Asset Valuation and Allocation: The Graham Risk Framework

Solutions for Principal Investors

LINKS

Create an objective response mechanism to long-term market dislocations and risks

The Graham Risk Framework

Asset valuation matters – this is a hard-earned and costly experience following multiple financial crises. Fixed asset allocations in an institutional setting are a thing of the past; timely response to a large-scale market valuation anomaly on the asset-class level may just make that difference.

LINKS Graham Risk is a unified multiple asset valuation framework, which consistently values public and private assets and liabilities across over thirty major asset classes.

With its unique consistent approach to valuing multiple asset classes based on a single metric as the main attraction, the Graham Risk framework to date has been used by some of the largest and most sophisticated funds in the world to achieve consistency in cross-asset valuation.

Use single consistent value measure for all asset classes

In order to arrive at asset allocation funds often use multiple asset-specific valuation frameworks, each with its own set of assumptions that are hard to reconcile across all the assets. LINKS Graham Risk framework is built ground up to handle all asset classes based on a single set of macroeconomic and microeconomic assumptions. A single measure – Graham Risk, describes the degree of over- and under-pricing of all asset classes.

Reconcile macroeconomic and valuation arguments

Most asset allocation processes treat macroeconomic assumptions independently and separately from valuation. Often, the two are handled by different people. As a consequence, the allocation process results in a conflict between the macroeconomic risk assessment and valuation arguments, which is hard to reconcile.

LINKS Graham Risk combines macroeconomic and valuation assumptions in a single framework, which makes it possible to reconcile all assumptions and concerns of the stakeholders.

Estimate the efficacy of valuation, tail risks and historical performance

LINKS Graham Risk framework provides a range of tools to audit the efficacy of valuation assumptions and models.

A consistent back-testing functionality gives an indication of the historic performance of the valuation assumptions.

Multiple possibilities for portfolio construction can be tested to assess the extent of tail risks, empirical impact on three-year forward returns and likely drawdowns.

What is Graham Risk?

GR is an Internal Rate of Return-based measure that compares the current rate of return of an asset with the "fair" IRR, which is a function of the macroeconomic environmental risks. Although Graham Risk does not remove uncertainty over the medium- to long-term returns, it does have a serious implication for the odds of a large drawdown. Since GR is based on a standard IRR methodology, it can be computed for all investable asset classes based on a unified methodology.

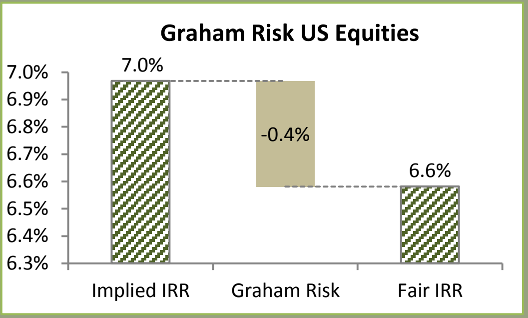
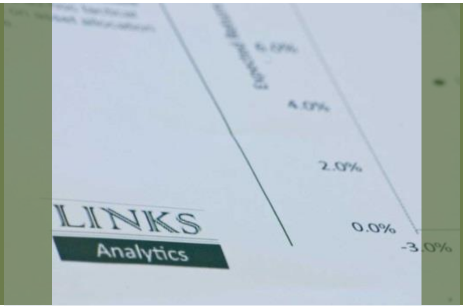


Figure: Graham Risk, U.S. Equities
Source: LINKS Analytics

Graham Risk - objective response to market dislocations and risks



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