

PREDICTING TURNING POINTS IN THE INTEREST RATE CYCLE

James W. Coons

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Volume 2

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JAMES W. COONS

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To Maggie

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Preface

Someone once said that forecasting is very difficult, especially if it is about the future. Vast amounts of resources have been devoted over the years in attempts to overcome this difficulty. The state-of-the-art today relies on a heavy dose of statistical analysis, usually involving some form of regression application. The poor track record of forecasters, particularly when it comes to interest rate forecasting, is a serious indictment of such attempts. The purpose of the study presented in this book is to evaluate an alternative approach—the sequential filter—to managing the uncertainty inherent in the future course of the interest rate cycle.

The book has a direct bearing on the work of asset-liability managers in financial institutions, and is accessible to those with an undergraduate-level background in statistics. The application of the sequential filter to the interest rate cycle has relevance to portfolio managers, securities traders, finance professionals, and individual investors. All forecasters should have an interest in the general approach.

The study presented in this book was prepared and submitted in June 1990 as a thesis in partial fulfillment of the requirements for graduation from the Stonier Graduate School of Banking conducted by The American Bankers Association at The University of Delaware. The thesis was one of eight studies selected by a committee of eight senior-level bankers and academicians in the industry to receive the prestigious Library Award, based on the significance and originality of the topic, the clarity of presentation, and the thoroughness of the research. A revised version of the thesis was presented during the Contributed Papers session at the thirty-second annual meeting of the National Association of Business Economists in Washington, D.C. Since the initial study was completed, the methods described and employed have been used to augment the interest rate forecasting process at The Huntington National Bank in Columbus, Ohio.

The material presented in this book draws on the research of many individuals, but especially that of Salih Neftci. Neftci's clever application of A.N. Shiryayev's formula to the problem of detecting turning points in the business cycle offers an entirely new approach to forecasting. I am indebted to senior management of The Huntington National Bank, especially Frank Wobst, Zuheir Sofia, Don Stuhldreher, and Judith Fisher, for their support, without which this book would not exist. Ed O'Hara provided valuable suggestions for the outline of the research project and the writing of the thesis. My friend and colleague Al Pankratz made many insightful comments that kept the project on track. I was also fortunate to receive the thoughtful and patient editorial assistance of Robert MacKenzie and Chuck Bartelt. Most of all, I am grateful to my wife, who gave me immeasurable support and encouragement.

James W. Coons
Columbus, Ohio

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