Synthetic Volatility Forecasting and Other Aggregation Techniques for Time Series Forecasting

Preliminary Exam

David Lundquist[1]

March 12, 2024

[1]davidl11@ilinois.edu

A seemingly unprecedented event might provoke the questions

1. What does it resemble from the past?
2. What past events are most relevant?
3. Can we incorporate past events in a systematic, principled manner?

When would we ever have to do this?

- Event-driven investing strategies (unscheduled news shock)
- Structural shock to macroeconomic conditions (scheduled news possibly pre-empted by news shock)
- Biomedical panel data subject to exogenous shock or interference

Example: weekend of March 7th and 8th, 2020

Punchline of the paper

Forecasting is possible under structural shocks, so long as we incorporate external information to account for the nonzero errors.

Background and related methods

Volatility Modeling

- GARCH is slow to react (Andersen et al. 2003)
- Asymmetric GARCH models may react faster but need post-shock data
- Realized GARCH (Hansen, Huang, and Shek 2012), in our setting, would require post-shock information and/or high-frequency data in order to outperform, and the model is highly parameterized

Forecast Augmentation

- Clements and Hendry 1998; Clements and Hendry 1996 laid the groundwork for modeling nonzero errors in time series forecasting
- Guerrón-Quintana and Zhong 2017 use a series' own errors to correct the forecast for that series
- Dendramis, Kapetanios, and Marcellino 2020 use a similarity-based procedure to correct linear parameters in time series forecasts
- Foroni, Marcellino, and Stevanovic 2022 adjust pandemic-era forecasts using intercept correction techniques and data from Great

Outline

The news has broken but markets are closed

- $y \in \mathbb{R}^n$, a mean-zero, real-valued response to be predicted

A Primer on GARCH

Bibliography

- Andersen, Torben G et al. (2003). "Modeling and forecasting realized volatility". In: *Econometrica* 71.2, pp. 579–625.
- Clements, Michael and David F Hendry (1998). *Forecasting economic time series*. Cambridge University Press.
- Clements, Michael P and David F Hendry (1996). "Intercept corrections and structural change". In: *Journal of Applied Econometrics* 11.5, pp. 475–494.
- Dendramis, Yiannis, George Kapetanios, and Massimiliano Marcellino (2020). "A similarity-based approach for macroeconomic forecasting". In: *Journal of the Royal Statistical Society Series A: Statistics in Society* 183.3, pp. 801–827.
- Foroni, Claudia, Massimiliano Marcellino, and Dalibor Stevanovic (2022). "Forecasting the Covid-19 recession and recovery: Lessons from the financial crisis". In: *International Journal of Forecasting* 38.2, pp. 596–612.
- Guerrón-Quintana, Pablo and Molin Zhong (2017). "Macroeconomic