

# Analytics Risk Summit London 2024

Creating frameworks for geopolitical risks

Raina Oberoi, global head of equity solutions research at MSCI

So geopolitical risk actually has returned as a key risk impacting investment risk and return.

It's actually cited as one of the most, if not the most important concern on top of mind for investors today.

0:19

Now, investors today, if you think about it in terms of geopolitics, everyone talks about it, but I think they lack a consistent framework to actually think about how to measure, manage and monitor geopolitical risk.

0:34

Now, even before we get into that, let's take a step back in terms of how do we define geopolitical risk.

0:40

And it's funny that geopolitical risk is different to different people.

0:46

So you might get a different answer depending on who you ask.

0:49

And the reality is that it is actually very loosely defined today.

0:53

So, simply put, you know, many will tell you that geopolitical risk is about the challenges and opportunities that you face when you invest in foreign markets.

1:04

Now that definition is very limited because it ignores economic exposures.

1:10

Your domestic portfolio could also be exposed to geopolitical risk.

1:14

Now, there are others who extend the definition of geopolitical risk to include other types of risks, such as risk related to climate change or AI, for example.

1:25

And the thought there is that, you know, if countries cannot align and come together, then these risks actually may be really material and we may realize these risks and you know, which is one school of thought, but there is the other school of thought that we are actually clubbing all these risks together.

1:43

And once you start clubbing a bunch of risks together, how do you really isolate what is driving your portfolio risk and return?

1:51

So investors are really thinking about geopolitical risk.

1:54

But I think the challenge is that they do lack a systematic framework to think about it and to assess it.

2:00

And what MSCI has tried to do is really address the gap here and really provide a framework to be able to measure, manage and monitor geopolitical risk and to keep the, you know, the framework intuitive and simple what we have done is think about the investment horizon because geopolitical risk can vary depending on your time frame.

2:22

And we've really taken this approach to bucket the framework into three categories.

2:27

So there's a short-term investment horizon, there's a medium-term investment horizon and there's a long-term investment horizon.

2:33

Now in the short-term, what we see is that when there's a spike in geopolitical risk, markets do, you know, react in a riskier fashion, but that doesn't last that long, and the recovery can be fairly quick.

2:48

So then we go to the medium-term.

2:50

And in the medium term, what we see is that there are companies that are more sensitive to geopolitical risk versus others. Geopolitical risk can, for some companies, to actually make changes to their business model, and make actually fundamental changes to how they operate.

3:09

Now this can impact investor behavior, it can impact asset prices as everyone's anticipating on these companies to change.

3:19

So it really depends on which sector you are in, which country you are in.

3:23

But the medium term can be quite important because it can really differentiate companies on how they react to geopolitical risk.

3:30

And this is again an area of work that that we are thinking through a lot more significantly.

3:35

And then you go on to the long-term where you know, geopolitical risk can impact, you know, GDP growth and inflation and as a result of long-term capital market assumptions.

3:46

And how do you think about that?

3:48

How do you think about the equity risk premium that comes in?

3:51

So those are things also that investors are grappling with and MSCI is trying to address that using our research.

3:58

So what geopolitical risk has really done, or geopolitics has really done is create economic blocks across the world.

4:07

And simply put, these are countries that like each other, trust each other and want to do business with each other.

4:14

And you know, this rewiring of the global economy has impacted everyone, has created winners and losers as far as countries are concerned, as far as investment opportunities are concerned.

4:25

Now a lot of countries have done - had made a lot of effort to actually shore up their supply chain, right?

4:34

But I think the biggest impact has been on emerging markets where we see this, where we see the difference and we see an even further fragmentation of emerging markets.

4:44

Now on the flip side, it's also made investors allocate differently to emerging markets.

4:50

One of the most important things that we've seen is the exclusion or the separation of China from emerging markets as investors think about allocating to emerging markets.

5:02

And this is because, you know, in some cases they want to manage the risk differently because they think the risk of China is different from the rest of emerging markets.

5:11

And in some cases, investors have actually reduced the allocation to China.

5:17

Now MSCI specifically has launched something called a next-generation emerging markets model that actually uses this dual structure of carving out China from the rest of emerging markets, because we want to, you know, showcase that actually the risk drivers of those two blocks are different, which will help investors eventually manage that risk better.

5:39

So MSCI plays an objective voice when it comes to helping investors navigate such challenges.

5:46

You know, I could go on with a long list, but I think the two main areas I want to focus on is the emerging markets model that we talked about earlier with the dual structure to be able to measure the risk of emerging markets excluding China and then the risk of China separately.

6:05

And the second one is the geopolitical risk framework.

6:08

And you know, there it's an important aspect because depending on which time horizon you are, there are different tools and different pieces of research that can really help you navigate that environment.

6:20

So in the short term, you know, you could think about MSCI's stress testing and scenario analysis tools to figure out what is the impact of a certain geopolitical event or a shock to my portfolio.

6:32

In the medium term, you could use MSCI's data sets such as geospatial data and which really determines where a company's assets are located, as well as MSCI's economic exposure data, which showcases where a company's revenues are coming from, to really determine where are those risks and opportunities in terms of geopolitics.

6:54

And this will really help to differentiate between a certain group of companies versus others and determine which ones are more sensitive to geopolitics versus not.

7:03

There's also a lot of work that we are doing to think about other metrics that can actually measure the sensitivity of companies to geopolitical risk.

7:12

And now in the long-term, you know, geopolitics obviously can impact GDP in terms of lower growth, in terms of higher inflation and capital market assumptions.

7:22

And you know, we are thinking about ways in which our macro finance model can actually help address some of these implications.

7:30

When I think about the future of risk management and analytics, you know, it boils down to two things, which is data and transparency.

7:38

The investment landscape has become extremely complex and clean granular data and robust tools and solutions are absolutely essential to be able to figure out the why and the how.

7:51

And MSCI actually has a pivotal role in this changing landscape.

## About MSCI

MSCI is a leading provider of critical decision support tools and services for the global investment community. With over 50 years of expertise in research, data and technology, we power better investment decisions by enabling clients to understand and analyze key drivers of risk and return and confidently build more effective portfolios. We create industry-leading research-enhanced solutions that clients use to gain insight into and improve transparency across the investment process. To learn more, please visit [www.msci.com](http://www.msci.com).

This document and all of the information contained in it, including without limitation all text, data, graphs, charts (collectively, the "Information") is the property of MSCI Inc. or its subsidiaries (collectively, "MSCI"), or MSCI's licensors, direct or indirect suppliers or any third party involved in making or compiling any Information (collectively, with MSCI, the "Information Providers") and is provided for informational purposes only. The Information may not be modified, reverse-engineered, reproduced or disseminated in whole or in part without prior written permission from MSCI.

The Information may not be used to create derivative works or to verify or correct other data or information. For example (but without limitation), the Information may not be used to create indexes, databases, risk models, analytics, software, or in connection with the issuing, offering, sponsoring, managing or marketing of any securities, portfolios, financial products or other investment vehicles utilizing or based on, linked to, tracking or otherwise derived from the Information or any other MSCI data, information, products or services.

The user of the Information assumes the entire risk of any use it may make or permit to be made of the Information. NONE OF THE INFORMATION PROVIDERS MAKES ANY EXPRESS OR IMPLIED WARRANTIES OR REPRESENTATIONS WITH RESPECT TO THE INFORMATION (OR THE RESULTS TO BE OBTAINED BY THE USE THEREOF), AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, EACH INFORMATION PROVIDER EXPRESSLY DISCLAIMS ALL IMPLIED WARRANTIES (INCLUDING, WITHOUT LIMITATION, ANY IMPLIED WARRANTIES OF ORIGINALITY, ACCURACY, TIMELINESS, NON-INFRINGEMENT, COMPLETENESS, MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE) WITH RESPECT TO ANY OF THE INFORMATION.

Without limiting any of the foregoing and to the maximum extent permitted by applicable law, in no event shall any Information Provider have any liability regarding any of the Information for any direct, indirect, special, punitive, consequential (including lost profits) or any other damages even if notified of the possibility of such damages. The foregoing shall not exclude or limit any liability that may not be excluded or limited, including without limitation (as applicable), any liability for death or personal injury to the extent that such injury results from the negligence or willful default of itself, its servants, agents or sub-contractors.

Information containing any historical information, data or analysis should not be taken as an indication or guarantee of any future performance, analysis, forecast or prediction. Past performance does not guarantee future results.

The Information should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. All Information is impersonal and not tailored to the needs of any person, entity or group of persons.

None of the Information constitutes an offer to sell (or a solicitation of an offer to buy), any security, financial product or other investment vehicle or any trading strategy.

It is not possible to invest directly in an index. Exposure to an asset class or trading strategy or other category represented by an index is only available through third party investable instruments (if any) based on that index. MSCI does not issue, sponsor, endorse, market, offer, review or otherwise express any opinion regarding any fund, ETF, derivative or other security, investment, financial product or trading strategy that is based on, linked to or seeks to provide an investment return related to the performance of any MSCI index (collectively, "Index Linked Investments"). MSCI makes no assurance that any Index Linked Investments will accurately track index performance or provide positive investment returns. MSCI Inc. is not an investment adviser or fiduciary and MSCI makes no representation regarding the advisability of investing in any Index Linked Investments.

Index returns do not represent the results of actual trading of investable assets/securities. MSCI maintains and calculates indexes, but does not manage actual assets. Index returns do not reflect payment of any sales charges or fees an investor may pay to purchase the securities underlying the index or Index Linked Investments. The imposition of these fees and charges would cause the performance of an Index Linked Investment to be different than the MSCI index performance.

The Information may contain back tested data. Back-tested performance is not actual performance, but is hypothetical. There are frequently material differences between back tested performance results and actual results subsequently achieved by any investment strategy.

Constituents of MSCI equity indexes are listed companies, which are included in or excluded from the indexes according to the application of the relevant index methodologies. Accordingly, constituents in MSCI equity indexes may include MSCI Inc., clients of MSCI or suppliers to MSCI. Inclusion of a security within an MSCI index is not a recommendation by MSCI to buy, sell, or hold such security, nor is it considered to be investment advice.

Data and information produced by various affiliates of MSCI Inc., including MSCI ESG Research LLC and Barra LLC, may be used in calculating certain MSCI indexes. More information can be found in the relevant index methodologies on [www.msci.com](http://www.msci.com).

MSCI receives compensation in connection with licensing its indexes to third parties. MSCI Inc.'s revenue includes fees based on assets in Index Linked Investments. Information can be found in MSCI Inc.'s company filings on the Investor Relations section of [www.msci.com](http://www.msci.com).

MSCI ESG Research LLC is a Registered Investment Adviser under the Investment Advisers Act of 1940 and a subsidiary of MSCI Inc. Except with respect to any applicable products or services from MSCI ESG Research, neither MSCI nor any of its products or services recommends, endorses, approves or otherwise expresses any opinion regarding any issuer, securities, financial products or instruments or trading strategies and MSCI's products or services are not intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Issuers mentioned or included in any MSCI ESG Research materials may include MSCI Inc., clients of MSCI or suppliers to MSCI, and may also purchase research or other products or services from MSCI ESG Research. MSCI ESG Research materials, including materials utilized in any MSCI ESG Indexes or other products, have not been submitted to, nor received approval from, the United States Securities and Exchange Commission or any other regulatory body.

Any use of or access to products, services or information of MSCI requires a license from MSCI. MSCI, Barra, RiskMetrics, IPD and other MSCI brands and product names are the trademarks, service marks, or registered trademarks of MSCI or its subsidiaries in the United States and other jurisdictions. The Global Industry Classification Standard (GICS) was developed by and is the exclusive property of MSCI and Standard & Poor's. "Global Industry Classification Standard (GICS)" is a service mark of MSCI and Standard & Poor's.

MIFID2/MIFIR notice: MSCI ESG Research LLC does not distribute or act as an intermediary for financial instruments or structured deposits, nor does it deal on its own account, provide execution services for others or manage client accounts. No MSCI ESG Research product or service supports, promotes or is intended to support or promote any such activity. MSCI ESG Research is an independent provider of ESG data, reports and ratings based on published methodologies and available to clients on a subscription basis. We do not provide custom or one-off ratings or recommendations of securities or other financial instruments upon request.

Privacy notice: For information about how MSCI ESG Research LLC collects and uses personal data concerning officers and directors, please refer to our Privacy Notice at <https://www.msci.com/privacy-pledge>.