

Exercises in Financial Risk: Extreme Value Statistics

March 25, 2019

- 1 In a peaks over thresholds analysis to compute VaR for the daily losses of a stock, the threshold $u = 2.2$ was chosen such that 3% of the losses were above u , and one then fitted a GP distribution to the excesses over the threshold. The estimated scale parameter was $\sigma = 0.71$ and the estimated shape parameter was $\gamma = 0.15$. What is then the estimated 99% daily VaR for the stock?
- 2 Below are shown the maximum likelihood estimates and the estimates of the covariance matrix from the block maxima method applied to a data set. Compute a 95% confidence interval for the shape parameter ξ .

data. This leads to the maximum likelihood estimate

$$(\hat{\mu}, \hat{\sigma}, \hat{\xi}) = (-1.64, 0.27, -0.084),$$

with a maximized value of the log-likelihood equal to -14.3 . The corresponding estimated variance-covariance matrix is

$$V = \begin{bmatrix} 0.00141 & 0.000214 & -0.000795 \\ 0.000214 & 0.000652 & -0.000441 \\ -0.000795 & -0.000441 & 0.00489 \end{bmatrix}.$$

- 3 Suppose that the monthly maximum losses of a financial instrument has a GEV distribution with location parameter μ , scale parameter σ and shape parameter $\gamma \neq 0$, and that the monthly losses are independent. Then also the yearly maximum losses have a GEV distribution. What are the parameters of this distribution?
- 4 Suppose X_1, X_2, \dots are independent and exponentially distributed random variables with parameter σ (so that their cumulative distribution function is $F(x) = 1 - e^{-x/\sigma}$ for $0 \leq x$ and $F(x) = 0$ for $x < 0$), and define $M_n = \max\{X_1, \dots, X_n\}$. Find norming values a_n, b_n such that

$$P\left(\frac{M_n - a_n}{b_n}\right) \rightarrow e^{-e^{-x}}, \quad \text{as } n \rightarrow \infty.$$

- 5 Suppose a data set contains 7-day losses (= - returns) during the last 2 years for a portfolio, and that the mean and standard deviation of the losses are -0.002 and 0.03 , respectively. If one assumes that losses are normally distributed and that SEK 1.7 million is invested in the portfolio, what is then the 7-day 99% VaR, in SEK, for the portfolio?

- 6 Suppose that daily portfolio losses are identically distributed and that 7-day maximum losses expressed in % have a GEV distribution function with estimated location parameter $\hat{\mu} = 0.96$, estimated scale parameter $\hat{\sigma} = 1.17$, and estimated shape parameter $\hat{\gamma} = 0.21$, and that the extremal index has been estimated to be $\hat{\theta} = 0.73$. Compute an estimate for the 1-day 95% VaR for such a portfolio with an initial value of SEK 1.7 million.
- 7 Suppose that an excesses of a threshold u has a GP distribution with scale parameter σ and shape parameter γ , where it for simplicity is assumed that $\gamma > 0$. Assume that $v > 0$. Then the conditional distribution of excesses of the level $u + v$ is also a GP distribution. What are the parameters of this distribution?
- 8 In a peaks over thresholds analysis to compute VaR one assumed that from very long experience it was known that the 95% quantile of the losses was exactly 2.60, with negligible error. Further, one used a GP distribution with shape parameter $\gamma = 0$, so that the distribution function was $H(x) = 1 - e^{-x/\sigma}$, to model the excesses over the threshold 2.60. The estimated parameter was $\hat{\sigma} = 0.90$, and the standard deviation of $\hat{\sigma}$ was estimated to be 0.057. Let $\widehat{VaR}_{.8}(H)$ be the the estimated 80% VaR of the distribution function H , so that the estimated 0.99 VaR of the losses equals $2.60 + \widehat{VaR}_{.8}(H)$. Then a 95% confidence interval for the 99% VaR of the losses is
- 9 Suppose that 5-day maximum losses are mutually independent and have a GEV distribution function with location parameter μ , scale parameter σ , and shape parameter γ . Then 20-day maximum losses also have a GEV distribution. What are the location, scale, and shape parameter for this distribution?
- 10 Suppose that the 5-day maximum loss (= - returns) has a GEV distribution function with location parameter $\mu = 1.27$, scale parameter $\sigma = 0.79$ and shape parameter $\gamma = 0.14$, and that additionally the extremal index is $\theta = 0.73$. Compute the one-day VaR from this.
- 11 In a peaks over thresholds analysis to compute VaR one used the threshold $u = 1.7$ chosen such that 5% of the losses were above u and fitted a GP distribution to the excesses over the thresholds. The estimated parameters were $\sigma = 0.8$ and $\gamma = 0.1$. Find an estimate of the 99% VaR.

- 12 Suppose X_1, X_2, \dots are independent and uniformly distributed random variables (so that their cumulative distribution function is $F(x) = x$ for $x \in [0, 1]$), and define $M_n = \max\{X_1, \dots, X_n\}$. Show that for normalizing constants $a_n = 1, b_n = \frac{1}{n}$ it holds that

$$P\left(\frac{M_n - a_n}{b_n} \leq x\right) \rightarrow e^x, \quad \text{for } x \leq 0, \text{ as } n \rightarrow \infty.$$

- 13 Let X_1 and X_2 be independent random variables which both have a GEV distribution function with shape parameter $\gamma = 0$, scale parameter $\sigma = 1.3$ and location parameter $\mu = 2.1$, so that they both have cumulative distribution function

$$G(x) = e^{-e^{-\frac{x-2.1}{1.3}}}.$$

Then also $M = \max X_1, X_2$, the maximum of X_1 and X_2 , has a GEV distribution function. Find the shape, scale, and location parameters of this GEV distribution function of M .

- 14 Below are shown the maximum likelihood estimates and the estimates of the covariance matrix from the block maxima method applied to a data set on glass fibre strengths. Find a 95% confidence interval for the scale parameter σ .

data. This leads to the maximum likelihood estimate

$$(\hat{\mu}, \hat{\sigma}, \hat{\xi}) = (-1.64, 0.27, -0.084),$$

with a maximized value of the log-likelihood equal to -14.3 . The corresponding estimated variance-covariance matrix is

$$V = \begin{bmatrix} 0.00141 & 0.000214 & -0.000795 \\ 0.000214 & 0.000652 & -0.000441 \\ -0.000795 & -0.000441 & 0.00489 \end{bmatrix}.$$

- 15 Suppose you have observed a sample x_1, x_2, \dots, x_n from a GP distribution with shape parameter $\gamma = 0$ and scale parameter σ .
- Find the maximum likelihood estimator $\hat{\sigma}$ of σ .
 - Use observed information to find an estimate of the variance of $\hat{\sigma}$.