

Total Assessed Risk (TaR), and the Method of Moments.

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Many methods exist for assessing and managing the risk of an enterprise or a portfolio. A common method is to use value at risk (VaR) to assess risk and to use duration matching to manage the risk. This research, drawing on recent criticisms of VaR, seeks to establish a more comprehensive measure of risk, considering the multidimensionality of risks, and to establish a more thorough risk management tool: the method of moments. This is especially germane for portfolios that have risk exposure to emerging markets. The modified risk management tools theoretically perform better than more traditional tools, especially in incomplete markets which typify emerging markets.

Emerging markets are unique in not having as well developed financial systems as more developed nations. This means there is an absence of common risk management tools like options, futures, and swaps. Not only do these markets tend to be incomplete, but they tend to be thin in the sense of not having many willing counterparties. For portfolio managers, this can mean the expected return on an asset is not great enough to compensate for the risk, leaving the market fallow. For banks, who often commit funds for long-periods of time, they can be left with unperforming loans, which deters foreign direct investment, which can be a stimulant to economic growth and market deepening.

Recently, the flow of new allocations to the emerging market asset class by pension funds has increased (Booth 2001/2). This means more individuals in developed nations have a financial stake in the markets of emerging countries, but they are also exposed to the incipient risks.

Standard risk measures tend to underestimate the risk of investing in emerging markets (Gunter, 2003). This has implications not only for fund managers, but especially for bank managers, in light of Basle Committee Capital Adequacy standards. By underestimating the risk of the portfolio of loans a bank holds, they will set aside an inadequate amount of capital to assure against insolvency in the event of borrower default.

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