#### **INVESTORS' RESPONSE TO GEOPOLITICS** OVERREACTION, RATIONALITY, RISK NEGLECT?

Client Advisory Acadian Asset Management



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#### Geopolitics: Salient Aspects

## Geopolitical Shocks

### Systemic Uncertainty

How to Manage?

Behavioral Lens to View Current Circumstances

# **Geopolitical Shocks**

## "The time to buy is when there's blood in the streets." – Baron Rothschild (??)

## Two Hypotheses

#### Overreaction

### **Economic Rationality**

#### "Shocks"



- Assassinations
- Coups/Revolutions
- Terrorism
- Civil Disruptions
- Industrial Disasters
- Natural Disasters
- Epidemics

## A Unique, Proprietary Dataset

- 1. Read-in/scrape on-line histories
- 2. Process text to select out events
- 3. Merge events with returns
- 4. Manual inspection



Sources: Acadian Asset Management LLC. Includes data from publically available blogs and wikis. For illustrative purposes only.

### The Data: Salient Stats

#### Туре

- Civil Disruptions + 86% Natural Disasters + Terrorism
- Assassinations + 5% Coups

Time	
• 1928 - 1997	27%
• 2006 - 2015	59%

Location	
• DM	39%
• EM	42%
• FM	16%

Sources: Acadian Asset Management LLC. Includes data from publically available blogs and wikis. Date Range: 1928-2015. For illustrative purposes only.

## Event Study Approach



Source: Acadian Asset Management LLC. For illustrative purposes only.



Cumulative Abnormal Excess Returns: Standardized vs. Control Window 0 Standard Deviations -1 All Events **Ex-Ante High Severity** -2 -3 -4 -2 -1 Event +1 +2 -3 +10-4 Trading Days Relative to Event

Local market returns (in USD) starting four trading days prior to an event. Standardized abnormal returns are daily returns less the market's prior 120-day average return and divided by its prior 120-day volatility. Date Range: 1931-2015. Ex-ante high severity events are those expected to impact markets based on a manual review of information likely available at the time of the event. Results reflect filtering of events with overlapping windows.

Sources: Acadian Asset Management LLC, Global Financial Data and publically available blogs and wikis. Returns are of the major local exchanges where each event occurred. It is not possible to invest directly in any index. Past results are not indicative of future results. Every investment program has an opportunity for loss as well as profits.

#### "Ex-Post" Severe Events

Cumulative Abnormal Excess Returns: Standardized vs. Control Window



Local market returns (in USD) starting four trading days prior to an event. Standardized abnormal returns are daily returns less the market's prior 120-day average return and divided by its prior 120-day volatility. Date Range: 1931-2015. Ex-post high-severity events are defined as those having cumulative losses during the event window (t-2 through t+1) in the worst 30% of the sample. Results reflect filtering of events with overlapping windows.

Sources: Acadian Asset Management LLC, Global Financial Data and publically available blogs and wilkis. Returns are of the major local exchanges where each event occurred. It is not possible to invest directly in any index. Past results are not indicative of future results. Every investment program has an opportunity for loss as well as profits.

#### Managing Event Risk: Quant Perspective



## Systemic Uncertainty

## Metrics of Uncertain Times



## Metrics of Uncertain Times

News-based Economic Policy Uncertainty Index U.S.: Green, Global: Blue



### But Macroeconomic Calm



Sources: CFNAI – Federal Reserve Bank of Chicago. Cross-sectional forecast dispersion, U.S. nominal GDP 4 quarters ahead, as measured by log difference of levels, 75<sup>th</sup> percentile minus 25<sup>th</sup> percentile. Source: Federal Reserve Bank of Philadelphia, Survey of Professional Forecasters. For illustrative purposes only. Past results are not indicative of future results. Every investment program has an opportunity for loss as well as profits.

## Seeds Of Risk Neglect?

Cognitive Vulnerabilities Disincentives to Prepare

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#### Analysis of geopolitics highlights quant frontiers

- Quantification of the qualitative (alt data)
- Deeper understanding of behavioral drivers

#### Geopolitical events: don't panic

- No evidence to motivate reflexive response
- Don't abandon systematic principles

#### Systemic uncertainty: market vulnerability?

- Previously offsetting uncertainties may soon reinforce
- Economic environment has been conducive to risk neglect

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