Discussion of:

# Political Risk Everywhere

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# Research question

- **Can political risk explain global asset returns?**
  - Political risk is central in policy discussions
  - But it is difficult to define, measure, and price
  - Existing work: theory, options/elections, policy news, geopolitical risk

- **This paper**
  - Identifies global systematic component in country political ratings
  - Prices countries and asset classes jointly: equities, bonds, FX
  - Uncovers the "everywhere" dimension of political risk

# The “everywhere” literature

- **Common approach**
  - Start from a factor known in one market
  - Apply the same economic idea across countries and asset classes
  - Ask whether the factor reveals a common source of expected returns

- **Examples**
  - Value and momentum everywhere; carry everywhere; trend everywhere
  - BAB/low-risk, volatility, tail risk, intermediary capital
  - General message: global assets share surprisingly simple factor structure

→ This paper adds **political risk** to this list

# What they do

1) **Measure political risk**
   - ICRG political risk, World Bank politics, WES politics and policy
   - Combine noisy proxies into a "combo" political risk measure

2) **Sort countries within asset classes**
   - High political risk countries earn higher average returns
   - Long-short spreads: equity, bonds, and currencies

3) **Build a global political risk factor**
   - Inverse-volatility combination of asset-class political factors
   - PCA motivates two-factor model: market level + GP slope factor

# How large is the premium?

- **Headline magnitude**
  - GP-factor earns 4.44% per year
  - Sharpe ratio of 0.70
  - Larger Sharpe than their global market factor (0.52)

- **Relative to the "everywhere" literature**
  - Similar to average carry strategies across asset classes (around 0.7)
  - Below diversified carry or time-series momentum (around 1.1)
  - Above many single asset-class BAB estimates (0.11–0.51 outside US equities)

- **My take**
  - Economically meaningful, not just statistically significant
  - But high enough to make measurement and real-time implementability central

# Comment 1: Two possible contributions

- **Contribution 1: interpretation**
  - Political risk helps organize known global return patterns
  - Valuable even if related to EM, FX, macro, or tail risk
- **Contribution 2: new factor**
  - Political risk is a distinct priced global risk factor
  - Requires stronger horse-race and exposure tests
- **What the paper shows very well**
  - Broad, economically large return pattern across stocks, bonds, FX
  - GP factor is not spanned by standard "everywhere" factors

$\rightarrow$ The paper **dances** between the two
- Rhetoric: "we do not aim to run a horse race" $\Rightarrow$ interpretation
- Empirics/contribution: "not subsumed" $\Rightarrow$ new factor

$\Rightarrow$ Be explicit about the claim; the required tests are different

# Comment 2: Political risk or resilience?

- **Alternative interpretation**
  - Countries differ in exposure to global shocks
  - Pandemics, climate shocks, wars, energy shocks, global stress
  - Political ratings may proxy for **resilience**

- **This could be a better framing**
  - Institutions, social fabric, state capacity, prosperity
  - Political risk is one observable summary of fragility
  - Broader story: "resilience everywhere"

→ Shock-specific exposure tests
  - Political vs. non-political global shocks
  - Does GP beta predict losses in both?

# Comment 3: Measuring political risk

- **Political risk is broad**
  - Government stability, rule of law, corruption, conflict, policy confidence
  - Authors: multiple dimensions of country governance
- **Levels vs. innovations**
  - Levels: country/development/EM risk?
  - Innovations: shocks to political conditions?
  - Betas: exposure to global political-risk news?
- **The paper already has useful diagnostics**
  - Demeaned ratings: within-country variation
  - Residualized ratings: strip out economic/macro risk
  - ICRG components: no single dimension explains GP

→ Move this center stage: what is priced, levels, changes, or GP betas?

# Comment 4: Global factor or local risks?

- **The paper shows a global structure**
  - PCA: common component across political-risk portfolios
  - GP factor helps price portfolios across assets
  - This is not just a collection of anecdotes

- **But what is the country-level exposure?**
  - Global-shock story: beta to common GP news
  - Local-risk story: Turkey risk, Brazil risk, Italy risk, etc.
  - Sorted portfolios may bundle persistent country risks

→ Make the beta interpretation more direct:

1) Estimate country/portfolio betas to the GP shock
2) Sort on these betas, not only rating levels
3) Freeze pre-2019 betas; test political shocks in 2020–25

# Comment 5: The mechanism

- **What is the bad state?**
  - GP-factor returns are associated with high growth and low uncertainty
  - Assets with positive GP exposure earn higher returns
  - Interpretation: they underperform when global political conditions deteriorate

- **Can we see the mechanism more directly?**
  - Event windows around salient political shocks
  - State dependence in recessions, VIX spikes, wars, elections, sanctions
  - Decompose cash-flow news vs. discount-rate news if possible

→ Connect the factor more tightly to a model of why investors dislike it

# Overall

- Ambitious and interesting paper
  - Clear contribution to global “everywhere” asset pricing
  - Political risk is an economically meaningful candidate factor
  - Impressive breadth across countries, assets, and measures

- My comments:
  - Clarify whether GP is a new factor or an interpretation of known risks
  - Consider political risk as country resilience/fragility
  - Sharpen what part of political risk is priced
  - Distinguish global political beta from local country risk
  - Make the bad-state mechanism more direct