May 16th, 12:00 PM - 3:00 PM

Short-Term Volatility Curve Predictions Using Singular Spectrum Analysis

Nick Odell
Western Washington University

Follow this and additional works at: https://cedar.wwu.edu/scholwk

Part of the Higher Education Commons


This Event is brought to you for free and open access by the Conferences and Events at Western CEDAR. It has been accepted for inclusion in Scholars Week by an authorized administrator of Western CEDAR. For more information, please contact westerncedar@wwu.edu.
Abstract
This project aims to produce accurate volatility forecasts, using high-frequency financial time series data. The primary mathematical methods used are functional data analysis (statistical analysis on smoothed curve observations), time series analysis techniques such as autoregressive models, and a comparison between multivariate and univariate singular spectrum analysis. These results aim to be useful for financial risk quantification.

Introduction
Quantifying financial risks for high-frequency financial time series data plays an important role in portfolio optimization and options pricing. It can be achieved by analyzing volatility curves, which roughly represent the absolute percentage differences in prices between subsequent data points.

Research Goals
Primary Research Goals: To come up with:
1. Accurate short-term volatility curve forecasts (1- to 5-day ahead forecasts), and;
2. Reliable prediction bands.

Models Being Compared: Two novel volatility models which utilize singular spectrum analysis (SSA), a recent time series technique, to extract trends and seasonalities in volatility curves. Specifically,
1. Univariate SSA (USSA) and
2. Multivariate SSA (MSSA) are compared using the mean-square error (MSE) values of appropriately transformed predicted volatility curves. A lower MSE value indicates a better forecast performance.

Data
Stocks Analyzed: Apple, BP, and Pfizer.
Time Resolution and Period: One-minute intraday price data from January 2010 to January 2018.
Data Source: QuantQuote (https://quantquote.com/).

Modeling Approach
Our novel SSA-based volatility curve models are constructed using the following ideas:

1. Symmetrizing Data Transformations
To make the distribution of the volatility curve data symmetric, we have applied ¼ power, mean-standardization, log transformation, and Yeo-Johnson transformations. After these transformations, we have a unit-free, symmetric curve that can be used to produce accurate forecasts.

2. Smoothing the Transformed Volatility Curves
The transformed volatility curve data are not suitable for statistical analysis due to their roughness. They are smoothed using 15 Fourier basis functions. After that, about a dozen of empirical functional principal components (EPPCs) are used to capture ≥ 90% of the variation in the smoothed data.

3. Capturing Deterministic and Stochastic Components
SSA is applied to the scores corresponding to the EPPCs for modeling their deterministic components. Because the EPPCs may be viewed as multivariate time series, we considered both the univariate and multivariate SSA approaches. After removing the deterministic components, an autoregressive (AR) model, which predicts future observations of stationary time series based on a number of previous observations, is applied to describe the stochastic components.

4. Forecasting Using SSA and AR Predictions
Predicted values from the SSA and AR models are combined to capture the absolute percentage differences. Predicted curves and prediction bands are also constructed by taking appropriate percentiles of their daily maximum errors (see Fig. 1).

Analysis
The predicted curves correctly capture a typical diurnal pattern (higher volatility at the beginning and end of day; see Fig. 1). The MSE values of USSA are about one fourth of that of MSSA. That indicates that USSA tends to produce much more accurate short-term volatility curve forecasts than MSSA (see Fig. 2).

References