

# Tail Risk and Return Predictability for the Japanese Equity Market

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June 25, 2018

## Abstract

This paper studies the predictability of the Japanese equity market, focusing on the forecasting power of nonparametric volatility and tail risk measures obtained from options data on the S&P 500 and Nikkei 225 market indices. As documented in prior work, the Japanese market is notoriously difficult to forecast using standard predictive indicators. We confirm that country-specific regressions for Japan contrary to existing evidence for other national equity indices produce insignificant predictability patterns. However, we also find that the U.S. option-implied tail risk measure provides significant forecast power both for the dollar-yen exchange rate and the Japanese excess returns, especially when measured in U.S. dollars. Thus, the dollar-denominated Japanese returns are, in fact, predictable through the identical mechanism as for other equity market indices, suggesting a high degree of global integration for the Japanese financial market.

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