Economic Policy Uncertainty and Global Portfolio Allocations

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The Effects of New Geopolitical Risks on Financial Markets and Firms
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Overall Assessment

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- Important topic and clever use of very rich data

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- Connect more clearly the different economic channels
- Alternative stories can be addressed
- Granularity of data can be further explored

Big Picture

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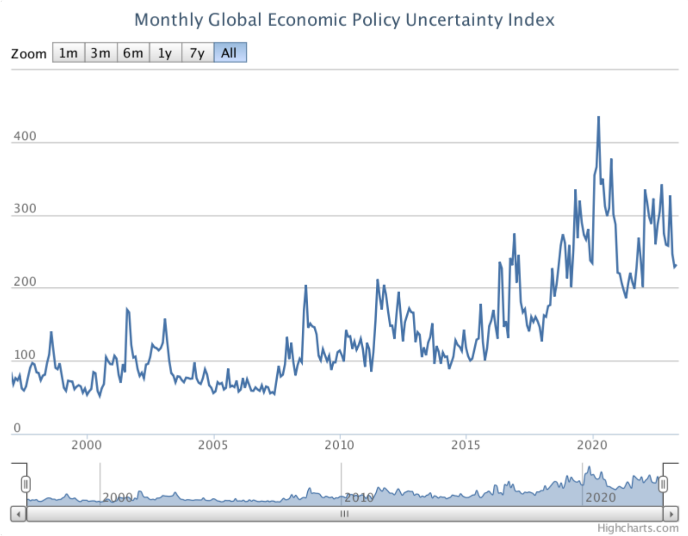

Source: `https://www.policyuncertainty.com/`

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Does economic policy uncertainty affect global institutional funds' allocations?

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Main result:

- 1 st.dev. $\Uparrow$ destination EPU (t) $\Rightarrow$ -1.27% fund's capital flows (t+1) - Non-G7
  - Results robust to inclusion of several granular fixed-effect specifications
  - Results not explained by financial market uncertainty (VIX)
  - Extensive margin also plays a role
  - Some mild outperformance of funds adverse to EPU

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- Cross-country: information transparency, institutional strength, cultural similarities, and geopolitical alignment
- Evidence of shock propagation across countries

Comments

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1. Do fund outflows matter?
2. Fire-sales liquidity provision?
3. Market timing?
4. Minor comments

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- The paper studies allocation of investment, but are these forced liquidations?
- Uncertainty $\Uparrow$ during recessions (Bloom et al., ECMA 2018) $\Rightarrow$ fund clientele redeem
- Transmission of uncertainty shocks: proportional liquidation after outflows?
  - "[...] a fund's reaction to a destination's EPU is conditional on its overall exposure to EPU at the portfolio level."
  - No sign of portfolio re-shuffling $\Rightarrow$ Looks like funds liquidate positions
- Hence, this might be a liquidity story rather than information asymmetry

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Suggestions

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- Stock-level: proportional liquidation?

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Result 1:

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Result 3:

Cross-Country Correlation Between Economic Policy Uncertainty

Panel A: Advanced Countries				Panel B: Emerging Countries			
Correlation With	US	World	Advanced		US	World	Emerging
UK	0.61	0.86	0.56	India	0.48	0.28	0.16
Australia	0.74	0.55	0.59	Mexico	0.27	0.08	-0.01
Ireland	0.59	0.69	0.56	Brazil	0.32	0.60	0.32
France	0.70	0.86	0.64	Chile	0.31	0.45	0.32
Greece	0.49	0.58	0.50	China	0.57	0.91	0.39
Italy	0.59	0.56	0.53	Russia	0.30	0.61	0.34
Japan	0.70	0.61	0.57				
Spain	0.63	0.55	0.52				
Germany	0.78	0.87	0.67				
Netherlands	0.59	0.30	0.41				
Hong Kong	0.45	0.58	0.37				
South Korea	0.76	0.78	0.42				
Canada	0.77	0.86	0.59				

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Suggestions

- Analysis of outflows from funds matter!

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- Relation between fund performance and flow-EPU covariance:

$$cov_{ft}(EPU_{c,t-1}, Flow_{fct}) = \sum_{k=1}^{K_{ft}} EPU_{c,t-1} \times \widetilde{Flows}_{fct}$$

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  - Do funds close their position just in time to cash in the risk premium?
  - Why is the outperformance so modest?

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- Central question: is funds' behavior value increasing/destroying?

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- Dynamics of fund trades? Do flows revert once EPU decreases?

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Very minor comments:

- Table 3 (correlation table) is missing Colombia
- Equation (4) - Fund EPU: shouldn't weight's numerator and denominator be measured contemporaneously?
  - Now, numerator is in t and denominator in $t-1$

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Possible paths to enhancement:

- Address alternative stories and clarify economic mechanism:
  - Outflows
  - Fire-sales liquidity provision
  - Market timing

Thank you!