of benchmark reform efforts. Swaptions valuations are based on the price of the underlying cleared interest rate swaps, typically those cleared at LCH. The clearing house is set to change the rate used to discount the present value of euro and US dollar interest rate swap cashflows, and to determine interest payments on cash collateral.

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MSCI warns of €1bn-plus funds running liquidity risks

July 2019. Nick Reeve (IPE News editor)

Roughly 1% of large, equity-based UCITS investment funds have less than half of their portfolios invested in highly liquid assets, raising questions about their ability to meet high levels of investor redemptions, according to analysis by MSCI. The data firm reviewed about 400 UCITS funds with assets of more than €1bn and found that seven held more than 15% in illiquid assets, while “approximately 1%” had less than half invested in “highly liquid” assets.

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How AI could tear up risk modelling canon

July 2019. Faye Kilburn (Senior Staff Writer at Risk.net)

A pale Mark Zuckerberg blinked nervously and shifted in his chair. The head of social media giant Facebook sat before stony-faced members of a US Congressional committee in April facing interrogation over a scandal that saw the personal data of millions of users harvested for political campaigning. The risk to the company’s future was evident, as Zuckerberg’s uncomfortable appearance betrayed. Yet, little of this risk was reflected in the standard financial metric for assessing the likelihood

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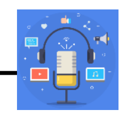
10 most common investment mistakes, how to avoid them and stay on the right track



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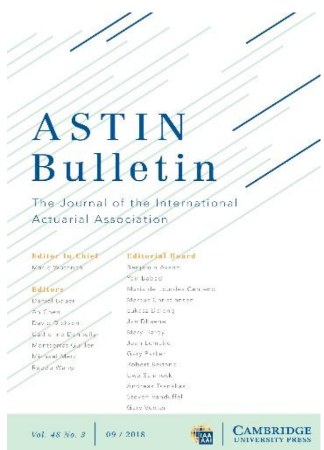

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