

"On improving the responsiveness of the fundamental factor models"

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Linear multifactor models are of great importance to portfolio construction and risk management: they allow the market dimensionality reduction, which has numerous useful implications. Particularly, factor models reduce dimensionality of the asset covariance matrix, allowing its better estimation. Since estimation is traditionally based on historical time series of asset returns and other attributes, a model based on such a covariance matrix tends to suffer from a time lag, i.e. undervalue risk during crisis times, and overvalue it when the crisis subsides.

In this talk certain methodologies of incorporating forward looking market data into a factor model will be discussed. Some results on the improvements of the responsiveness and forecasting power of the linear factor models will be demonstrated.