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Election Dump and Scenario Testing

By Max J. Rudolph, FSA CFA CERA

With the mid-term elections about to happen, kicking off the next Presidential cycle, where do we stand?

- The Trump administration is focused on short term wins. They have to say they won every fight. This will be to the detriment of long time horizon goals.
- Numerous actions are moving away from and inciting others to eliminate the dollar as the world reserve currency. There are many unintended consequences resulting from these actions, primarily making fiscal policy much more important. Budget deficits are the signal (signal and noise). It reminds me of the mark to market accounting, mortgage crisis, saving & loan crisis and the Enron fiasco. Politicians promise, but someone has to be the adult in the room, and this is 100 times more so if you are not the reserve currency.
- Why aren't we offering long term treasuries to take advantage of low rates?
- How can the dollar rise, as it must with emerging markets and Japan tanking, at the same time as gold explodes? Or is it temporary until the US loses control of the currency?
- I help each year at a Junior Achievement day trading event. One year I participated in the adult version of the game. Many times we didn't even know what we owned. Why would anyone think this was a good way to invest?
- Tariffs are a boom for the largest player in a market as it allows them to keep lower priced competitors out -
- It surprises me that ISIS has not attacked any of the Trump Towers around the world. Perhaps they think he would get more serious if they did. It's smart for ISIS to stay quiet and let Trump blow up on his own. It reminds me of the game plan bin Laden used, with a goal of disruption rather than overthrow. Anyone who has flown on an airplane understands that it was successful.
- My driver's license was due in 2018. I changed my party affiliation from Republican to Democrat and voted against every incumbent on the federal and state ballots. Maybe someone in the Republican Party will listen to that if enough follow suit. Unfortunately I find no candidates that follow a moderate view of life. I disagree with the right on every issue, and the left is just as bad on most although closer to my view on immigration (similar to trust but verify) and birth control (none of my business).

The biggest fear I have is of Donald Trump as a lame duck and the damage he could leave for his successor, whether after 4 years or 8. I don't think he can win in 2020, but I was wrong in 2016. Pence is at risk in the Mueller investigation. Who is the backup plan that the Koch brothers would bankroll? For the Democrats the old-timers should fade

away. Pelosi should transition to someone else before 2020, and a white male run for President. This doesn't mean there won't be good minority or female candidates, just that the complexity of the election will make it harder. Having Obama campaign for Beto O'Rourke can work better than for Cory Booker.

We'll soon find out.

Scenario Testing

Each year in the fall I suggest a set of scenarios that could be used as part of reserve adequacy (cash flow) testing. This year I suggest the following:

- NY 7 without floors (allow negative rates, parallel shifts)
- Annual increases of 3% over 4 years (total 12% increase)
- Pandemic spike in mortality of .5% (absolute increase) or opioid scenario
- Mortality decrease applied to payout annuities
- High credit risk – double default rate for below investment grade bonds
- **Double default rate on BBB bonds**
- Equities – down 50%
- Indexed products – report separately including options, test derivative market failure
- Measure exposure to counterparties at a high level
- Global climate change scenario – qualitatively assess markets, suppliers
- If you are worried about a couple of specific scenarios from the past; e.g., the 1930s or 1970s – include them in this year's stress testing – this era looks a lot like 1937 so might be a good scenario to test, **also consider 1973**

Bold reflects update from prior year

These scenarios do not all have to be run each year. Set up a rotation and test based on the current environment and your specific risk exposure. Look at stress scenarios qualitatively and graphically in addition to quantitative focus. Consider a combination of several deterministic scenarios, including one where the Wall Street tool kit (e.g., derivatives market) is not available.

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