



# The global crisis and risk characteristics & measures for investors

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# The global crisis and risk measures



The way the global crisis of 2008-09 is changing the perception, characteristics and measures of risks for investors

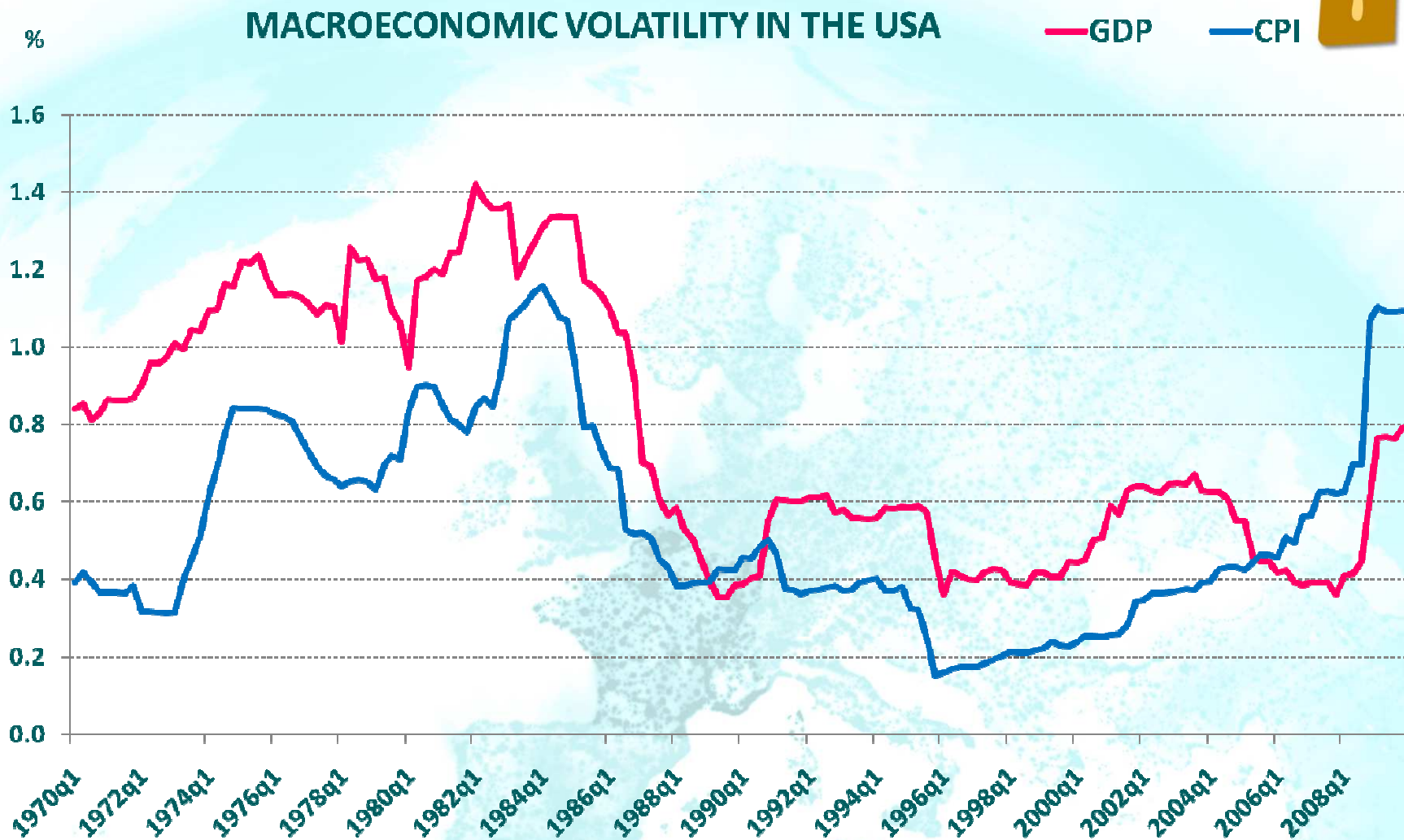
1. The “Great Moderation” and the illusion of risk under control
2. Uncertainty, risk and investment implications

# 1 - The “Great Moderation”



- A steady decline in macroeconomic volatility in major countries, coupled with evidence of successful “convergence” of major emerging markets
- Massive reliance on quantitative models, with fundamental assumptions on probability distributions and “rare events”
- Financial innovations and deregulation suggesting a better spread of risks across financial institutions

# 1 - The “Great Moderation”



Source: TAC, BEA, BLS 4

## 2 – Uncertainty, risk and investment

### Decisions and investment



- The Knight concept of risk versus uncertainty: implication for modeling and quantification
- The critical role of macro elements in risk measures, and non-linearity between macro and risk
- Application to investment decision: cost of capital revisited

## 2 – Uncertainty, risk and investment



### Decisions and investment

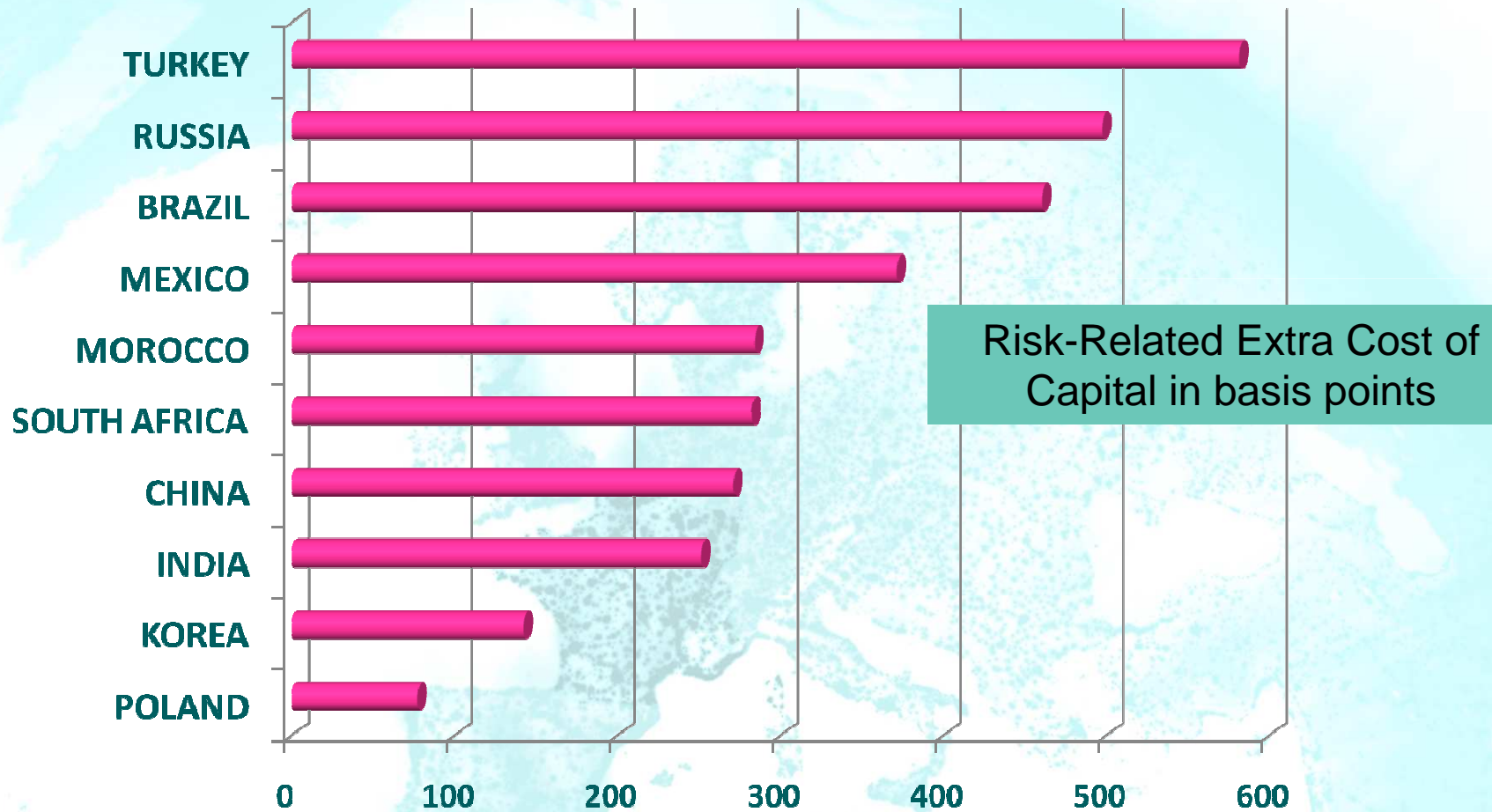
#### Application to investment decision: cost of capital revisited

- ❑ Move away from traditional CAPM models and incorporate macro factors as determinant of risk to be captured in hurdle rates and comparison with IRR
- ❑ Applied to both developed and emerging economies:
  - In developed countries, a risk premium defined by volatility of macroeconomic or macro-financial indicators with a specific attention to “fat tails”
  - In emerging economies, a risk premium defined by country risk assessment including political risk, currency risk payment risk and activity risk

## 2 – Uncertainty, risk and investment



Application to investment decision: cost of capital revisited



Risk-Related Extra Cost of Capital in basis points

Source: TAC



TAC is an independent research company specializing on applied economic and financial issues for investors, financial institutions and industrial companies

A strong quantitative expertise, notably in non-linear modeling, completed by in-depth knowledge and long-standing experience of macro / financial issues as well as emerging economies

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