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Quantile Dependence between the Stock, Bond and Foreign Exchange Markets - Evidence from the UK

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Abstract

In the wake of Brexit, this paper aims to provide a measure for the quantile dependence amongst different financial assets – bond, stock, and currency – within the UK market and their cross-border linkages with the European equity market. We implement a nonparametric estimation method for both the tail and quantile dependence parameters on weekly data over the period 1989-2016 using copula. Our results suggest that the contagion effects between stock and currency markets are limited, even under extreme fluctuations. We also find a weak comovement between currency and bond markets, however, evidence of asymmetry is found in the dependence structure, possibly due to the ‘risk-reward’ scenario of international investors. Finally, our results indicate a weak dependence between stock returns and bond yields, possibly due to the low-yielding gilt and the thirst for income, pushing investors to diversify globally into other financial markets.

Keywords: Quantile Dependence, Copula, Nonparametric Estimation, Asymmetric Dependence

JEL Codes: C22, G12

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