Stress tests, ESG and other innovations

Client Conference 2023

ABOUT US

Ronald Janssen

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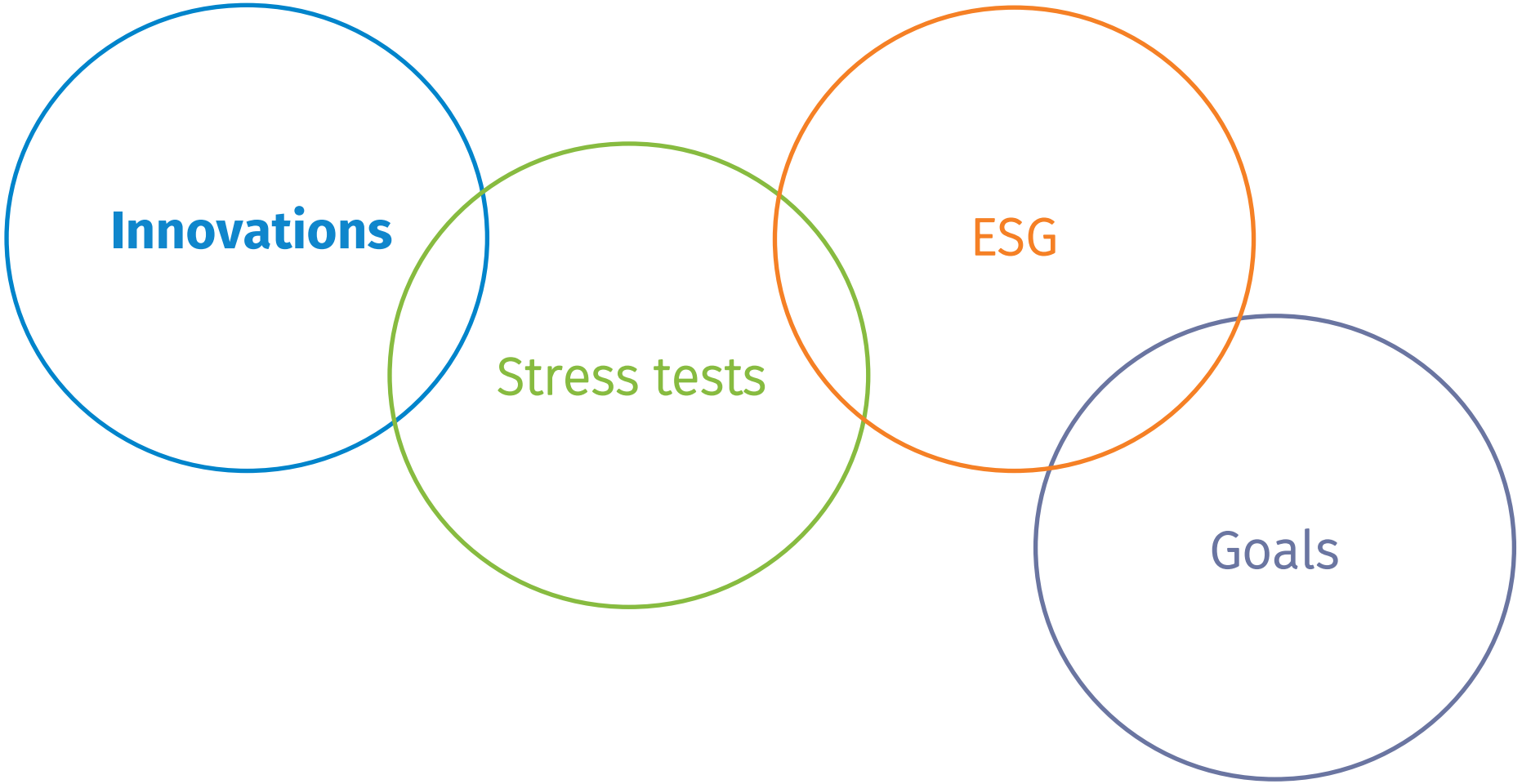

Innovations
Stress tests
ESG
Goals

How to handle stress tests in OPAL?

But first: why?

Decision support

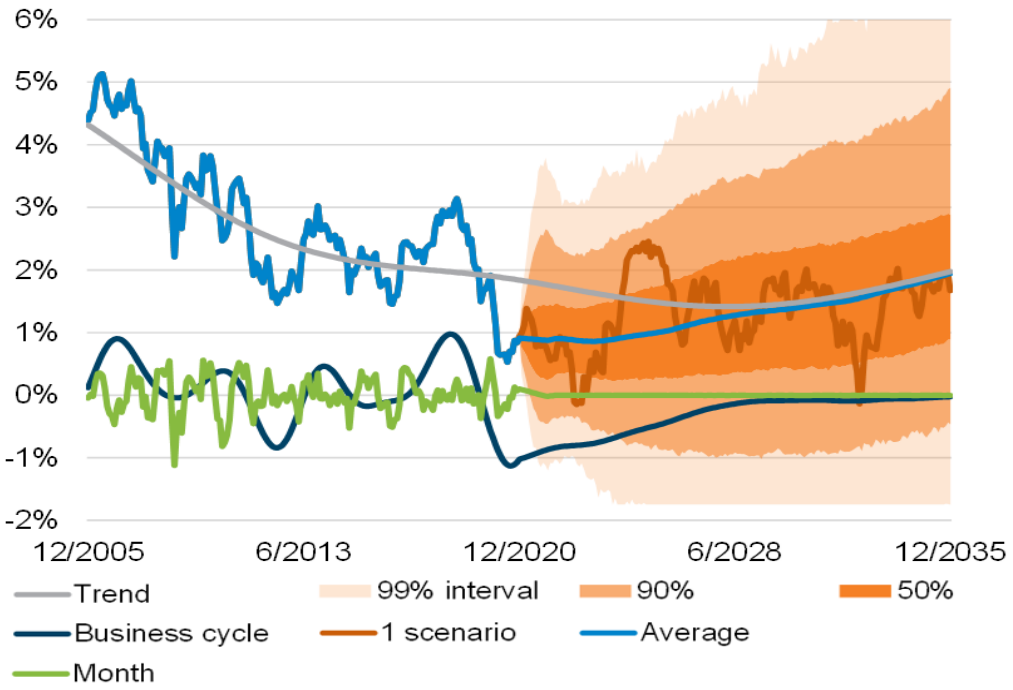
Through scenario analysis

- **Insights into risk and return**

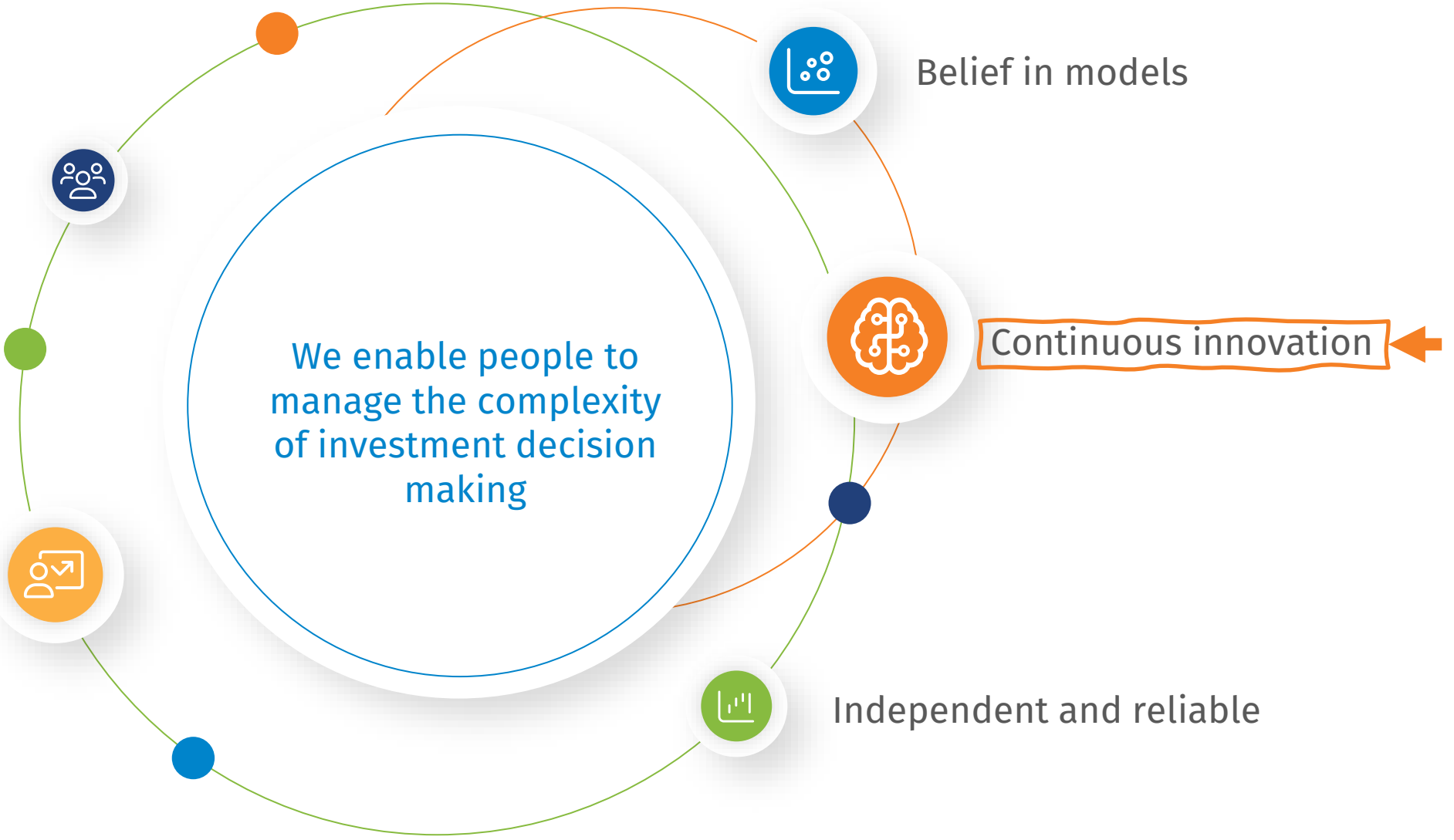
  → input for informed decisions on how to reach investment goals

- Methodology based on historical data, patterns, trends, business cycles, expert opinions and the current market situation

  → realistic **economic scenarios**

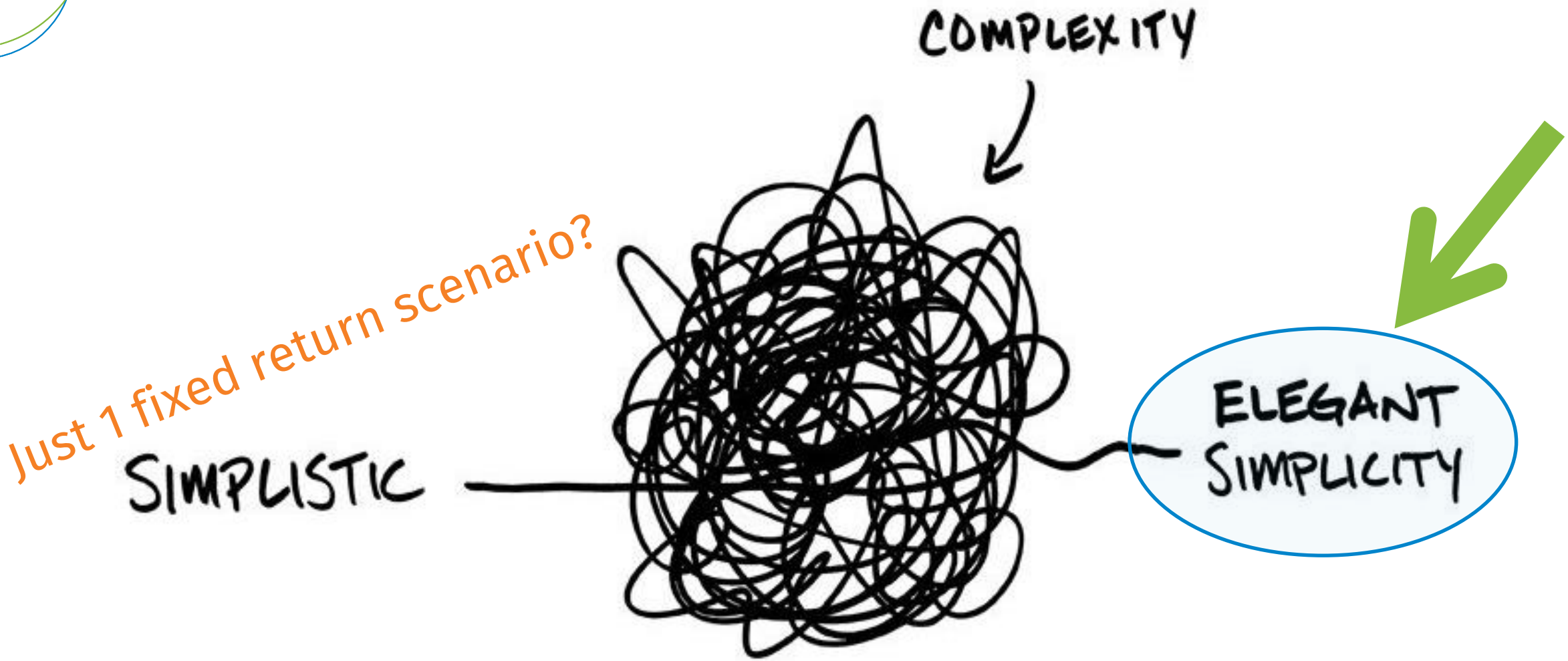


Our mission and core values



We enable people to manage the complexity of investment decision making

Current state?



How can we help financial advisors who are no scenario experts?

A scenario graph only is not always enough to ‘tell the story’ …

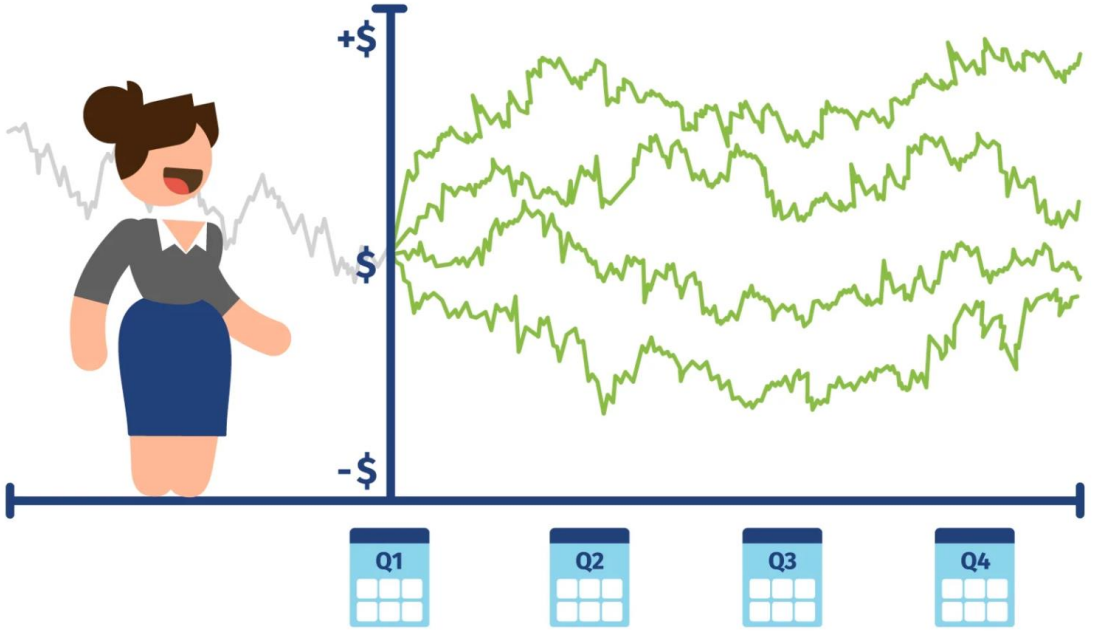
Scenarios to support ‘story telling’

- Helping to tell the story via our economic scenarios, including:
  - specific scenarios like specific market conditions, stress tests and what-ifs
  - simple stories about what's happening in the world or might happen
- High-over to more detailed approach
- Key facts & figures
- Easy to use and easy to understand

Scenarios to support ‘story telling’

And also…

- Helping advisors to:
  - show added value
  - discuss certain market conditions and impact on the client situation
  - manage the expectations of clients
- Higher risk awareness for clients



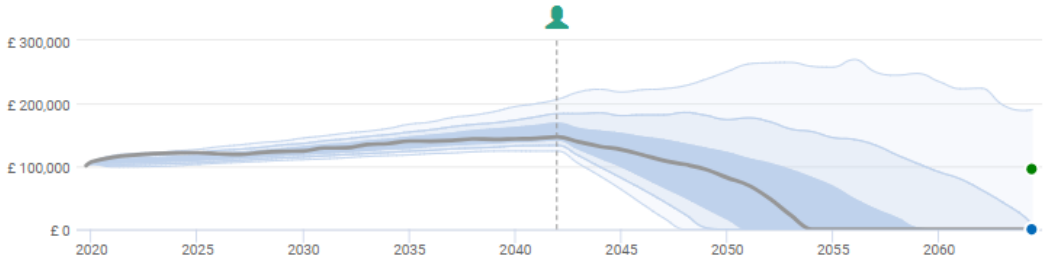
In user trainings we use examples like weather forecasts

As an easy way to explain stochastic scenario simulation

Projection of client's future financial situation:

All necessary information for financial insights:

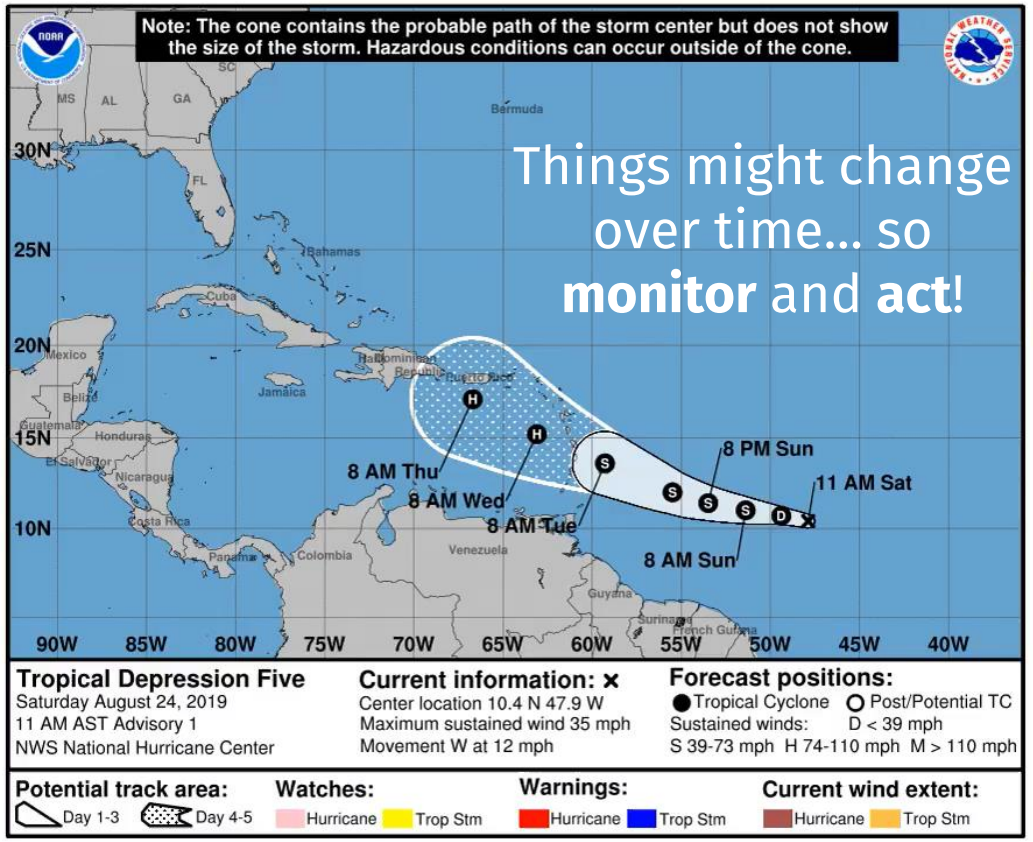
- Economic drivers
- Product information
- Client information and goals



Weather forecasts:

In order to take the right measures, you need to know what could happen, by assessing all drivers that affect conditions:

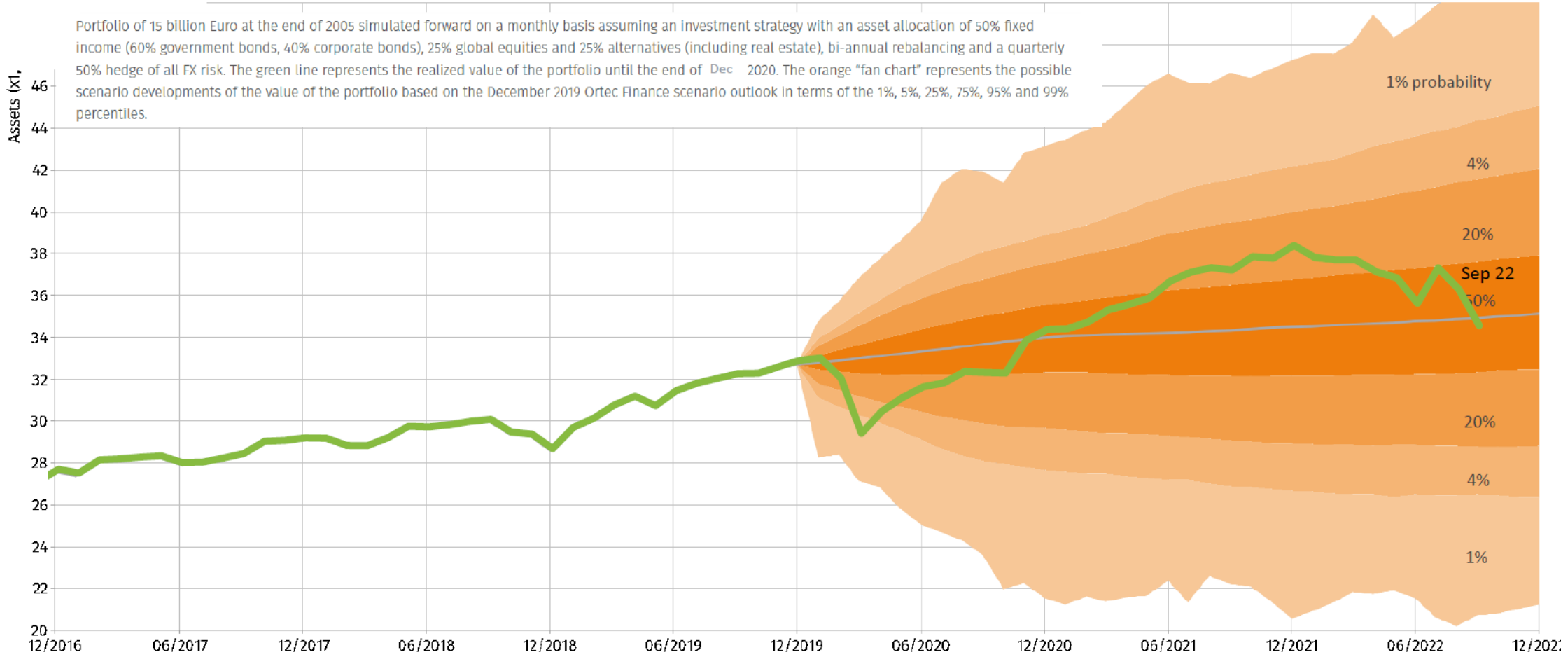
- Wind and temperature
- Humidity
- Geolocation
- …



As proof of our methodology we show back testing info

Monthly asset only portfolio value and risk according to a typical investment strategy of a European pension fund

December 2019 scenario outlook



Extra scenarios based on specific market conditions

Narratives (what-ifs) → 'deterministic scenarios'

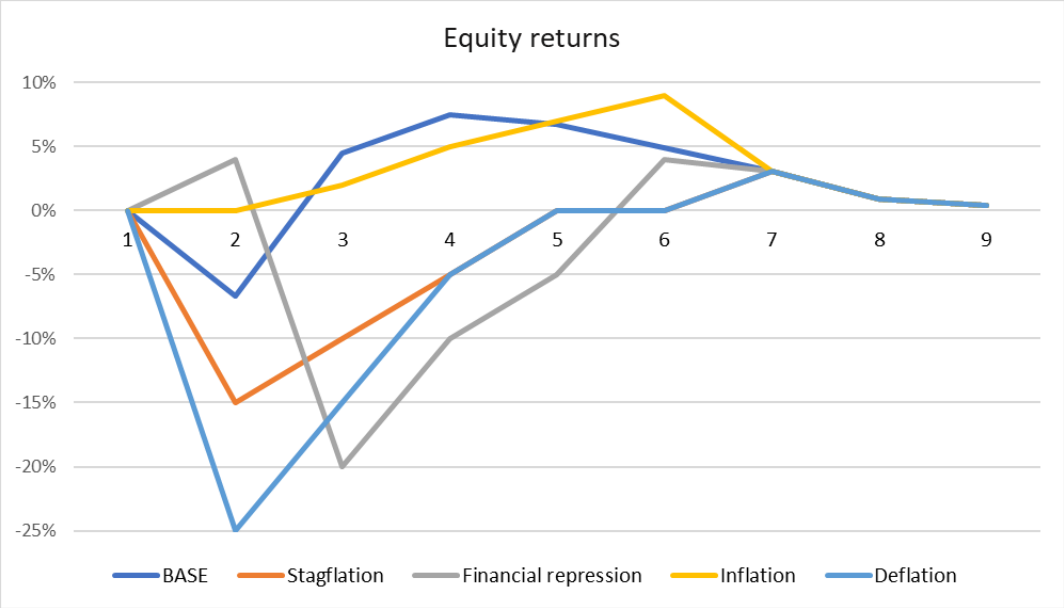
Still in our innovation thinking process, so not developed (yet)

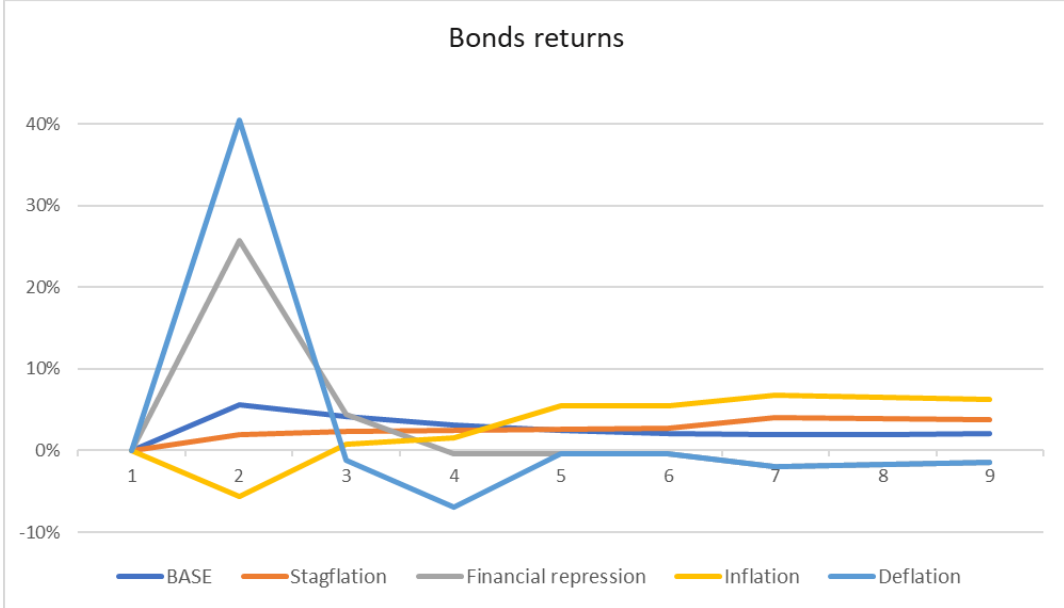
Stagflation

Financial repression

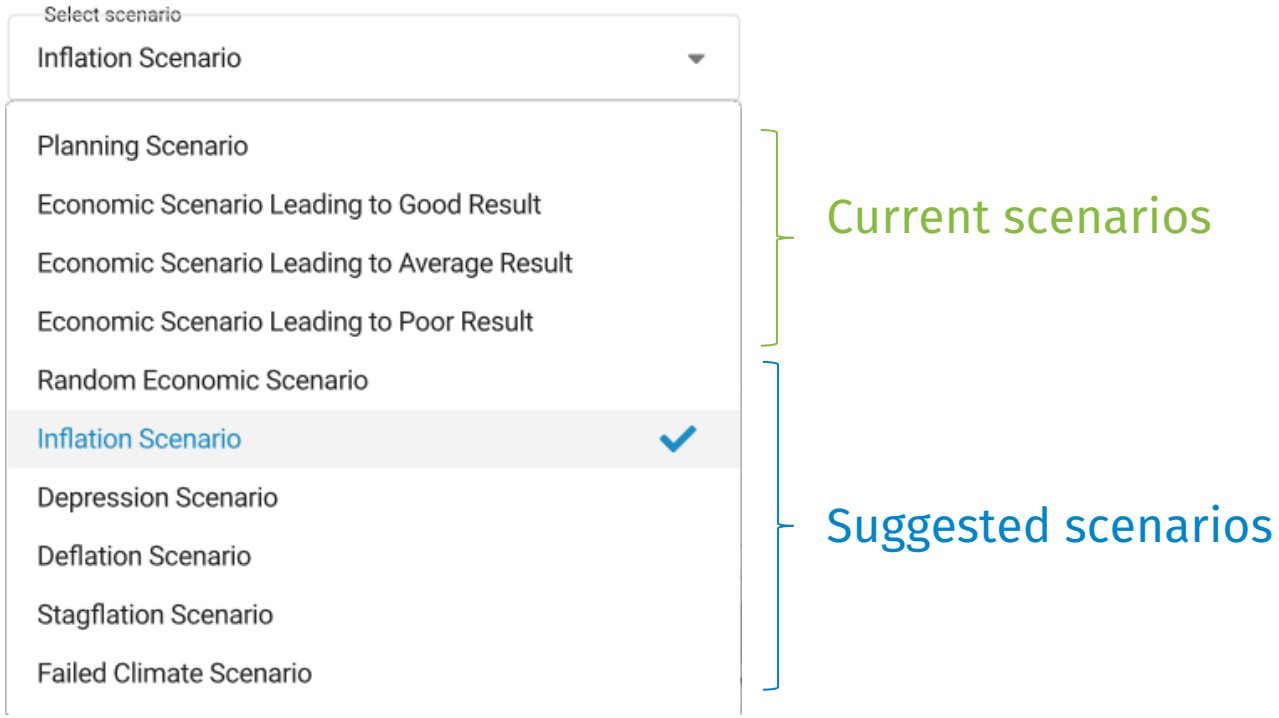
Inflation

Deflation





Scenario selector (example in OPAL GUI)



Inflation

Facts:

- revolutionary innovations → higher than expected growth
- higher wages, tightness labour market → wage-price spiral
- central banks fighting against interest rate hikes → bonds more attractive, equity down on short term
- in the end: inflation in control
- interest rate term flatter

Stagflation

Facts:

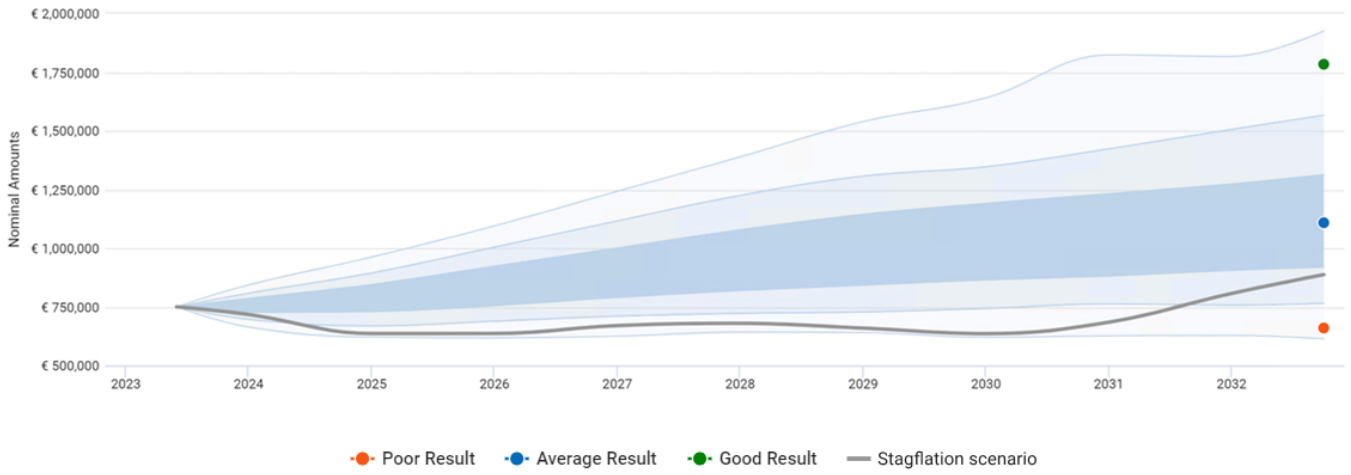
- extraordinairy monetary support (war/pandemic)
- labour market shortages / supply chains / energy transition → higher price levels
- sharp increase inflation
- productivity lower
- confidence crisis → sharp correction equity markets and widen yield spreads
- reluctance to increase interest rates further

example

Capital projection based on economic scenarios

Select scenario

Stagflation Scenario



Stagflation scenario explanation

A perfect storm represented by a decade of extraordinary monetary policy support, unprecedented pandemic-related fiscal stimulus, the war in Ukraine, and persistent labor market shortages trigger a sharp increase in inflation. Also, medium-term inflation remains elevated due to the reorientation of global supply chains as well as the energy transition. The pandemic outbreak as well as the war in Ukraine made countries increasingly realize that they need to reduce external dependencies in important sectors by reshoring important activities and reduce geopolitical risks. The decoupling of global supply chains causes sustained upward price pressures as it will take years to adjust. Moreover, productivity is likely to be lower as countries increasingly prefer self-sufficiency over efficiency. Additionally, the energy transition has led countries to underinvest in traditional energy sources, which amplify upward energy price pressures. Moreover, the switch to green technologies requires much more intensive use of metals and minerals as well as significant up-front investments, which causes medium-term inflation as well.

In the stagflation scenario, the cocktail of inflationary forces mentioned above, and the perceived lack of price stability triggers a confidence crisis represented by a sharp correction in equity markets. Also, high-yield credit spreads start to significantly widen as default risks increase. In response, central banks are reluctant to raise interest rates much further as signs of financial stress start to emerge and economic activity plummets as consumers cut back on spending and companies trim their investments. Nevertheless, the persistence of the inflationary shock in absence of more forceful central bank intervention leads to an initial increase in break-even inflation expectations and an initial decline in real interest rates. The economy slowly recovers, and central banks gradually employ a more restrictive policy stance with real interest rates slowly rising while entering (close-to) positive territory in year 5 of the scenario horizon.

In this scenario, there are negative returns on risk-bearing investments such as equities that go through a sharp repricing episode as fundamentals adjust to low prospective earnings as well as high interest rates. At the same time, a specific set of commodities and real estate may likely represent outperformers as they prove to be historically strong inflation hedges.

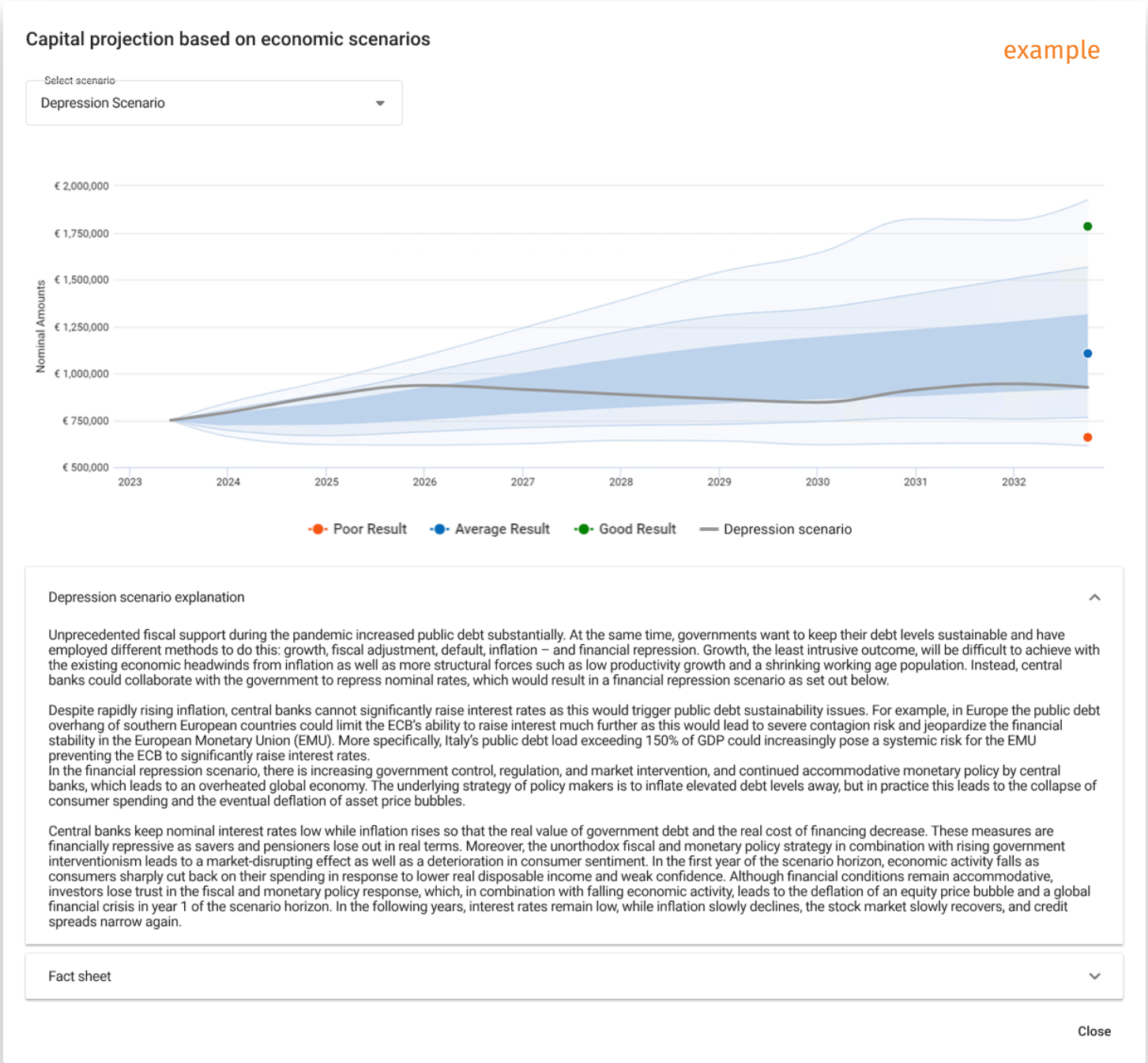
Fact sheet

Close

Financial repression

Facts:

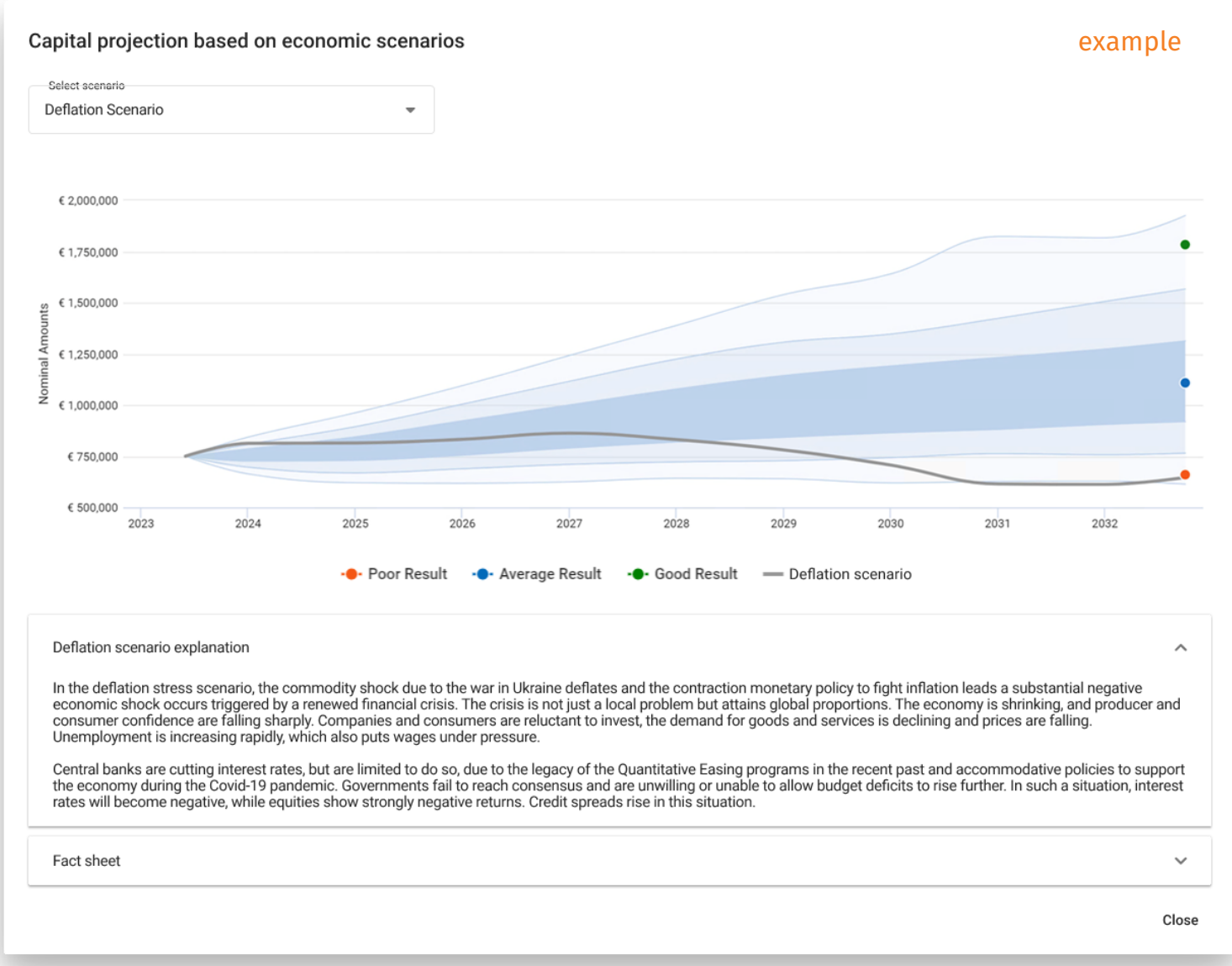
- unprecedented fiscal support
- rising interest rates to stimulate not an option
- rates lower than rising inflation
- over heating; in the end: deflation
- collapse consumer spending
- deflation asset price bubbels



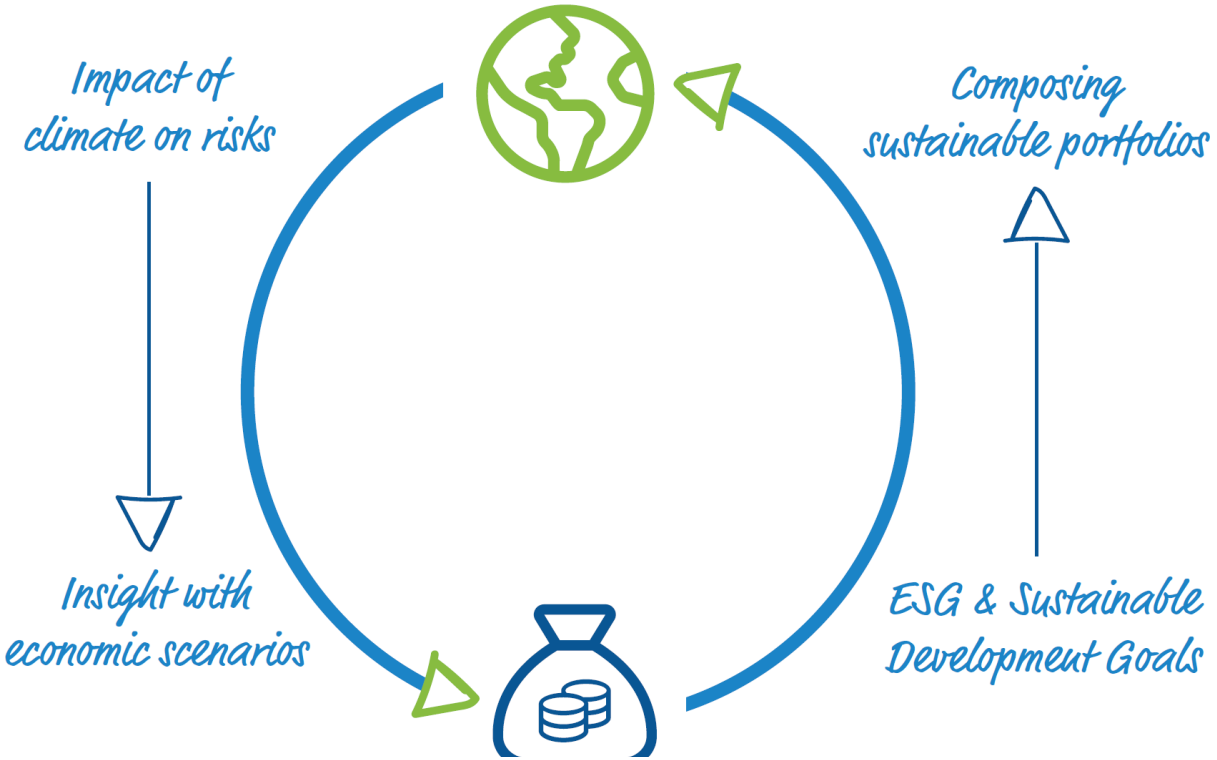
Deflation

Facts:

- commodity chock due to Ukraine war
- contraction monetary policy to fight inflation → new financial crisis globally
- economy shrinking, confidence falling → lower prices and demand
- cutting interest rates, negative rates and equity returns



Climate risk scenarios

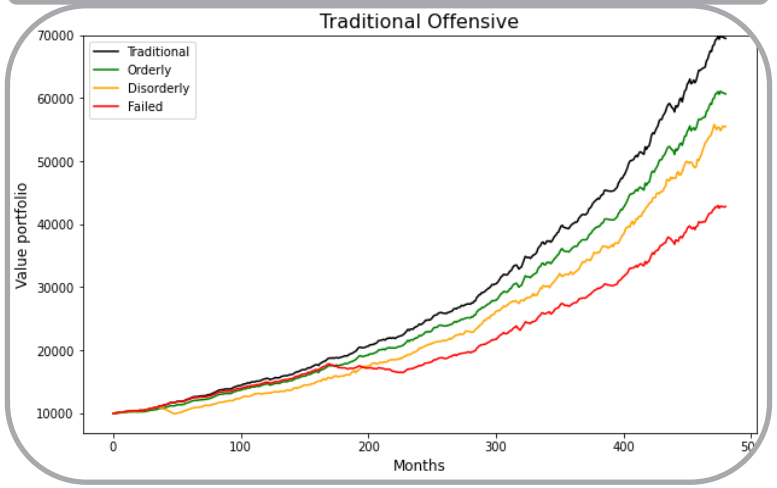


Climate risk scenarios

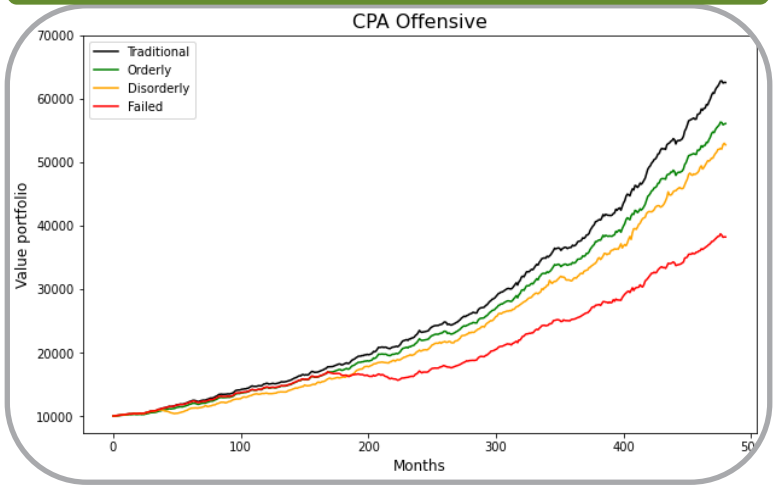
Costs of climate could impact portfolio returns

- The Ortec Finance Scenarioset (OFS) doesn't include a specific climate paths (no 'view')
- Adding specific scenarios based on IPCC climate scenarios could visualize that **climate impacts** future return prospects

Traditional portfolio



Sustainable portfolio



- With the climate scenario data, we can test the **differences** between portfolios, given climate risk

Climate change and investment decisions

We defined three Climate scenarios

Paris Orderly Transition

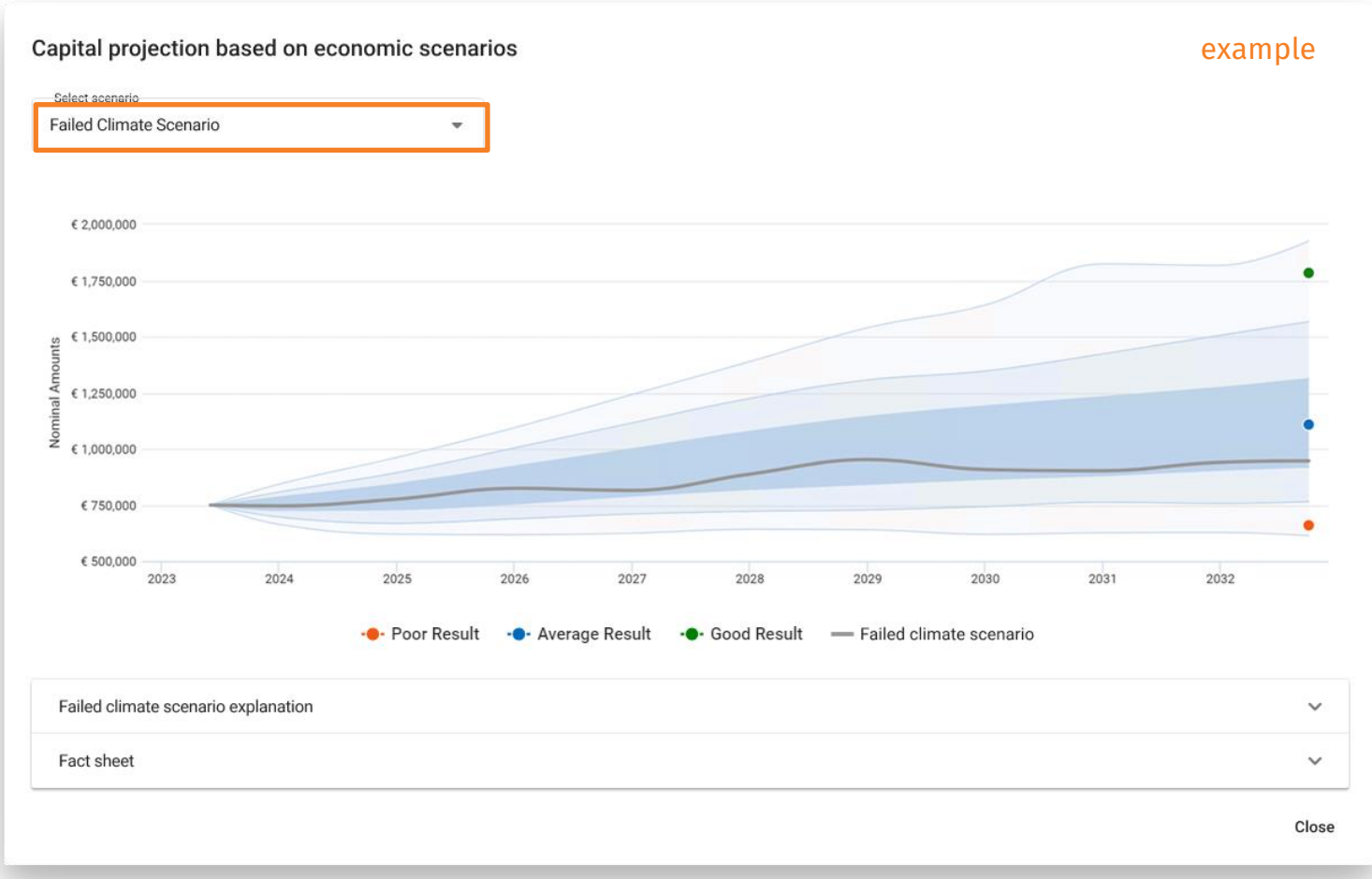
Paris Disorderly Transition

Failed Transition

Climate risk

"How could climate change affect my portfolio?"

"What is the difference between portfolio A and B in terms of transition risk?"



How to check clients’ ESG preferences on both client level and product level?

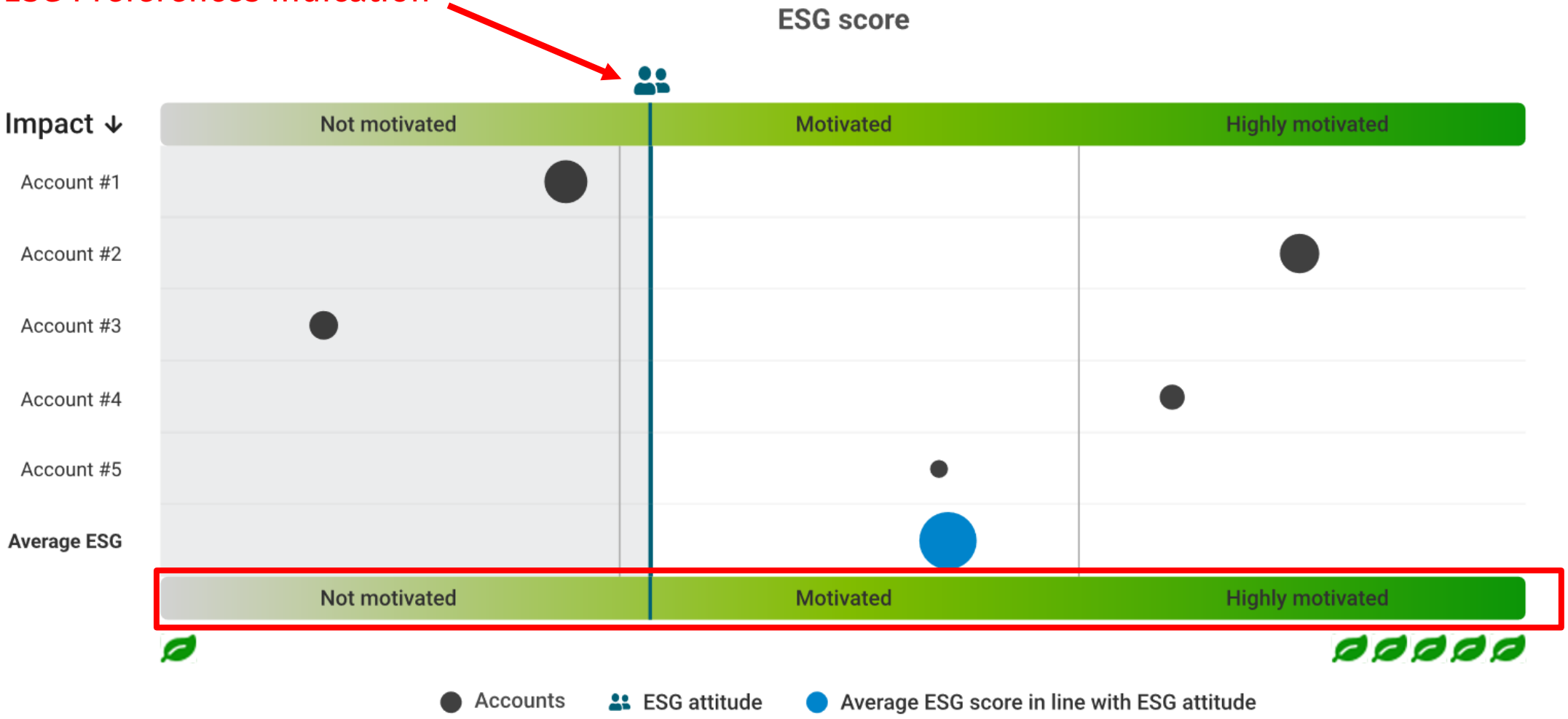
Intake ESG-preferences

Do you already do an intake of ESG?

- How do you map the result to a product?
- Is this on product level or on clientlevel?

Example: ESG Communication

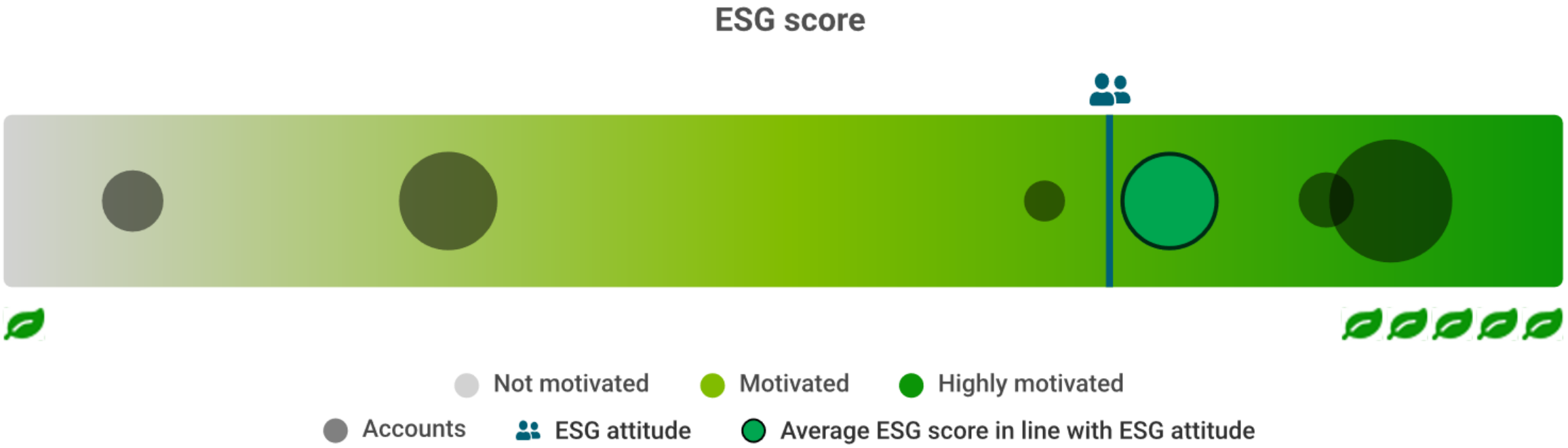
ESG Preferences indication



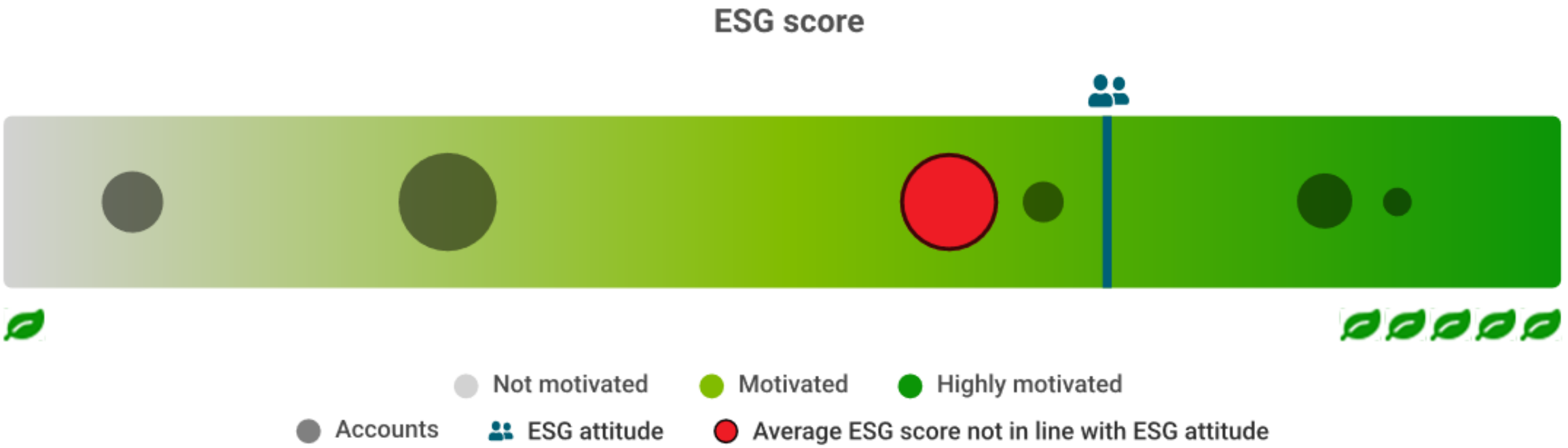
Example: ESG Communication

Willingness to invest Sustainable with this portfolio

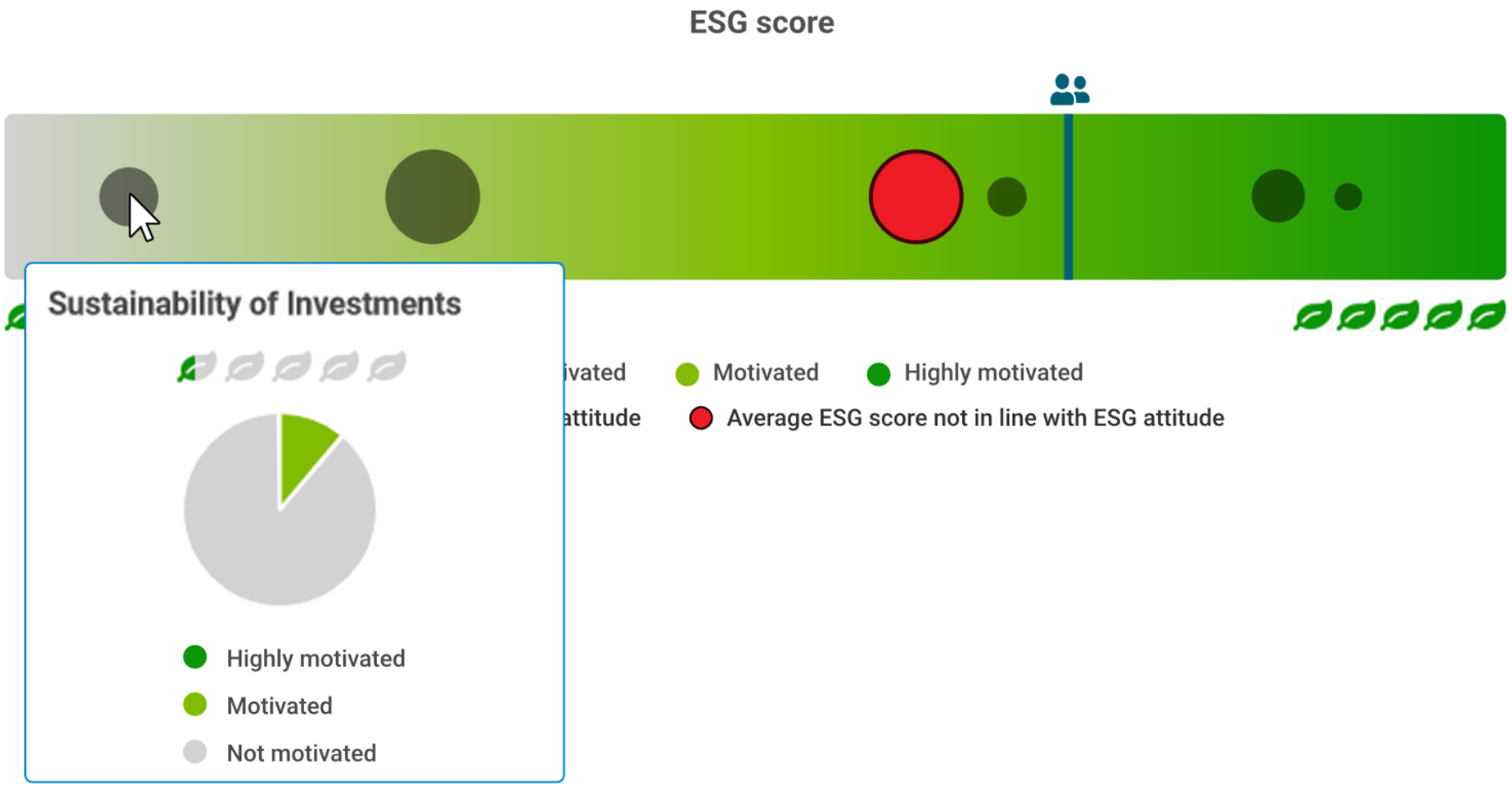
Example: ESG Communication



Example: ESG Communication

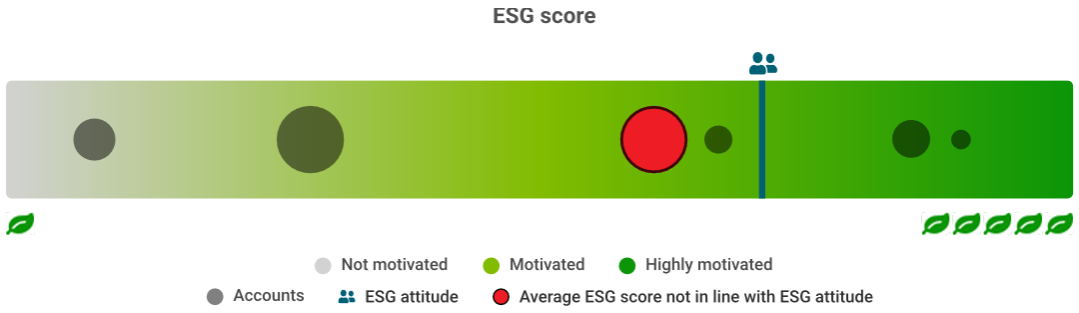


Example: ESG Communication



Which communication do you prefer and why?

1.



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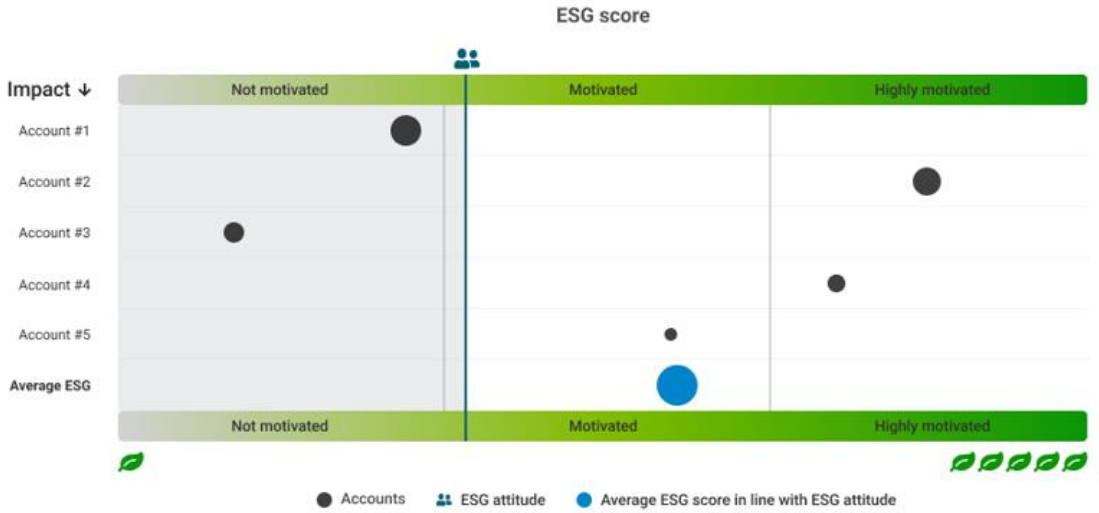
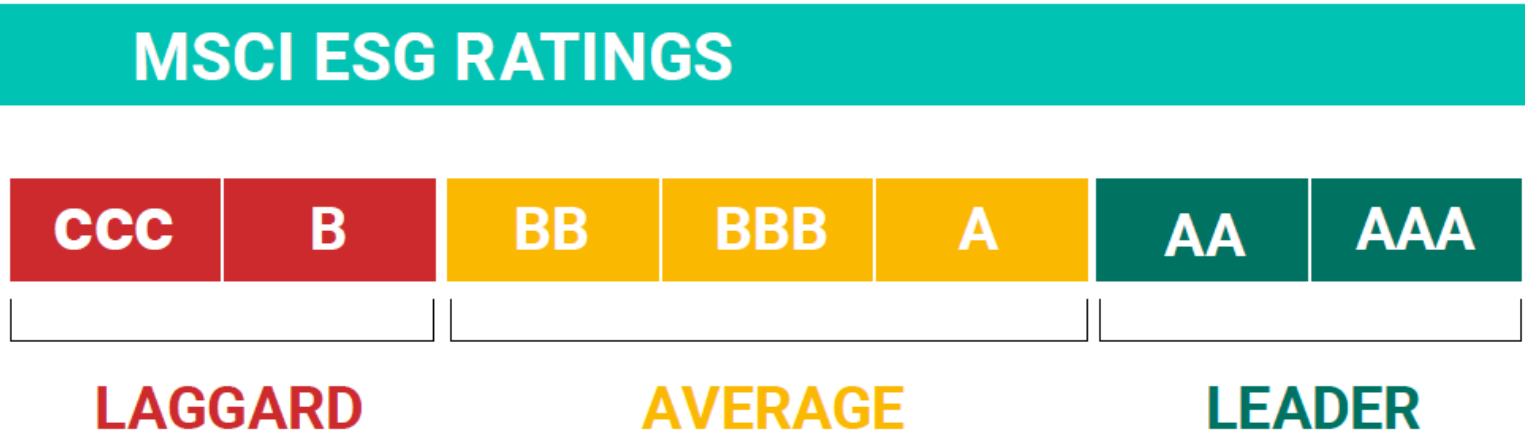


Different rating structures

combine Key Issues and weights and normalize relative to industry peers to derive the ESG Rating



Different rating structures

Article 6: all remaning financial products (None)

Article 8: products that promote ESG (Promote)

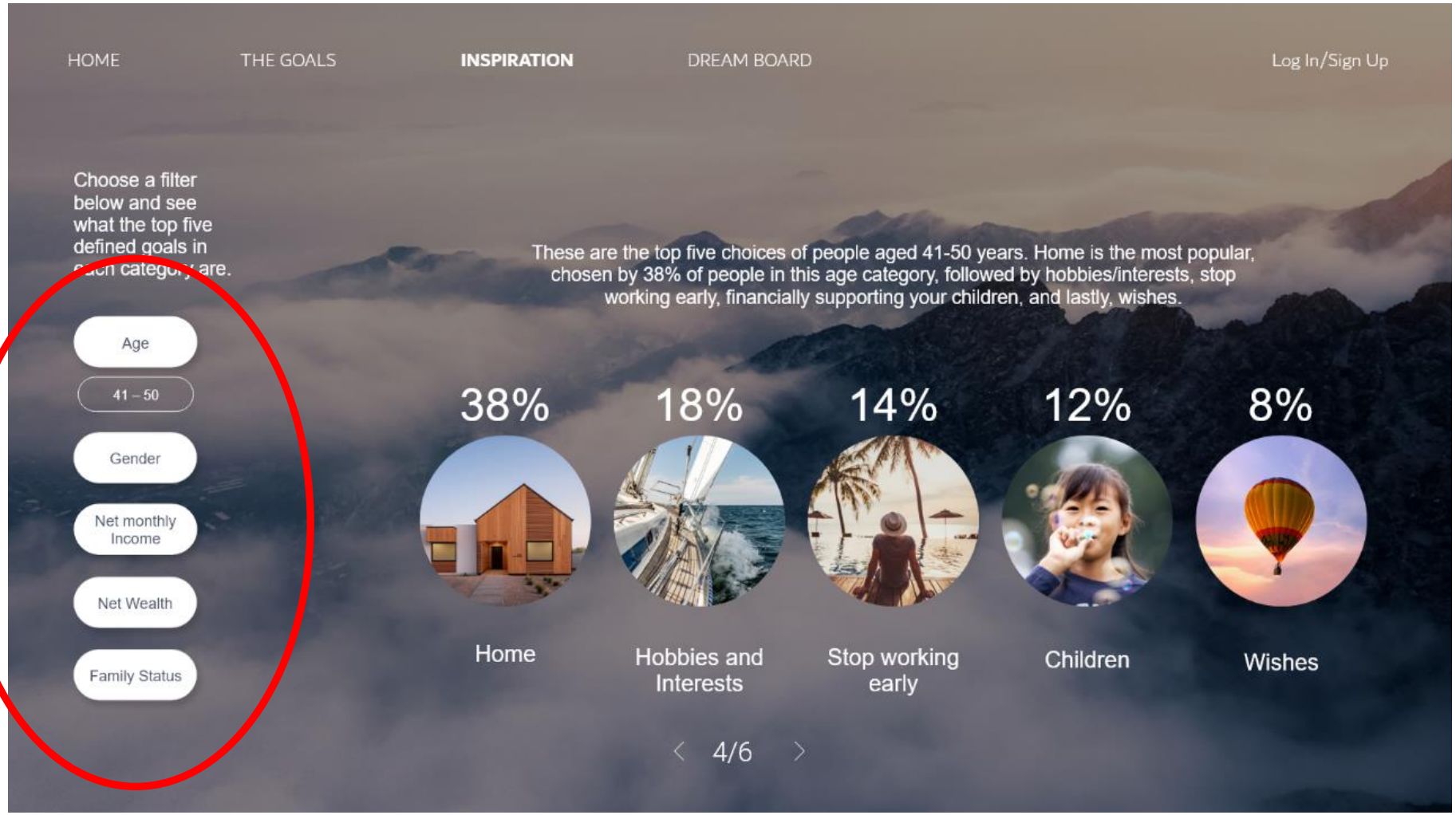
Article 9: products with sustainable objective (Comitted)

How to define goals together with your clients?

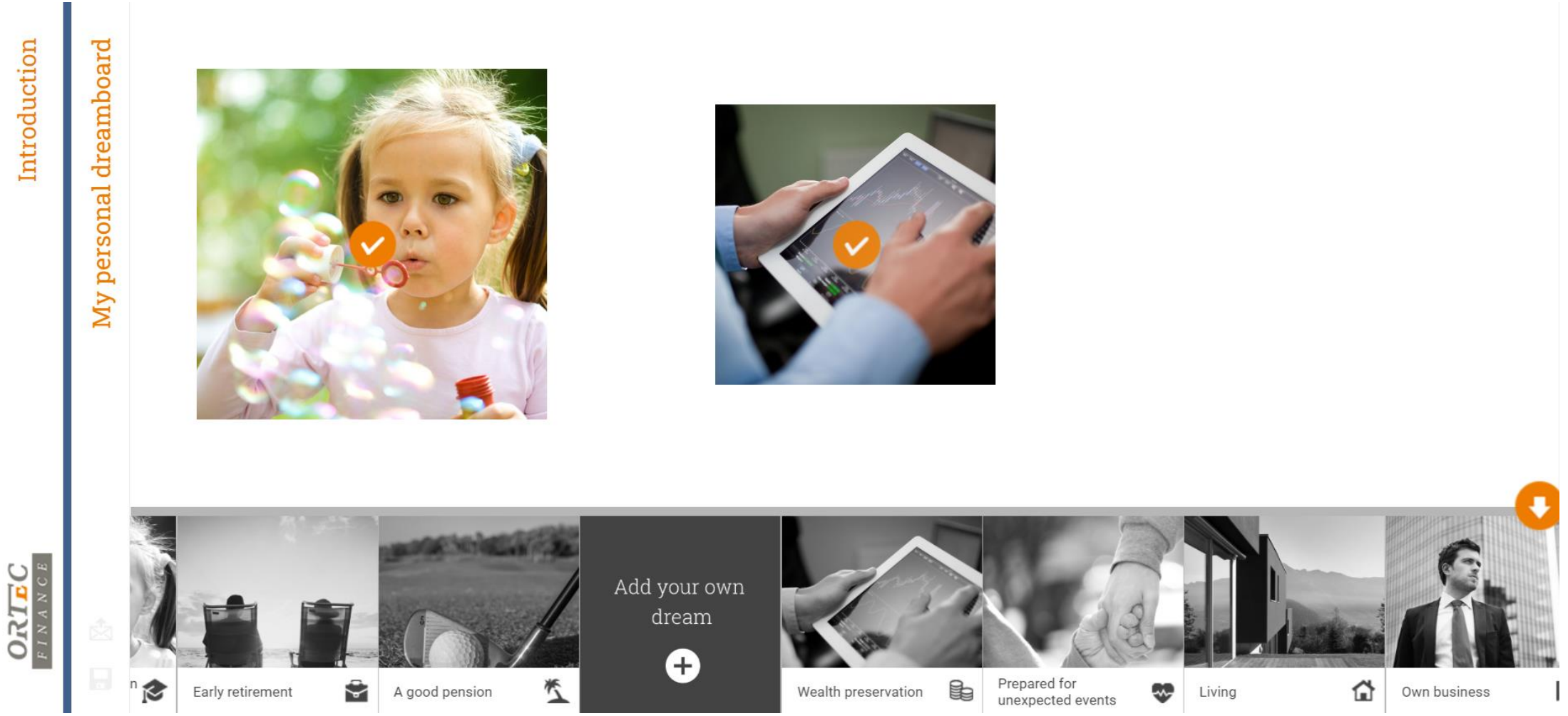
Scenarios to support ‘story telling’

- Research with the University of Maastricht on Automated Advice
  - Goal Definition (consumors and advisors)
- Pilots withs clients

Research Peer-to-Peer



Goal Intake


Introduction
My personal dreamboard
ORTEC FINANCE
Early retirement
A good pension
Add your own dream
Wealth preservation
Prepared for unexpected events
Living
Own business

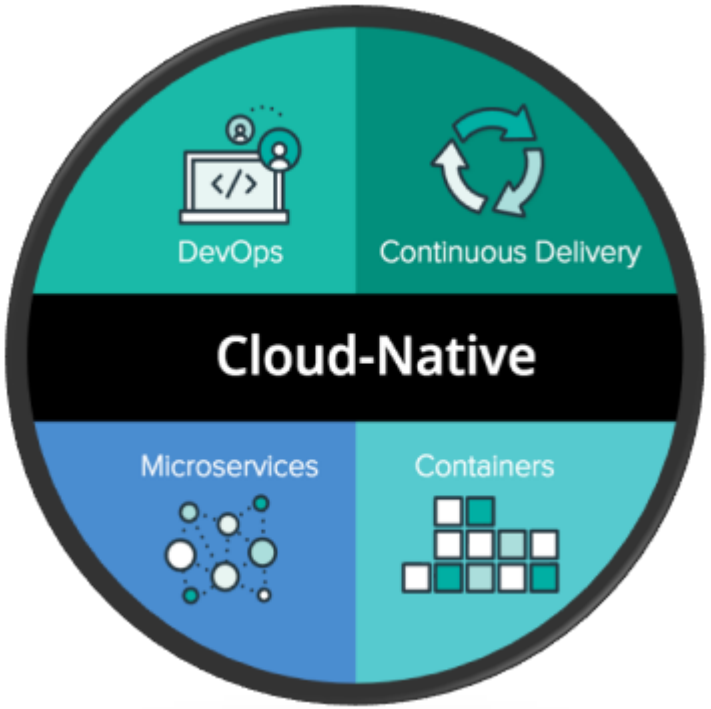
Other innovations

To stay future proof

In development: Cloud Native

2023-2024

- future-proof technical platform
- scalability improvement
- quality and performance assurance



→ More info follows through our consultants

Do you like these innovations?

Which one do you prefer?

Go to menti.com and use the code 1580 0558

Which innovation do you like the most (put the innovations in order of priority)?

14

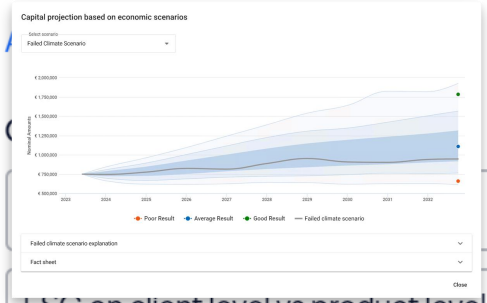
Content

This Menti has results

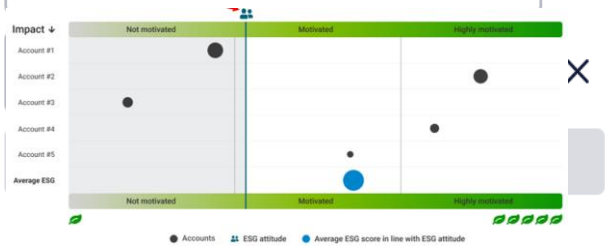
Manage results

Your question

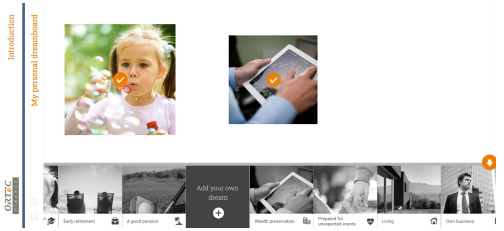
Which innovation do you like the most (put



ESG on client level vs product level



Remove question



OF

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Content

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Got feedback?

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Do you have other suggestions regarding stress tests?

great depression

example for customers

cyberwar

interest rates boom

dotcom bubble

Content

This Menti has results

Manage results

Your question

Do you have other suggestions regarding s

Add longer description

Entries per participant

8

Extras

Let participants submit multiple times

Remove question

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Your question

Do you have other suggestions regarding I

Add longer description

Entries per participant

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Extras

Let participants submit multiple times

Remove question

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Which other innovations could we pick up?

tax calculation
easier integration
real prio setting
portfolio data feed
easy customer view
adjuist goal optimize
ui gamification

Content

This Menti has results

Manage results

Your question

Which other innovations could we pick up?

Add longer description

Entries per participant

8

Extras

Let participants submit multiple times

Remove question

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Thanks!

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