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Forecast of value at risk for equity indices: an analysis from developed and emerging markets

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Abstract

Purpose

The purpose of this paper is to compare the performance of commonly used value at risk (VaR) estimation methods for equity indices from both developed countries and emerging markets.

Design/methodology/approach

In addition to traditional time-series models, this paper examines the recently developed nonparametric kernel estimator (KE) approach to predicting VaR. KE methods model tail behaviors directly and independently of the overall return distribution, so are better able to take into account recent extreme shocks.

Findings

The paper compares the performance and reliability of five major VaR methodologies, using more than 26 years of return data on 37 equity indices. Through back-testing of the resulting models on a moving window and likelihood ratio tests, it shows that KE models produce remarkably good VaR estimates and outperform the other common methods.

Practical implications

Financial assets are known to have irregular return patterns; not only the volatility but also the distributions themselves vary over time. This analysis demonstrates that a nonparametric approach (the KE method) can generate

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The paper evaluates the performance of several common VaR estimation approaches using a comprehensive sample of empirical data. The paper also reveals that kernel estimation methods can achieve remarkably reliable VaR forecasts. A detailed and complete investigation of nonparametric estimation methods will therefore significantly contribute to the understanding of the VaR estimation processes.

Keywords

Value analysis

Risk analysis

Equity capital

Emerging markets

Citation

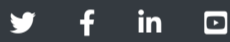
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