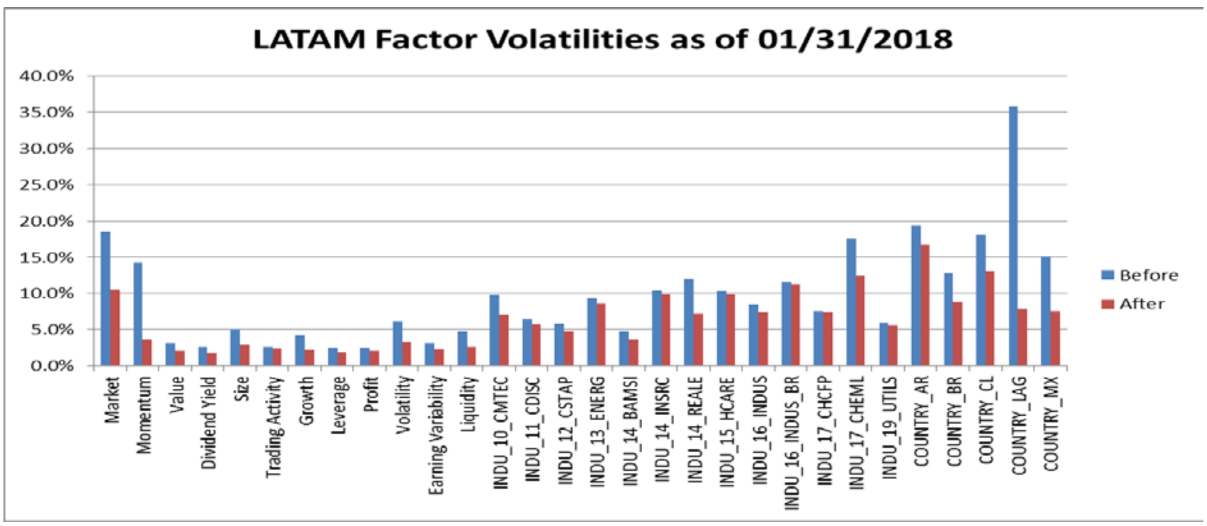
Accounting for Hyperinflation in the PORT Risk Model

PORT is Bloomberg’s portfolio analytics and risk management solution offering users a range of risk models to evaluate and decompose the drivers of portfolio volatility. The following update is specific only to the Latin America Regional Equity and Global Equity risk models.

Both of these models have historically included Venezuelan stocks in their estimation universe. Over the last few years, Venezuela's hyperinflationary economic environment caused asset prices to increase dramatically. At the same time, the official currency exchange rate remained artificially low distorting the estimated factor returns and in turn factor volatilities and correlations. Lacking a realistic exchange rate reflecting the true value of Venezuelan stocks, we have decided to exclude Venezuelan stocks from the estimation universe of these models. Please note that Venezuelan stocks will remain in the coverage universe of both models.

The Latin America Regional Equity risk model incurs the biggest change when comparing the risk factor volatilities before and after the adjustment. The individual factors with the greatest volatility reduction are the Momentum and the Latin America Group (Country_LAG) risk factors as seen in the chart below.



While the Global Equity risk model is also affected, the impact is almost entirely isolated to the Latin America emerging market country factor (Country_Emg_LA).

The exclusion of Venezuelan stocks from the estimation universe of these two models has been in place since February 2018. However, historical factor realizations prior to that date still affect factor volatilities and correlations. For this reason, we have decided to restate both models starting from August 3, 2016. The restatement will become effective on Monday, July 23 2018 and will serve to bring the estimated risk factor volatilities and correlations back in line with the intended model forecast.