

Making forecasts more holistic

–DEFINING A FRAMEWORK FOR RISK ANALYSIS

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Boom times

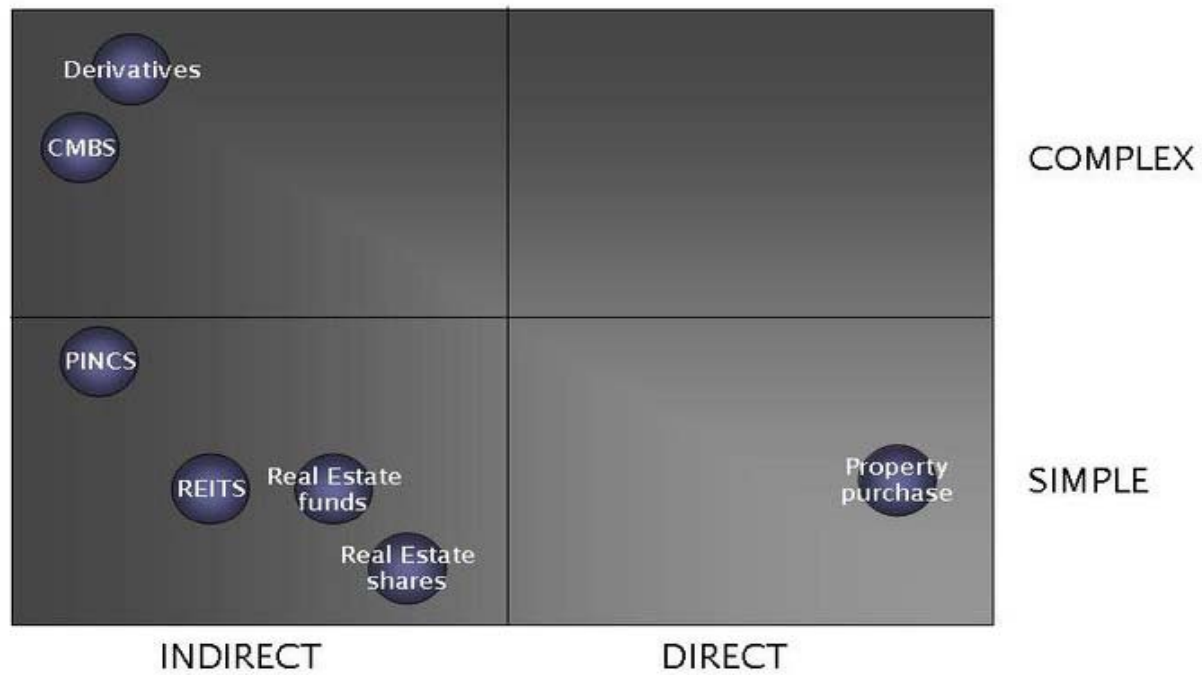


**Autumn economic forecasts 2006-2008: solid growth
and unemployment and deficits falling**

EU press release 6/11/2006

But then.....





Risk assessment

Market risk

Asset specific risk

Indirect

Direct

Indirect

Direct

Rating agencies

Market Actors

Rating agencies

Market Actors

Time to rein in the rating agencies

S.E.C. Criticizes Ratings Agencies' Conflicts of Interest

The great credit rating scandal

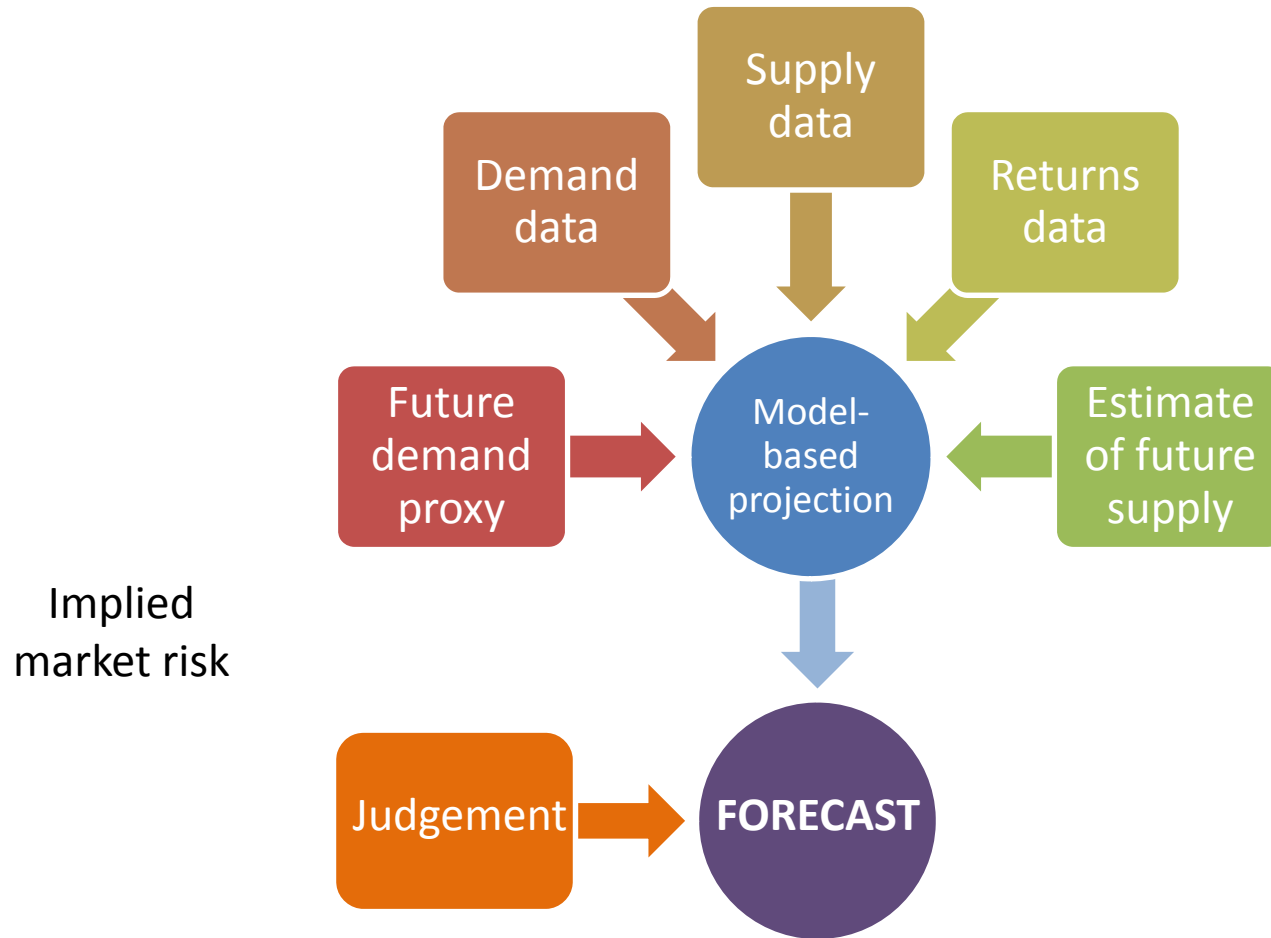


Brussels to reveal rating agency plans

Banks' links with rating agencies probed

Senators accuse rating agencies of conflicts of interest in market turmoil

Forecasts



What can the fund manager do with a forecast?

- Use it to wow the investment committee
- File it away
- Use it as one input to further analysis of the asset/ portfolio

If things turn out well he is a genius, if things go badly the forecaster can be blamed

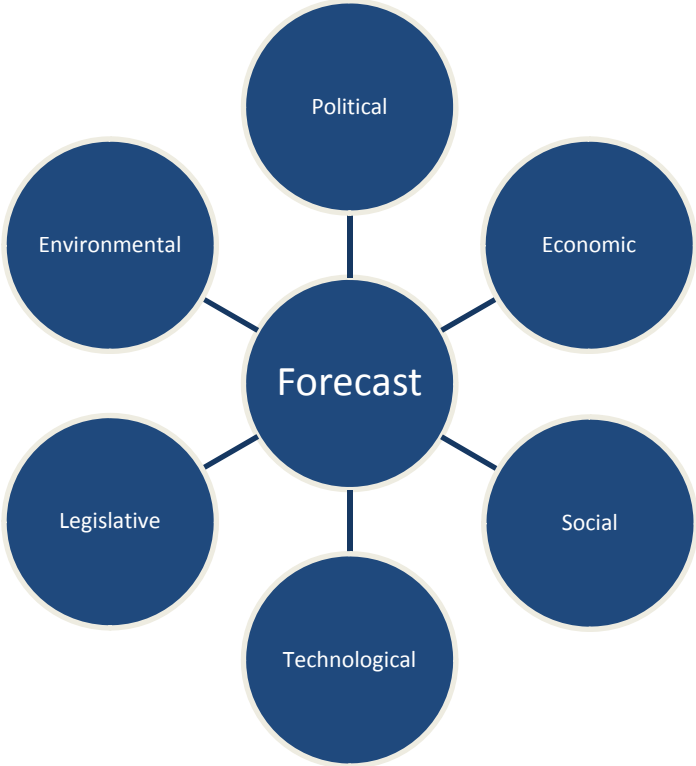
The investment decision has already been taken over lunch

Explore different market risk scenarios and make a more rounded decision

We need a model that:

- Takes forecasts as inputs
- Treats market risk objectively
- Applies judgement in a structured and explicit way
- Removes the influence of any optimism bias

PESTLE risk framework



Model

- Balanced scorecard
- Consultation on structural weights
- Potential for crowdsourcing of time weights

Summary

- Lessons from the recession :
 - Market risk is real
 - Outsourcing the analysis doesn't solve the problem
 - Structured, documented, holistic analysis is required
- Work in progress – next step build the model!