

Scenarios and Risk

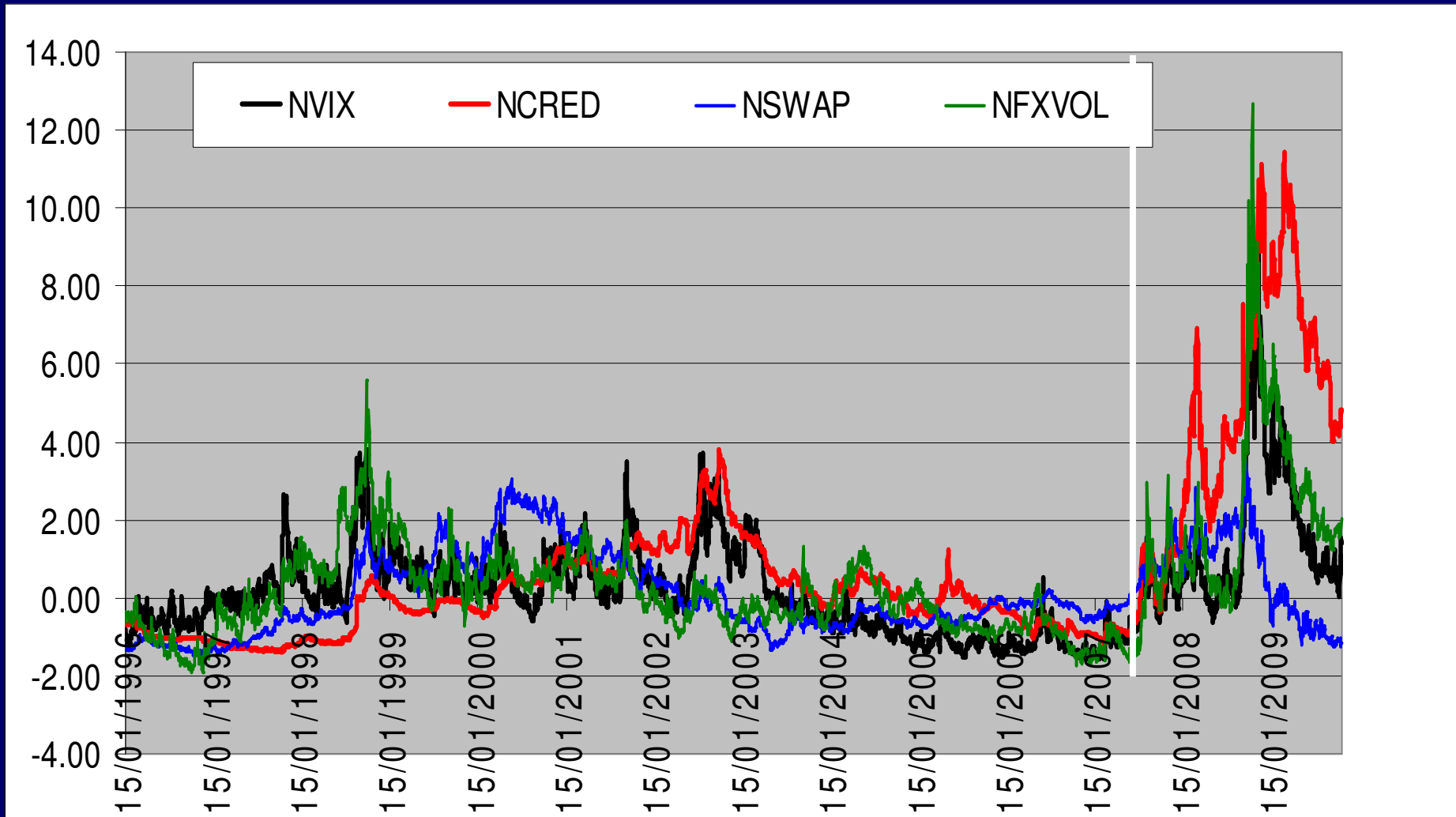
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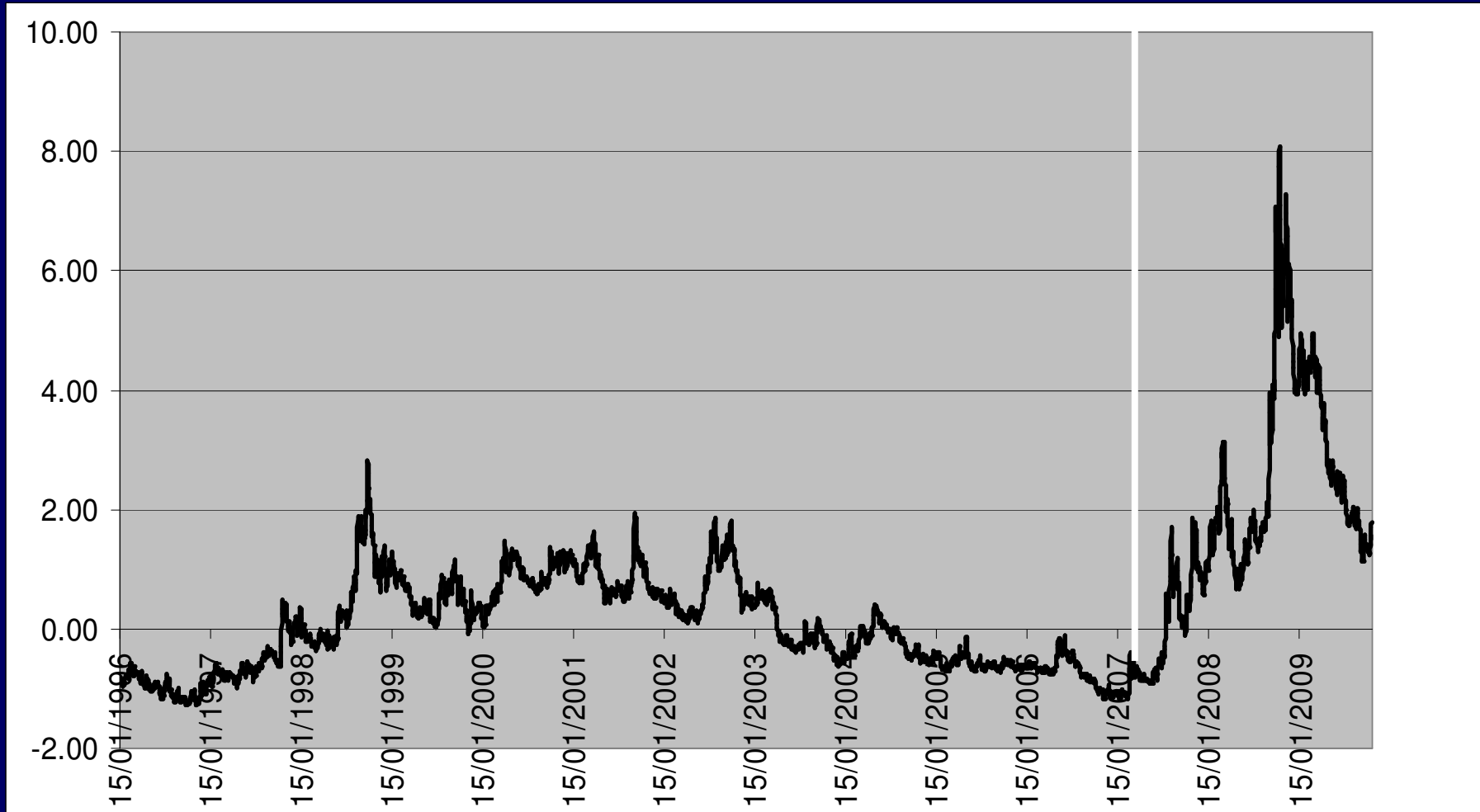
- **Risk Indicators**
- **Some VIXing Thoughts**
- **Current State**
- **Investment Themes**

Risk Indicators



NormedBarometer

(avg., scale normalized on 96-07 distribution)



VIX May08-date



VIX zoom: Jun08-Oct08



Note not only the level, but also the **intra-daily variation**

Vol-of-vol peaking

What do we make of that?

VIX zoom: May09-date



Note the recent
intra-daily
move 25→30

→ Must analyze
scenarios

15% for <750

What do we
make of that?

"Green shoots or yellow weeds?" **is back!**

■ **CONSUMERS: tapped out**

- De-lever? How?
- Home equity ↘
- Savings ↘
- Wages stagnant, commodities up

■ **CORPORATES: tapped out**

- De-lever? How?
- Credit EXPENSIVE
- Earnings ↘
- Capital investment ↘
- Freeze frame

■ **BANKS: tapped out**

- Earnings + writeoffs 🟡↘
- Toxic assets
- More trouble ahead? (cmbs, consumer,...)
- Freeze frame*

■ **INFLATION**

- Deficit >10% as far as the eye...
- Why not? (debt ↘...)

■ **EMPLOYMENT**

- Lagging AND leading

■ **The \$**

- Inflation
- Deficit >10% as far as the eye...
- Central bank rebalancing
- Further LT bond purchases (?)
- Safety allure dented (AAA?)

■ **CREDIT**

- Government-run sector (no exit)
- Priority, hence pricing, in disarray

■ **REAL ESTATE**

Hot issues:

The Economy:

- Excess capacity meets dwindling stimulus
- Stimulus II ?
 - damn if you do (inflation, ccy crisis)
 - dam if you don't (W)

The Financial Sector:

- Resolution regime
 - damn if you do (can we handle the truth?)
 - dam if you don't (banks=GSEs)
- Neither banking nor credit pricing is issue, it's the liquidity/maturity mismatch of assets and liabilities

INVESTMENT THEME: stagflation scenario

Longs

- TIPs
- Corp bonds
of MNCs, ccy and ir risk protected
- GLD
commodities more generally

Key question: diversification
(decoupling), affects perception
of eg EM ccys, bonds and equities

downwt / Short

- LT Gvmnts
- Equities
esp financials
- USD
- **Macro Hedges**

	<i>peak-trough</i>	<i>trough-now</i>
<i>SP500</i>	-55%	55%
<i>STOXX50</i>	-60%	50%
<i>H S I</i>	-62%	84%

Major risk factors

- Where is the EXIT?
 - Excess liquidity → asset bubble
- More stimulus
 - Currency and bond crisis
- Decoupling a myth
- ...way down the road (2-3yrs at least) (?): sovereign crisis