



Retooling Risk Management

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Client's Reactions: Portfolio Construction

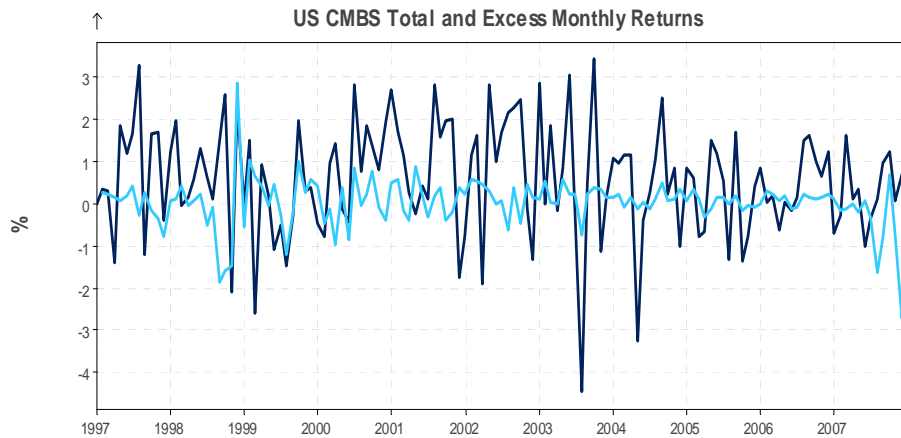
POINT Portfolio Modeling

- 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

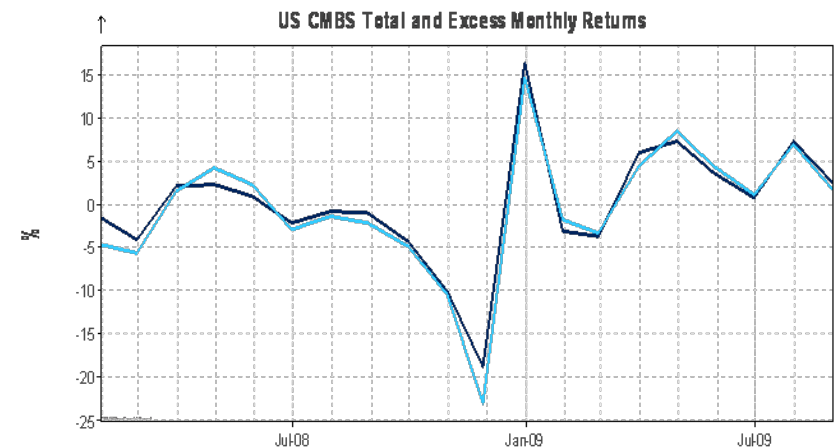
- Risk
 - ▶ Intensive use of the models
 - ▶ Different spin on the use of risk models
 - Know the models, assumptions, and their conditional nature
 - Know the people
 - Breadth of research
 - State-of-art modeling – Bounce back ideas
 - Track record of implementing and communicating model changes
 - Close to the market

Risk Models: What Went Wrong

- 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	07/31/2003	3.44	09/30/2003	0.57	1.32
—	Left Inv Grade CMBS - Excess Return	0.91	-2.70	11/30/2007	2.84	11/30/1998	0.03	0.59



Key	Axis Name	Last	Minimum	Maximum	Mean	SD		
—	Left Inv Grade CMBS - Total Return	2.49	-18.80	11/28/2008	16.45	12/31/2008	-0.07	6.96
—	Left Inv Grade CMBS - Excess Return	1.72	-23.19	11/28/2008	14.66	12/31/2008	-0.59	7.58

Source: Barclays Capital

Risk Models: What Went Right

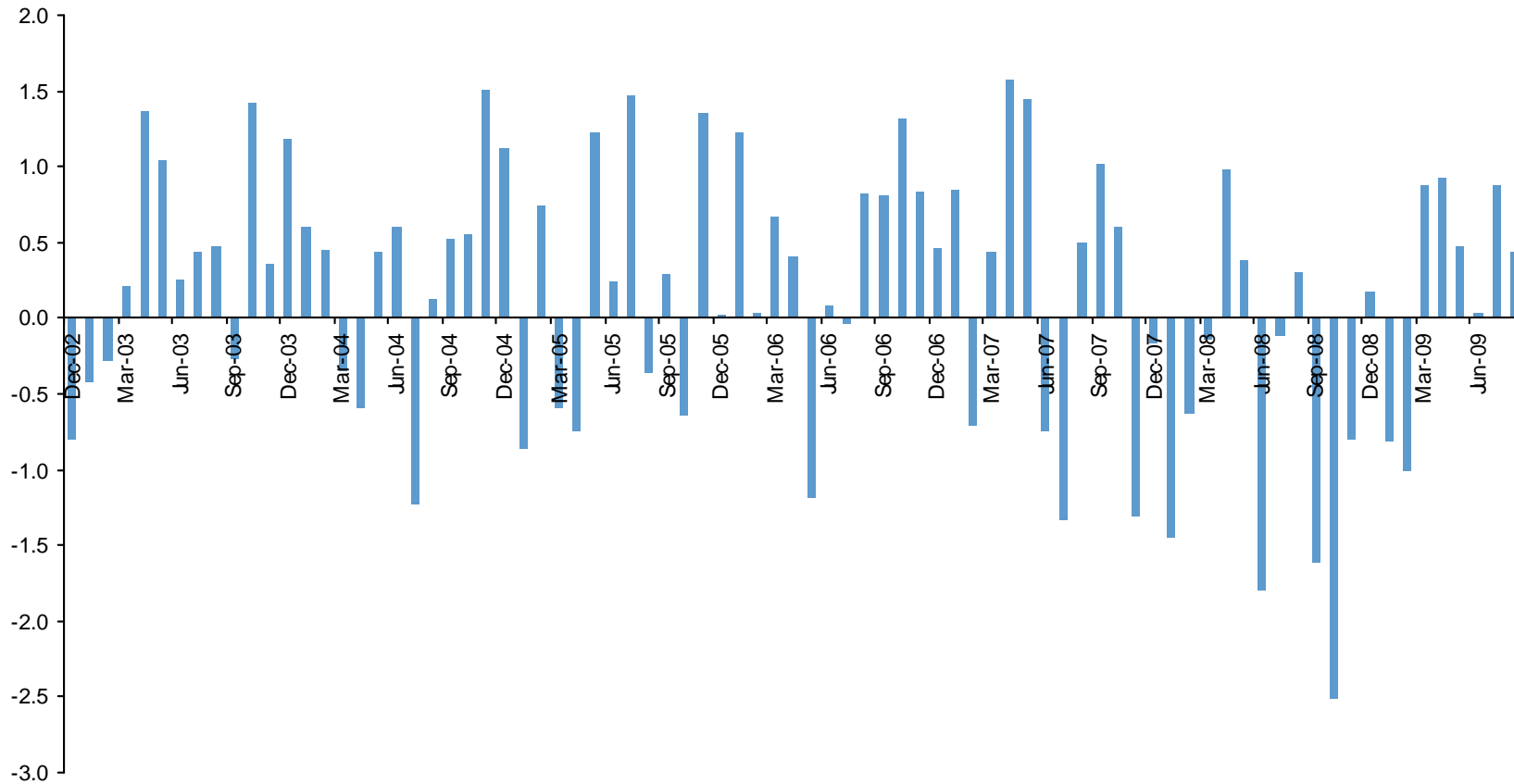
POINT Portfolio Modeling

- 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

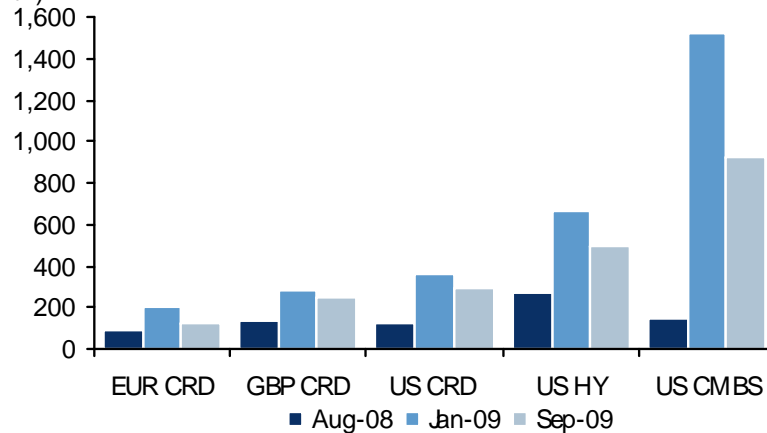


Source: POINT, Barclays Capital

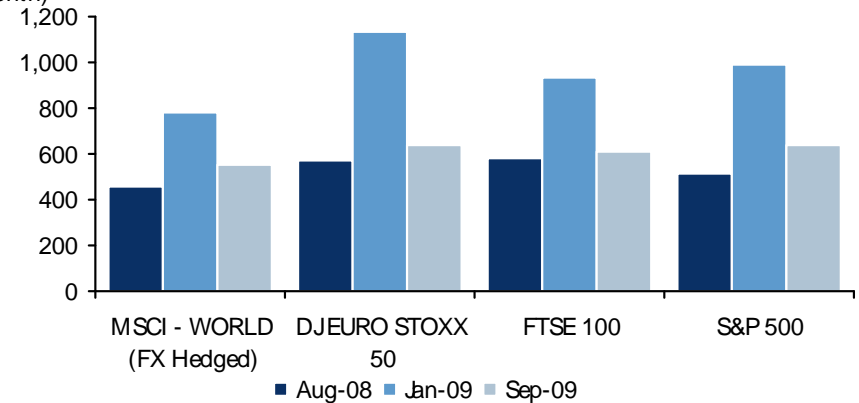
What Went Right: Example II

POINT Portfolio Modeling

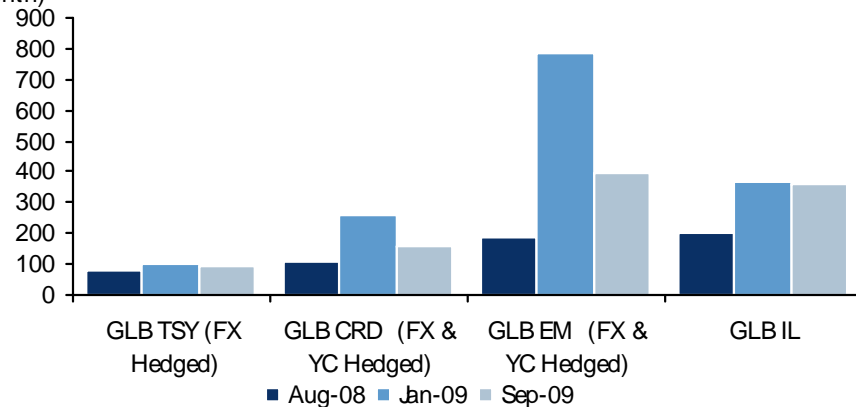
TEV Forecast
(bp/ month)



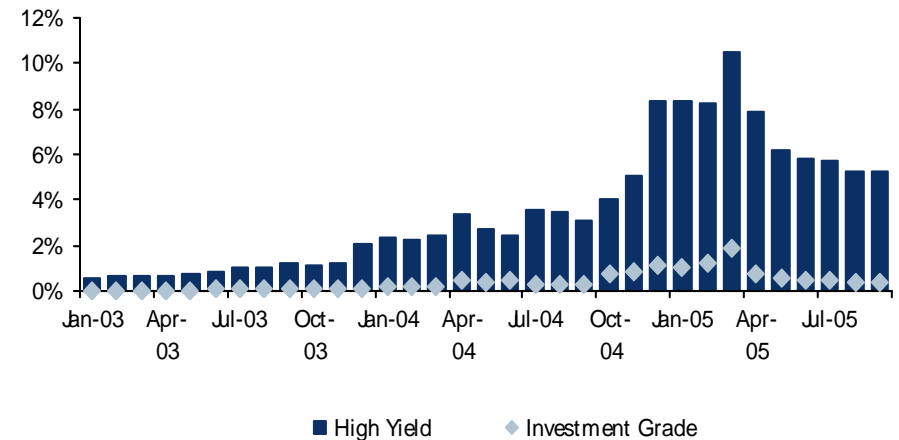
TEV Forecast
(bp/ month)



TEV Forecast
(bp/ month)



POINT Corporate Default Probability (1 year)



Source: POINT, Barclays Capital

Going forward

- 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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