UNIVERSITY OF ROCHESTER

William E. Simon Graduate School of Business Administration

FIN 533 | **Professor G. William Schwert**
Special Topics in Finance | Fall 2000

Home work Assignment #2 Due: October 25, 2000

There are two data files for this assignment (Eviews file F533HW3.WF1, or Excel spreadsheet F533HW3.XLS). There are three variables in these files: Stock, are returns to a value-weighted index of NYSE-listed stocks; Int, are returns to short-term riskless bonds; and BC, is an indicator/dummy variable representing NBER recessions.

Estimate several alternative models for the conditional heteroskedasticity of monthly stock returns. Use the sample periods 1885:01 through 1998:08, 1926:01 through 1998:08, and 1953:01 through 1998:08.

Also, model the conditional heteroskedasticity of the risk premium (difference between stock returns and the short-term interest rate). Are the results different from looking at raw stock returns? ***Why or why not?***

Explain the different models and/or methods you use to represent conditional heteroskedasticity and how you interpret the results of your analysis. For example, which method works "best," and what do you learn about the behavior of the data from this analysis?

Is volatility unusually high now?

You should write a short, concise report that includes a minimum of computer output. Show only what is necessary.