

# Contents

Preface .....	V
Contents .....	IX
Denotations, Symbols and Abbreviations .....	XIII
List of Utilized Matlab Built-in Functions.....	XVII
Chapter 1     Data Acquisition .....	1
1.1     Imports from Free Sources .....	1
1.1.1     Prague Stock Indices from pse.cz .....	1
1.1.2     Stock Financial Time Series from Yahoo Finance.....	4
1.1.3     Foreign Exchange Rates from CNB.....	5
1.1.4     Foreign Exchange Rates from TrueFX.com .....	6
1.2     Data Resampling.....	9
1.2.1     Resampling by Time .....	10
1.2.2     Resampling by Price Movements .....	10
1.3     Combination of Time Series .....	12
1.3.1     Small Indices Dataset.....	12
1.3.2     Dow Jones Industrial Average dataset .....	14
1.3.3     S&P 500 Dataset.....	15
Chapter 2     Returns – Calculation and Modelling .....	17
2.1     Returns Calculation and Estimation.....	17
2.1.1     Individual Assets Returns .....	17
2.1.2     Portfolio Returns.....	18
2.1.3     Returns Calculation for Different Periods .....	19
2.1.4     Aggregation of Returns Across Time and Across Assets .....	20
2.1.5     Individual Assets Returns Estimation .....	20
2.1.6     Portfolio Returns Estimation.....	21
2.2     Marginal Distributions .....	22
2.2.1     Gaussian Distribution .....	23
2.2.2     Student Distribution .....	24

2.3	Lévy Models .....	26
2.3.1	Variance Gamma Distribution .....	27
2.3.2	Normal Inverse Gaussian Distribution.....	28
2.3.3	Comparison of Gaussian, Student and NIG Distributions .....	29
2.4	GARCH Models .....	31
2.5	Dependency Modelling.....	35
2.5.1	Elliptical Copula Functions.....	36
2.5.2	Archimedean Copula Functions.....	38
2.5.3	Copula Parameters Estimations .....	40
2.5.4	Utilization of Copula Functions in Matlab .....	40
2.5.5	Combinations of Marginals and Copula Functions.....	40
2.6	Joint GARCH-Copula Model .....	41
2.7	Discussion and Further Research Ideas .....	43
Chapter 3	Portfolio Optimization .....	47
3.1	Mean-Variance Framework .....	47
3.2	Generation of Feasible Set and Naive Search for Efficient Set .....	48
3.3	Efficient Set as the Solution to Minimization Problem .....	54
3.3.1	Optimal Portfolio .....	56
Chapter 4	Backtesting of Portfolio Optimization .....	61
4.1	Backtesting Framework .....	61
4.2	Performance Measures.....	63
4.2.1	Maximum Drawdown .....	64
4.2.2	Sharpe Ratio.....	64
4.2.3	Rachev Ratio.....	65
4.3	Empirical Results of Portfolio Optimization Backtesting.....	66
4.3.1	Different Values of Parameter $k$ .....	66
4.3.2	Different Values of Historical Window .....	74
4.3.3	Different Values of Portfolio Recalibration Period.....	76
4.4	Discussion and Further Research Ideas .....	78

Chapter 5	Portfolio Risk Estimation and Its Backtesting .....	81
5.1	Risk Measures.....	81
5.1.1	Value at Risk.....	82
5.1.2	Conditional Value at Risk.....	83
5.2	Methods for Risk Estimation .....	84
5.2.1	Historical Simulation .....	84
5.2.2	Filtered Historical Simulation.....	85
5.2.3	Analytical Solution .....	87
5.2.4	Monte Carlo Simulation.....	89
5.3	Backtesting Procedure and Statistical Inference .....	90
5.3.1	Kupiec's Unconditional Coverage Test.....	93
5.3.2	Christoffersen's Conditional Coverage Test .....	94
5.4	Empirical Results of Statistical Testing.....	96
5.4.1	Historical Simulation .....	98
5.4.2	Filtered Historical Simulation.....	100
5.4.3	Joint Gaussian Distribution.....	103
5.4.4	NIG-Copula Model.....	104
5.5	Discussion and Further Research Ideas .....	110
Chapter 6	Conclusion .....	113
Appendix	.....	117
References	.....	143
List of Tables	.....	151
List of Figures	.....	153
List of Programs	.....	155
Index	.....	157

# Appendix

Appendix A Basic description of Matlab.....	119
Appendix B Composition of DJIA index.....	127
Appendix C S&P 500 dataset import.....	129
Appendix D Example of GARCH estimation for S&P 500 index.....	131
Appendix E GARCH Structure Search.....	133
Appendix F Programs for efficient sets under different conditions .....	135
Appendix G Programs for VaR estimation by means of FHS .....	137
Appendix H Backtesting results of filtered historical simulation .....	139

# List of Programs

Program 1–1 Import of PX index history values .....	2
Program 1–2 Import of PX-TR index history values .....	3
Program 1–3 Import of PX-GLOBAL index history values .....	3
Program 1–4 Function downloadyahoo.m .....	5
Program 1–5 Function downloadCNB.m .....	6
Program 1–6 Function importfxdata.m .....	8
Program 1–7 Function importfxdirectory.m .....	8
Program 1–8 Function resamplebytime.m .....	10
Program 1–9 Function resamplebyprice.m .....	11
Program 1–10 Historical dataset of stock market indices .....	13
Program 1–11 Historical dataset of the stocks incorporated in DJIA .....	14
Program 2–1 Calculation of average return annualized .....	20
Program 2–2 Gaussian distribution estimation and simulation .....	24
Program 2–3 Estimation of parameters and plot of probability density .....	31
Program 2–4 Fixed structure AR-GARCH estimation .....	32
Program 2–5 Fixed structure AR-GARCH simulation .....	33
Program 2–6 Computation of AIC and BIC .....	34
Program 2–7 Variable structure AR-GARCH estimation .....	35
Program 2–8 Generation of random numbers with corresponding dependence .	38
Program 2–9 Generation of random numbers with corresponding dependence .	39
Program 2–10 Function for copula function parameters estimation .....	41
Program 2–11 Function for copula function estimation, selection .....	43
Program 2–12 Estimation and simulation of returns series .....	44
Program 3–1 Function for weights generation .....	49
Program 3–2 Feasible set calculation and plot .....	49
Program 3–3 Efficient set of portfolios .....	51
Program 3–4 Relaxation of short selling .....	51
Program 3–5 Relaxation of no risk-free asset allowance .....	52
Program 3–6 Function solving problem (3-7) .....	55
Program 3–7 Efficient set under Markowitz model constraints .....	56
Program 3–8 Search for optimal portfolio .....	58
Program 4–1 Function for portfolio optimization backtesting .....	62
Program 4–2 Calculation of ex-post portfolio returns and wealth evolution .....	63
Program 4–3 Calculation of performance measures .....	63
Program 4–4 Maximum drawdown calculation .....	64
Program 4–5 Calculation of Sharpe ratio .....	65
Program 4–6 Calculation of Rachev ratio .....	65
Program 4–7 Program for different values of parameter $k$ backtesting .....	66

Program 4–8 Program for different values of parameter $k$ backtesting .....	69
Program 4–9 Quantities of assets in portfolios composed from DJIA dataset....	70
Program 4–10 Program for different values of parameter $k$ backtesting .....	73
Program 4–11 Quantities of assets in portfolios .....	73
Program 4–12 Program for different values of historical window backtesting ..	74
Program 4–13 Program for backtesting .....	76
Program 5–1 Function for VaR computation.....	83
Program 5–2 Function for CVaR computation .....	83
Program 5–3 VaR estimation by means of historical simulation.....	85
Program 5–4 VaR estimation by means of filtered historical simulation .....	87
Program 5–5 VaR estimation by means of joint normal distribution .....	88
Program 5–6 VaR estimation by means of NIG-copula model .....	89
Program 5–7 Probabilities for quantities of exceptions distribution.....	91
Program 5–8 Kupiec's unconditional coverage test .....	94
Program 5–9 Christoffersen independence test .....	95
Program 5–10 Christoffersen's conditional coverage test.....	96
Program 5–11 General backtesting framework .....	97
Program 5–12 Program to plot the results of backtesting .....	97
Program 5–13 Program for calculation of statistical tests .....	97
Program C–1 Historical dataset of the stocks incorporated in S&P 500.....	129
Program D–1 Program for GARCH estimation and plotting the results.....	131
Program E–1 Function to choose statistically significant structure .....	133
Program F–1 Efficient set (short sales allowed) .....	135
Program F–2 Efficient set (risk-free asset allowed).....	135
Program F–3 Efficient set (short sales and risk-free asset allowed) .....	136
Program G–1 VaR estimation by means of filtered historical simulation .....	137
Program G–2 VaR estimation by means of filtered historical simulation .....	137
Program G–3 VaR estimation by means of filtered historical simulation .....	137