



Fat tailed Probability Distributions: Applications in Asset Pricing and Financial Econometrics

Guest Editor:

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Message from the Guest Editor

It is now widely established that financial time series, such as commodity prices and prices of company stocks, are better described by probability distributions that exhibit fat tails. In particular, modeling these time series with such distributions is superior to modeling with the much more commonly used Gaussian distributions.

The development of volatility models sparked a debate on whether fat tails were a consequence of volatility clustering exhibited by these models. However, the ensuing literature has convincingly established the suitability of modeling financial time series with fat-tailed distributions, in addition to modeling their time-varying volatility.

Ignoring fat tails, when present, leads to consequences for properties of estimators, such as incorrect standard errors, non-standard asymptotic distributions, and so forth. This has consequences for myriad issues related to modeling financial time series, such as testing for predictability of stock returns, measurements of value-at-risk, measurements of implied volatility, options prices, to name a few.

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