War Premium?

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Overview

- Is the Topic Stale Already?
- Core Issue or Catalyst?
- How Risk Has Changed
- Looking Forward
Major Shifts in Risk Perception

- Russian coup attempt (1989)
- Gulf War (1990-91)
- ERM crisis (1992-93)
- Canadian Referendum (1995)
- LTCM/Russian default/Brazilian debt (1998)
- Iraq War (2002-03)
This Cycle Is Certainly Over

Russell 1000 Value vs. Growth

cumulative price growth of $1

value  growth

The average spread in implied Internal Rate of Return has been 2.5%. In early 2000, it reached 3.9%, a 3.1 standard deviation event.
The spread in implied Internal Rate of Return can be adjusted to reflect differences accounted for by differences in industry and style exposure.
Opportunities Appear “Normal”

Relative valuations reflect as much difference on average as they have historically.
... But Actually Spreads Are Narrow Today

Relative valuations have generally narrowed with cheap German equities being the one clear exception.
Risk Has Changed

- Historical Volatility
  - Realized volatility
  - Option implied

- Seemingly Improbable Outlier Events
Volatility Remain High

Monthly S&P 500 Volatility

Option Implied Volatility

Realized Volatility
Summary

- There was a war premium
  - But war was also a catalyst for market adjustment

- Valuation cycle has probably ended

- Higher risk today should suppress market prices