A system for assessing country risk in terms of capital and trade investment has been found to be reasonably predictive of future equity returns. The conclusion was based on research by Campbell Harvey, a professor at the Fuqua School of Business at Duke University, and First Chicago Investment Management’s Claude Erb and Tadas Viskanta.

They used the International Country Risk Guide, a monthly publication covering 130 countries, to do a historical analysis of risk ratings for every month dating back to 1984 and compare the ratings to actual equity market returns.

The research showed a simple buy-sell strategy based on an upgrade or downgrade in the ICRG risk ratings produced “extremely high” risk-adjusted returns, both in mutual funds of stable industrialized countries and volatile emerging markets.
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