

GEOPOLITICAL RISK AND MANAGER RESEARCH FUNDING

The combination of heightened global geopolitical risk, alongside new UK/EU research regulations, is materially reshaping the post-MiFID II research funding landscape for asset managers and asset owners.

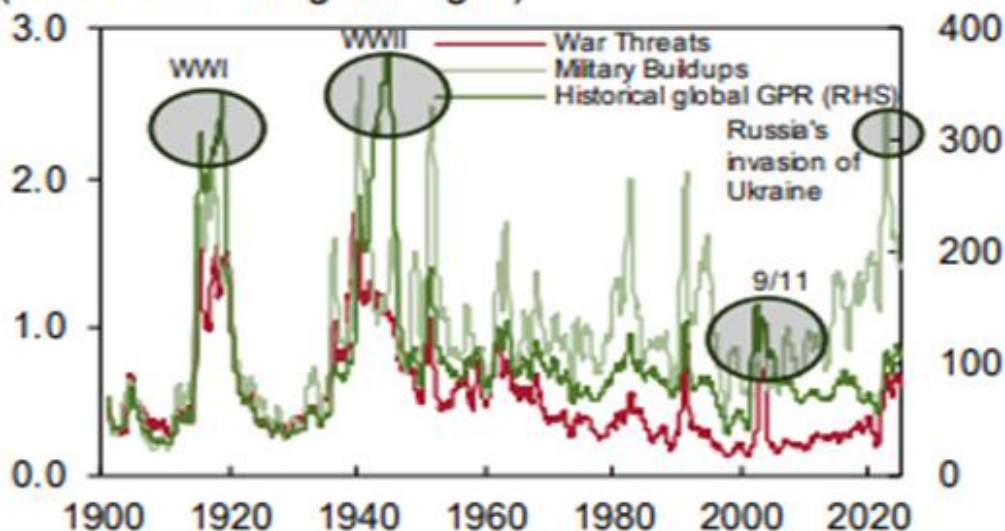
A substantial body of academic analysis has proven that elevated geopolitical risk increases market volatility, equity risk premia and both inter-sector and single stock dispersion.

Key Manager Research Questions for Asset Owners To Consider:

1. Do asset owners believe that we are in an environment of ongoing elevated geopolitical risk?
2. Given the potential volatility across asset classes, is it wise for asset owners to actively constrain their managers' access to information at this time?
3. What is the risk/reward of these tiny research "savings" for asset owners relative to the range of their potential portfolio outcomes?
4. During market drawdowns, is it in the interests of asset owners to have their external managers' access to information mirror those declines in a leveraged fashion, potentially amplifying risk?

Long Term Historical Geopolitical Risk (GPR) Perspectives

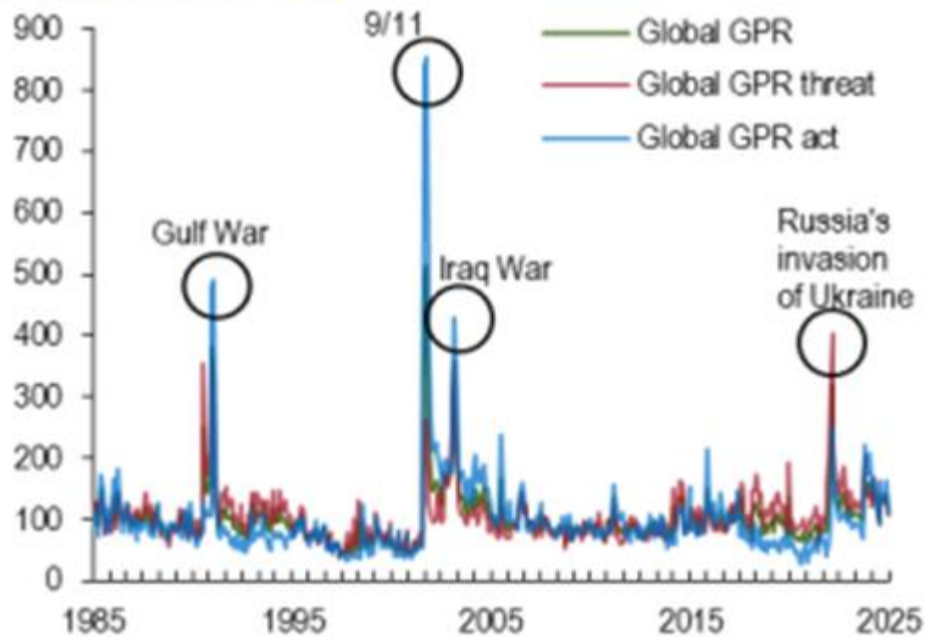
3. Global GPR (historical) and some of its sub-components (12-month moving averages)



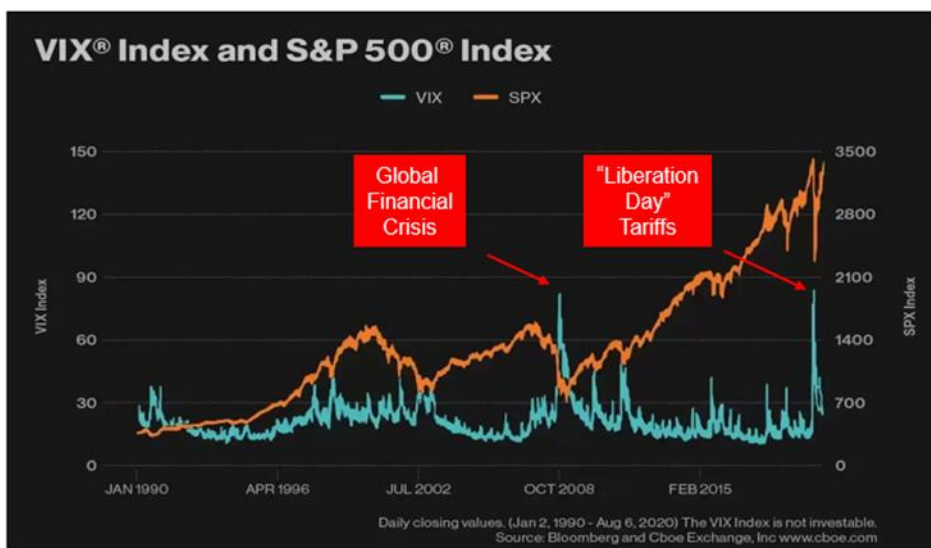
Sources: Caldara and Iacoviello (2022); and IMF staff calculations

More Recent Data

1. Global GPR indices



Cross-Referencing Market Volatility (VIX)



War
With
Iran

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Impact on
Manager
AUM &
research
budgets?

The Bottom Line - Unless Geopolitical Risk Suddenly Disappears:

- Performance differentials between funds will likely increase.
- External research is more important than ever to help managers rapidly analyze and manage tail-risk outcomes - possibly in unexpected industry/geographic segments. Flexibility is key.

- The huge gap between minor research costs for asset owners - (a handful of basis points) and vast fund performance differentials (thousands of basis points across dozens of equity categories) - is likely to increase.

If there were ever a time for asset owners not to handicap their asset managers by denying them miniscule research budgets, this is it.

Ironically, depressed cross-asset returns may provide an incentive for asset owners and asset managers to develop a more collaborative and sustainable approach to research funding.

2022 was the first year since 1969 in which both bonds and equities declined. (Stagflation resulting from the invasion of Ukraine) This multi-asset weakness was a key catalyst for UK/EU regulators and governments to amend MiFID II research rules as they suddenly realized that the lower that markets went, the less and less research P&L managers could access as it was a function of their profitability - driven by declining AUM.

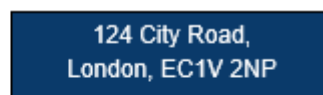
Will 2026 be a repeat of 2022?

Frost has produced a detailed paper on the implications of geopolitical for research funding models and is happy to speak to relevant asset manager internal groups including:

- Executive Committees
- Investment Teams
- Client Service Teams
- Implementation Teams

.....and also to asset manager clients.

This analysis could represent a key component of the client communication strategy with asset owners in the return to client-funded research models. The interests of both asset owners and asset managers are extremely aligned in periods of (mutual) volatility.



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