Modelling Realized Covariances and Returns*

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Abstract

This paper proposes new dynamic component models of returns and realized covariance (RCOV) matrices based on time-varying Wishart distributions. Bayesian estimation and model comparison is conducted with a range of multivariate GARCH models and existing RCOV models from the literature. The main method of model comparison consists of a term-structure of density forecasts of returns for multiple forecast horizons. The new joint return-RCOV models provide superior density forecasts for returns from forecast horizons of 1 day to 3 months ahead as well as improved point forecasts for realized covariances. Global minimum variance portfolio selection is improved for forecast horizons up to 3 weeks out.

key words: Wishart distribution, predictive likelihoods, density forecasts, MCMC. JEL: C11, C32, C53, G17

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1 Introduction

This paper proposes new dynamic component models of returns and realized covariance (RCOV) matrices based on time-varying Wishart distributions. Bayesian estimation and model comparison are discussed. While the current literature has focused on the forecasting of realized covariances, this paper demonstrates the benefits to forecasts of the return distribution from the joint modelling of RCOV and returns.

Multivariate volatility modelling is a key input into portfolio optimization, risk measurement and management. There has arose a voluminous literature on how to approach this problem. The two popular approaches based on return data are multivariate GARCH (MGARCH) and multivariate stochastic volatility (MSV). Bauwens et al. (2006) provide a survey of MGARCH modelling while Asai et al. (2006) review the MSV literature. Despite the important advances in this literature there remain significant challenges. In practise the covariance of returns is unknown and is either projected onto past data in the case of MGARCH or is assumed to be latent in the case of MSV. For MSV sophisticated simulation methods must be used to deal with the unobserved nature of the conditional covariances. However, if an accurate measure of the covariance matrix could be obtained many of these difficulties could be avoided.

Recently, a new paradigm has emerged in which the latent covariance of returns is replaced by an accurate estimate based upon intraperiod return data. The estimator is nonparametric in the sense that we can obtain an accurate measure of daily ex post covariation without knowing the underlying data generating process. Realized covariance (RCOV) matrices open the door to standard time series analysis. See Andersen et al. (2003), Barndorff-Nielsen and Shephard (2004b) and Bandi and Russell (2005b) for the theoretical foundations and Andersen et al. (2009) and McAleer and Medeiros (2008) for surveys of the literature.

Among the few models in the literature for RCOV matrices is the Wishart autoregressive model of Gourieroux, Jasiak, and Sufana (2009). The process is defined by the Laplace transform and naturally leads to method of moments estimation (see also Chiriac (2006)) while the transition density is a noncentral Wishart. In a different approach Bauer and Vorkink (2011) decompose the RCOV matrix by a log-transformation and then use various time-series approaches to model the elements. Chiriac and Voev (2010) use a 3-step procedure, by first decomposing the RCOV matrices into Cholesky factors and modelling them with a VARFIMA process before transforming them back.

MSV Wishart specifications for the covariance of returns are proposed in Asai and McAleer (2009) and Philipov and Glickman (2006). These models specify a standard Wishart transition density for the inverse covariance matrix of returns. In contrast to modelling the Cholesky factor or log-transformation of RCOV, contemporaneous covariances between elements in the RCOV matrix are straightforward to interpret and model using a Wishart law of motion.

Our approach is also related to the independent work of Golosnoy et al. (2010) and Asai

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1 The Wishart distribution is a generalization of the univariate gamma distribution to nonnegative-definite matrices.

2 An advantage to working with the Wishart distribution is that the pdf and simulation methods for random draws are readily available, while this is not the case for the noncentral Wishart distribution (Gauthier and Possamai 2009).
and So (2010) who propose alternative dynamic Wishart models for stock market volatility. These papers focus on RCOV dynamics while our interest is in the joint modelling of returns and realized covariances and density forecasts. In addition, we propose component models in which the lag length of a component is estimated.

The RCOV is estimated using the realized kernels of Barndorff-Nielsen et al. (2008). The empirical analysis of 5 stocks show the strong persistence of the daily time series of RCOV elements. We propose new Wishart specifications with components to capture the persistence properties in realized covariances. A component is defined as a sample average of past RCOV matrices based on a particular window of data. Different windows of data give different components. Two types of time-varying Wishart models are considered. The first assumes the components affect the scale matrix in an additive fashion while the second has the components enter by a multiplicative term. The additive specification performs the best in our analysis.

The models are estimated from a Bayesian perspective. We show how to estimate the length of data windows that enter into the components of the models. For each of the RCOV models the second component is associated with 2 weeks of data while the third component is associated with about 3 months of past data. The component models deliver a dramatic improvement in capturing the time series autocorrelations of the smallest and largest eigenvalues of the RCOV matrices.

Besides providing new tractable models for returns and realized covariances we also evaluate the models over a term structure of density forecasts of returns and a term structure of global minimum-variance portfolios. It is important to consider density forecasts of returns since this is the quantity that in principle enters into all financial decisions such as risk measurement and management. In general the covariance of future returns is not a sufficient statistic for the density of returns. Daily returns are common to both the MGARCH and return-RCOV models and provide a common metric to compare models that use high and low-frequency data. In contrast to the value-at-risk measures that focus on the tails of a distribution, the cumulative log-predictive likelihoods measure the accuracy of the whole return distribution. A term structure of forecasts from 1 to 60 days ahead is considered in order to assess model forecast strength at many different horizons.

An important lesson from our work is that the use of realized covariances, which exploit high-frequency intraday data, do not necessarily deliver superior density forecasts of returns. Indeed, several of the models studied in this paper that use realized covariances do not provide any improvements relative to a MGARCH model with Student-t innovations estimated from daily returns. The functional form of the dynamics of realized covariances is critical to obtaining a better characterization of the distribution of returns. Our results on density forecasts of returns are a new contribution to the literature.

Another contribution of this paper is to extend the RCOV models of Bonato et al. Estimation of RCOV this way has several benefits including imposing the positive definiteness and accounting for the bias that market microstructure and nonsynchronous trading can have. Maheu and McCurdy (2011) introduced the term structure of density forecasts for returns using joint models for returns and realized volatility for individual assets. We extend this to include multivariate assets and global minimum variance portfolios. For instance, the predictive density of returns in the models integrate out both parameter uncertainty and uncertainty regarding future RCOV values, making the density highly non-Gaussian.
(2009) and Chiriac and Voev (2010) to joint return-RCOV models that we estimate by a full likelihood approach. The models serve as a comparison to the new specifications. Our additive component Wishart model provides superior density forecasts of returns and point forecasts of realized covariances. The improvements are from 1 day ahead forecasts to 3 months ahead. For global minimum variance portfolio selection most of the RCOV models give improvements beyond a MGARCH model for up to 3 weeks ahead.

The joint return-RCOV model based on Bonato et al. (2009) performs poorly relative to the other specifications. The model is a HAR type parametrization based on the Wishart autoregressive model of Gourieroux et al. (2009). In these models the source of time variation in the conditional mean of RCOV is the noncentrality matrix. By proposing another non-central Wishart model which has the same form of the condition mean we show that the data strongly favor time variation in the conditional mean coming through the scale matrix and not the noncentrality matrix.

In summary, we provide a new approach to modelling multivariate returns that consists of joint models of returns and RCOV matrices. We find that it is critical to include the components to obtain improved performance relative to MGARCH models and other existing models of RCOV. This paper is organized as follows. In Section 2, we review the theory and the procedures of constructing the RCOV estimator and the data. In Section 3, several models for returns and RCOV are introduced including two benchmark multivariate GARCH models of volatility based on daily returns. Section 4 explains the estimation procedure while the computation of density forecasts are found in Section 5. Out-of-sample model comparison results are reported in Section 6, followed by full sample estimates. Section 7 concludes. The Appendix contains details on posterior simulation.

## 2 Realized Covariance

### 2.1 RCOV Construction

Suppose the $k$-dimensional efficient log-price $Y(t)$, follows a continuous time diffusion process defined as follows:

$$Y(t) = \int_0^t a(u)du + \int_0^t \Phi(u)dW(u),$$

where $a(t)$ is a vector of drift components, $\Phi(t)$ is the instantaneous volatility matrix, and $W(t)$ is a vector of standard independent Brownian motions.\(^7\) The quantity of interest here is $\int_0^T \Phi(u)\Phi'(u)du$, known as the integrated covariance of $Y(t)$ over the interval $[0, \tau]$. It is a measure of the ex-post covariance of $Y(t)$. For simplicity, we normalize $\tau$ to be 1. Results from stochastic process theory (e.g. Protter (2004)) imply that the integrated covariance of $Y(t)$,

$$\int_0^1 \Phi(u)\Phi'(u)du,$$

6See Corsi (2009) for the heterogeneous autoregressive (HAR) model for realized volatility.

7Jumps are not considered in this paper. How to model individual asset jumps and common jumps among several assets is an open question which we leave for future work.
is equal to its quadratic variation over the same interval,

\[ [Y](1) \equiv \text{plim}_{n \to \infty} \sum_{j=1}^{n} \{Y(t_j) - Y(t_{j-1})\} \{Y(t_j) - Y(t_{j-1})\}' \]  \hspace{1cm} (3)

for any sequence of partitions 0 = t_0 < t_1 < \ldots < t_n = 1 with \( \sup_j \{t_{j+1} - t_j\} \to 0 \) for \( n \to \infty \).

An important motivation for our modelling approach is Theorem 2 from Andersen, Bollerslev, Diebold and Labys (2003). They show that the daily log-return follows,

\[ Y(1) - Y(0)|\sigma\{a(v), \Phi(v)\}_{0 \leq v \leq 1} \sim N\left( \int_0^1 a(u)du, \int_0^1 \Phi(u)\Phi'(u)du \right), \]

where \( \sigma\{a(v), \Phi(v)\}_{0 \leq v \leq 1} \) denotes the sigma-field generated by \( \{a(v), \Phi(v)\}_{0 \leq v \leq 1} \). In our empirical work we will assume the drift term is approximately 0 while the integrated covariance can be replaced by an accurate estimate using high-frequency intraday data.

We follow the procedure in Barndorff-Nielsen et al. (2008) (BNHLS) to construct RCOV using the high-frequency stock returns. BNHLS propose a multivariate realized kernel to estimate the ex-post covariation of log-prices. They show this new estimator is consistent, guaranteed to be positive semi-definite, can accommodate endogenous measurement noise and can also handle non-synchronous trading. To synchronize the data, they use the idea of refresh time. A kernel estimation approach is used to minimize the effect of the microstructure noise, and to ensure positive semi-definiteness. We review these key ideas.

The econometrician observes the log price process \( X = (X^{(1)}, X^{(2)}, \ldots, X^{(k)})' \), which is generated by \( Y \), but is contaminated with market microstructure noise. Prices arrive at different times and at different frequencies for different stocks over the unit interval, \( t \in [0, 1] \).

Suppose the observation times for the \( i \)-th stock are written as \( t_1^{(i)}, t_2^{(i)}, \ldots, i = 1, 2, \ldots, k \). Let \( N_1^{(i)} \) count the number of distinct data points available for the \( i \)-th asset up to time \( t \). The observed history of prices for the day is \( X^{(i)}(t_j^{(i)}) \), for \( j = 1, 2, \ldots, N_1^{(i)} \), i.e., the \( j \)-th price update for asset \( i \) is \( X^{(i)}(t_j^{(i)}) \), it arrives at \( t_j^{(i)} \). The steps to computing daily RCOV are the following.

1. Synchronizing the data.
   
   The first key step is to deal with the non-synchronous nature of the data. The idea of refresh time is used here. Define the first refresh time as \( \tau_1 = \max\left(t_1^{(1)}, \ldots, t_1^{(k)}\right) \),
   
   and then subsequent refresh times as \( \tau_{j+1} = \max\left(t_1^{(1)} + 1, \ldots, t_k^{(k)} + 1\right) \). \( \tau_1 \) is the time it has taken for all the assets to trade, i.e. their posted prices have been updated at least once. \( \tau_2 \) is the first time when all the prices are again updated, etc. From now on, we will base our analysis on this new conformed time clock \( \{\tau_j\} \), and treat the entire \( k \)-dimensional vector of price updates as if it is observed at these refreshed times \( \{\tau_j\} \). The number of observations of the synchronized price vector is \( n + 1 \), which is no larger than the number of observations of the stock with the fewest price updates. Then, the synchronized high frequency return vector is defined as \( x_j = X(\tau_j) - X(\tau_{j-1}), j = 1, 2, \ldots, n \), where \( n \) is the number of refresh return observations for the day.
2. Compute the positive semi-definite realized kernel. Having synchronized the high-frequency vector of returns \( \{ x_j \}, j = 1, 2, \ldots, n \), daily \( RCOV_t \) is calculated as,

\[
RCOV_t = \sum_{s=-n}^{n} f \left( \frac{s}{S+1} \right) \Upsilon_s.
\]

(4)

where \( f() \) is the Parzen kernel and \( \Upsilon_s \) is the sample autocovariance of \( x_j \). For full details along with the selection of bandwidth \( S \), see BNHLS.

We apply this multivariate realized kernel estimation to our high-frequency data, obtaining a series of daily \( RCOV_t \) matrices, which will then be fitted by our proposed Wishart Model.\(^8\) The j-th diagonal element of \( RCOV_t \) is called realized volatility\(^9\) and is an ex post measure of the variance for asset j. Realized correlation between asset i and j is \( RCOV_{t,ij} = \sqrt{RCOV_{t,ii} RCOV_{t,jj}} \) where \( RCOV_{t,ij} \) is the element from the i-th row and j-th column.

### 2.2 Data

We use high-frequency stock prices for 5 assets, namely Standard and Poor’s Depository Receipt (SPY), General Electric Co. (GE), Citigroup Inc. (C), Alcoa Inc. (AA) and Boeing Co. (BA). The sample period runs from 1998/12/04 – 2007/12/31 delivering 2281 days. We reserve the data back to 1998/01/02 (219 observations) as conditioning data for the components models. The data are obtained from the TAQ database. We use transaction prices and closely follow Barndorff-Nielsen et al. (2008) to construct daily RCOV matrices. The data is cleaned as follows. First, trades before 9:30 AM or after 4:00 PM are removed as well as any trades with a zero price. We delete entries with a corrected trade condition, or an abnormal sale condition.\(^{10}\) Finally, any trade that has a price increase (decrease) of more than 5% followed by a price decrease (increase) of more than 5% is removed. For multiple transactions that have the same time stamp the price is set to the median of the transaction prices. From this cleaned data we proceed to compute the refresh time and the realized kernel discussed in the previous section. The daily return \( r_t \), is the continuously compounded return from the open and close prices and matches RCOV. Table 1 reports the average number of daily transaction for each stock. The average number of transactions based on the refresh time is much lower at 1835. This represents just under 5 transactions per minute. Based on this our sample is quite liquid.

Table 2 shows the sample covariance from daily returns along with the average RCOV. Figure 1 displays daily returns while the corresponding realized volatilities (RV) are in Figure 2.

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8Throughout the paper realized covariance (RCOV) is used instead of realized kernel.

9Also called realized variance in the literature.

10Specifically we remove a trade with CORR \( \neq 0 \), or a trade that has COND letter other than E or F in the TAQ database.
3 Models

3.1 New Joint Models of Returns and Realized Covariances

Compared to existing approaches which model factors of RCOV matrices (Cholesky factors, Chiriac and Voev (2010), principle components, Bauer and Vorkink (2011)) an advantage of the Wishart distribution is that it has support over symmetric positive definite matrices and allows for the joint modelling of all elements of a covariance matrix. Conditional moments between realized variances and covariances have closed form expressions.

Motivated by Philipov and Glickman (2006) and Asai and McAleer (2009), we propose to model the dynamics of RCOV by a time-varying Wishart distribution. This choice is similar to Gourieroux, Jasiak, and Sufana (2009) however they use a noncentral Wishart distribution. We have also explored the inverse Wishart density as another distribution to govern the dynamics of realized covariances but found the Wishart provided superior performance.\textsuperscript{11}

Two models are presented in which the scale matrix of the Wishart distribution follows an additive and multiplicative structure. Both models feature components, which is important to providing gains against standard multivariate GARCH models, and accounting for persistence in RCOV elements.

The approach to modelling components is related to Andersen, Bollerslev and Diebold (2007), Corsi (2009), Maheu and McCurdy (2011) among others which uses the Heterogeneous AutoRegressive (HAR) model of realized variance in the univariate case in order to capture long-memory like features of volatility parsimoniously.

3.1.1 An Additive Component Wishart Model

Let $\Sigma_t \equiv RCOV_t$, then the Wishart-RCOV-A(K) model with $K \geq 1$ components is defined as,

\begin{align*}
\mathbb{r}_t | \Sigma_t & \sim N(0, \Sigma_t^{1/2} \Lambda (\Sigma_t^{1/2})') \\
\Sigma_t | \nu, S_{t-1} & \sim \text{Wishart}_k(\nu, S_{t-1}) \\
\nu S_t & = B_0 + \sum_{j=1}^K B_j \odot \Gamma_{t,\ell_j} \\
\Gamma_{t,\ell} & = \frac{1}{\ell} \sum_{i=0}^{\ell-1} \Sigma_{t-i} \\
B_j & = b_j b_j', \quad j = 1, \ldots, K \\
1 = \ell_1 < \cdots < \ell_K.
\end{align*}

$\text{Wishart}_k(\nu, S_{t-1})$ denotes a Wishart distribution over positive definite matrices of dimension $k$ with $\nu > k - 1$ degrees of freedom and scale matrix $S_{t-1}$. $\odot$ denotes the Hadamard product of two matrices. Parameters are $B_0, \nu, b_1, \ldots, b_K, \ell_2, \ldots, \ell_K$. $B_0$ is a $k \times k$ symmetric positive

\textsuperscript{11}Note that the choice of the distribution governing the dynamics of $\Sigma_t$ is unrelated to the Bayesian conjugate analysis that uses the Wishart as a conjugate prior for $\Sigma_t^{-1}$ for Gaussian observations.
definite matrix, and $b_j$’s are $k \times 1$ vectors making $B_j$ rank 1. This specification ensures $S_t$ is symmetric positive definite. $\Lambda$ is a symmetric positive definite matrix and allows the covariance of returns to deviate from the RCOV measure. $\Lambda$ is estimated and provides a simple way to adjust for estimation error in RCOV. Except for the first component, each $\Gamma_{t,\ell}$ is an average of past $\Sigma_t$ over $\ell$ observations. Rather than preset the components to weekly and monthly terms each $\ell$ is estimated. The components are found to be critical to providing improvements to forecasts.

By the properties of the Wishart distribution, the conditional expectation of $\Sigma_t$ is:

$$E(\Sigma_t | \Sigma_{1:t-1}) = \nu S_{t-1} = B_0 + \sum_{j=1}^{K} B_j \odot \Gamma_{t-1,\ell_j},$$

(11)

where $\Sigma_{1:t-1} = \{\Sigma_1, \ldots, \Sigma_{t-1}\}$. Conditional moments are straightforward to obtain and interpret. The conditional variance of element $(i, j)$ is $\text{Var}(\Sigma_{t,ij} | \Sigma_{t-1}, \nu) = \frac{1}{\nu} [S_{t-1,ij} + \tilde{S}_{t-1,ii} \tilde{S}_{t-1,jj}]$ where $\tilde{S}_{t-1,ij}$ is element $(i, j)$ of (11). The conditional variance is increasing in $\tilde{S}_{t-1,ii}$, $\tilde{S}_{t-1,jj}$, and $\tilde{S}_{t-1,ij}$. The conditional covariance between elements has a similar form, $\text{Cov}(\Sigma_{t,ij}, \Sigma_{t,km} | \Sigma_{t-1}, \nu) = \frac{1}{\nu} [\tilde{S}_{t-1,ij} \tilde{S}_{t-1,km} + \tilde{S}_{t-1,ii} \tilde{S}_{t-1,jj}]$. The degree of freedom parameter $\nu$ determines how tight the density of $\Sigma_t$ is centered around its conditional mean, with larger $\nu$ meaning the random matrices are more concentrated around $\nu S_{t-1}$. Thus, the modelling of the scale matrix and $\nu$ are the key factors in affecting the conditional moments of $\Sigma_t$. If $B_1 = \ldots, B_K = 0$ then $\Sigma_t \sim i.i.d.Wishart_k(\nu, B_0/\nu)$. On the other hand if $B_0 = 0$, $B_1 = \nu' \Gamma$ and $K = 1$ we obtain $E(\Sigma_t | \Sigma_{1:t-1}) = \Sigma_{t-1}$.

Each element $(i, j)$ of the scale matrix is a function only of element $(i, j)$ of lagged $\Sigma_t$. Many other parametrization could be considered but this specification is reasonably parsimonious and performs well in the empirical work. In related independent work Golosnoy et al. (2010) consider a similar model for RCOV matrices without components but with an autoregressive structure. They provide important results on the unconditional moments for our time-varying Wishart model. For instance, the unconditional mean of $\Sigma_t$ is finite if all elements of $\sum_{j=1}^{K} B_j$ are less than 1 in modulus.

Instead of estimating $B_0$, we implement RCOV targeting by setting $B_0 = (\nu_0 - B_1 - \cdots - B_K) \odot \bar{\Sigma}_t$, where $\bar{\Sigma}_t$ is the sample mean of $\Sigma_t$. This ensures that the long-run mean of $\Sigma_t$ is equal to $\bar{\Sigma}_t$. In estimation we reject any posterior draws in which $B_0$ is not positive definite.

\footnote{The inverse of RCOV follows the inverse-Wishart distribution with the conditional expectation being:}

$$E(\Sigma_t^{-1} | \Sigma_{1:t-1}) = (\nu - k - 1)^{-1} S_{t-1}^{-1}.$$
3.1.2 A Multiplicative Component Wishart Model

Related to the SV model Philipov and Glickman (2006) we propose a multiplicative Wishart model. The Wishart-RCOV-M(K) model with \( K \geq 1 \) components is defined as,

\[
\begin{align*}
    r_t | \Sigma_t & \sim N(0, \Sigma_t^{1/2} \Lambda(\Sigma_t^{1/2})^t) \\
    \Sigma_t | \nu, S_{t-1} & \sim \text{Wishart}_k(\nu, S_{t-1}) \\
    S_t &= \frac{1}{\nu} \left[ \prod_{j=K}^{K} \Gamma_{t;\tau_j}^{d_j} \right] A \left[ \prod_{j=1}^{K} \Gamma_{t;\tau_j}^{d_j} \right] \\
    \Gamma_{t,\ell} &= \frac{1}{\ell} \sum_{i=0}^{\ell-1} \Sigma_{t-i} \\
    1 = \ell_1 < \cdots < \ell_K.
\end{align*}
\]

(12) \quad (13) \quad (14) \quad (15) \quad (16)

\( A \) is a positive definite symmetric parameter matrix and \( d_j \) is a positive scalar.

The components enter as a sample average of past \( \Sigma_t \) raised to a different matrix power \( d_k/2 \). The first component is assumed to be a function of only \( \Sigma_t, \ell_1 = 1 \). The component terms \( \Gamma_{t,\ell} \) allow for more persistence in the location of \( \Sigma_t \) while the different values of \( d_j \) allow the effect to be dampened or amplified. In (12) the order of the product operator is important and differs in the two terms.

To discuss some of the features of this model consider the special case with \( K = 1 \) component, \( S_t = \frac{1}{\nu} (\Sigma_t^{d_1/2}) A (\Sigma_t^{d_1/2}) \). By the properties of the Wishart distribution, the conditional expectation of \( \Sigma_t \) is:

\[
E(\Sigma_t | \Sigma_{1:t-1}) = \nu S_{t-1} = (\Sigma_{t-1}^{d_1/2}) A (\Sigma_{t-1}^{d_1/2}).
\]

(17)

Additional conditional moments for \( \Sigma_t \) follow the Wishart-RCOV-A(K) discussion above.

The scalar parameter \( d_1 \) measures the overall influence of past RCOV on current RCOV. This parameter is closely related to the degree of persistence present in the RCOV series, with larger \( d_1 \) the stronger the persistence. Suppose \( A \) is the identity matrix and \( d_1 = 1 \), then by equation (17), \( E(\Sigma_t | \Sigma_{1:t-1}) = \nu S_{t-1} = \Sigma_{t-1} \), which is a random walk in matrix form. If \( d_1 = 0 \), then \( E(\Sigma_t | \Sigma_{1:t-1}) = A \), so the RCOV matrix follows an i.i.d. Wishart distribution over time.

By expanding to several components each with a different window lag length \( \ell_j \) and parameter \( d_j \), we obtain a richer model to capture the time series dependencies in realized covariances. Unfortunately, we do not know the unconditional moments for this model with \( K \) components, nevertheless, our Bayesian estimation and model comparison approach does not depend on this.

\(^{13}\)We also examined a geometric average version using the following specification: \( \Gamma_{\ell,\ell}^{d_j} = \Sigma_{t-1}^{d_j} \Sigma_{t-2}^{d_j} \cdots \Sigma_{t-1}^{d_j} \). We found this geometric average version, while it has similar performance in almost every aspect, is computationally more costly. We will hence focus our results on the sample average version.
3.2 Benchmark return-RCOV Models

In this section we extend existing specifications for RCOV dynamics by Chiriac and Voev (2010) and Bonato et al. (2009) to joint return-RCOV models to compare with our new models.

3.2.1 Cholesky-VARFIMA\((1, m, 1)\)

Apply the Cholesky decomposition to \(\Sigma_t\) such that \(\Sigma_t = L_tL'_t\), where \(L_t\) is lower triangular. Let \(Z_t = \text{vech}(L'_t)\) be the \(k(k+1)/2\) vector obtained by stacking the upper triangular elements of \(L'_t\). Chiriac and Voev (2010) propose to model \(Z_t\) as a vector autoregressive fractionally integrated moving average (VARFIMA\((p, m, q)\)) model. A restricted VARFIMA\((1, m, 1)\) specification is shown to forecast \(\Sigma_t\) well. Extending this model to include returns we have,

\[
\begin{align*}
  r_t | \Sigma_t & \sim N(0, \Sigma_t^{1/2} \Lambda(\Sigma_t^{1/2})') \\
  (1 - \delta L)(1 - L)^m I[Z_t - c] & = (1 - \psi L)\xi_t, \quad \xi_t \sim N(0, \Xi).
\end{align*}
\]

(18)

(19)

There is a common long-memory parameter \(m\) to each element of the Cholesky decomposition. The parameters here are \(\delta, m, \psi, c, \Xi\). \(\delta, m, \psi\) are scalars, \(c\) is a \(k(k+1)/2\) vector of constants, and \(\Xi\) is a \(k(k+1)/2 \times k(k+1)/2\) symmetric positive definite matrix. Regarding the mean vector \(c\), we follow Chiriac and Voev (2010) to set it at the sample mean of \(Z_t\) in estimation, which leaves the number of parameters to be estimated equal to \(3 + \frac{k(k+1)}{2}(\frac{k(k+1)}{2} + 1)/2\).\(^\text{14}\)

Chiriac and Voev (2010) apply the conditional maximum likelihood method developed in Beran (1995). With the same spirit in our Bayesian setting, we follow Ravishanker and Ray (1997)(Section 2.2) and construct the posterior distribution based on the conditional likelihood function, rather than the exact likelihood function. See Appendix 8.4 for details.

3.2.2 Wishart Autoregressive Model

Gourieroux et al. (2009) introduce the Wishart Autoregressive process (WAR) to model the dynamics of RCOV by a noncentral Wishart distribution. The Wishart Autoregressive process of order 1 (WAR(1)) is defined as

\[
\begin{align*}
  \Sigma_t | \nu, S, V_{t-1} & \sim \text{NCW}_k(\nu, S, V_{t-1}) \\
  V_t & = M\Sigma_t M'.
\end{align*}
\]

(20)

(21)

\(\text{NCW}_k(\nu, S, V_{t-1})\) denotes a noncentral Wishart distribution over positive definite matrices of dimension \(k\). \(\nu\) is the real-valued degree of freedom and \(\nu > k - 1\). \(S\) is the scale matrix, which is symmetric positive definite. \(V_t\) is the noncentrality matrix, which is symmetric positive semi-definite. \(M\) is the \(k \times k\) matrix of autoregressive parameters. The central Wishart previously discussed is a special case with \(V_{t-1} = 0\).

Bonato et al. (2009) propose a block structure on the matrix \(M\) to reduce the number of parameters and also incorporate the HAR structure of Corsi (2009) to account for persistence.

\(^{14}\)As pointed out in Chiriac and Voev (2010), \(\Xi\) is irrelevant for constructing a point forecast. However, it’s used in determining the forecast errors, and is also needed in simulation.
in RCOV. In our paper we implement their diagonal-HAR-WAR specification extended to a joint model with returns as follows:

\[ r_t | \Sigma_t \sim N(0, \Sigma_t^{1/2} \Lambda(\Sigma_t^{1/2})^\top) \]
\[ \Sigma_t | \nu, S, V_{t-1} \sim NCW_k(\nu, S, V_{t-1}) \]
\[ V_t = M_1 \Gamma_{t,1} M_1' + M_2 \Gamma_{t,5} M_2' + M_3 \Gamma_{t,22} M_3' \]
\[ \Gamma_{t,\ell} = \frac{1}{\ell} \sum_{i=0}^{\ell-1} \Sigma_{t-i}, \quad \ell = 1, 5, 22. \]

where \( M_1, M_2, M_3 \) are diagonal matrices. Under this specification, the conditional mean of \( \Sigma_t \) becomes:

\[ E(\Sigma_t | \Sigma_{1:t-1}) = M_1 \Gamma_{t-1,1} M_1 + M_2 \Gamma_{t-1,5} M_2 + M_3 \Gamma_{t-1,22} M_3 + \nu S. \]

In estimation, we reparametrize \( S \) by its Cholesky factor \( L_S \) (i.e. \( S = L_S L_S' \), \( L_S \) is lower triangular), and restrict the diagonal elements of \( L_S \) to be positive. For \( M_1, M_2 \) and \( M_3 \), we restrict the \((1, 1)\) element of each matrix to be positive for identification purpose. For \( \nu \), we consider 2 cases. In the first case, we impose the condition that \( \nu > k - 1 \). In the second case, in addition to the first condition, we also restrict it to be integer-valued for the purpose of simulation.\(^{15}\) All forecasting and empirical applications (where simulation is needed) are based on the second case. See Appendix 8.5 for estimation details.

### 3.3 GARCH Models of Daily Returns

#### 3.3.1 Vector-diagonal GARCH Model

Ding and Engle (2001) introduce the vector-diagonal GARCH (VD-GARCH-t) model to which we add Student-t innovations as follows

\[ r_t | r_{1:t-1} \sim t(0, H_t, \zeta) \]
\[ H_t = CC' + aa' \odot r_{t-1} r_{t-1}' + bb' \odot H_{t-1}, \]

where \( r_t \) is a \( k \)-dimensional daily return series, and \( r_{1:t-1} = \{ r_1, \ldots, r_{t-1} \} \). The parameters are \( C \), a \( k \times k \) lower triangular matrix; \( a \) and \( b \) are \( k \times 1 \) vectors, and \( \zeta \) is the degree of freedom in the Student-t density. In estimation, covariance targeting is achieved by replacing \( CC' \) with \( \text{Cov}(r) \odot \left( \frac{\zeta}{\zeta-2} uu' - aa' - \frac{\zeta}{\zeta-2} bb' \right) \), where \( \text{Cov}(r) \) is the sample covariance matrix estimated from daily returns, and \( u \) is a \( k \times 1 \) vector of 1. This model assumes that the conditional covariance \( h_{ij,t} \) is only a function of the past shock \( r_{i,t-1} r_{j,t-1}' \), and the past conditional covariance \( h_{ij,t-1} \). The conditional covariance of returns is \( \frac{\zeta}{\zeta-2} H_t \) assuming \( \zeta > 2 \).

---

\(^{15}\)To simulate a noncentral Wishart, we use the method proposed by Gleser (1976). In fact this is the only method we know of that is practically feasible and easy to implement. For this method to work, however, either \( \nu \) needs to be greater than \( 2k - 1 \), or \( \nu \) needs to be an integer. There is no easy way to simulate noncentral Wishart in all cases (Gauthier and Possamai 2009). In estimation we first allow \( \nu \) to be any real number greater than \( k - 1 \), which results in a posterior mean around 8.4. In our empirical work \( k = 5 \), this result does not satisfy the condition of \( \nu > 2k - 1 \), in which case we cannot simulate \( \Sigma_t \). To solve the problem, we estimate the model and restrict \( \nu \) to be integer-valued, which results in a posterior mean of 8. See Table 9
3.3.2 Dynamic Conditional Correlation Model

The second model is a dynamic conditional correlation (DCC-t) model of Engle (2002) with Student-t innovations,

\[
\begin{align*}
    r_t | r_{1:t-1} & \sim t(0, H_t, \zeta) \\
    H_t & = D_t R_t D_t \\
    D_t & = \text{diag}(\sigma_{i,t}) \\
    \sigma_{i,t}^2 & = \omega_i + \kappa_i r_{i,t-1}^2 + \lambda_i \sigma_{i,t-1}^2, \ i = 1, \ldots, k \\
    \epsilon_t & = \left( \frac{\zeta - 2}{\zeta} \right)^{1/2} D_t^{-1} r_t \\
    Q_t & = \overline{Q}(1 - \alpha - \beta) + \alpha \epsilon_{t-1} \epsilon_{t-1}' + \beta Q_{t-1} \\
    R_t & = \text{diag}(Q_t)^{-1/2} Q_t \text{diag}(Q_t)^{-1/2}
\end{align*}
\]

\(D_t, R_t, Q_t, \overline{Q}\) are all \(k \times k\) matrices. The parameters are \(\omega_1, \ldots, \omega_k, \kappa_1, \ldots, \kappa_k, \lambda_1, \ldots, \lambda_k, \alpha, \beta, \zeta\). Following Engle (2002), \(\overline{Q}\) is replaced by \(\text{Corr}(\epsilon_t)\), the sample correlation. In this way the number of parameters is greatly reduced from \(\frac{k^2 + 5k}{2} + 2\) to \(3k + 2\). Equation (31) governs the dynamics of the conditional variances of each individual return by a univariate GARCH process; equation (33) governs the dynamics of the time-varying conditional correlation of the whole return vector. Because \(\text{Corr}(\epsilon_t)\) is symmetric positive definite, and \(\epsilon_t \epsilon_t'\) is symmetric positive semi-definite, the conditional correlation matrices are guaranteed to be symmetric positive definite.

4 Model Estimation

We apply standard Bayesian estimation techniques to estimate the models using MCMC methods for posterior simulation. The posterior distribution is unknown for all the models considered, but a Markov Chain that has as its limiting distribution the posterior distribution of the parameters of interest can be sampled from using MCMC simulations. Features of the posterior density can then be estimated consistently based on the samples obtained from the posterior. For example, we can estimate the posterior mean of model parameters by the sample average of the MCMC draws. For more details on MCMC methods see Chib (2001).

In the following we outline estimation for the Wishart-RCOV-A(3) model and provide specific details for this model and others in the Appendix. To apply Bayesian inference, we need to first assign priors to the parameters. In general all priors are uninformative but proper. The priors on the elements of \(b_j\)’s are all \(N(0, 100)\), except the first element of each \(b_j\) is truncated to be positive for identification purposes. For the degree of freedom parameter \(\nu \sim \exp(\lambda_0) I_{\nu > k-1}\), an exponential distribution with support truncated to be greater than \(k-1\).\(^{16}\) To make the prior flat, \(\lambda_0\) is set to 100. In the empirical work focus is given to \(K = 3\) components as this was found to produce good results. The priors for \(\ell_2\) and \(\ell_3\) are uniform discrete with support \(\{2, 3, \ldots, 200\}\), with the restriction that \(\ell_2 < \ell_3\) for identification. We assume independence among the prior distributions of parameters.

\(^{16}\)In posterior simulation only draws of \(\nu > k - 1\) are accepted.
The joint density of returns and realized covariances is decomposed as

\[ p(r_t, \Sigma_t|\Lambda, \Theta, r_{1:t-1}, \Sigma_{1:t-1}) = p(r_t|\Lambda, \Sigma_t)p(\Sigma_t|\Theta, \Sigma_{1:t-1}) \tag{35} \]

where \( \Theta \) is the parameters in the RCOV specification. \( p(r_t|\Lambda, \Sigma_t) \) has a density in (5) while \( p(\Sigma_t|\Theta, \Sigma_{1:t-1}) \) has the density from (6). Equation (35) implies that estimation of \( \Lambda \) and \( \Theta \) can be done separately.

Bayes’ rule gives the posterior for \( \Theta \) in the Wishart model as

\[ p(\Theta|\Sigma_{1:T}) \propto \left[ \prod_{t=1}^{T} p(\Sigma_t|\Theta, \Sigma_{1:t-1}) \right] p(\Theta) \tag{36} \]

where \( p(\Theta) \) is the prior discussed above. Conditional distributions used in posterior simulation are proportional to this density.

The Wishart-RCOV-A(3) model has parameters \( \Theta = \{b_1, b_2, b_3, \nu\}, \) with \( \ell = \{\ell_2, \ell_3\} \). MCMC sampling iterates making parameter draws from the following conditional distributions.

- \( \Theta_j|\Theta_{-j}, \Sigma_{1:T} \),

where \( \Theta_j \) denotes one element of the parameter vector \( \Theta \) and \( \Theta_{-j} \) is \( \Theta \) excluding \( \Theta_j \). For the parameters in \( b_1, b_2, b_3, \nu \) a single-move Metropolis-Hastings step using a random walk proposal is employed. The conditional posterior of \( \ell_2 \) and \( \ell_3 \) has support on discrete points and the proposal density is a random walk with Poisson increments that are equally likely to be positive or negative.

Taking a draw from all of the conditional distributions constitutes one sweep of the sampler. After dropping an initial set of draws as burnin we collect \( N \) draws to obtain \( \{\Theta^{(i)}\}_{i=1}^{N} \). Simulation consistent estimates of posterior moments can be obtained as sample averages of the draws. For instance, the posterior mean of \( \Theta \) can be estimated as \( N^{-1} \sum_{i=1}^{N} \Theta^{(i)} \).

Posterior simulation from \( \Lambda|r_{1:T}, \Sigma_{1:T} \) is based on recognizing that \( \tilde{r}_t = \Sigma_t^{-1/2} r_t \sim N(0, \Lambda) \). Setting the prior density of \( \Lambda^{-1} \) to \( \text{Wishart}_k(k + 1, I_k) \), results in a standard conjugate result for the multivariate normal model. This is done separately from the estimation for the RCOV models.

All of the details of the conditional distributions and proposal distributions along with details for the other models are collected in the Appendix.

5 Density Forecasts of Returns

It is important to consider density forecasts of returns since this is the quantity that in principle enters into all financial decisions such as portfolio choice and risk measurement.\(^{17}\) Another reason for comparing models this way is that the daily returns are common to both the GARCH and the joint return-RCOV models and provides a common metric to compare models that use high and low frequency data. In contrast to the value-at-risk measures that

\(^{17}\)In general the covariance of returns is not a sufficient statistic for the future return distribution except with a Gaussian assumption.
focus on the tails of a distribution the predictive likelihoods test the accuracy of the whole distribution. Finally, a term structure of forecasts is considered in order to assess model forecast strength at many different horizons.

From a Bayesian perspective the predictive likelihoods are a key input into model comparison through predictive Bayes factors (Geweke (2005)).\footnote{Classical approaches to comparison of density forecasts include Amisano and Giacomini (2007), Bao, Lee, and Saltoglu (2007) and Weigend and Shi (2000).} Following Maheu and McCurdy (2011) we evaluate a term structure of a model’s density forecasts of returns. This is the cumulative log-predictive likelihood based on out-of-sample data for \( h = 1, \ldots, H \) period ahead density forecasts of returns.

For a candidate model \( \mathcal{A} \), we compute the following cumulative log-predictive likelihood:

\[
\hat{p}_h^{\mathcal{A}} = \sum_{t=T_0-h}^{T-h} \log(p(r_{t+h}|I_t, \mathcal{A})),
\]

for \( h = 1, 2, \ldots, H \) and \( T_0 < T \). For each \( h \), \( \hat{p}_h^{\mathcal{A}} \) measures the forecast performance based on the same common set of returns: \( r_{T_0}, \ldots, r_T \). Therefore, \( \hat{p}_1^{\mathcal{A}} \) is comparable with \( \hat{p}_h^{\mathcal{A}} \) and allows us to measure the decline in forecast performance as we move from 1 day ahead forecasts to 10 day ahead forecasts using model \( \mathcal{A} \). We are also interested in comparing \( \hat{p}_h^{\mathcal{A}} \) for a fixed \( h \) with another specification \( \mathcal{B} \), using its cumulative log-predictive likelihood \( \hat{p}_h^{\mathcal{B}} \). Better models, in terms of more accurate predictive densities, will have larger (37).

For the joint return-RCOV models \( I_t = \{r_{1:t}, \Omega_{1:t}\} \) while for the MGARCH models \( I_t = \{r_{1:t}\} \). The predictive likelihood \( p(r_{t+h}|I_t, \mathcal{A}) \), is the \( h \)-period ahead predictive density for model \( \mathcal{A} \) evaluated at the realized return \( r_{t+h} \),

\[
p(r_{t+h}|I_t, \mathcal{A}) = \int p(r_{t+h}|\theta, \Omega_{t+h}, \mathcal{A})p(\Omega_{t+h}|\theta, I_t, \mathcal{A})p(\theta|I_t, \mathcal{A})d\theta d\Omega_{t+h}.
\]

Parameter uncertainty from \( \theta \) and the future latent covariance of returns \( \Omega_{t+h} \) are both integrated out and will in general result in a highly non-Gaussian density on the left hand side of (38). In the DCC-t and VD-GARCH-t models \( \Omega_t \equiv H_t \) while for each of the models that exploit RCOV information \( \Omega_t \equiv \Sigma_t \), while \( \theta \) is the respective parameter vector. The integration is approximated as

\[
\int p(r_{t+h}|\theta, \Omega_{t+h}, \mathcal{A})p(\Omega_{t+h}|\theta, I_t, \mathcal{A})p(\theta|I_t, \mathcal{A})d\theta d\Omega_{t+h} \approx \frac{1}{N} \sum_{i=1}^{N} p(r_{t+h}|\theta^{(i)}, \Omega^{(i)}_{t+h}, \mathcal{A}),
\]

where \( \Omega^{(i)}_{t+h} \sim p(\Omega_{t+h}|\theta^{(i)}, I_t, \mathcal{A}) \), and \( \theta^{(i)} \sim p(\theta|I_t, \mathcal{A}) \). \( \{\theta^{(i)}\}_{i=1}^{N} \) are the MCMC draws from the posterior distribution \( p(\theta|I_t, \mathcal{A}) \) for the model given the information \( I_t \).

For the GARCH models, \( p(r_{t+h}|\theta^{(i)}, \Omega^{(i)}_{t+h}, \mathcal{A}) \) is the pdf of a multivariate Student-t density with mean 0, scale matrix \( H^{(i)}_{t+h} \) and degree of freedom \( \zeta^{(i)} \) evaluated at \( r_{t+h} \). \( H^{(i)}_{t+h} \) is simulated out from the last in-sample value \( H^{(i)}_t \) which is computed using the GARCH recursion and the parameter draw \( \theta^{(i)} \) from the posterior density given data \( I_t = \{r_{1:t}\} \).

For the RCOV models, \( p(r_{t+h}|\theta^{(i)}, \Omega^{(i)}_{t+h}, \mathcal{A}) \) is the pdf of a multivariate Normal density with mean 0 and covariance \( (\Sigma^{(i)}_{t+h})^{1/2}A^{(i)}((\Sigma^{(i)}_{t+h})^{1/2})' \) evaluated at \( r_{t+h} \). \( \Sigma^{(i)}_{t+h} \) is simulated out
using the Wishart, Cholesky-VARFIMA, or diagonal-HAR-WAR dynamics of the particular model and conditional on \( \theta^{(i)}, \Lambda^{(i)} \) from the posterior density, given data \( I_t = \{r_{1:t}, \Sigma_{1:t}\} \).

Note that for each term \( p(r_{t+h} | I_t, A) \) in the out-of-sample period we re-estimate the model to obtain a new set of draws from the posterior to compute (39). In other words the full set of models is recursively estimated for \( t = T_0 - H, \ldots, T - 1 \).

Given a model \( A \) with log-predictive likelihood \( \hat{p}^A \), and model \( B \) with log-predictive likelihood \( \hat{p}^B \), based on the common data \( \{r_{r_0}, \ldots, r_T\} \), the predictive Bayes factor in favor of model \( A \) versus model \( B \) is \( BF_{AB} = \exp(\hat{p}^A - \hat{p}^B) \). The Bayes factor is a relative ranking of the ability of the models to account for the data. A value greater than 1 means that model \( A \) is better able to account for the data compared to model \( B \). Kass and Raftery (1995) suggest interpreting the evidence for \( A \) as: not worth more than a bare mention if \( 1 \leq BF_{AB} < 3 \); positive if \( 3 \leq BF_{AB} < 20 \); strong if \( 20 \leq BF_{AB} < 150 \); and very strong if \( BF_{AB} \geq 150 \).

6 Results

6.1 Density Forecasts of Returns

In this section, we compare the joint return-RCOV models to the other benchmark models, focusing on their out-of-sample performance. The out-of-sample data begins at \( T_0 = 2006/03/31 \) and ends at 2007/12/31 for a total of 441 observations. This is true for each model and each forecast horizon \( h \). The full set of models is recursively estimated for \( t = T_0 - H, \ldots, T - 1 \) with a burnin of 1000 iterations after which N=5000 draws are collected to compute the predictive likelihoods and other predictive quantities. Figures 3 and 4 present the full range of log-predictive likelihoods for the models while Table 3 presents specific values for selected \( h \). The table can be used to compute log-predictive Bayes factors by taking the difference in \( \hat{p}_h \) for two models.

Figure 3 plots \( \hat{p}_h \) for the MGARCH models against \( h = 1, 2, \ldots, H = 60 \), giving each model a cumulative log-predictive likelihood term structure. Included are the DCC model with Gaussian innovations and the DCC-t and VD-GARCH-t both with Student-t innovations. All specifications have a downward sloping term structure. Intuitively, forecasting further out is more difficult. The t-distribution provides significant improvements in density forecasts of returns at all forecast horizons. In general, the VD-GARCH-t model has the best performance among the MGARCH specifications and we include it in further discussion as a benchmark that uses only daily return data.

Turning to Figure 4 the term structure of log-predictive likelihood for returns is presented for several of the joint return-RCOV models. Included are the following models: Wishart-RCOV-A(3), Wishart-RCOV-M(3), Cholesky-VARFIMA, diagonal-HAR-WAR as well as the VD-MGARCH-t and a new specification, diagonal-HAR-NCW, which we will discuss below.

First the VD-MGARCH-t model is competitive and is generally producing better density forecasts than the Cholesky-VARFIMA model that exploits high frequency information. For instance, the predictive Bayes factor in favor of the VD-MGARCH-t is \( \exp(7.04) \), \( h = 5 \),
Recall that the Bayes factor represents the improvement that the GARCH model gives in describing the data. Although Chiriac and Voev (2010) demonstrate that point forecasts of RCOV matrices are improved using their model as compared to DCC alternatives this does not translate into better density forecasts of returns. The dynamics of the RCOV matrices is also important. The Wishart-RCOV-M(3) model provide further gains but the Wishart-RCOV-A(3) dominates all competitors across the forecast horizon.

To further investigate the statistical significance of these results Figures 5 and 6 display log-predictive Bayes factors over each forecast horizon $h$. The first plot shows that the Wishart-RCOV-M(3) does not always improve on the VD-MGARCH-t model. For $h = 17 – 35$ the MGARCH model has better density forecasts. The Wishart-RCOV-A(3) beats the MGARCH model at each $h$. It provides substantial improvements particularly for small and large $h$.

The second plot shows that the Wishart-RCOV-M(3) is often better than the Cholesky-VARFIMA specification but there are forecast horizons that the latter performs well, particularly for $h > 55$. On the other hand, the Wishart-RCOV-A(3) strongly dominates the Cholesky-VARFIMA model for all $h$. This translates into predictive Bayes factors on the order of $\exp(10)$ to $\exp(20)$ in favor of the Wishart-RCOV-A(3).

Next we turn to the diagonal-HAR-WAR model which is shown in Figure 4 to have very poor performance compared to all other models. Why does this occur? After exploring other similar specifications we conjecture that the time variation in the diagonal-HAR-WAR model comes through the wrong channel. This model makes the noncentral parameter time-varying while fixing the scale matrix. Our Wishart models have a noncentral parameter of 0 but time variation in the scale matrix. To investigate the importance of where the time variation in the model should be we propose the following diagonal-HAR-noncentral Wishart (diagonal-HAR-NCW) specification as

\[
\Sigma_t \mid \nu, S_{t-1}, V \sim \text{NCW}_k(\nu, S_{t-1}, \nu V)
\]

\[
\nu S_t = \tilde{M}_1 \Gamma_{t,1} \tilde{M}_1 + \tilde{M}_2 \Gamma_{t,5} \tilde{M}_2 + \tilde{M}_3 \Gamma_{t,22} \tilde{M}_3
\]

\[
\Gamma_{t,\ell} = \frac{1}{\ell} \sum_{i=0}^{\ell-1} \Sigma_{t-i}, \quad \ell = 1, 5, 22.
\]

$\nu$ is the real-valued degree of freedom, $S_{t-1}$ is the scale matrix, $\nu V$ is the noncentrality matrix. $\tilde{M}_1, \tilde{M}_2, \tilde{M}_3$ are diagonal matrices. Under this specification, the conditional mean of $\Sigma_t$ becomes:

\[
E(\Sigma_t \mid \Sigma_{t-1}) = \tilde{M}_1 \Gamma_{t-1,1} \tilde{M}_1 + \tilde{M}_2 \Gamma_{t-1,5} \tilde{M}_2 + \tilde{M}_3 \Gamma_{t-1,22} \tilde{M}_3 + \nu V,
\]

and is exactly the same form as the conditional mean for the diagonal-HAR-WAR model in (25). The difference between the diagonal-HAR-WAR and the diagonal-HAR-NCW is that the roles of the scale matrix and the noncentrality matrix in the noncentral Wishart transition density are switched. In the diagonal-HAR-WAR model, the time series dependence in $\Sigma_t$ is captured in the noncentrality matrix $V_t$, while the scale matrix $S$ is set to a constant. In $^\text{19}$For $h = 1$ the VD-MGARCH-t and Cholesky-VARFIMA models have essentially the same predictive power.
the diagonal-HAR-NCW model, however, the time dependence goes into the scale matrix $S_t$, while the noncentrality matrix $V$ (up to a constant $\nu$) is constant.

Figure 4 shows that switching the time variation from the noncentrality matrix to the scale matrix results in a huge improvement in density forecasts. Further improvements are possible for this model by estimating the lag length of the components $\Gamma_{t,t'}$ (not reported). From Table 3 the predictive Bayes factors in favor of the diagonal-HAR-NCW model range from $\exp(75.75)$, $h = 1$ to $\exp(186.38)$, $h = 60$. We conclude that the existing WAR models, according to our results, are likely to be poor performers unless additional time variation in the conditional mean is incorporated into the scale matrix.

In summary, the Wishart-RCOV-A(3) provides superior density forecasts for returns as compared to MGARCH models and existing RCOV models.

### 6.2 Forecasts of RCOV

Figure 7 and Table 4 report the root mean squared error for predicting $\Sigma_t$ based on the predictive mean from each model. This is reported for each of the forecast horizons $h$. As in the density forecasts, each model is re-estimated for each observation in the out-of-sample period to produce the predictive mean. The reason the Wishart-RCOV-A model performs well in density forecasts of returns is that it has the best point forecasts of $\Sigma_t$ amongst all the models. Both the Wishart-RCOV-M and Cholesky-VARFIMA are similar while the diagonal-HAR-WAR is the worst.\footnote{Chiriac and Voev (2010) also find the diagonal-HAR-WAR model performs poorly in point forecasts.} Compared to the diagonal-HAR-WAR, the alternative diagonal-HAR-NCW model shows great improvements, as it did in the density forecasts discussed above.

### 6.3 Economic Evaluation

In this section, we evaluate the out-of-sample performance of the models from a portfolio optimization perspective. We focus on the simple problem of finding the global minimum variance portfolio, so the issue of specifying the expected return is avoided. The $h$-period ahead global minimum variance portfolio (GMVP) is computed as the solution to

$$
\min_{w_{t+h|t}} \Omega_{t+h|t} w_{t+h|t}
\text{ s.t. } w'_{t+h|t} \Omega_{t+h|t} w_{t+h|t} = 1.
$$

$\Omega_{t+h|t}$ is the predictive mean of the covariance matrix at time $t + h$ given time $t$ information for a particular model. From the posterior draws the predictive mean of the covariance matrix at time $t + h$ is simulated along the lines of the previous subsection. $w_{t+h|t}$ is the portfolio weight, and $t$ is a vector with all the elements equal to 1. The optimal portfolio weight is

$$
 w_{t+h|t} = \frac{\Omega^{-1}_{t+h|t} t}{t'\Omega^{-1}_{t+h|t} t}.
$$

\footnote{Chiriac and Voev (2010) also find the diagonal-HAR-WAR model performs poorly in point forecasts.}
It can be shown (Engle and Colacito (2006)) that if the portfolio weights, \( w_t \), are constructed from the true conditional covariance, then the variance of a portfolio computed using the GMVP from any other model must be larger.

We evaluate model performance starting at 2006/03/31 to 2007/12/31 for a total of 441 observations for \( h = 1, \ldots, H = 60 \). The specifications considered are: Wishart-RCOV-A(3), Wishart-RCOV-M(3), Cholesky-VARFIMA, diagonal-HAR-WAR, and the DCC-t. As in the density forecasts the models are estimated using data up to and including time \( t \) and weights are computed from (43). For the MGARCH models \( \Omega_{t+h|t} = E[\Sigma_{t+h} | \Omega_{t}, \ldots, \Omega_{1}] \) and for the RCOV models \( \Omega_{t+h|t} = E[\Sigma_{t+h} | \Sigma_{t}, \Sigma_{1}] \). These terms are computed by simulation and have parameter uncertainty integrated out. Observation \( t + 1 \) is added and the models are re-estimated and the new weights computed, etc.

We report the sample variances\(^{21}\) of the GMVPs across models in Figure 8. Table 5 reports the portfolio variance for selected values of \( h \). As in the density forecast exercise we use a common set of returns to evaluate the performance over different \( h \). As a result, the upwards sloping portfolio variances indicates that time-series information is most useful for short term portfolio choice. With the exception of the diagonal-HAR-WAR model, all of the return-RCOV time-series models improve upon the DCC-t model for about 15 days out after which the portfolio variance is similar. The Wishart-RCOV-M(3) model has the lowest portfolio variance but the Wishart-RCOV-A(3) model remains very competitive.

### 6.4 Full Sample Estimates

This section presents full sample estimates for selected models. Tables 6 and 7 report posterior moments for the new time-varying Wishart models.\(^{22}\) Both models have a degree of freedom parameter of about 14 and components with windows of length 9 and 64. These components correspond to roughly 2 weeks and 3 months of data. We found it critical to have 3 components and to estimate the window width of each component to obtain good out-of-sample results. All the 0.95 posterior density intervals show the parameters to be precisely estimated.

The remaining joint return-RCOV model estimates are reported in Tables 8-10. The common long-memory parameter \( m \) has a posterior mean of 0.4295 in the VARFIMA specification. The parameter estimates of the diagonal-HAR-WAR model with a real valued degree of freedom parameter (not reported) are almost identical to the estimates in Table 9 which imposes an integer value of \( \nu \). The degree of freedom parameter is concentrated at 8. Recall, that for the noncentral Wishart it is necessary to impose an integer value on \( \nu \) in order to simulate the model for \( \nu < 2k - 1 \). For the diagonal-HAR-NCW model (Table 10) we estimate \( \nu = 14.55 > 2k - 1 = 9 \) which allows us to treat \( \nu \) as real valued.\(^{23}\) This latter estimate of \( \nu \) is close to the estimation results for \( \nu \) in the Wishart-RCOV models.

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\(^{21}\)An alternative to comparing the sample variances is to compare the realized variance for each portfolio. However, as we discuss in the next section, \( \Sigma_t \) is biased for the covariance of returns and would not represent the true variance that investors face.

\(^{22}\)The *inefficiency factors* in the tables are the ratio of the long-run variance estimate to the sample variance where the latter assumes an i.i.d. sample. This serves as an indicator of how well the chain mixes. The lower the value is, the closer the sampling is to i.i.d.

\(^{23}\)In fact all posterior draws of \( \nu \) in the diagonal-HAR-NCW model are above \( 2k - 1 \).
Finally, the posterior mean and 0.95 density intervals are reported for the lower triangular elements of \( \Lambda \) in Table 11. \( \Lambda \) is close to a diagonal matrix with four diagonal elements being significantly smaller than 1. The effect this matrix has is to reduce the conditional variance of returns. For instance, the determinant (generalized variance, Muirhead (1982)) is reduced since \( |\Sigma_t^{1/2} \Lambda (\Sigma_t^{1/2})'|/|\Sigma_t| = |\Lambda| = 0.53 \) and the eigenvalues of the covariance matrix of returns are reduced.\(^{24}\) The Bayes factor is strongly in favor of \( \Lambda \) being estimated versus it being set to an identity matrix.

7 Conclusion

This paper proposes new dynamic component models of returns and realized covariance (RCOV) matrices based on time-varying Wishart distributions. Bayesian estimation and model comparison is conducted with a range of multivariate GARCH models and existing RCOV models from the literature. The new joint return-RCOV models provide superior density forecasts for returns from forecast horizons of 1 day to 3 months ahead as well as improved point forecasts for RCOV. Global minimum variance portfolio selection is improved for forecast horizons up to 3 weeks out.

8 Appendix

8.1 Wishart-RCOV-\( \Lambda(K) \) Estimation

Parameters are \( \Theta = \{\nu, b_1, \ldots, b_K, \ell_2, \ldots, \ell_K\} \). The likelihood function is the product of the Wishart densities,

\[
p(\Sigma_{1:T} | \Theta) = \prod_{t=1}^{T} \text{Wishart}_k(\Sigma_t | \nu, S_{t-1}).
\]

The joint posterior distribution of the parameters \( p(\Theta | \Sigma_{1:T}) \) then is the product of the data density and the individual priors for each parameter, with the priors given in Section 4. For a particular parameter \( \Theta_i \in \Theta \), the conditional posterior distribution is:

\[
p(\Theta_i | \Theta_{-i}, \Sigma_{1:T}) \propto p(\Theta_i) \times \prod_{t=1}^{T} \text{Wishart}_k(\Sigma_t | \nu, S_{t-1})
\]

\[
= p(\Theta_i) \times p(\Sigma_{1:T} | \Theta)
\]

\[
= p(\Theta_i) \prod_{t=1}^{T} \frac{|\Sigma_t|^{\nu-k-1} |S_{t-1}^{-1}|^{\frac{\nu}{2}}}{2^{k} \prod_{j=1}^{k} \Gamma(\frac{\nu+1-j}{2})} \exp \left( -\frac{1}{2} Tr(\Sigma_t S_{t-1}^{-1}) \right)
\]

We iteratively sample from the conditional posterior distribution of each parameter conditional on the other parameters by Metropolis-Hastings scheme. For each parameter, a random walk with normal proposal is applied, except for \( \ell_i, i = 2, \ldots, K \), in which case the

\(^{24}\)This is based on the posterior mean of \( \Lambda \).
proposal distribution is a Poisson random variable multiplied by a random variable that takes on values 1 and $-1$ with equal probability. The density of the proposal is

$$q(\ell) = \begin{cases} \frac{\lambda^\ell e^{-\lambda}}{2\ell!} & \ell = 1, 2, \ldots \\ e^{-\lambda} & \ell = 0 \\ \frac{\lambda^{-\ell} e^{-\lambda}}{2(-\ell)!} & \ell = -1, -2, \ldots \end{cases}$$

In the empirical work $\lambda = 2$. Given the value $\ell_i$ in the Markov chain, the new proposal $\ell_i' \sim q(\ell)$ is accepted with probability

$$\min \left\{ \frac{p(\ell_i'|b_1, \ldots, b_K, \ell_{-i}, \nu, \Sigma_{1:T})}{p(\ell_i|b_1, \ldots, b_K, \ell_{-i}, \nu, \Sigma_{1:T})}, 1 \right\}. \quad (46)$$

### 8.2 Wishart-RCOV-M(K) Estimation

The parameters are $\{A, d, \ell, \nu\} = \Theta$. For priors, $A^{-1} \sim \text{Wishart}_k(\gamma_0, Q_0)$, a Wishart distribution with $Q_0 = I_k$ and $\gamma_0 = k + 1$ set to reflect a proper but relatively uninformative prior. Each $d_j$ follows a uniform prior, $d_j \sim U(-1, 1)$, and $\nu \sim \exp(\lambda_0)I_{\nu > k-1}$, an exponential distribution with support truncated to be greater than $k - 1$. To make the prior flat, $\lambda_0$ is set to 100. Given the priors, the conditional posterior distributions for the parameters are as follows.

$$p(A^{-1}|\nu, d, \ell, \Sigma_{1:T}) \propto \text{Wishart}_k(A^{-1}|\gamma_0, Q_0) \times \prod_{t=1}^T \text{Wishart}_k(\Sigma_t|\nu, S_{t-1})$$

$$\propto |A^{-1}|^{\frac{n-k-1}{2}} |Q_0^{-1}|^{\frac{n}{2}} \exp \left( -\frac{1}{2} Tr(A^{-1}Q_0^{-1}) \right)$$

$$\times \prod_{t=1}^T \frac{|\Sigma_t|^\frac{\nu-k-1}{2} |S_{t-1}|^\frac{\nu}{2}}{2^\frac{\nu k}{2} \prod_{j=1}^k \Gamma(\frac{\nu+1-j}{2})} \exp \left( -\frac{1}{2} Tr(\Sigma_t S_{t-1}^{-1}) \right)$$

$$\propto |A^{-1}|^{\frac{T
u+\gamma_0-k-1}{2}} \exp \left( -\frac{1}{2} Tr[A^{-1}(Q_0^{-1} + \nu \sum_{t=1}^T \prod_{j=1}^k \Gamma(\frac{-d_j}{t-1, \ell_j}) \Sigma_t \prod_{j=K}^1 \Gamma(\frac{-d_j}{t-1, \ell_j})] \right)$$

$$\propto \text{Wishart}_k(A^{-1}|\tilde{\gamma}, \tilde{Q}) \quad (47)$$

Where $\tilde{Q}^{-1} = \nu \sum_{t=1}^T \left[ \prod_{j=1}^K \Gamma(\frac{-d_j}{t-1, \ell_j}) \right] \Sigma_t \left[ \prod_{j=1}^1 \Gamma(\frac{-d_j}{t-1, \ell_j}) \right] + Q_0^{-1}$, $\tilde{\gamma} = T\nu + \gamma_0$.

For $d_i, i = 1, \ldots, K$ we have,

$$p(d_i|A, d_{-i}, \ell, \nu, \Sigma_{1:T}) \propto p(d_i) \times \prod_{t=1}^T \text{Wishart}_k(\Sigma_t|\nu, S_{t-1})$$

$$= p(d_i) \prod_{t=1}^T \frac{|\Sigma_t|^\frac{\nu-k-1}{2} |S_{t-1}|^\frac{\nu}{2}}{2^\frac{\nu k}{2} \prod_{j=1}^k \Gamma(\frac{\nu+1-j}{2})} \exp \left( -\frac{1}{2} Tr(\Sigma_t S_{t-1}^{-1}) \right)$$

$$\propto p(d_i) \exp \left( -\frac{d_i \nu \phi_i}{2} - \frac{1}{2} Tr(\nu A^{-1}Q^{-1}) \right), \quad (48)$$

20
where $\phi_i = \sum_{t=1}^{T} \log |\Gamma_{t-1, \ell_i}|$, and $Q^{-1} = \sum_{t=1}^{T} \left[ \prod_{j=1}^{K} \Gamma_{t-1, \ell_j}^{-d_j} \right] \Sigma_t \left[ \prod_{j=K}^{t-1} \Gamma_{t-1, \ell_j}^{-d_j} \right]$. To sample from this density we do the following. If $d_i$ is the previous value in the chain we propose $d'_i = d_i + u$ where $u \sim N(0, \sigma^2)$ and accept $d'_i$ with probability

$$\min \left\{ \frac{p(d'_i | A, d_{-i}, \ell, \nu, \Sigma_{1:T})}{p(d_i | A, d_{-i}, \ell, \nu, \Sigma_{1:T})}, 1 \right\},$$

(49)

and otherwise retain $d_i$. $\sigma^2$ is selected to achieve a rate of acceptance between 0.3-0.5.

For $\ell_i, i = 2, \ldots, K$ we have,

$$p(\ell_i | A, d, \ell_{-i}, \nu, \Sigma_{1:T}) \propto p(\ell_i) \times \prod_{t=1}^{T} \text{Wishart}_k(\Sigma_t | \nu, S_{t-1})$$

$$\propto p(\ell_i) \exp \left( -\frac{d_i \nu \phi_i}{2} - \frac{1}{2} Tr(\nu A^{-1} Q^{-1}) \right),$$

(50)

where $\phi_i$ and $Q^{-1}$ are defined the same way as in the previous case. To sample from the conditional posterior we use a simple random walk proposal. The proposal distribution is a “symmetric Poisson”, as in Wishart-RCOV-A(K). Finally, $\nu$ has the conditional posterior density

$$p(\nu | A, d, \ell, \Sigma_{1:T}) \propto p(\nu) \times p(\Sigma_{1:T} | A, d, \nu)$$

$$= p(\nu) \prod_{t=1}^{T} \frac{|\Sigma_t|^\nu |\Gamma_{t-1}^{-1}|^{\nu/2}}{2^{\nu k/2} \prod_{j=1}^{k} \Gamma(\frac{\nu+1-j}{2})} \exp \left( -\frac{1}{2} Tr(\nu A^{-1} Q^{-1}) \right)$$

$$= p(\nu) \prod_{t=1}^{T} \frac{|\Sigma_t|^\nu |\Gamma_{t-1}^{-1}|^{\nu/2}}{2^{\nu k/2} \prod_{j=1}^{k} \Gamma(\frac{\nu+1-j}{2})} \exp \left( -\frac{1}{2} Tr(\nu A^{-1} Q^{-1}) \right)$$

$$\times \exp \left( -\lambda_0 \nu + \frac{TV}{2} \log |A|^{-1} + \frac{TVk}{2} \log \frac{\nu}{2} - T \sum_{j=1}^{k} \log \Gamma \left( \frac{\nu+1-j}{2} \right) \right)$$

$$\times \exp \left( \frac{\nu}{2} \sum_{t=1}^{T} \log |\Sigma_t| - \nu \sum_{i=1}^{K} d_i \phi_i - \frac{1}{2} Tr(\nu A^{-1} Q^{-1}) \right)$$

(51)

where $Q^{-1}$ and $\phi_i$ are defined as in previous cases. This is a nonstandard distribution which we sample using a Metropolis-Hastings step with a random walk proposal analogous to the sampling in the previous step above.
8.3 Sampling from $\Lambda | r_{1:T}, \Sigma_{1:T}$

To estimate $\Lambda$, define $\tilde{r}_t = \Sigma_t^{-1/2} r_t$, then $\tilde{r}_t \sim N(0, \Lambda)$. We let the prior of $\Lambda^{-1}$ be $Wishart_k(\gamma_1, Q_1)$, and we set $Q_1 = I$ and $\gamma_1 = k + 1$. The posterior distribution of $\Lambda^{-1}$ is

$$p(\Lambda^{-1} | r_{1:T}) \propto Wishart_k(\Lambda^{-1} | \gamma_1, Q_1) \times \prod_{t=1}^{T} N(\tilde{r}_t | 0, \Lambda)$$

by the conjugacy of the Wishart prior of the precision matrix with respect to a multivariate Normal likelihood. Here $\tilde{\gamma} = T + \gamma_1$, and $\tilde{Q} = (\sum_{t=1}^{T} \tilde{r}_t \tilde{r}_t^T + Q_1^{-1})^{-1}$

8.4 VARFIMA(1,m,1) Estimation

Pre-multiply both sides of equation (19) by $(1 - \psi L)^{-1}$, we get the VAR representation of VARFIMA(1,m,1):

$$\xi_t = (1 - \psi L)^{-1} (1 - \delta L)(1 - L)^m [Z_t - c]$$

$$= \Psi(L)(Z_t - c)$$

$$= \sum_{i=0}^{\infty} \Psi_i(Z_{t-i} - c)$$

Follow Ravishanker and Ray (1997), let

$$\xi_t = \sum_{i=0}^{t-1} \Psi_i(Z_{t-i} - c) \quad t = 1, \ldots, T,$$

then the conditional likelihood function is proportional to

$$|\Xi|^{-\frac{T}{2}} \times \exp \left( \sum_{t=1}^{T} \xi_t^T \Xi^{-1} \xi_t \right)$$

The parameters are $\Theta = \{\delta, m, \psi, \Xi\}$, where $c$ is set at the sample mean of $Z_t$. For $\Theta_i = \delta$, $m$, or $\psi$, the conditional posterior distribution is:

$$p(\Theta_i | \Theta_{-i}, \Sigma_{1:T}) \propto p(\Theta_i) \times \exp \left( \sum_{t=1}^{T} \xi_t \Psi^{-1} \xi_t \right),$$

with the all the priors being independent Normal of mean 0 and variance 100 truncated on the interval $(-1, 1)$. To sample from the posterior distributions, we use Metropolis-Hastings scheme with a random walk proposal analogous to the sampling in the previous subsections. For $\Xi$, we use an inverse Wishart distribution $Wishart^{-1}(\gamma_2, Q_2)$ as the prior, where $\gamma_2 =$
\( k \times (k+1) / 2 + 1 \) and \( Q_2 = I \). By the conjugacy of inverse Wishart prior for the covariance matrix of a multivariate Normal, the conditional posterior distribution is:

\[
p(\Xi \mid \delta, m, \psi, \Sigma_{1:t}) \propto \text{Wishart}^{-1}(\Xi \mid \gamma_2, Q_2) \times |\Xi|^{-\frac{T}{2}} \times \exp \left( \sum_{t=1}^{T} \xi_t^T \Xi^{-1} \xi_t \right) \propto \text{Wishart}^{-1}(\Xi \mid \tilde{\gamma}_2, \tilde{Q}_2),
\]

where \( \tilde{\gamma}_2 = T + \gamma_2, \tilde{Q}_2 = \sum_{t=1}^{T} \xi_t \xi_t^T + Q_2 \).

### 8.5 diagonal-HAR-WAR Estimation

The parameters are \( \Theta = \{ \nu, M_1, M_2, M_3, L_S \} \). \( M_1, M_2, M_3 \) are diagonal matrices, \( L_S \) is a lower triangular matrix. The prior on \( \nu \) is an exponential distribution with support truncated to be greater than \( k - 1 \), \( p(\nu) = \exp(100)I_{\nu > k-1} \).25 All the other parameters are each assigned an independent Normal prior \( p(\Theta_i) \) with mean 0 and variance 100, with the following truncations:

\[
M_1(1, 1) > 0, \ M_2(1, 1) > 0, \ M_3(1, 1) > 0, \ L_S(i, i) > 0, \ i = 1, \ldots, k
\]

Given \( \Theta \) the likelihood function is a product of the noncentral Wishart densities (see Muirhead (1982) p. 442),

\[
p(\Sigma_{1:T} \mid \Theta) = \prod_{t=1}^{T} \text{NCW}_k(\Sigma_t \mid \nu, S; V_{t-1})
\]

\[
= \prod_{t=1}^{T} \frac{|\Sigma_t|^{\nu-k-1}}{2^{\nu/2} \pi^{k/2} \Gamma(\nu/2)} \exp \left( -\frac{1}{2} Tr[S^{-1}(\Sigma_t + V_{t-1})] \right) \times _0F_1(\nu; \frac{1}{4} S^{-1} V_{t-1} S^{-1} \Sigma_t)
\]

where \(_0F_1\) is the hypergeometric function of matrix argument, which we evaluate using the Laplace approximation method developed in Butler and Wood (2003, 2005).

The conditional posterior distribution of each parameter is proportional to the product of its prior and the likelihood function:

\[
p(\Theta_i \mid \Theta_{-i}, \Sigma_{1:t}) \propto p(\Theta_i) \times \prod_{t=1}^{T} \text{NCW}_k(\Sigma_t \mid \nu, S; V_{t-1})
\]

To sample from the posterior distributions, we use Metropolis-Hastings scheme with a random walk proposal analogous to the sampling in the previous subsections. In the case where \( \nu \) is real-valued, the proposal is normal. In the case where \( \nu \) is integer-valued, the proposal distribution is a Poisson random variable multiplied by a random variable that takes on values 1 and \(-1\) with equal probability.

25In posterior simulation only draws of \( \nu > k - 1 \) are accepted.
8.6 VD-GARCH-t Estimation

The parameters are \{a_1, \ldots, a_k, b_1, \ldots, b_k, \zeta\} = \Theta. All parameters are assigned an independent Normal prior with mean 0 and variance 100, with \(a_1\) and \(b_1\) restricted to be positive for identification purpose. The joint prior \(p(\Theta)\) is just the product of the individual priors. The likelihood function \(p(r_{1:T}|\Theta)\) is:

\[
p(r_{1:T}|\Theta) = \prod_{t=1}^{T} \frac{\Gamma((\zeta + k)/2)[1 + \frac{1}{\zeta} r_t' H_t^{-1} r_t]^{-(\zeta + k)/2}}{\Gamma(\zeta/2)(\zeta \pi)^{k/2}|H_t|^{1/2}}
\]

The posterior of the parameters \(p(\Theta|r_{1:T})\) is:

\[
p(\Theta|r_{1:T}) \propto p(\Theta) \prod_{t=1}^{T} \frac{\Gamma((\zeta + k)/2)[1 + \frac{1}{\zeta} r_t' H_t^{-1} r_t]^{-(\zeta + k)/2}}{\Gamma(\zeta/2)(\zeta \pi)^{k/2}|H_t|^{1/2}}
\]

To sample from the joint posterior distribution \(p(\Theta|r_{1:T})\), we do the following steps: We first adopt a single move sampler. For each iteration, the chain cycles through the conditional posterior densities of the parameters in a fixed order. For each parameter, a random walk with normal proposal is applied. After dropping an initial set of draws as burnin, we collect \(M\) draws and use them to calculate the sample covariance matrix of the joint posterior. Then, a block sampler is used to jointly sample the full posterior. The proposal density is a multivariate normal random walk with the covariance matrix set to the sample covariance, obtained from the draws of the single-move sampler, scaled by a scalar. When the model is recursively estimated as a new observation arrives the previous sample covariance is used as the next covariance in the multivariate normal random walk. This results in fast efficient sampling.

8.7 DCC-t Estimation

The parameters are \{\omega_1, \ldots, \omega_k, \kappa_1, \ldots, \kappa_k, \lambda_1, \ldots, \lambda_k, \alpha, \beta, \zeta\} = \Theta. All parameters are assigned an independent Normal prior with mean 0 and variance 100, with the following restrictions are imposed:

\[
\omega_i > 0, \, \kappa_i \geq 0, \, \lambda_i \geq 0, \, \zeta > 2, \, \frac{\kappa_i \zeta}{\zeta - 2} + \lambda_i < 1, \, i = 1, \ldots, k, \, \alpha \geq 0, \, \beta \geq 0, \, \alpha + \beta < 1.
\]

The joint prior \(p(\Theta)\) is just the product of the individual priors. The likelihood function \(p(r_{1:T}|\Theta)\) is:

\[
p(r_{1:T}|\Theta) = \prod_{t=1}^{T} \frac{\Gamma((\zeta + k)/2)[1 + \frac{1}{\zeta} r_t' H_t^{-1} r_t]^{-(\zeta + k)/2}}{\Gamma(\zeta/2)(\zeta \pi)^{k/2}|H_t|^{1/2}}
\]

The posterior of the parameters \(p(\Theta|r_{1:T})\) is:

\[
p(\Theta|r_{1:T}) \propto p(\Theta) \prod_{t=1}^{T} \frac{\Gamma((\zeta + k)/2)[1 + \frac{1}{\zeta} r_t' H_t^{-1} r_t]^{-(\zeta + k)/2}}{\Gamma(\zeta/2)(\zeta \pi)^{k/2}|H_t|^{1/2}}
\]
For the special case of DCC with Normal innovations, the parameters are

\[ \{ \omega_1, \ldots, \omega_k, \kappa_1, \ldots, \kappa_k, \lambda_1, \ldots, \lambda_k, \alpha, \beta, \} = \Theta. \]

The restriction on the priors are similar:

\[ \omega_i > 0, \quad \kappa_i \geq 0, \quad \lambda_i \geq 0, \quad \kappa_i + \lambda_i < 1, \quad i = 1, \ldots, k, \quad \alpha \geq 0, \quad \beta \geq 0, \quad \alpha + \beta < 1. \quad (66) \]

The posterior of the parameters \( p(\Theta| r_{1:T}) \) is:

\[
p(\Theta| r_{1:T}) \propto p(\Theta)(2\pi)^{\frac{T_2}{2}} \prod_{t=1}^{T} |D_t R_t D_t|^{-\frac{1}{2}} \exp \left( -\frac{1}{2} \sum_{t=1}^{T} r_t' (D_t R_t D_t)^{-1} r_t \right) \quad (67)
\]

The sampling procedure is similar to that of the VD-GARCH-t.
Reference


Table 1: Average daily number of transactions and average daily refresh time (RT) observations per day

<table>
<thead>
<tr>
<th></th>
<th>SPY</th>
<th>GE</th>
<th>C</th>
<th>AA</th>
<th>BA</th>
<th>RT</th>
</tr>
</thead>
<tbody>
<tr>
<td>6985</td>
<td>7479</td>
<td>6121</td>
<td>3279</td>
<td>3745</td>
<td>1835</td>
<td></td>
</tr>
</tbody>
</table>

This table reports the average daily number of transactions (after data cleaning) for Standard and Poor’s Depository Receipt (SPY), General Electric Co. (GE), Citigroup Inc. (C), Alcoa Inc. (AA) and Boeing Co. (BA). The total number of days is 2281. RT reports the average number of daily observations according to the refresh time.

Table 2: Summary statistics: Daily returns and RCOV

<table>
<thead>
<tr>
<th>Sample covariance from daily returns</th>
<th>Average of realized covariances</th>
</tr>
</thead>
<tbody>
<tr>
<td>SPY</td>
<td>SPY</td>
</tr>
<tr>
<td>GE</td>
<td>GE</td>
</tr>
<tr>
<td>C</td>
<td>C</td>
</tr>
<tr>
<td>AA</td>
<td>AA</td>
</tr>
<tr>
<td>BA</td>
<td>BA</td>
</tr>
</tbody>
</table>

This table reports the sample covariance from daily returns and the sample average of the realized covariances. The data are Standard and Poor’s Depository Receipt (SPY), General Electric Co. (GE), Citigroup Inc. (C), Alcoa Inc. (AA) and Boeing Co. (BA). Total observations is 2281.

Table 3: Cumulative log-predictive likelihoods \( \hat{p}_h \) across models for various forecast horizon \( h \)

<table>
<thead>
<tr>
<th>Model</th>
<th>( h = 1 )</th>
<th>( h = 5 )</th>
<th>( h = 10 )</th>
<th>( h = 20 )</th>
<th>( h = 60 )</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wishart-RCOV-A(3)</td>
<td>-2737.53</td>
<td>-2762.59</td>
<td>-2768.55</td>
<td>-2791.22</td>
<td>-2812.09</td>
</tr>
<tr>
<td>Wishart-RCOV-M(3)</td>
<td>-2740.11</td>
<td>-2764.99</td>
<td>-2774.46</td>
<td>-2797.86</td>
<td>-2832.94</td>
</tr>
<tr>
<td>Cholesky-VARFIMA(1,m,1)</td>
<td>-2754.29</td>
<td>-2776.32</td>
<td>-2788.35</td>
<td>-2807.29</td>
<td>-2825.10</td>
</tr>
<tr>
<td>diagonal-HAR-WAR</td>
<td>-2816.14</td>
<td>-2897.86</td>
<td>-2939.19</td>
<td>-2983.14</td>
<td>-3034.82</td>
</tr>
<tr>
<td>diagonal-HAR-NCW</td>
<td>-2740.39</td>
<td>-2773.12</td>
<td>-2786.52</td>
<td>-2820.60</td>
<td>-2848.44</td>
</tr>
<tr>
<td>VD-GARCH-t</td>
<td>-2754.37</td>
<td>-2709.28</td>
<td>-2781.57</td>
<td>-2796.63</td>
<td>-2835.97</td>
</tr>
</tbody>
</table>

Table 4: Root mean squared error \( RMSE_h \) of forecasts of \( \Sigma_t \) across models for various forecast horizon \( h \)

<table>
<thead>
<tr>
<th>Model</th>
<th>( h = 1 )</th>
<th>( h = 5 )</th>
<th>( h = 10 )</th>
<th>( h = 20 )</th>
<th>( h = 60 )</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wishart-RCOV-A(3)</td>
<td>2.969</td>
<td>3.349</td>
<td>3.508</td>
<td>3.741</td>
<td>3.751</td>
</tr>
<tr>
<td>Wishart-RCOV-M(3)</td>
<td>2.969</td>
<td>3.384</td>
<td>3.564</td>
<td>3.881</td>
<td>4.029</td>
</tr>
<tr>
<td>Cholesky-VARFIMA(1,m,1)</td>
<td>3.199</td>
<td>3.507</td>
<td>3.655</td>
<td>3.842</td>
<td>3.981</td>
</tr>
<tr>
<td>diagonal-HAR-WAR</td>
<td>3.678</td>
<td>4.619</td>
<td>5.062</td>
<td>5.504</td>
<td>5.989</td>
</tr>
<tr>
<td>diagonal-HAR-NCW</td>
<td>3.025</td>
<td>3.495</td>
<td>3.726</td>
<td>4.095</td>
<td>4.192</td>
</tr>
</tbody>
</table>

\[
RMSE_h = \frac{1}{T-t_{t+h+1}} \sum_{t=T-h}^{T-h} \| \Sigma_t + h - E[\Sigma_t+h|I_t] \|, \text{ where } \|A\| = \sqrt{\sum_i \sum_j |a_{ij}|^2}, \text{ and } E[\Sigma_t+h|I_t] \text{ denotes a model’s predictive mean.}
\]
Table 5: Sample variances of GMVP across models for various forecast horizon $h$

<table>
<thead>
<tr>
<th>Model</th>
<th>$h = 1$</th>
<th>$h = 5$</th>
<th>$h = 10$</th>
<th>$h = 20$</th>
<th>$h = 60$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wishart-RCOV-A(3)</td>
<td>0.419</td>
<td>0.438</td>
<td>0.452</td>
<td>0.476</td>
<td>0.477</td>
</tr>
<tr>
<td>Wishart-RCOV-M(3)</td>
<td>0.419</td>
<td>0.435</td>
<td>0.446</td>
<td>0.470</td>
<td>0.470</td>
</tr>
<tr>
<td>Cholesky-VARFIMA(1,m,1)</td>
<td>0.431</td>
<td>0.446</td>
<td>0.457</td>
<td>0.474</td>
<td>0.483</td>
</tr>
<tr>
<td>diagonal-HAR-WAR</td>
<td>0.452</td>
<td>0.480</td>
<td>0.495</td>
<td>0.511</td>
<td>0.526</td>
</tr>
<tr>
<td>DCC-t</td>
<td>0.461</td>
<td>0.469</td>
<td>0.472</td>
<td>0.481</td>
<td>0.490</td>
</tr>
</tbody>
</table>

Table 6: Estimation results for Wishart-RCOV-A(3)

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Mean</th>
<th>NSE</th>
<th>0.95 DI</th>
<th>Ineff</th>
</tr>
</thead>
<tbody>
<tr>
<td>$b_{11}$</td>
<td>0.5744</td>
<td>0.0012</td>
<td>(0.5556, 0.5905)</td>
<td>55.655</td>
</tr>
<tr>
<td>$b_{12}$</td>
<td>0.5579</td>
<td>0.0019</td>
<td>(0.5354, 0.5783)</td>
<td>90.5498</td>
</tr>
<tr>
<td>$b_{13}$</td>
<td>0.5995</td>
<td>0.0017</td>
<td>(0.5835, 0.6155)</td>
<td>138.5520</td>
</tr>
<tr>
<td>$b_{14}$</td>
<td>0.4888</td>
<td>0.0005</td>
<td>(0.4628, 0.5127)</td>
<td>3.5098</td>
</tr>
<tr>
<td>$b_{15}$</td>
<td>0.5878</td>
<td>0.0010</td>
<td>(0.5668, 0.6077)</td>
<td>25.4376</td>
</tr>
<tr>
<td>$b_{21}$</td>
<td>0.6732</td>
<td>0.0010</td>
<td>(0.6518, 0.6932)</td>
<td>28.8173</td>
</tr>
<tr>
<td>$b_{22}$</td>
<td>0.6536</td>
<td>0.0023</td>
<td>(0.6314, 0.6821)</td>
<td>104.4400</td>
</tr>
<tr>
<td>$b_{23}$</td>
<td>0.6536</td>
<td>0.0013</td>
<td>(0.6381, 0.6691)</td>
<td>73.1365</td>
</tr>
<tr>
<td>$b_{24}$</td>
<td>0.6918</td>
<td>0.0005</td>
<td>(0.6649, 0.7174)</td>
<td>3.7541</td>
</tr>
<tr>
<td>$b_{25}$</td>
<td>0.5623</td>
<td>0.0017</td>
<td>(0.5290, 0.5963)</td>
<td>33.6903</td>
</tr>
<tr>
<td>$b_{31}$</td>
<td>0.4242</td>
<td>0.0010</td>
<td>(0.3992, 0.4519)</td>
<td>16.6831</td>
</tr>
<tr>
<td>$b_{32}$</td>
<td>0.4854</td>
<td>0.0024</td>
<td>(0.4544, 0.5111)</td>
<td>76.9035</td>
</tr>
<tr>
<td>$b_{33}$</td>
<td>0.4410</td>
<td>0.0019</td>
<td>(0.4187, 0.4644)</td>
<td>85.4987</td>
</tr>
<tr>
<td>$b_{34}$</td>
<td>0.4475</td>
<td>0.0010</td>
<td>(0.4066, 0.4833)</td>
<td>7.9212</td>
</tr>
<tr>
<td>$b_{35}$</td>
<td>0.5384</td>
<td>0.0013</td>
<td>(0.5064, 0.5709)</td>
<td>17.9957</td>
</tr>
<tr>
<td>$\nu$</td>
<td>14.6666</td>
<td>0.0037</td>
<td>(14.4875, 14.8439)</td>
<td>4.6488</td>
</tr>
<tr>
<td>$\ell_2$</td>
<td>8.9967</td>
<td>0.0031</td>
<td>(9.0000, 9.0000)</td>
<td>8.7925</td>
</tr>
<tr>
<td>$\ell_3$</td>
<td>63.8190</td>
<td>0.0379</td>
<td>(62.0000, 66.0000)</td>
<td>3.3739</td>
</tr>
</tbody>
</table>

This table reports the posterior mean, its numerical standard error (NSE), a 0.95 density interval (DI) and the inefficiency factor for model parameters.

Table 7: Estimation results for Wishart-RCOV-M(3)

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Mean</th>
<th>NSE</th>
<th>0.95 DI</th>
<th>Ineff</th>
</tr>
</thead>
<tbody>
<tr>
<td>$d_1$</td>
<td>0.2553</td>
<td>0.0004</td>
<td>(0.2415, 0.2671)</td>
<td>17.6101</td>
</tr>
<tr>
<td>$d_2$</td>
<td>0.4502</td>
<td>0.0006</td>
<td>(0.4303, 0.4715)</td>
<td>17.0676</td>
</tr>
<tr>
<td>$d_3$</td>
<td>0.2651</td>
<td>0.0006</td>
<td>(0.2413, 0.2858)</td>
<td>15.5695</td>
</tr>
<tr>
<td>$\nu$</td>
<td>14.6679</td>
<td>0.0032</td>
<td>(14.4736, 14.8603)</td>
<td>5.3509</td>
</tr>
<tr>
<td>$\ell_2$</td>
<td>9.0280</td>
<td>0.0219</td>
<td>(8.0000, 10.0000)</td>
<td>13.5203</td>
</tr>
<tr>
<td>$\ell_3$</td>
<td>64.1822</td>
<td>0.0294</td>
<td>(63.0000, 67.0000)</td>
<td>3.0019</td>
</tr>
</tbody>
</table>

This table reports the posterior mean, its numerical standard error (NSE), a 0.95 density interval (DI) and the inefficiency factor for model parameters.
Table 8: Estimation results for VARFIMA(1, m, 1)

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Mean</th>
<th>NSE</th>
<th>0.95 DI</th>
<th>Ineff</th>
</tr>
</thead>
<tbody>
<tr>
<td>$\delta$</td>
<td>0.3477</td>
<td>0.0012</td>
<td>(0.3157, 0.3769)</td>
<td>18.7313</td>
</tr>
<tr>
<td>$m$</td>
<td>0.4295</td>
<td>0.0011</td>
<td>(0.4058, 0.4501)</td>
<td>32.6552</td>
</tr>
<tr>
<td>$\psi$</td>
<td>0.6121</td>
<td>0.0017</td>
<td>(0.5808, 0.6430)</td>
<td>35.9129</td>
</tr>
</tbody>
</table>

This table reports the posterior mean, its numerical standard error (NSE), a 0.95 density interval (DI) and the inefficiency factor for $\delta, m, \psi$.

Table 9: Estimation results for diagonal-HAR-WAR with integer-valued $\nu$

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Mean</th>
<th>NSE</th>
<th>0.95 DI</th>
<th>Ineff</th>
</tr>
</thead>
<tbody>
<tr>
<td>$M_1(1,1)$</td>
<td>0.4425</td>
<td>0.0010</td>
<td>(0.4167, 0.4677)</td>
<td>17.8611</td>
</tr>
<tr>
<td>$M_1(2,2)$</td>
<td>0.4502</td>
<td>0.0012</td>
<td>(0.4184, 0.4818)</td>
<td>16.8463</td>
</tr>
<tr>
<td>$M_1(3,3)$</td>
<td>0.4968</td>
<td>0.0011</td>
<td>(0.4727, 0.5191)</td>
<td>28.6441</td>
</tr>
<tr>
<td>$M_1(4,4)$</td>
<td>0.2981</td>
<td>0.0022</td>
<td>(0.2472, 0.3415)</td>
<td>26.5445</td>
</tr>
<tr>
<td>$M_1(5,5)$</td>
<td>0.4770</td>
<td>0.0012</td>
<td>(0.4431, 0.5056)</td>
<td>14.6781</td>
</tr>
<tr>
<td>$M_2(1,1)$</td>
<td>0.4956</td>
<td>0.0022</td>
<td>(0.4646, 0.5228)</td>
<td>65.4310</td>
</tr>
<tr>
<td>$M_2(2,2)$</td>
<td>0.4589</td>
<td>0.0025</td>
<td>(0.4121, 0.5089)</td>
<td>29.8145</td>
</tr>
<tr>
<td>$M_2(3,3)$</td>
<td>0.4112</td>
<td>0.0018</td>
<td>(0.3649, 0.4491)</td>
<td>21.9140</td>
</tr>
<tr>
<td>$M_2(4,4)$</td>
<td>0.6201</td>
<td>0.0028</td>
<td>(0.5792, 0.6528)</td>
<td>75.6611</td>
</tr>
<tr>
<td>$M_2(5,5)$</td>
<td>0.4559</td>
<td>0.0015</td>
<td>(0.4077, 0.5013)</td>
<td>13.4569</td>
</tr>
<tr>
<td>$M_3(1,1)$</td>
<td>0.4159</td>
<td>0.0022</td>
<td>(0.3879, 0.4416)</td>
<td>73.9334</td>
</tr>
<tr>
<td>$M_3(2,2)$</td>
<td>0.4475</td>
<td>0.0017</td>
<td>(0.4075, 0.4835)</td>
<td>25.0029</td>
</tr>
<tr>
<td>$M_3(3,3)$</td>
<td>0.4488</td>
<td>0.0014</td>
<td>(0.4176, 0.4802)</td>
<td>23.4271</td>
</tr>
<tr>
<td>$M_3(4,4)$</td>
<td>0.3297</td>
<td>0.0034</td>
<td>(0.2814, 0.3780)</td>
<td>54.6142</td>
</tr>
<tr>
<td>$M_3(5,5)$</td>
<td>0.3591</td>
<td>0.0024</td>
<td>(0.3091, 0.4024)</td>
<td>33.4427</td>
</tr>
<tr>
<td>$\nu$</td>
<td>8</td>
<td>0.0000</td>
<td>(8, 8)</td>
<td>1.0000</td>
</tr>
</tbody>
</table>

This table reports the posterior mean, its numerical standard error (NSE), a 0.95 density interval (DI) and the inefficiency factor for $M_1, M_2, M_3$ and $\nu$.
Table 10: Estimation results for diagonal-HAR-NCW

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Mean</th>
<th>NSE</th>
<th>0.95 DI</th>
<th>Ineff</th>
</tr>
</thead>
<tbody>
<tr>
<td>(\tilde{M}_1(1,1))</td>
<td>0.4827</td>
<td>0.0024</td>
<td>(0.4500, 0.5145)</td>
<td>65.6861</td>
</tr>
<tr>
<td>(\tilde{M}_1(2,2))</td>
<td>0.4927</td>
<td>0.0025</td>
<td>(0.4587, 0.5228)</td>
<td>74.8778</td>
</tr>
<tr>
<td>(\tilde{M}_1(3,3))</td>
<td>0.5418</td>
<td>0.0024</td>
<td>(0.5143, 0.5753)</td>
<td>75.9262</td>
</tr>
<tr>
<td>(\tilde{M}_1(4,4))</td>
<td>0.2679</td>
<td>0.0018</td>
<td>(0.2140, 0.3205)</td>
<td>13.5440</td>
</tr>
<tr>
<td>(\tilde{M}_1(5,5))</td>
<td>0.5488</td>
<td>0.0021</td>
<td>(0.5106, 0.5835)</td>
<td>40.0412</td>
</tr>
<tr>
<td>(\tilde{M}_2(1,1))</td>
<td>0.6046</td>
<td>0.0027</td>
<td>(0.5733, 0.6355)</td>
<td>95.3429</td>
</tr>
<tr>
<td>(\tilde{M}_2(2,2))</td>
<td>0.5626</td>
<td>0.0055</td>
<td>(0.5197, 0.6038)</td>
<td>191.0160</td>
</tr>
<tr>
<td>(\tilde{M}_2(3,3))</td>
<td>0.5386</td>
<td>0.0039</td>
<td>(0.4804, 0.5870)</td>
<td>66.6818</td>
</tr>
<tr>
<td>(\tilde{M}_2(4,4))</td>
<td>0.7407</td>
<td>0.0019</td>
<td>(0.7077, 0.7695)</td>
<td>43.8908</td>
</tr>
<tr>
<td>(\tilde{M}_2(5,5))</td>
<td>0.4468</td>
<td>0.0046</td>
<td>(0.3779, 0.5039)</td>
<td>58.2833</td>
</tr>
<tr>
<td>(\tilde{M}_3(1,1))</td>
<td>0.6123</td>
<td>0.0019</td>
<td>(0.5889, 0.6405)</td>
<td>65.8317</td>
</tr>
<tr>
<td>(\tilde{M}_3(2,2))</td>
<td>0.6587</td>
<td>0.0031</td>
<td>(0.6280, 0.6859)</td>
<td>128.5340</td>
</tr>
<tr>
<td>(\tilde{M}_3(3,3))</td>
<td>0.6438</td>
<td>0.0012</td>
<td>(0.6127, 0.6761)</td>
<td>19.1210</td>
</tr>
<tr>
<td>(\tilde{M}_3(4,4))</td>
<td>0.5719</td>
<td>0.0025</td>
<td>(0.5390, 0.6072)</td>
<td>61.7975</td>
</tr>
<tr>
<td>(\tilde{M}_3(5,5))</td>
<td>0.6903</td>
<td>0.0025</td>
<td>(0.6602, 0.7208)</td>
<td>86.7010</td>
</tr>
</tbody>
</table>

This table reports the posterior mean, its numerical standard error (NSE), a 0.95 density interval (DI) and the inefficiency factor for \(\tilde{M}_1,\tilde{M}_2,\tilde{M}_3\) and \(\nu\).

Table 11: Estimation results for \(\Lambda\)

<p>| | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1.0783</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(0.0314)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>-0.0043</td>
<td>0.8923</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(0.0208)</td>
<td>(0.0264)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>-0.0188</td>
<td>0.0723</td>
<td>0.7905</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(0.0198)</td>
<td>(0.0176)</td>
<td>(0.0237)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>0.0050</td>
<td>0.0182</td>
<td>0.0057</td>
<td>0.8346</td>
<td></td>
</tr>
<tr>
<td>(0.0199)</td>
<td>(0.0178)</td>
<td>(0.0168)</td>
<td>(0.0249)</td>
<td></td>
</tr>
<tr>
<td>-0.0140</td>
<td>0.0173</td>
<td>0.0070</td>
<td>0.0171</td>
<td>0.8599</td>
</tr>
<tr>
<td>(0.0199)</td>
<td>(0.0181)</td>
<td>(0.0176)</td>
<td>(0.0180)</td>
<td>(0.0253)</td>
</tr>
</tbody>
</table>

This table reports the posterior mean, and the posterior standard deviation in parentheses for the lower triangle of \(\Lambda\).
Figure 1: Daily returns
Figure 2: RV for individual assets
Figure 3: Term structure of cumulative log-predictive likelihoods for MGARCH models
Figure 4: Term structure of cumulative log-predictive likelihoods for return-RCOV models

Figure 5: Log Predictive Bayes Factors: Wishart-RCOV vs VD-GARCH
Figure 6: Log Predictive Bayes Factors: Wishart-RCOV vs Cholesky-VARFIMA

Figure 7: Root mean squared error of forecasts of $\Sigma_t$. $RMSE_h = \frac{1}{T-T_0+1} \sum_{t=T_0-h}^{T-h} \| \Sigma_t + h - E[\Sigma_{t+h}|I_t] \|$, where $\| A \| = \sqrt{\sum_i \sum_j |a_{ij}|^2}$, and $E[\Sigma_{t+h}|I_t]$ denotes a model’s predictive mean.
Figure 8: Sample variances of global minimum variance portfolios against forecast horizon for various models.