Scenarios and Risk

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- Risk Indicators
- Some VIXing Thoughts
- Current State
- Investment Themes
NormedBarometer
(avg., scale normalized on 96-07 distribution)
### VIX May08-date

**VIX 29.78Y as of close 11/2**

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<td>Date</td>
<td>Range: 05/05/08 - 11/02/09</td>
<td>Upper Candle Chart</td>
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<td>Period</td>
<td>Daily</td>
<td>Lower Candle Chart</td>
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<td>Events</td>
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**Last:** 29.78

**High on:** 10/24/08 89.53

**Average:** 34.79

**Low on:** 05/19/08 15.82

![Graph showing VIX index over time](chart).
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?
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 \(\downarrow\)
  - Savings \(\downarrow\)
  - Wages stagnant, commodities up

- **CORPORATEs: tapped out**
  - De-lever? How?
  - Credit EXPENSIVE
  - Earnings \(\downarrow\)
  - Capital investment \(\downarrow\)
  - Freeze frame

- **BANKs: tapped out**
  - Earnings + writeoffs \(\downarrow\) \(\downarrow\)
  - Toxic assets
  - More trouble ahead? (cmbs, consumer,...)
  - Freeze frame*

- **INFLATION**
  - Deficit >10% as far as the eye...
  - Why not? (debt \(\downarrow\)...)  

- **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

**downwt / Short**
- LT Gvmnts
- Equities esp financials
- USD
- **Macro Hedges**

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

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<tr>
<th></th>
<th>peak-trough</th>
<th>trough-now</th>
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<tbody>
<tr>
<td>SP500</td>
<td>-55%</td>
<td>55%</td>
</tr>
<tr>
<td>STOXX50</td>
<td>-60%</td>
<td>50%</td>
</tr>
<tr>
<td>H S I</td>
<td>-62%</td>
<td>84%</td>
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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