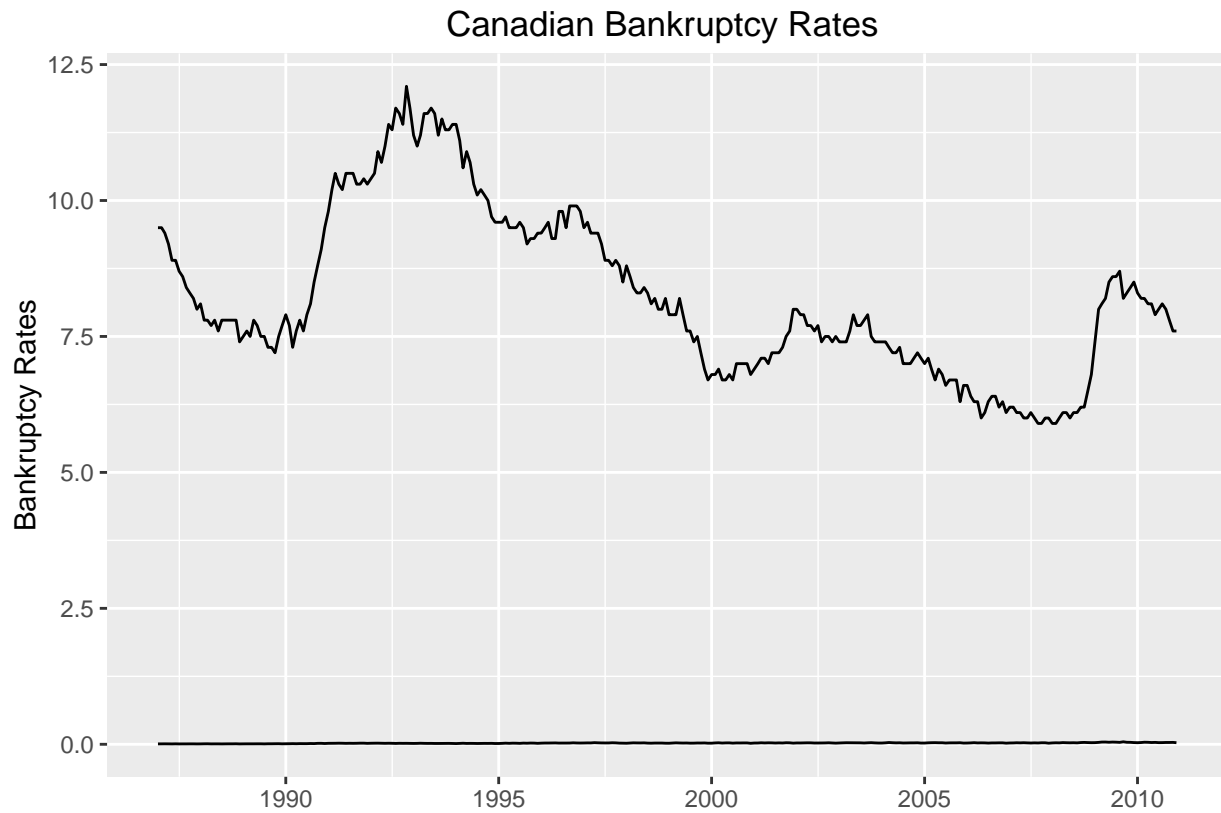


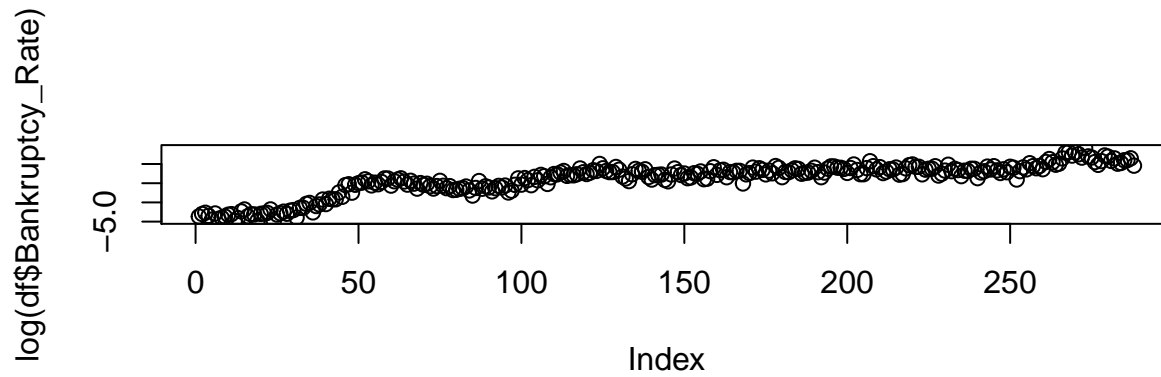
Final Method chosen

Evelyn Peng

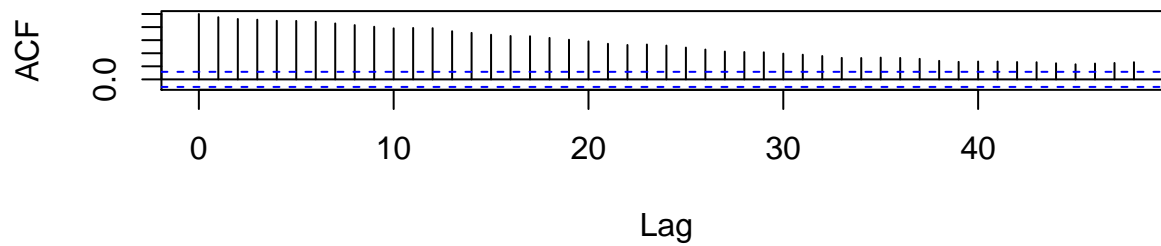
November 27, 2016



Plot time series data and ACF to see if the data is stationary.

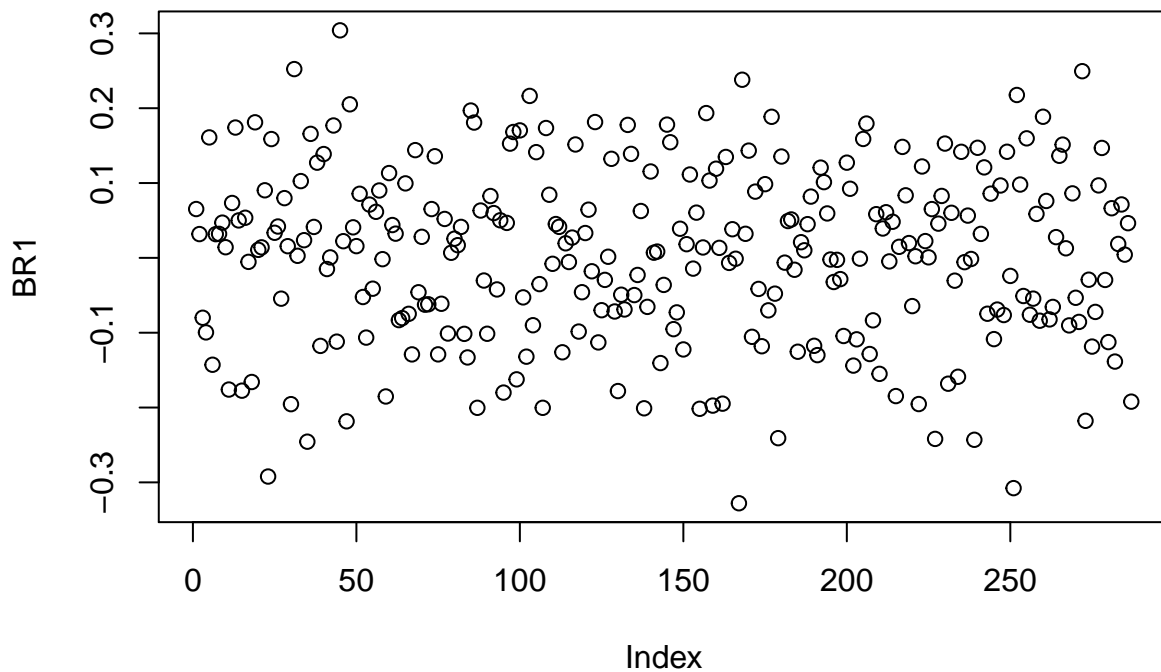


Series log(df\$Bankruptcy_Rate)

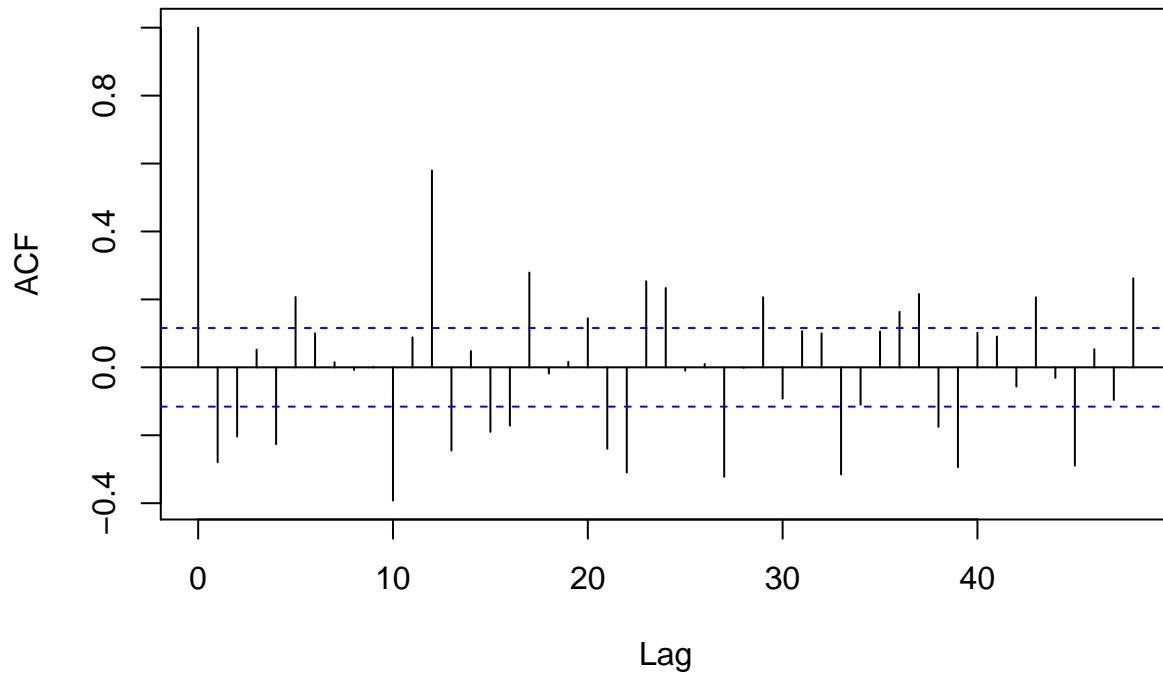


```
##                               Dickey-Fuller
## "Test Statistic:"           "-2.0311"         "P-value:"           "0.5631"
```

We found the ACF showing undesirable slow decay indicating the data has a trend. And formal test, Augmented Dickey-Fuller, also support this observation with p-value = 0.3859. We should not reject the null hypothesis that the time series data is not stationary. To stable the time series, we begin with ordinary difference to minimize the trend. We then difference the data until the transformed time series looks flat.



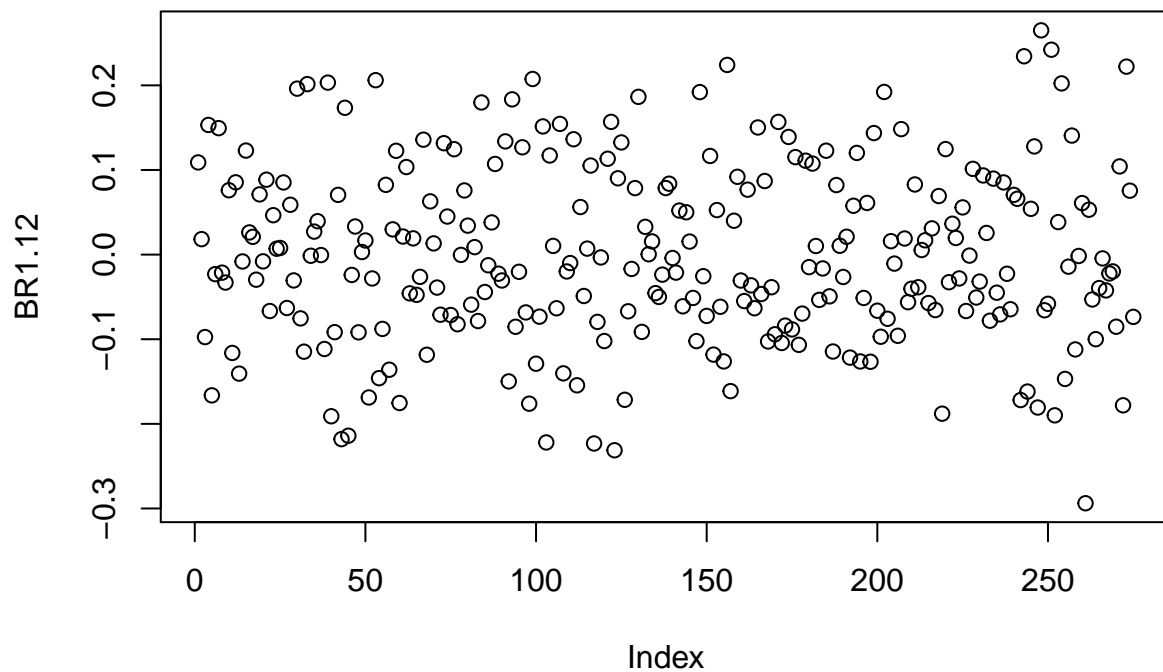
Series BR1



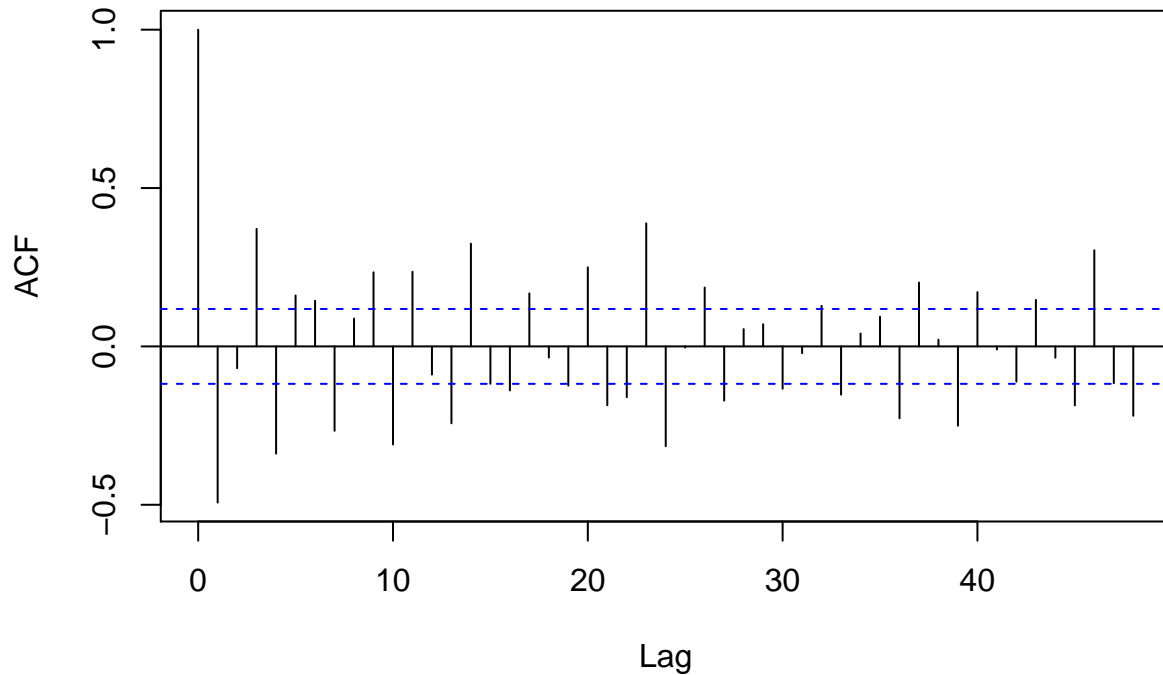
```
## Warning in adf.test(BR1): p-value smaller than printed p-value
```

```
##                               Dickey-Fuller
## "Test Statistic:"             "-7.3221"      "P-value:"             "0.01"
```

The Bankruptcy Rate passed Dickey-Fuller test after difference once. The data is now stationary without trend and we need to eliminate seasonality next.



Series BR1.12



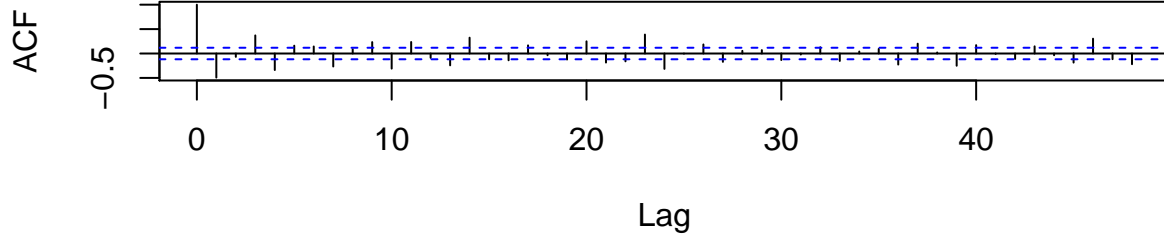
ACF plots looks better after seasonal difference once. The peaks between two cycle decay rapidly. We then use auto.arima to check if using library will give the same result.

```
## Series: log(df$Bankruptcy_Rate)
## ARIMA(3,1,3)
##
## Coefficients:
##          ar1      ar2      ar3      ma1      ma2      ma3
##          0.0857 -0.0425 -0.6524 -0.4415 -0.2148  0.8090
## s.e.    0.0929  0.0877  0.0830  0.0779  0.0933  0.0687
##
## sigma^2 estimated as 0.00931:  log likelihood=265.5
## AIC=-516.99  AICc=-516.59  BIC=-491.37

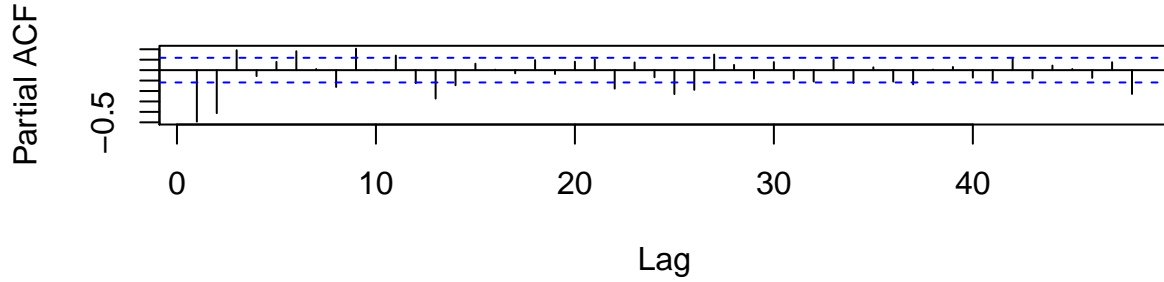
## [1] 0
```

Even though auto.arima diagnose the data should perform without seasonality, we could still see a clear seasonal cycle in the data. We will process with ordinary difference with once and seasonal difference with twice. From the acf plot of the final different-ed data, the candidate q is between 1 and 7. The possible range of p is 1 and 8. And P, Q both could fall in 0 to 2.

Series BR1.12



Series BR1.12



(Using nested for loop) [should not included in the final report], (p,q,P,Q) with value $(8,2,1,2)$ has the lowest AIC value, this servers as our first candidate model. And $(6, 5, 2, 2)$ server as our second candidate model.

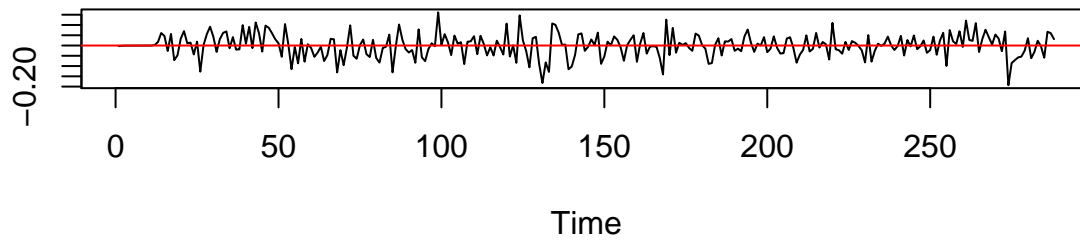
```
## Warning in arima(log(df$Bankruptcy_Rate), order = c(7, 1, 3), seasonal =
## list(order = c(1, : possible convergence problem: optim gave code = 1
```

	$(6,1,5)X(2,1,2)$	$(7,1,2)X(0,1,2)$	$(7,1,3)X(1,1,1)$	$(8,1,2)X(1,1,2)$
$\hat{\sigma}^2$	0.003256	0.00333	0.003299	0.003257
log likelihood	385.86	381.7	382.54	384.43
AIC	-739.7	-739.4	-739.0	-740.8

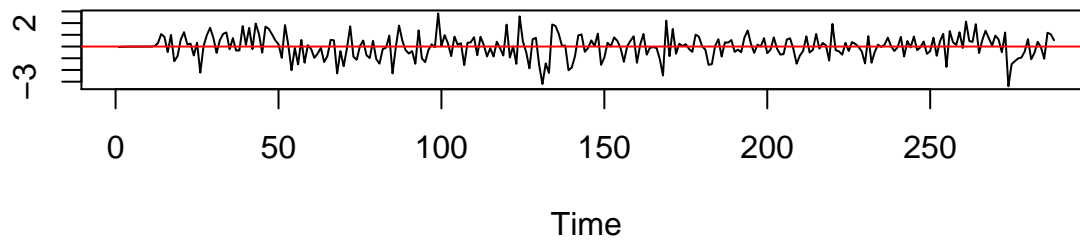
From the comparison table, we could clearly confirm the first model perform better than the others. Although the AIC is not the smallest among these four models, but it has least $\hat{\sigma}^2$ and largest log likelihood value. And it only traded off AIC for less than 0.1. We therefore choose the parameter of arima model $(6,1,5)X(2,1,2)$ accordingly. With the candidate model arima $(6,1,5)X(2,1,2)$, we start checking if it satisfy the formal and informal residual diagnostics.

i. Zero-Mean

Residuals vs t



Standardized Residuals vs t

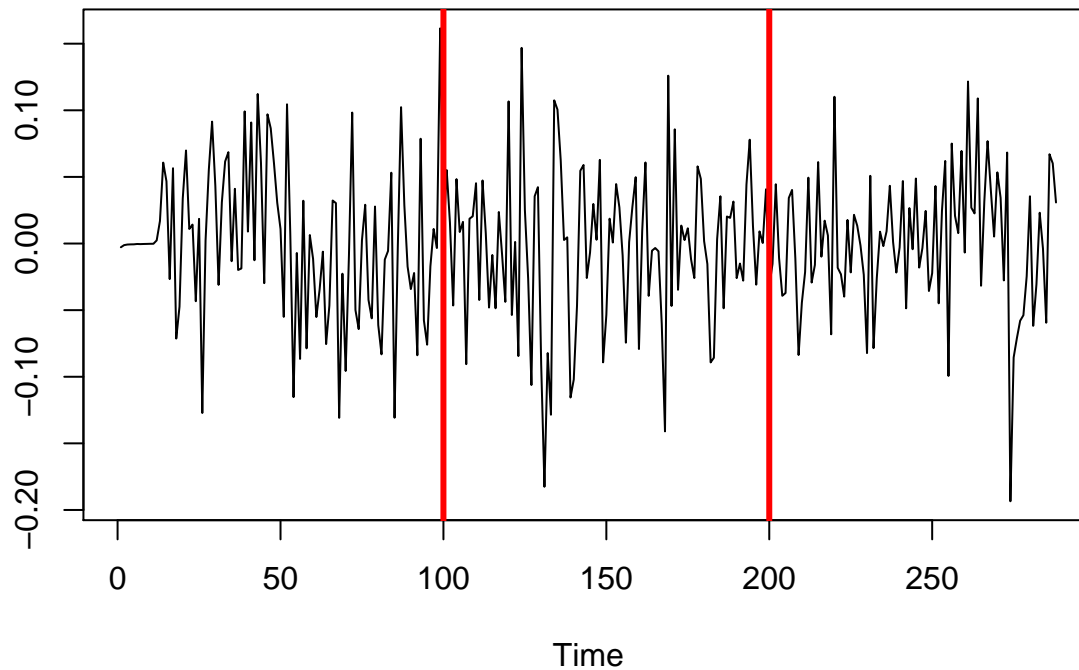


```
##                                     t
## "Test Statistic:"                  "-0.2535"          "P-value:"          "0.8001"
```

From the plot of standardized residuals and time t , we see no obvious above or below 0. And the one sample t -test gave $p\text{-value} = 0.8001$ indicating we should not reject the null hypotheses. The true mean is equal to 0 with more than 95 percent confidence level.

ii. Homoscedasticity

Residuals vs t

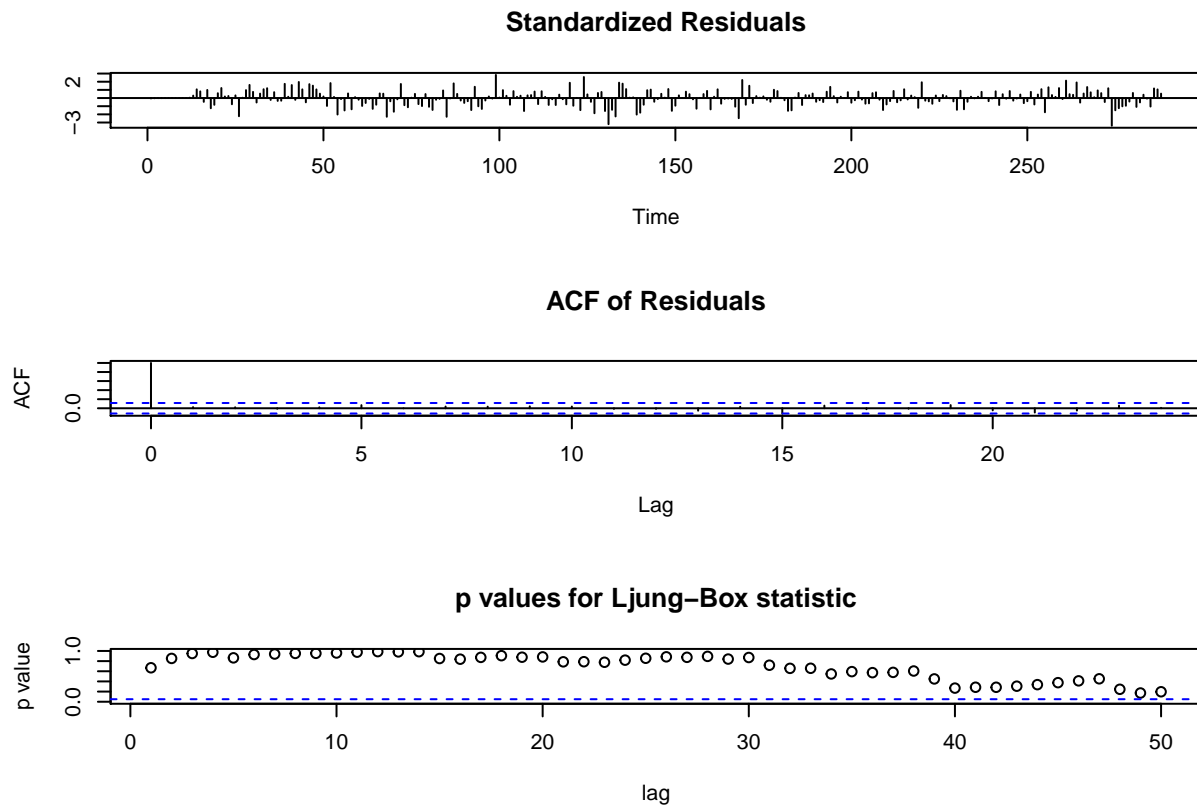


```
##                               Test Statistic
## "Test Statistic:"             "0.4371"         "P-value:"         "0.6463"

##                               Bartlett's K-squared
## "Test Statistic:"             "1.9205"         "P-value:"
##
## "0.3828"
```

From the plot of standardized residuals and time t , we see no obvious differences variance between groups. I divided the group by 3. The variance stays constant for all the groups. And both levene test (0.6463) and Bartlett test (0.3828) gave p-value more than 0.3, indicating we should not reject the null hypothesis that all variance are the same across groups.

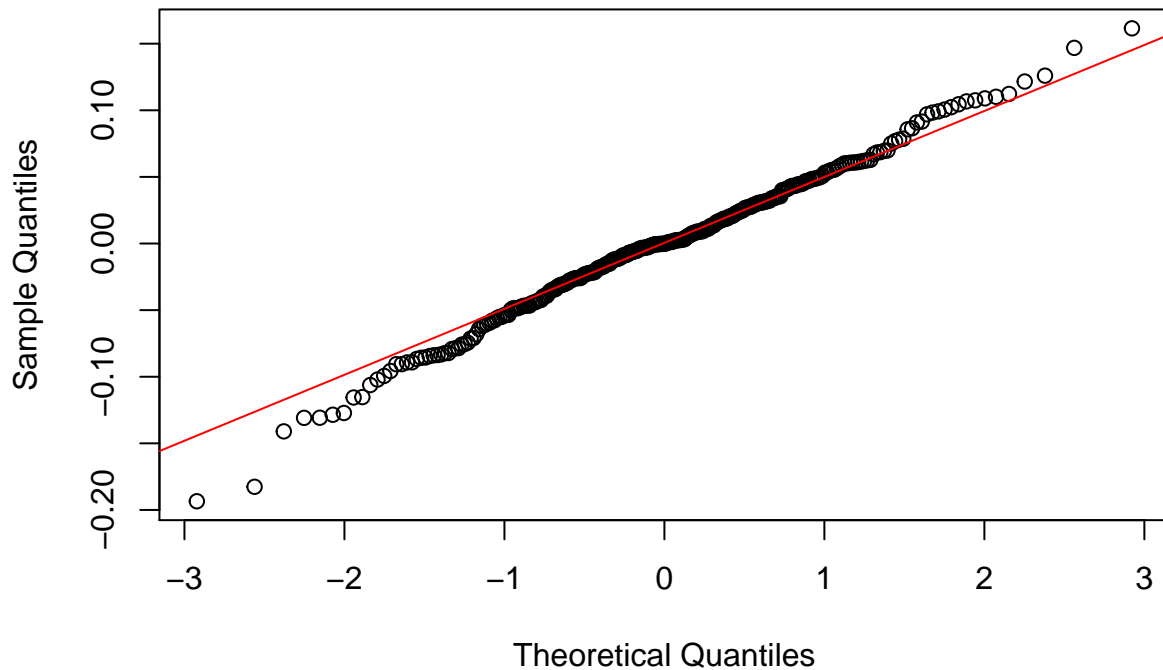
iii. Zero-Correlation



The function `tsdiag` give the graph of ACF and Ljung-Box test all in one! From the ACF plots, it shows the residuals' are uncorrelated (only one spikes at 0 and no spikes afterwards) and for formal test of correlation, Ljung-Box test, all the p-value are larger than the critical value and we should not reject the null hypothesis that all correlations are equal to 0 because all the p value is above the confidence interval. The residuals do not have correlation for all lags.

iv. Normality

QQ-plot of Residuals



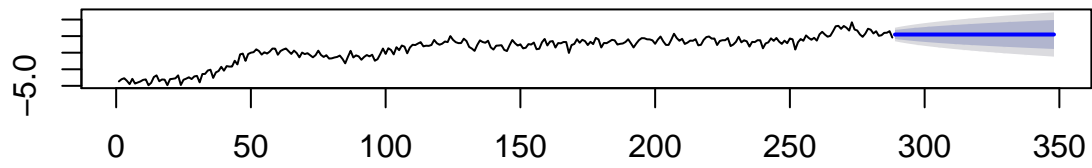
```
##                                     W
## "Test Statistic:"                 "0.9928"      "P-value:"      "0.1755"
```

The qqplot seems quite good, the empirical dots lie on the theoretical normal distribution line. And the formal test for normality-shapiro test, gave a p-value = 0.1755 suggesting not reject the null hypothesis. The residuals are normally distributed.

Exponential smoothing (Holt-Winters Methods)

From previous diagnosis, we found there are trend and seasonality in these data. Therefore, we adapt Triple Exponential Smoothing method with multiple effect (apply on heteroskedastic data). However, after trying four different types of Holt-Winter method, there is no sign of seasonality. We cannot use Exponential Smoothing to predict future bankruptcy rates.

Forecasts from HoltWinters



Forecasts from HoltWinters

