EconWorld2016@Barcelona

Capturing Conditional Systematic Risk across the UK Financial Spectrum: An Empirical Analysis 2000-2012

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Abstract

This paper examines the variability of beta (2000-2012) for each of the UK financial sectors; banking, insurance, finance companies, investment trusts and real estates. In order to compute the time varying beta five different approaches were undertaken these included the Kalman filter, bivariate BEKK GARCH, bivariate GJR-GARCH, DCC-GARCH and the rolling regression technique. Overall, we establish that the insurance sector possesses the highest systematic risk across all financial sectors and holds greatest variability in terms of time-varying beta. Our findings also suggest the highest precision of in-sample forecasting is most suited to rolling regression technique as well as the Kalman filter approach. The importance of successfully predicting/forecasting beta in the financial sector cannot be emphasised enough to investors as they will be able to position themselves more accurately. As a result, financial institutions can utilise the conditional beta through capital structure decision making as well as through investment appraisal.

Keywords Conditional Systematic Risk; Time-variying Beta; Financial Sectors

JEL G11, G12, G17

Presented at EconWorld2016@Barcelona, Barcelona, Spain.