

The Role of Conditional Probabilities in Risk Assessment

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Abstract

It has become common to use historical data as a guide in analyzing future risks. However, the statistical tools used often are based on the assumption that the data (regardless of the source) may be treated as independent data for risk analysis purposes. In some cases, the data is conditional in nature, and the proper tool needs to be one that reflects this characteristic of the data. This paper highlights the impact such a change would have on a variety of risk assessment models, with specific emphasis on investment forecasting.