

THE INTERNATIONAL ASSOCIATION OF FINANCIAL ENGINEERS



**IAFE Annual Conference –**

# **Financial Markets: Innovation or Revolution?**

**May 24, 2006 - New York, New York**

## **Where is all the risk?**

**with panelists**

**Stephen Figlewski**

**Professor of Finance, Stern School of Business - New York University**

**Charles Fishkin**

**Director – Office of Risk Assessment, Securities and Exchange Commission**

**Andrew Weisman**

**Managing Director, Merrill Lynch**

**Moderator**

**David Rowe**

**EVP for Risk Management, SunGard-Adaptiv**

# Elements of the Risk Puzzle



# IAFE Annual Conference 2006

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## Panel Discussion:

### Where is All the Risk?

by Stephen Figlewski

NYU Stern School of Business



# Shoes Waiting to Drop

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*"Things that can not continue the way they are now...won't."*

- **Federal budget deficit**
  - **Balance of trade / balance of payments**
  - **Long term interest rates**
  - **Real estate prices**
  - **Demand for oil at \$70+ per barrel**
  - **Equity volatilities; credit spreads**
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# Shoes Waiting to Drop

## The VIX Index in the Last 3 Months

CBOE SPX MARKET VOLATILITY INDE  
as of 22-May-2006



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# **Past Performance is No Guarantee of Future Results**

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## *Statistical Analysis of Historical Data Can Be Misleading*

- **Inherent limits to statistical estimation**
  - **Volatilities and correlations go up in a crisis**
  - **Time variation in the economic environment**
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# Crouching Risk, Hidden Disaster

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*Even for Known Unknowns, It's Hard to Know Much*

- **nonlinearity**
  - **separating expectations from risk tolerance in implied parameters**
  - **behavioral factors**
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# Elements of the Risk Puzzle



**Summary  
And  
Conclusion**