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NOVEL RISKS AND SOURCES OF VOLATILITY:
Identification and Measurement Challenges for Portfolio Management

guest co-editor
AHMET K. KARAGOZOGLU

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Editors' Introduction to the Special Issue on Novel Risks and Sources of Volatility: Identification and Measurement Challenges for Portfolio Management

Frank J. Fabozzi and Ahmet K. Karagozoglu

INTRODUCTION

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In a broad sense, novel risks arise from environmental-, governance-, healthcare-, social responsibility–, sustainability-, and technology-related shortcomings of or challenges faced by firms, as well as the uncertainty caused by potential domestic and global regulatory policy responses. The recent announcements made by the Securities and Exchange Commission during the first quarter of 2021 highlight the importance of environmental, social, and governance (ESG) risk and climate change risk, as well as how rapidly the regulatory and policy framework is evolving for these risks. The most recent ransomware attacks in May 2021 targeting a major US energy distributor and a major US food processor underscore the proliferation of potential vulnerabilities from cybersecurity risk. These developments have been taking place as the financial markets process the impact of COVID-19 pandemic, which has been affecting the world since February 2020 (as of writing in August 2021), bringing pandemic risk to the forefront of risk taxonomy and heightening sensitivity to geopolitical risk as the perfect storm of novel risks seems to converge on economies across the globe.

In the lead article, "Novel Risks: A Research and Policy Overview," Ahmet K. Karagozoglu presents a review of the recent academic literature, identifying common themes for data and measurement and discussing future directions for research and regulatory policy development. According to the author, recent academic literature suggests that there are parallels among ESG risk, climate change risk, cybersecurity risk, and geopolitical risk in terms of measurement challenges, including but not limited to emerging data and measurement methods; similarities in terms of their insufficient, noncomparable, less-specific, and non–decision-useful disclosures; and the potential interaction between these risks. Karagozoglu concludes that the establishment of consistent disclosure policy and reporting requirements and improvement in measuring the impact of these novel risks on asset prices, volatility, and global financial stability are at the forefront of contemporary financial economics and portfolio management.

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