

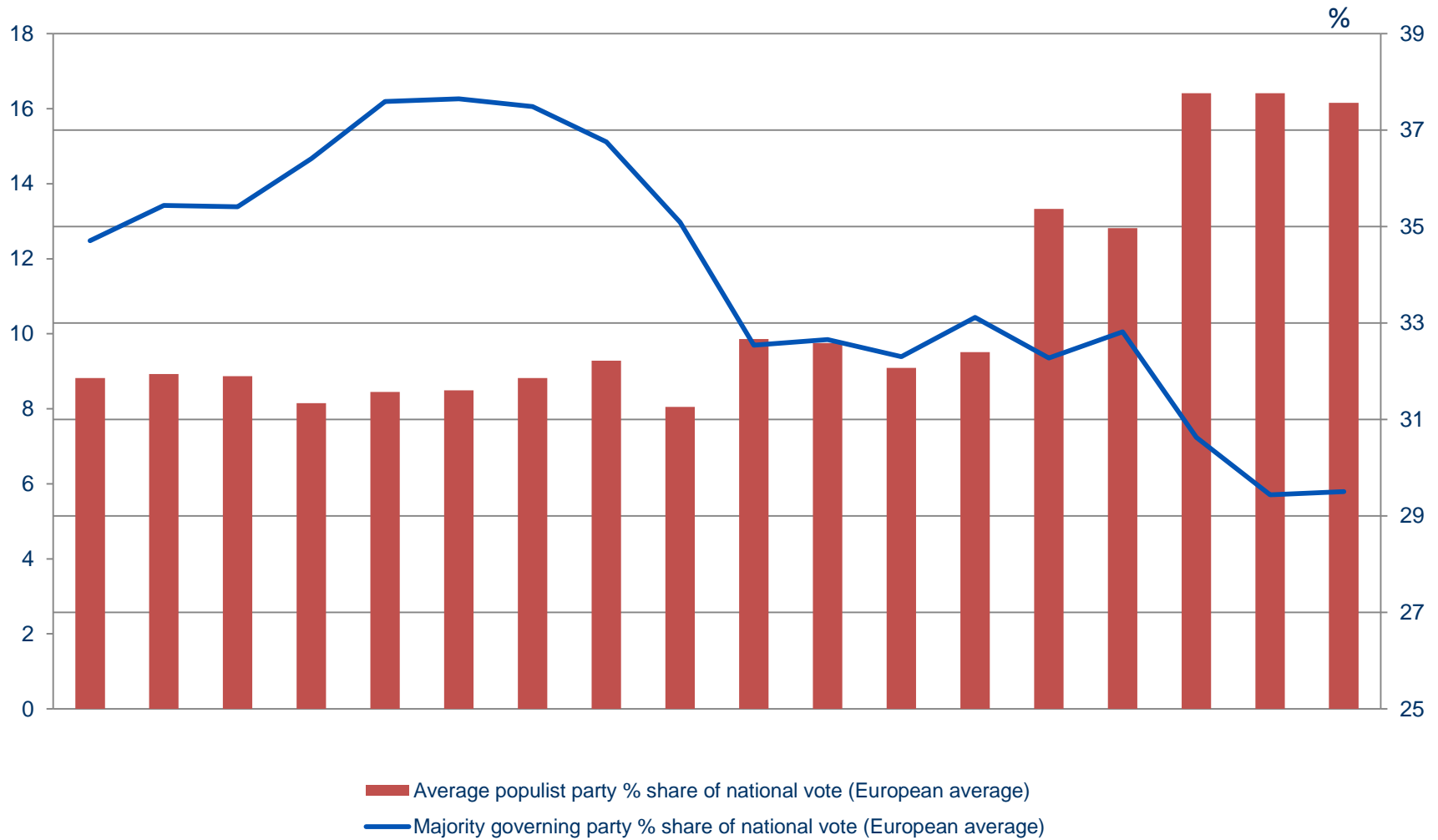
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# **What Makes Politics Tick?**

## **Building A Political Risk Framework**

**Stephanie Kelly**  
**Political Economist**

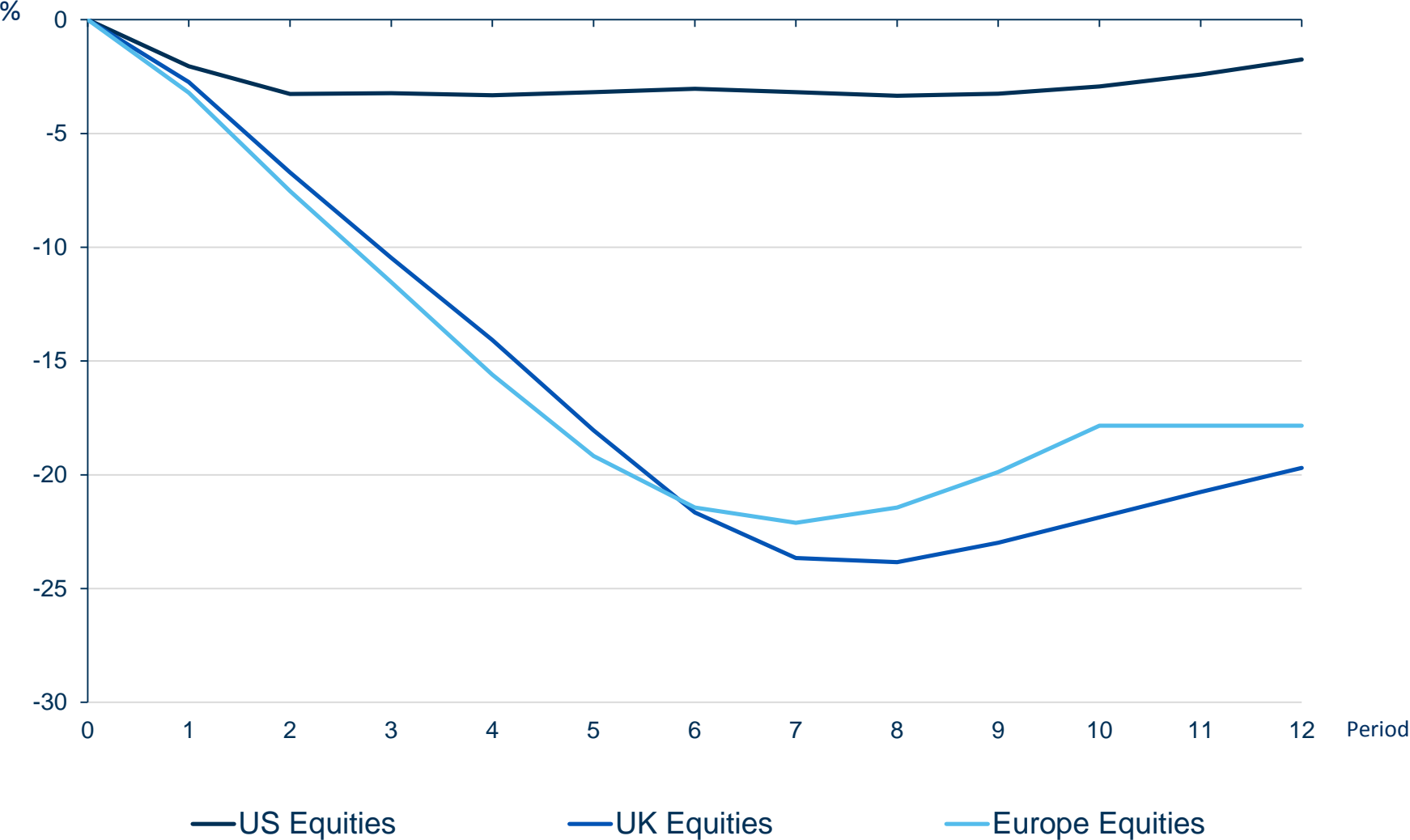
# New Challenges for Investors: Populism's Pull



Source: World Bank, Standard Life Investments (as of 2016). Please see important information at the back of this presentation

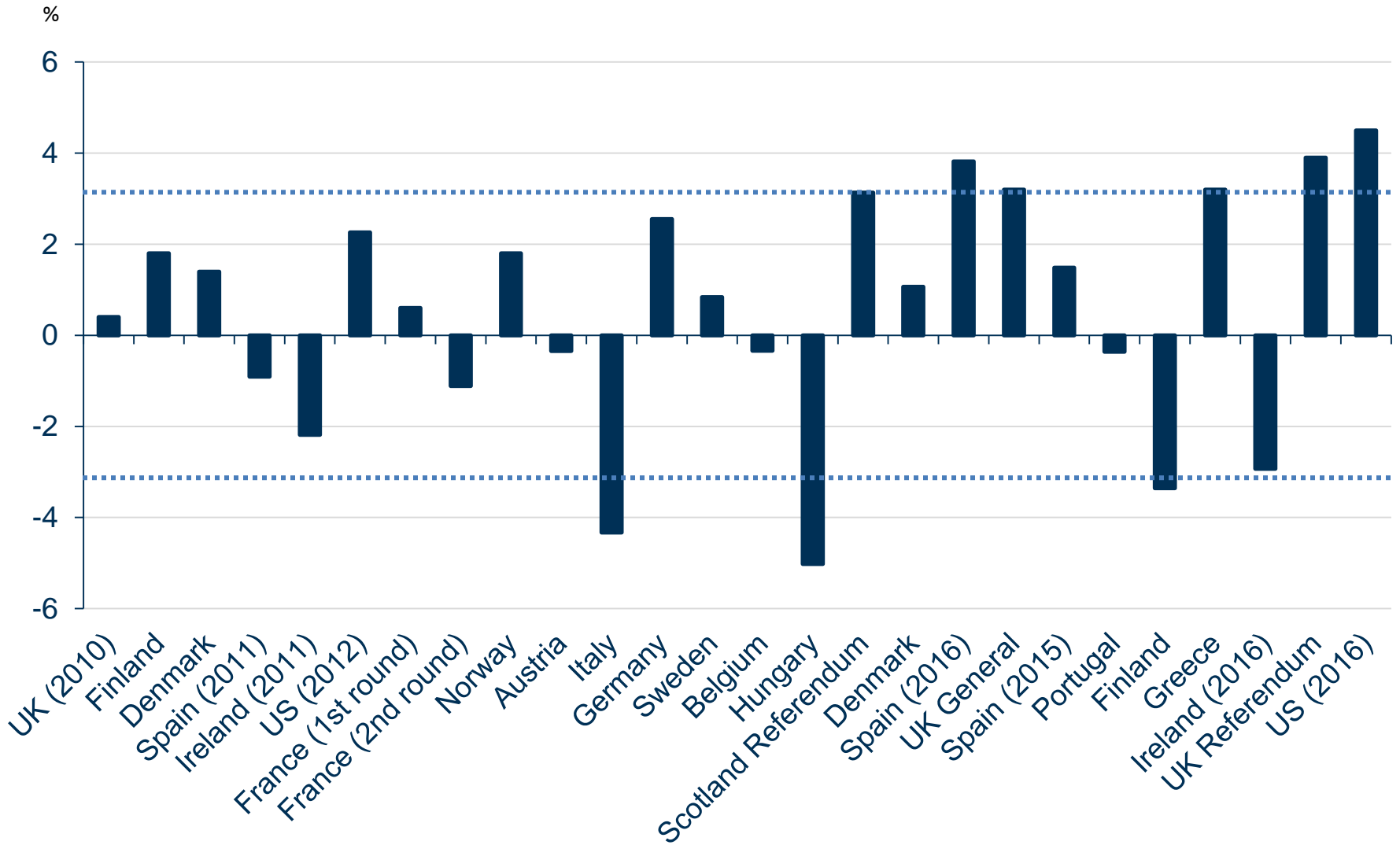
*\*Sample includes data from 11 EU member states*

# The Impact of Policy Uncertainty May Be Significant for Markets



Source: Standard Life Investments, Bloomberg, Haver (as of 2016). Please see important information at the back of this presentation

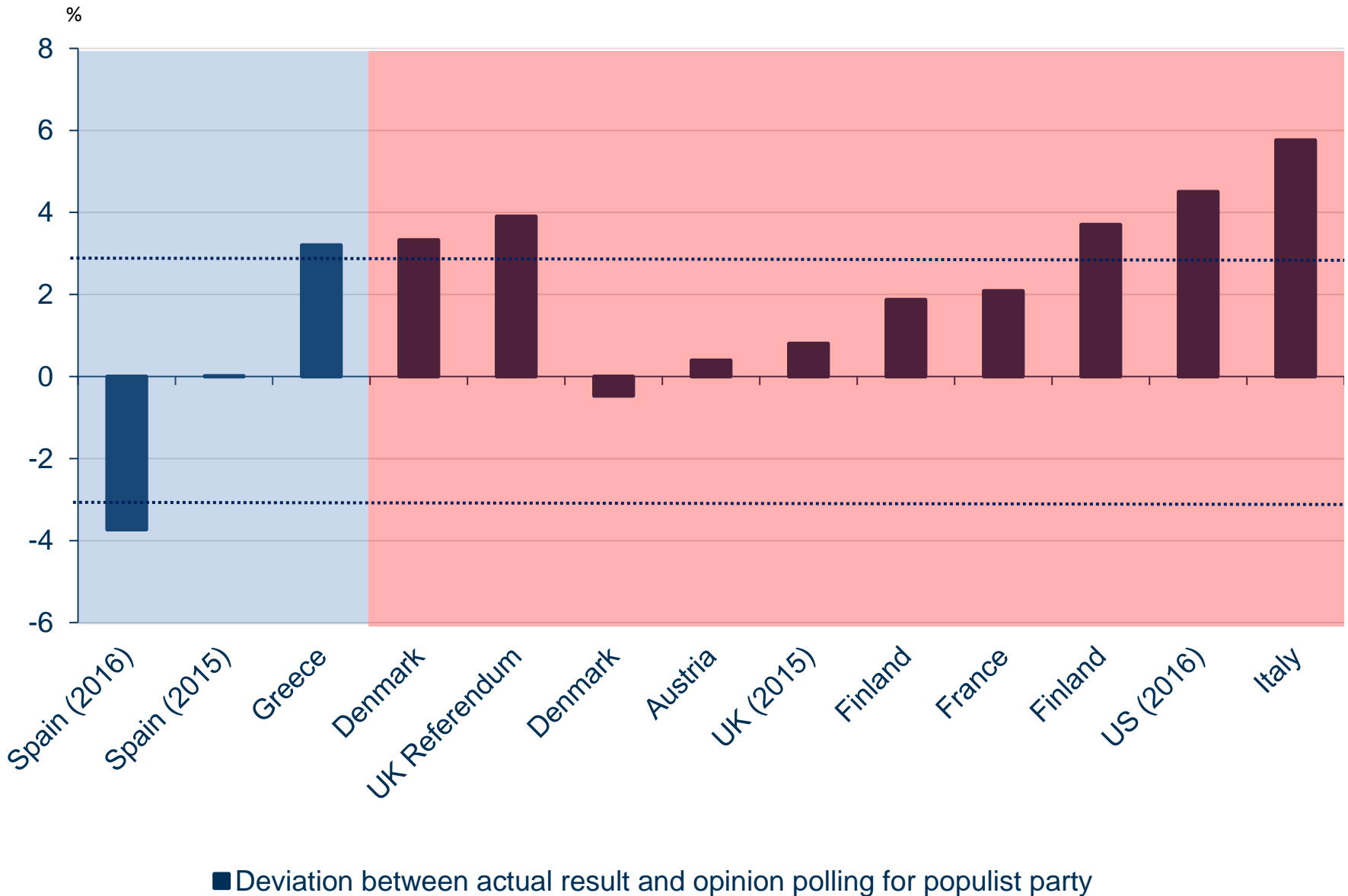
# Traditional Polling Methods Have Become Less Accurate...



■ Difference between actual result and polls

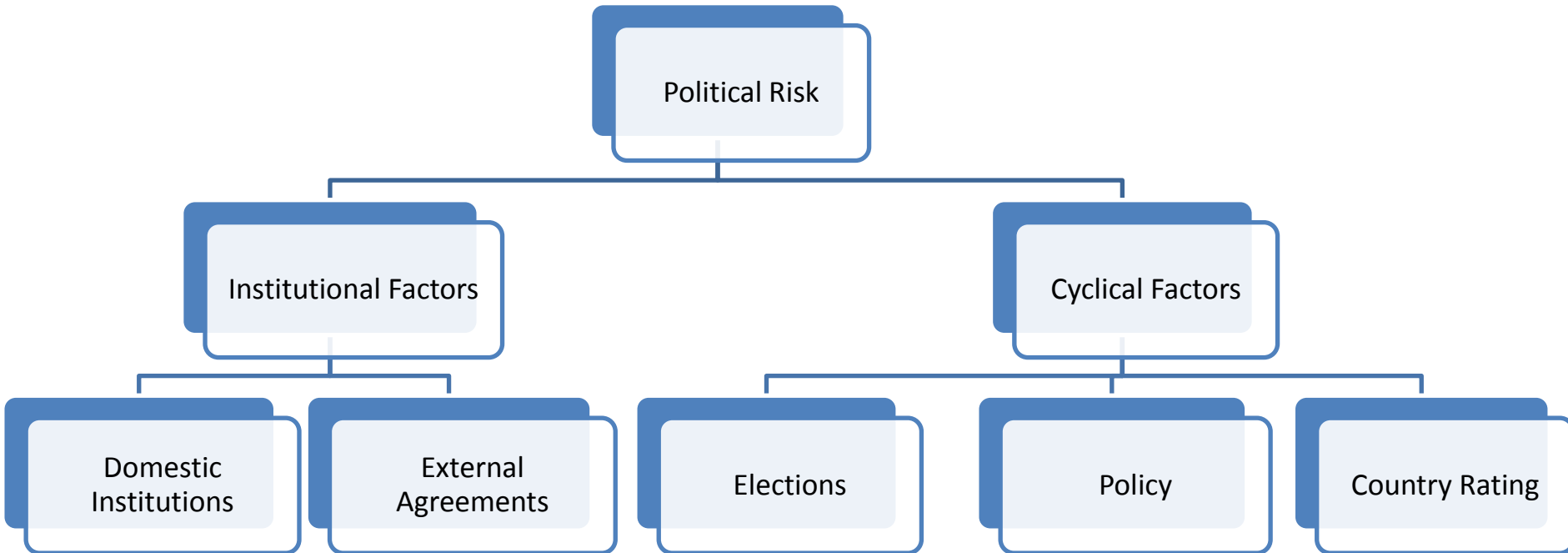
Source: Standard Life Investments, National sources (as of 2016). Please see important information at the back of this presentation

# Especially Underestimating Populist Right Wing Parties



Source: Standard Life Investments, National sources (as of 2016). Please see important information at the back of this presentation

# Building an in-house Framework of Political Risk



# French Presidential Election

## Building the Base Case

Institutional Factors	Cyclical Factors
Two round electoral system	Populist upswing
Hybrid Presidential Parliamentary system	Populist polling undershoot
	Event risk

- *Red: Significant hurdle to Le Pen/Frexit*
- *Orange: Potential hurdle to Le Pen/Frexit*
- *Yellow: Potential support to Le Pen/Frexit*
- *Green: Significant support to Le Pen/Frexit*

# French Presidential Election

## Scenario Analysis of the Tail Risk

President	Parliament Majority	Policy Outlook	Economic Impact	Market Impact	Why it could happen	Risks to success
<b>Le Pen</b>	<p>Base case: Cohabitation</p> <p>Tail Risk Front National</p>	<p>Right wing “French-first”, anti-Islam, Europhobic, anti-globalization and pro-public sector agenda.</p>	--	<p>Bunds rally 50bps</p> <p>French yields rise 100bps</p> <p>European risk assets sell off</p>	<p>Addresses concerns about security and Islam in France</p> <p>Already has strong pockets of support in certain regions</p>	<p>Far-right agenda unlikely to appeal to center-right/left in 2nd round.</p>



# Gaming the System: Applying Game Theory to UK-EU Trade Relations

		EU		
		High	Moderate	Low
UK	High	FTA Max no tariffs, generous services agreement, generous UK work visa program	Swiss style agreement	EEA
	Moderate	Generous FTA no tariffs, generous services agreement, immigration controls	Regular FTA no tariffs, some service sector agreement, immigration controls	Limited FTA no tariffs but no services access, immigration controls
	Low	Brexit Ideal	Limited FTA no tariffs, some service sector agreement, tight immigration controls	WTO

- *Green = High likelihood*
- *Yellow = Moderate likelihood*
- *Orange = Low likelihood*
- *Red = Extremely low likelihood*

Source: Standard Life Investments (as of 2017). Please see important information at the back of this presentation

# Key Takeaways

We believe:

- Political risk analysis should not rely purely on polls, nor should they be disregarded
  - Incorporate polls into analysis but applying wider confidence intervals
- Effective political risk event analysis requires a systematic approach
  - Build the risk focused base case using a framework approach and expert insight
  - Conduct scenario analysis for event tail risks to assess market risks
- Complex political risk analysis requires creative solutions by investment professionals
  - Borrowing from other disciplines can be helpful
  - Game theory provides a lens to develop a coherent assessment of the multi stage UK - EU trade negotiations

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