

Preface xiii

I Foundations

- 1 Introduction 3
 - 1.1 Outline of the Book 3
 - 1.2 Technical Notes 12

- 2 Loss Functions 13
 - 2.1 Construction and Specification of the Loss Function 14
 - 2.2 Specific Loss Functions 20
 - 2.3 Multivariate Loss Functions 28
 - 2.4 Scoring Rules for Distribution Forecasts 29
 - 2.5 Examples of Applications of Forecasts in Macroeconomics and Finance 31
 - 2.6 Conclusion 37

- 3 The Parametric Forecasting Problem 39
 - 3.1 Optimal Point Forecasts 41
 - 3.2 Classical Approach 47
 - 3.3 Bayesian Approach 54
 - 3.4 Relating the Bayesian and Classical Methods 56
 - 3.5 Empirical Example: Asset Allocation with Parameter Uncertainty 59
 - 3.6 Conclusion 62

- 4 Classical Estimation of Forecasting Models 63
 - 4.1 Loss-Based Estimators 64
 - 4.2 Plug-In Estimators 68
 - 4.3 Parametric versus Nonparametric Estimation Approaches 73
 - 4.4 Conclusion 74

- 5 Bayesian Forecasting Methods 76
 - 5.1 Bayes Risk 77
 - 5.2 Ridge and Shrinkage Estimators 81
 - 5.3 Computational Methods 83
 - 5.4 Economic Applications of Bayesian Forecasting Methods 85
 - 5.5 Conclusion 88

- 6 Model Selection 89
 - 6.1 Trade-Offs in Model Selection 90
 - 6.2 Sequential Hypothesis Testing 93
 - 6.3 Information Criteria 96
 - 6.4 Cross Validation 99

6.5	Lasso Model Selection	101
6.6	Hard versus Soft Thresholds: Bagging	104
6.7	Empirical Illustration: Forecasting Stock Returns	106
6.8	Properties of Model Selection Procedures	115
6.9	Risk for Model Selection Methods: Monte Carlo Simulations	121
6.10	Conclusion	125
6.11	Appendix: Derivation of Information Criteria	126

II Forecast Methods

7	Univariate Linear Prediction Models	133
7.1	ARMA Models as Approximations	134
7.2	Estimation and Lag Selection for ARMA Models	142
7.3	Forecasting with ARMA Models	147
7.4	Deterministic and Seasonal Components	155
7.5	Exponential Smoothing and Unobserved Components	159
7.6	Conclusion	164
8	Univariate Nonlinear Prediction Models	166
8.1	Threshold Autoregressive Models	167
8.2	Smooth Transition Autoregressive Models	169
8.3	Regime Switching Models	172
8.4	Testing for Nonlinearity	179
8.5	Forecasting with Nonlinear Univariate Models	180
8.6	Conclusion	185
9	Vector Autoregressions	186
9.1	Specification of Vector Autoregressions	186
9.2	Classical Estimation of VARs	189
9.3	Bayesian VARs	194
9.4	DSGE Models	206
9.5	Conditional Forecasts	210
9.6	Empirical Example	212
9.7	Conclusion	217
10	Forecasting in a Data-Rich Environment	218
10.1	Forecasting with Factor Models	220
10.2	Estimation of Factors	223
10.3	Determining the Number of Common Factors	229
10.4	Practical Issues Arising with Factor Models	232
10.5	Empirical Evidence	234
10.6	Forecasting with Panel Data	241
10.7	Conclusion	243
11	Nonparametric Forecasting Methods	244
11.1	Kernel Estimation of Forecasting Models	245
11.2	Estimation of Sieve Models	246
11.3	Boosted Regression Trees	256
11.4	Conclusion	259

12	Binary Forecasts	260
12.1	Point and Probability Forecasts for Binary Outcomes	261
12.2	Density Forecasts for Binary Outcomes	265
12.3	Constructing Point Forecasts for Binary Outcomes	269
12.4	Empirical Application: Forecasting the Direction of the Stock Market	272
12.5	Conclusion	273
13	Volatility and Density Forecasting	275
13.1	Role of the Loss Function	277
13.2	Volatility Models	278
13.3	Forecasts Using Realized Volatility Measures	288
13.4	Approaches to Density Forecasting	291
13.5	Interval and Quantile Forecasts	301
13.6	Multivariate Volatility Models	304
13.7	Copulas	306
13.8	Conclusion	308
14	Forecast Combinations	310
14.1	Optimal Forecast Combinations: Theory	312
14.2	Estimation of Forecast Combination Weights	316
14.3	Risk for Forecast Combinations	325
14.4	Model Combination	329
14.5	Density Combination	336
14.6	Bayesian Model Averaging	339
14.7	Empirical Evidence	341
14.8	Conclusion	344
	III Forecast Evaluation	
15	Desirable Properties of Forecasts	347
15.1	Informal Evaluation Methods	348
15.2	Loss Decomposition Methods	352
15.3	Efficiency Properties with Known Loss	355
15.4	Optimality Tests under Unknown Loss	365
15.5	Optimality Tests That Do Not Rely on Measuring the Outcome	368
15.6	Interpreting Efficiency Tests	368
15.7	Conclusion	371
16	Evaluation of Individual Forecasts	372
16.1	The Sampling Distribution of Average Losses	373
16.2	Simulating Out-of-Sample Forecasts	375
16.3	Conducting Inference on the Out-of-Sample Average Loss	380
16.4	Out-of-Sample Asymptotics for Rationality Tests	385
16.5	Evaluation of Aggregate versus Disaggregate Forecasts	388
16.6	Conclusion	390

- 17 Evaluation and Comparison of Multiple Forecasts 391
 - 17.1 Forecast Encompassing Tests 393
 - 17.2 Tests of Equivalent Expected Loss: The Diebold–Mariano Test 397
 - 17.3 Comparing Forecasting Methods: The Giacomini–White Approach 400
 - 17.4 Comparing Forecasting Performance across Nested Models 403
 - 17.5 Comparing Many Forecasts 409
 - 17.6 Addressing Data Mining 413
 - 17.7 Identifying Superior Models 415
 - 17.8 Choice of Sample Split 417
 - 17.9 Relating the Methods 418
 - 17.10 In-Sample versus Out-of-Sample Forecast Comparison 418
 - 17.11 Conclusion 420

- 18 Evaluating Density Forecasts 422
 - 18.1 Evaluation Based on Loss Functions 423
 - 18.2 Evaluating Features of Distributional Forecasts 428
 - 18.3 Tests Based on the Probability Integral Transform 433
 - 18.4 Evaluation of Multicategory Forecasts 438
 - 18.5 Evaluating Interval Forecasts 440
 - 18.6 Conclusion 441

IV Refinements and Extensions

- 19 Forecasting under Model Instability 445
 - 19.1 Breaks and Forecasting Performance 446
 - 19.2 Limitations of In-Sample Tests for Model Instability 448
 - 19.3 Models with a Single Break 451
 - 19.4 Models with Multiple Breaks 455
 - 19.5 Forecasts That Model the Break Process 456
 - 19.6 Ad Hoc Methods for Dealing with Breaks 460
 - 19.7 Model Instability and Forecast Evaluation 463
 - 19.8 Conclusion 465

- 20 Trending Variables and Forecasting 467
 - 20.1 Expected Loss with Trending Variables 468
 - 20.2 Univariate Forecasting Models 470
 - 20.3 Multivariate Forecasting Models 478
 - 20.4 Forecasting with Persistent Regressors 480
 - 20.5 Forecast Evaluation 486
 - 20.6 Conclusion 489

- 21 Forecasting Nonstandard Data 490
 - 21.1 Forecasting Count Data 491
 - 21.2 Forecasting Durations 493
 - 21.3 Real-Time Data 495

21.4	Irregularly Observed and Unobserved Data	498
21.5	Conclusion	504

Appendix 505

A.1	Kalman Filter	505
A.2	Kalman Filter Equations	507
A.3	Orders of Probability	514
A.4	Brownian Motion and Functional Central Limit Theory	515

Bibliography 517

Index 539