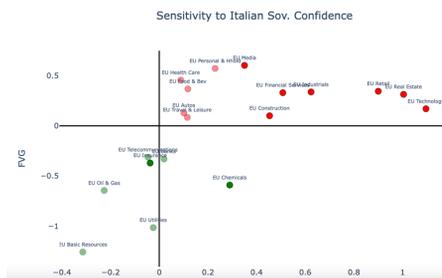




20.07.2022

How to measure Italian political risk

- Marrying bottom up & top down analysis is hard enough. How are portfolio managers supposed to handicap **political risk**?
- Instead of relying on the opinion of geopolitical strategists, the Qi framework uses financial securities to capture the markets' current perceptions of the risk around certain political scenarios.
- Asset swap spreads for peripheral EuroZone sovereigns like Italy, Spain & Greece can be used to measure the **degree of stress** markets are pricing in highly indebted southern European economies.
- Qi's algorithm detrends & vol adjusts each spread, & then runs Principal Component Regression to capture the **independent sensitivity** of any security to this factor.
- In the chart below we look at European equity sectors & overlay sensitivity to peripheral spreads with overall macro valuations. Sectors to the right of the vertical zero bound want Italian spreads to remain well behaved. The further to the right, the greater the sensitivity; i.e. the more vulnerable they are if BTP spreads blow wider. Red dots above the horizontal zero bound are currently rich relative to macro fair value.



- Today, Mario Draghi addresses the Senate; tomorrow the ECB meet. A new Draghi coalition government plus details of a credible anti—fragmentation tool would help assuage market fears about a blow-out in BTP spreads.
- If you hold that view, European [Chemicals](#) look an interesting prospect. If your fear further political instability ahead choose between EU [Technology](#) (highly sensitive) or [Media](#) (rich valuation).

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Quant Insight Limited
42-46 Princelet Street
London E1 5LP
United Kingdom
Tel: +44 203 9941310
www.quant-insight.com