

# Numerical Optimization in DROP

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**Convex Optimization - Introduction and Overview**

**Motivation, Background, and Setup**

1. Mathematical Formulation and Framework: Convex Optimization is an important class of constrained optimization problems that subsumes linear and quadratic programming. Such problems are specified in the form

such that

where the feasible set

is a *convex* closed subset of and is a *convex function* (Hauser (2012)).

1. Local Minima as Global Minima: Convex optimization problems are important because all local minima are also guaranteed to be globally minimal, although this value may not be reached necessarily at a unique point.

**Convex Sets and Convex Hull**

1. Definition of a Convex Set: A convex set satisfies the following property. For any two points and in the point for

lies in as well. In other words, the line segment between any two points in must also lie in .

1. Definition of a Convex Hull: The smallest convex set containing another set is called the *convex Hull* of .
2. Definition of a Convex Function: A function of a scalar field is convex if it satisfies the following property:

for all and and any

In other words, the function value between any two points and lies below the line of connecting and . An equivalent definition is that on the line segment between and the area over the graph of forms a convex set.

1. Minima of a Convex Function: Convex functions are always somewhat “bowl shaped”, have no local maxima (unless constant), and have no more than one local minimum value. If a local minimum exists, then it is also a global minimum. Hence gradient descent and Newton methods (with line search) are guaranteed to produce the global minimum when applied to such functions.

**Properties of Convex Sets/Functions**

1. Connection Property: Convex sets are connected.
2. Intersection Property: The intersection of any number of convex sets is also a convex set.
3. Axiomatic Convex Sets: The empty set, the whole space, any linear sub-spaces, and half-spaces are also convex.
4. Convex Set Dimensionality Reduction: If a convex set of is of a lower dimension than its surrounding space then lies on a linear sub-space of .
5. Typical Convex Set Closure Properties: Some common convex functions include , , where is an even number. Convex functions are closed under addition, the operator, monotonic transformations of the variable, and scaling by a non-negative constant.
6. Convex Set from Ellipsoidal Constraints: Constraints of the form

produce a closed convex set (an ellipsoid) if is positive semi-definite, and is a non-negative number.

1. Transformation onto Semi-definite Programs: The set of positive semi-definite matrices is a closed convex set. Optimization problems with these constraints are known as *semi-definite programs* (SDPs). A surprising number of problems, including LPs and QPs, can be transformed into SDPs.

**Convex Optimization Problems**

1. General Form of Convex Optimization: An optimization problem in general

such that

and

is convex as long as is convex, all of the for

are convex, and all of the for

are linear.

1. Elimination of the Equality Constraints: In convex optimization we will typically eliminate the equalities before optimizing, either by converting them into two inequalities

and

or by performing a null-space transformation. Hence the ’s can be dropped from typical treatments.

**References**

* Hauser (2012): [Convex Optimization and Interior Point Methods](http://homes.soic.indiana.edu/classes/spring2012/csci/b553-hauserk/convex_optimization.pdf)

**Newton’s Method in Optimization**

**Method**

1. Iterative Root Finding vs Optimization: In calculus Newton’s method is an iterative method for finding the roots of a differentiable function , i.e., solutions to the equation

In optimization the Newton’s method is applied to the derivative of a twice-differentiable function to find the roots of the derivative, i.e., solutions to

also known as the stationary points of .

1. The Stationary Point of : In the problem the Newton’s method attempts to construct a sequence from an initial guess that converges towards some value satisfying

This is a stationary point of (Newton’s Method in Optimization (Wiki)).

1. Taylor Expansion of around : One wishes to find such that is a maximum. Thus, one seeks to solve the equation that sets the derivative of the last expression with respect to equal to zero:
2. Conditions for approximating the Stationary Point: For the value of

which is a solution to the above equation, typically

will be closer to the stationary point . Provided that is a twice-differentiable function and other technical conditions are satisfied, the sequence will converge to the point satisfying

1. Geometric Interpretation of the Newton’s Method: The geometric interpretation of the Newton’s method is that at each iteration one approximates by a quadratic function and then takes a step towards a maximum/minimum of that quadratic function. In higher dimensions, this stationary point may also be a saddle point. Of course, if happens to *be* a quadratic function then the exact extremum is found in one step.

**Higher Dimensions**

1. Determination of the Iteration Increment: The above iteration scheme can be generalized to several dimensions by replacing the derivative with a gradient and the reciprocal of the second derivative with the inverse of the Hessian matrix . One thus obtains the iteration scheme
2. Adjustment to the Iteration Increment: Often Newton’s method is modified to include a small step size

instead of

to result in

This is often done to ensure that the Wolfe conditions are satisfied at each step

of the iteration.

1. Newton’s Method - Speed of Convergence: Where applicable Newton’s method converges much faster towards the local maximum or minimum than gradient descent. In fact, every local minimum has a neighborhood such that if one starts with

Newton’s method with step size

converges quadratically. The only requirements are that the Hessian be invertible, and it be a Lipschitz-continuous function of in that neighborhood.

1. By-passing Explicit Hessian Computation: Finding the inverse of the Hessian in high dimensions can be an expensive exercise. In such cases, instead of directly inverting the Hessian it may be better to calculate the vector

as a solution to the system of linear equations

This may be solved by various factorizations or approximately – and to great accuracy – using iterative methods.

1. Caveats of the Matrix Methods: Many of these methods are only applicable to certain types of equations – e.g., the Cholesky factorization and the conjugate gradient method will work only if is a positive definite matrix. While this may seem like a limitation, it is often a useful indicator of something gone wrong. For instance, if a maximization problem is being considered and is not positive definite, the iterations end up converging to a saddle point and not to a minimum.
2. Stable Variants of these Methods: On the other hand if constrained optimization is being considered – for example using Lagrange multipliers – the problem may become one of saddle point finding, in which case the Hessian will be symmetric indefinite and a solution for needs to be done with approaches that will work for such situations, such as the variant of the Cholesky factorization or the conjugate gradient method.
3. Techniques of Quasi-Newton Methods: There are exist various quasi-Newton methods where the approximation for the Hessian – or its direct inverse – is built up from the changes in the gradient.
4. Challenges with non-invertible Hessians: If a Hessian is close to a non-invertible matrix the inverted Hessian can be numerically unstable and the solution may diverge. In this case certain workarounds have been tried in the past, each of which have had varied success in differing setups.
5. Converting Hessian to Positive Definite: For example, one can modify the Hessian by adding a correction matrix so as to make positive definite. On approach is to diagonalize and choose so that has the same eigenvectors as but with each negative eigenvalue replaced by
6. Approach used by Levenberg-Marquardt: An approach exploited by the Levenberg-Marquardt algorithm – which uses an approximate Hessian – is to add a scaled identity matrix to the Hessian, with the scale adjusted at every iteration as needed.
7. Comparison with Gradient Descent Approach: For large and small Hessian, the iterations behave like gradient descent with a step size . This results in slower but more reliable convergence when the Hessian doesn’t provide useful information.

**Wolf Conditions**

1. Motivation, Rationale, and Primary Purpose: In the unconstrained minimization problem setting, the **Wolf Conditions** are a set of inequalities for performing *inexact* line search, especially in quasi-Newton methods (Wolf (1969, 1971)).
2. Problem Setup - Function Extremization: In these methods the idea is to find

for some smooth

Each step often involves approximately solving the sub-problem

where is the current best guess

is a search direction, and

is the step length.

1. Application of the Wolfe Conditions: The inexact line search provides an efficient way of computing an acceptable step length that reduces the objective function sufficiently rather than minimizing the objective function over

exactly. A line search algorithm can use the Wolfe conditions as a requirement for any guessed before finding a new search direction .

**Armijo Rule and Curvature Condition**

1. The Inequalities of Wolfe Condition: A step length is said to satisfy the *Wolfe conditions*, restricted to the direction , if the following inequalities hold:

with

In examining the second condition once recalls that to ensure is a descent direction one has

1. Choices for and : is usually chosen quite small while is much larger. Nocedal and Wright (2006) provide example values of

and

for Newton or quasi-Newton methods, and

for the non-linear conjugate gradient method. The first inequality is known as the **Armijo Rule** (Armijo (1966)) and ensures that the step length decreases sufficiently. The second inequality is called the **Curvature Condition**; it ensures that the slope has reduced sufficiently.

1. Strong Wolfe Conditions on Curvature: Denoting by a univariate function restricted to the direction as

there are situations where the Wolfe conditions can result in a value for the step length that is not close to a minimizer of . If one modifies the curvature condition to

then the curvature condition along with the Armijo rule form the so-called **strong Wolfe conditions**, and force to lie close to a critical point of .

**Rationale for the Wolfe Conditions**

1. Convergence of the Gradient to Zero: The principal reason for imposing the Wolfe conditions in an optimization algorithm where

is to ensure the convergence of the gradient to zero. In particular if the cosine of the angle between and the gradient

is bounded away from zero, and Armijo rule and curvature conditions (modified) hold,

1. Positive Definiteness of Update Matrix: An additional motivation, in the case of a quasi-Newton method, is that if

where the matrix  is updated by the BFGS or the DFP formula, then if is positive, the (modified) curvature condition implies that is also positive definite.

**References**

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**Constrained Optimization**

**Constrained Optimization – Definition and Description**

1. Constrained Optimization Definition – Variable Constraints: In mathematical optimization **constrained optimization** is the process of optimizing an objective function with respect to some variables in the presence of constraints on those variables.
2. Constrained Optimization Definition - Objective Function: The objective function is either a cost function or an energy function that is to be minimized, or a reward function or a utility function that has to be maximized.
3. Hard vs Soft Variable Constraints: Constraints can either be *hard constraints* that set conditions on variables required to be satisfied, or *soft constraints* that have some variable values that are penalized in the objective function if – and based on the extent that – the conditions on the variables are not satisfied (Constrained Optimization (Wiki)).

**General Form**

1. Constrained Optimization Problem – Mathematical Specification: A general constrained minimization problem may be written as follows:

subject to

for

equality constraints and

for

inequality constraints where

for

and

for

are the constraints to be satisfied; these are called the hard constraints.

1. Constrained Optimizers - Soft Objective Function: In some problems, often called *constraint optimization problems*, the objective function is a sum of the cost functions, each of which penalized the extent if any to which a soft constraint – a constraint that is preferred but not required to be satisfied - is violated.

**Solution Methods**

1. Adaptation from Unconstrained Algorithms: Many unconstrained optimization algorithms can be adapted to the constrained case, often via the use of a penalty method. However, the search steps taken by the unconstrained method may be unacceptable for the constrained problem, leading to a lack of convergence. This is referred to as the Maratos effect (Sun and Yua (2010)).
2. Equality Constraints Lagrange Multiplier Technique: If the constrained problem has only equality constraints the method of Lagrange multipliers can be used to convert it to an unconstrained problem whose number of variables is the original number of variables plus the number of constraints.
3. Equality Constraints - Cross Variable Substitution: Alternatively, if the constraints are all equality constraints and linear, they can be solved for some of the variables in terms of the others, and the former can be substituted out of the objective function, leaving an unconstrained problem in a smaller number of variables.
4. Inequality Constraints - Conditions on Variables: With inequality constraints the problem can be characterized in terms of Geometric Optimality Conditions, Fritz-John Conditions, and Karush-Kuhn-Tucker Conditions in which simple problems may be directly solvable.
5. Linear Programming – Simplex/Interior Point: If the objective function and all of the hard constraints are linear, then the problem is a linear programming one. This can be solved by the Simplex method, which usually works in polynomial time in the problem size but is not guaranteed to, or by interior point methods, which are guaranteed to work in polynomial time.
6. Quadratic Programming - Objective Function Constraints: If all the hard constraints are linear but the objective function is quadratic the problem is a quadratic programming problem.
7. Quadratic Programming Convex Objective Function: Quadratic Programming problems can be solved by the ellipsoid method in polynomial time if the objective function is convex; otherwise the problem is NP hard.

**Constraint Optimization: Branch and Bound**

1. Idea behind Branch and Bound: Constraint optimization can be solved by branch-and-bound algorithms. These are back-tracking algorithms that store the cost of the best solution found during execution and use it eventually to avoid part of the search.
2. Back Tracking vs. Solution Extension: More precisely whenever the algorithm encounters a partial solution that cannot be extended to form a solution with better cost than the best stored cost, the algorithm back tracks instead of trying to extend this solution.
3. Efficient of Back Tracking Algorithms: Assuming that the cost is to be minimized the efficiency of these algorithms depends on how the cost can be obtained from extending a partial solution is evaluated. Indeed, if the algorithms can back track from a partial solution, part of the search can be skipped. The lower the estimated cost the better the algorithm, as a lower estimated cost is more likely to be lower than the best cost of the solution found so far.
4. Algorithm Lower and Upper Bounds: On the other hand, this estimated cost cannot be lower than the effective cost obtained by extending the solution, as otherwise the algorithm could backtrack while a solution better than the best found so far exists. As a result, the algorithm requires an upper bound on the cost that can be obtained by extending a partial solution and this upper bound should be as small as possible.
5. Hansen’s Branch-and-Bound Variation: A variation of the above method called Hansen’s method uses interval methods (Leader (2004)). It inherently implements rectangular constraints.

**Branch-and-Bound: First-Choice Bounding Conditions**

1. Separately treating each Soft Constraint: One way of evaluating this upper bound for a partial solution is to consider each soft constraint separately. For each soft constraint the maximal possible value for any assignment to the unassigned variables is assumed. The sum of these variables is an upper bound because the soft constraints cannot assume a higher value.
2. Exact Nature of Upper Bound: It is exact because the maximal nature of soft constraints may derive from different evaluations: a soft constraint may be maximal for

while another soft constraint is maximal for

**Branch-and-Bound Russian Doll Search**

1. Branch-and-Bound Sub-problems: This method runs a branch-and-bound algorithm on problems where is the number of variables (Verfaillie, Lemaitre, and Schiex (1996)). Each such sub-problem is the sub-problem obtained by dropping the sequence from the original problem along with the constraints containing them.
2. Sub-problem Cost Upper Bound: After the problem on variables is solved its optimal cost can be used as an upper bound while solving the other problems.
3. Assigned/Unassigned Variables Sub-problem: In particular the cost of estimating a solution having is added to the cost that derives from the evaluated variables. Virtually this corresponds to ignoring the evaluate variables and solving the problem on the unassigned ones, except that the latter problem has been already solved.
4. Sub-problem Total Cost Update: More precisely the cost of the constraints containing both the assigned and the unassigned variables is estimated as above, or using another arbitrary method; the cost of soft constraints using unassigned variables is instead estimated using the optimal solution of the corresponding problem, which is already known at this point.
5. Similarities with Dynamic Programming Approach: Like Dynamic Programming Russian Doll Search solves the sub-problems in order to solve the whole problem.
6. Differences with Dynamic Programming Approach: However, whereas Dynamic Programming directly combines the results obtained on the sub-problems to get the result of the whole program, the Russian Doll Search only uses them as bounds during the search.

**Branch-and-Bound – Bucket Elimination**

1. Elimination of a Specified Variable: The bucket elimination algorithm can be used for constraint optimization. A given variable can be removed from the problem by replacing all the soft constraints containing it with a new soft constraint.
2. Removed Variable Constraint-Cost Expression: The cost of the constraint expression is estimated assuming the maximal objective function value for each of the removed variable. Formally if is the variable to be removed, are the constraints containing it, and are the variables containing , the new soft constraint is defined by
3. Bucket of all Variable Constraints: Bucket elimination works with an arbitrary ordering of the variables. Every variable is associated with a bucket of constraints; the bucket of a variable contains all the constraints having the variable has the highest in the order.
4. Order of the Bucket Elimination: Bucket elimination proceeds from the last variable to the first. For each variable, all constraints of the bucket are replaced as above to remove the variable. The resulting constraint is then placed in the appropriate bucket.

**References**

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**Lagrange Multipliers**

**Motivation, Definition, and Problem Formulation**

1. Purpose behind the Lagrange Methodology: In mathematical optimization the **method of Lagrange multipliers** (Lagrange (1811)) is a strategy for finding the local maxima and minima subject to equality constraints (Lagrange Multiplier (Wiki)).
2. Optimization Problem Mathematical Setup: Consider the optimization problem of maximizing subject to

A new variable is introduced (this is called the Lagrange multiplier) and the Lagrange function (or Lagrangian) defined by

is studied. Here the term may be either added or subtracted.

1. Lagrange Multipliers as Stationary Points: If is the maximum of for the original constrained problem, then there exists a such that is a stationary point for the Lagrangian function (stationary points are those where the partial derivatives of are zero).
2. Necessary Conditions for Constrained Optimality: However not all stationary points yield a solution to the original problem. Thus, the method of Lagrange multipliers yields necessary conditions for optimality in constrained problems (Hiriart-Urruty and Lemarechal (1993), Bertsekas (1999), Vapnyarskii (2001), Lemarechal (2001), Lasdon (2002)).
3. Sufficient Conditions for Constrained Optimality: Sufficient conditions for a maximum or a minimum also exist. Sufficient conditions for a constrained local maximum or a minimum can be stated in terms of a sequence of principal minors, i.e., determinants of the upper-left-justified sub-matrices, of the bordered Hessian matrix of the second derivatives of the Lagrangian expression (Chiang (1984)).

**Introduction, Background, and Overview**

1. Advantage of the Lagrange Multiplier Formulation: One of the most common problems in calculus is that of finding the extrema of a function, but it is often difficult to find a closed form for the function being extremized. Such difficulties often arise when one wishes to extremize the function subject to fixed outside constraints or conditions. The method of Lagrange multipliers is a powerful tool for solving this class of problems without the need to explicitly solve for the conditions and use them to eliminate the extra variables.
2. Intuition behind the Lagrange Multiplier Methodology: Consider the 2D problem introduced above: maximize subject to

The method of Lagrange multipliers relies on the intuition that at the maximum cannot be increasing in the direction of any neighboring point where

If it did, one could walk along

to get higher, meaning that the starting point wasn’t actually the maximum.

1. Function Realization/Constraint Value Contours: The contours of given by

for various values of as well as the contours of given by

may be visualized as being parallel/tangential to each other.

1. Invariance of along the Constraint: Suppose one walks along the contour with

One is interested in funding points along that do not change along the walk since these points may be maxima. There are two ways this can happen. First one could be walking along the contour line of since by definition does not change along the contour line. This would mean that the contour lines of and are parallel here. The second possibility is that one has reached a “level” part of meaning that cannot change in any direction.

1. Constraint/Objective Function Gradient Scaling: To check for the first possibility, one notices that the gradient of a function is perpendicular to its contour lines, and the contour lines of and are parallel if and only if the gradients of and are parallel. Thus, one wants points where

and

for some where

are the respective gradients. The constant is required because although the two gradient vectors are parallel, the magnitudes of the gradient vectors are generally not equal. This constant is called the Lagrange multiplier (the negative sign is a convention).

1. The “Level” Plateau of : This method also addresses the second possibility; if is level then its gradient is zero, and setting

is a solution regardless of .

1. Formulation of the Lagrangian Function: To incorporate these conditions into one equation one introduces an auxiliary function

and solves for

This is the method of Lagrange multipliers. Note that

implies

To summarize

results in

and

The constrained extrema of are the *critical points* but they are not necessarily the *local extrema* of .

1. Alternate Formulations for the Lagrangian: One may re-formulate the Lagrangian as a Hamiltonian, in which case the solutions are the local minima for the Hamiltonian. This is done in optimal control theory in the form of Pontryagin’s minimum principle.
2. Non-Extremum Solutions to Lagrangian: The fact that the solutions to the Lagrangian are not necessarily the extrema also poses difficulties for numerical optimization. This can be addressed by computing the *magnitude* of the gradient, as the zeroes of the magnitude are necessarily the local minima, as illustrated later in the part on numerical optimization.

**Handling Multiple Constraints**

1. Notation Used for Multiple Constraints: Throughout this section the independent variables are denoted and, as a group denoted as

Also, the function being analyzed will be denoted and the constraints will be represented by the equations

1. Basic Idea behind the Constraints: The basic idea remains essentially the same: if we consider only satisfy the constraints (i.e., are *in* the constraints) then a point is a stationary point (i.e., a point in a *flat* region) of if and only if the constraints at that point do not allow movement in a direction where changes value. Once the stationary points are located further tests are needed to see if it is a minimum, a maximum, or just a stationary point that is neither.
2. Multi-dimensional Invariance of : Consider the level set of at . Let the set of vectors contain the directions in which one can move and still remain in the same level set, the directions where the value of does not change (i.e., the change equals zero). For every vector in the following relation must hold:

where the notation above refers to the component of the vector .

1. Invocation of the Gradient of : The equation above can be re-written in a more compact geometric form that helps the intuition:

i.e.

This makes it clear that if one is at then *all* directions from this point that do *not* change the value of *must be perpendicular to* (the gradient of at ).

1. Usage of the Constraint Gradient: Each constraint limits the directions that one can move from a particular point and still satisfy the constraint. One uses the same set of procedures above to look for a set of vectors that contain the directions in which can move and still satisfy the constraint. As above, for every vector in the following relation must hold:

i.e.

From this it can be seen that at point all directions from this point that will satisfy the constraint must be proportional to .

1. Lagrange Multiplier Method Formal Definition: A point on is a constrained stationary point if and only if the direction that changes violates at least one of the constraints, i.e., it has no “component” in the legal space perpendicular to . Mathematically this means that the gradient of at this constrained stationary point is perpendicular to the space spanned by the set of vectors which in turn is perpendicular to the gradients of the constraints
2. Single Constraint Gradients: For a single constraint the above statement says that at stationary points the direction that changes is the same as that violates the constraint. To determine if two vectors are in the same direction, note that if two vectors start from the same point then open vector can always reach the other by changing its length and/or flipping or the opposite way along the same direction line. This requires that

implying that

1. Single Constraint Case - Compact Formulation: On adding another simultaneous equation to guarantee that this test is performed only at the point that satisfies the constraint two simultaneous equations result, which when solved identify all the constrained stationary points.

implies that satisfies the constraint, thus

is a stationary point.

1. Single Constraint Case Expanded Formulation: Fully expanded, there are simultaneous equations that need to be solved for variables, which are and :
2. Multiple Constraints and their Gradients: For more than one constraint a similar reasoning applies. Each gradient function has a space of allowable directions at – the space of vectors perpendicular to . The set of directions allowed by all constraints is thus the space of directions perpendicular to all of the constraint gradients. Denoting the space of allowable moves by and the span of gradients by , using the discussion above

the space of vectors perpendicular to every element in .

1. Multiple Constraints Case Gradient Formulation: If is an optimum any element not perpendicular to is not an allowable direction. One can show that this implies

Thus, there are scalars such that

implies

As before the simultaneous equations are added to guarantee that this test is performed only at a point that satisfies every constraint, and the resulting equations, when satisfied, identify all the constrained stationary points.

implies that satisfies all constraints; further

indicates that is a stationary point.

1. Multiple Gradient Case Lagrangian Formulation: The method is complete now from the standpoint of finding the stationary points, but these equations can be condensed into a more succinct and elegant form. The equations above look like partial derivatives of a larger scalar function that takes all the and all the as inputs. Setting every equation to zero is exactly what one would have to do to solve for the *unconstrained* stationary points of the larger function. Finally, the larger function with partial derivatives that are exactly the ones that we require can be constructed very simply as

Solving the above equation for its *unconstrained* stationary points generates exactly the same stationary points as solving for the *constrained* stationary points of under the constraints

1. The Method of Lagrange Multipliers: In Lagrange’s honor the above function is called a *Lagrangian*, the scalar multipliers are called *Lagrange Multipliers*, and the method itself is called *The Method of Lagrange Multipliers*.
2. The Karush-Kuhn-Tucker Generalization: The method of Lagrange multipliers is generalized by the Karush-Kuhn-Tucker conditions, which also takes into account inequality constraints of the form

**Modern Formulation via Differentiable Manifolds**

1. Local Extrema of : Funding the local maxima of a function

where is an open subset of is done by finding all points such that

and then checking whether all of the eigenvalues of the Hessian are negative. Setting

is a non-linear problem and, in general, arbitrarily difficult. After funding the critical points checking for the eigenvalues is a linear problem and thus easy.

1. Extrema under the Level-Set Constraint: When

is a smooth function such that

for all in the level set

then becomes an dimensional smooth manifold by the level set theorem. Funding local maxima is by definition a local problem, so it can be done on the local charts of after funding a diffeomorphism

from an open subset of

onto an open subset

and thus, one can apply the algorithm in the previous part to the function

1. Approach of Lagrange Multiplier Method: While the above idea sounds good it is difficult to compute in practice. *The entire method of Lagrange multipliers reduces to skipping that step and finding the zeroes of directly.* It follows from the construction in the level set theorem that is the inclusion map

Therefore

if and only if

from writing for

1. Existence of the Linear Map: By the first isomorphism theorem this is true if and only if there exists a linear map

such that

As a linear map one must have that

for a fixed

Therefore, funding the critical point of is equivalent to solving the system of equations

in the variables

and

This is in general a non-linear system of equations and unknowns.

1. Multiple Constraints Surjective Linear Map: In the case of general constraints one works with

and replaces the condition

for all

with the requirement that be surjective at all such points. In this case will be a linear map i.e., a row vector with entries.

**Interpretation of the Lagrange Multipliers**

1. As a Rate of Change Quantity: Often the Lagrange multipliers have an interpretation as some quantity of interest. For example, if the Lagrangian expression is

then

So is the rate of change of the quantity being optimized as a function of the constraint variable.

1. Examples of Lagrange Multiplier Roles: As examples, in Lagrangian mechanics the equations of motion are derived by finding stationary points of action, i.e., the time integral of the difference between the potential and the kinetic energies. Thus, the force on a particle due to a scalar potential

can be interpreted as a Lagrange multiplier determining the change in action – transfer of potential to kinetic energy – following a variation in the particle’s constrained trajectory. In control theory this formulated instead as co-state equations.

1. Marginal Effect of the Constraint: Moreover, by the control theorem the optimal value of a Lagrange multiplier has an interpretation as the marginal effect of the corresponding constraint constant upon on the optimal attainable value of the original objective function. Denoting the optimum with an asterisk it can be shown that
2. Lagrange Multiplier Usage in Economics: For example, in economics the optimal profit to a player is calculated subject to a constrained space of actions, where the Lagrange multiplier is the change in the optimal value of the objective function (profit) due to the relaxation of a given constraint – e.g., through a change in the income. In such a context is the marginal cost of the constraint, and is referred to as the shadow price.

**Lagrange Application: Maximal Information Entropy**

1. Information Entropy Maximization – Problem Setup: Suppose on wishes to find the discrete probability distribution on the points with maximal information entropy. This is the same as saying that one wishes to find the least biased probability on the points . In other words, one wishes to maximize the Shannon entropy equation
2. Cumulative Discrete Probability Normalization Constraint: For this to be a probability distribution the sum of the probabilities at each point must equal , so the constraint becomes
3. Application of the Lagrange Multipliers: Using Lagrange multipliers to find the point of maximum entropy across all discrete probability distributions on requires that

which gives a system of equations with indices

such that

1. Solution to the Discrete Probability: Carrying out the differentiation on these equations one gets

This shows that all are the same because they depend only on . By using the constraint

one finds that

Hence the uniform distribution is the distribution with the greatest entropy, using distributions on points.

**Lagrange Application: Numerical Optimization Techniques**

1. Local Minima vs. Saddle Points: The critical points of the Lagrangian occur at saddle points rather than the local minima or maxima (Heath (2005)). Unfortunately, many numerical optimization techniques such as hill climbing, gradient descent, some of the quasi-Newton methods, among others, are designed to find local minima (or maxima) and not the saddle points.
2. Conversion to an Extremization Problem: For this reason one must modify the formulation to ensure that this is a minimization problem – for example by extremizing the square of the gradient of the Lagrangian – or use an optimization technique that finds stationary points and not necessarily extrema, e.g., such as Newton’s method without an extremum seeking line search.
3. “Saddle” Critical Points - An Example: As a simple example consider the problem of finding the value of that minimizes the function

constrained such that

Clearly this problem is pathological because there are only two values that satisfy the constraint, but it is useful for illustration purposes because the corresponding unconstrained function can be visualized in three dimensions.

1. Application of the Lagrange Multipliers: Using Lagrange multipliers this problem can be converted into an unconstrained optimization problem

The two critical points occur at the saddle points where

and

1. Transformation to Local Extremum Problem: In order to solve this problem with a numerical optimization technique one must first transform this problem such that the critical points occur at the local minima. This is done by computing the magnitude of the gradient of the unconstrained optimization problem.
2. Objective Variate/Constraint Multiplier Jacobian: First one computes the partial derivative of the unconstrained problem with respect to each variable;

If the target function is not easily differentiable the differential with respect to each variable can be approximated using the divided differences technique, i.e.

where is a small value.

1. Computing the Magnitude of the Gradient: Next one computes the magnitude of the gradient, which is the square root of the sum of squares of the partial derivatives:

Since the magnitude is always non-negative optimizing over the squared magnitude is equivalent to optimizing over the magnitude. Thus, the square root may be omitted from these equations with no expected differences in the results of the optimization.

1. Critical Points as Local Extrema: The critical points of occur at

and

just as in . However, the critical points in occur at local minima, so the numerical optimization techniques can be used to find them.

**Lagrange Multipliers – Common Practice Applications**

1. Lagrange Multipliers Applied in Economics: Constrained optimization plays a central role in economics. For example, the choice problem for a customer is represented as one of maximizing a utility function subject to a budget constraint. The Lagrange multiplier has an interpretation as the shadow price associated with that constraint – in this instance the marginal utility of the income. Other examples include profit maximization for a firm, along with various macro-economic applications.
2. Lagrange Multipliers in Control Theory: In optimal control theory the Lagrange multipliers are represented as co-state variables and are re-formulated as the minimization of the Hamiltonian, e.g., they are the basis behind the Pontryagin’s minimum principle.
3. Lagrange Multipliers in Non-linear Programming: The Lagrange multiplier method has several generalizations. In non-linear programming there are several multiplier rules, e.g., the Caratheodery-John Multiplier Rule and the Convex Multiplier Rule for inequality constraints (Pourciau (1980)).

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# Spline Optimizer

**Constrained Optimization using Lagrangian**

1. Base Set up: Use the Lagrangian objective function to optimize a multi-variate function to incorporate the constraint

as

Here is called the Lagrange multiplier, and use one Lagrange multiplier per constraint.

1. Optimize (Maximize/Minimize) the Lagrangian: Optimize (i.e., maximize/minimize) the Lagrangian with respect to , , and – thus

and

Notice that

automatically implies the validity of the constraint

thereby accommodating it in a natural way.

* Further

always, since is linear in . Further, since the constraint is true by the optimizer construction, there should be no explicit dependence on .

1. Comparison with unconstrained optimization:

* Unconstrained Optimization results in

and

Constrained Optimization results in

and

automatically reduces the constrained case to the unconstrained.

* Advantage of the Lagrange Multiplier Incorporation into Optimization => This ends up converting the constrained formulation space over on to the unconstrained, thereby providing with as many equations as the number of optimization unknowns, and one equation each per every constraint.
* Drawback of the Lagrange Multiplier Optimization Incorporation => While it lets you passively move to the unknowns’ space from the constrained formulation space, this may end up impacting the application of certain boundary conditions, such as financial boundary, natural boundary conditions, Not-A-Knot boundary condition, etc.

1. Constraints of inequality or : Solutions to these constraints exist either inside the unconstrained set, in which case the unconstrained equations can be solved, or they don’t, in which case convert the inequality to an equality and give it the Lagrange multiplier treatment.
2. Comparison with Convex Optimization: Convex optimization is predicated on the presence of at least one minimum/maximum in the zone of interest. One example is variance/covariance constrained optimization, where both the variance/covariance and the constraints are both quadratic. Eigenization (just another type of constrained variance/covariance optimization) is another.
3. Penalizing Optimizer as a Constrained Optimization Setup: Naively put

where, from a calibration point of view, “Good” refers to closeness of fit, and “Bad” to the curvature/smoothness penalty. Thus, constrained optimization here corresponds to “maximize the Good, and minimize the Bad”.

* De-coupling “Good/Bad” from closeness of fit and curvature/smoothness penalty, respectively, can lead to alternate optimization framework formulations in finance, along with its insights.

**Least Squares Optimizer**

1. Least Squares Optimization Formulation:
2. Least Squares Matrix Formulation:

Then

As expected,

is the optimized least squares tight fit.

**Karush-Kuhn-Tucker Conditions**

**Introduction, Overview, Purpose, and Motivation**

1. KKT Conditions - Necessity and Scope: In mathematical optimization the Karush-Kuhn-Tucker (KKT) Conditions – also known as Kuhn-Tucker Conditions – are the first order necessary conditions for a solution in non-linear programming to be optimal provided some regularity conditions are satisfied (Karush-Kuhn-Tucker Conditions (Wiki)).
2. KKT Conditions vs. Lagrange Multipliers: Allowing for inequality constraints the KKT approach to non-linear programming generalizes the method of Lagrange multipliers, which only allows for equality constraints.
3. Mathematical Foundation behind Optimization Algorithms: The system of equations corresponding to the KKT conditions is usually not solved directly except in a few special cases where a closed-form solution may be derived analytically. In general, many optimization algorithms can be interpreted as methods for numerically solving the KKT systems of equations (Boyd and van den Berghe (2009)).
4. KKT Conditions - Historical Attribution Revision: The KKT conditions were originally named after Harold W. Kuhn and Albert W. Tucker who first published the conditions in 1951 (Kuhn and Tucker (1951)). Later scholars discovered that then necessary conditions for this problem had been stated by William Karush in his master’s thesis (Karush (1939), Kjeldsen (2000)).

**Necessary Conditions for Optimization Problems**

1. KKT Statement - Non-linear Optimization Problem: Consider the following non-linear optimization problem: Maximize subject to

and

where is the optimization variable, is the *objective* or the *utility* function, are the inequality constraint functions, and are the equality constraint functions. The numbers of the inequality and the equality constraints are denoted and respectively.

1. KKT Statement - The Necessary Condition: Suppose that the objective function

and the constraint functions

and

are continuously differentiable at the point . If is a local optimum that satisfies some regularity conditions below, there exist constants and called KKT multipliers that have the following properties.

1. KKT Statement - Optimal Stationary Conditions: For maximizing

For minimizing

1. KKT Statement - Primal Feasibility Conditions:

for all

and

for all

1. KKT Statement - Dual Feasibility Conditions:

for all

1. KKT Statement – Complementary Slackness Conditions:

for all

1. Reduction to the Lagrange Criterion: In the particular case

where there are no inequality constraints the KKT conditions turn into the Lagrange conditions and the KKT multipliers become the Lagrange multipliers.

1. Non-differentiable Version of KKT: If some of the functions are non-differentiable sub-differentiable versions of the KKT conditions are available (Eustaquio, Karas, and Ribeiro (2008)).

**Regularity Conditions or Constraint Qualifications**

1. The KKT Necessary Regularity Conditions: In order for a minimum point to satisfy the above KKT conditions the problem should satisfy some regularity conditions. The most common ones are listed below.
2. Linear Constraint Qualification: If and are affine functions the no other condition is needed to be satisfied.
3. Linear Independence Constraint Qualification (LICQ): The gradients of the active inequality constraints and the gradients of the equality constraints are linearly independent at .
4. Mangasarian-Fromovitz Constraint Qualification (MFCQ): The gradients of the active inequality constraints and the gradients of the equality constraints are positive-linearly independent at .
5. Constant Rank Constraint Qualification (CRCQ): For each subset of the gradients of the active inequality constraints and the gradients of the active equality constraints the rank at the vicinity of is constant.
6. Constant Positive Linear Dependence Constraint Qualification (CPLD): For each subset of the gradients of the active inequality constraints and the gradients of the equality constraints, if it is positive-linearly dependent at , then it is positive-linearly dependent at the vicinity of .
7. Quasi-Normality Constraint Qualification (QNCQ): If the gradients of the active inequality constraints and the gradients of the active equality constraints are positive-linearly dependent at with the associated multipliers for equalities and for inequalities then there is no sequence

such that

implies

AND

implies

1. Slater Condition: For a convex problem there exists a point such that

and

1. Positive Linear Dependency Condition Definition: The set of vectors is positive linearly dependent if there exists

not all zero such that

1. Strength Order of Constraint Qualifications: It can be shown that

and

– the converses are not true – although MFCQ is not equivalent to CRCQ (Ruszczynski (2006)). In practice weaker constraint qualifications are preferred since they provide stronger optimality conditions.

**Sufficient Conditions**

1. The Second Order Sufficiency Conditions: In some cases, the necessary conditions are also sufficient for optimality. In general, the necessary conditions are not sufficient for optimality and more information is needed, such as the Second Order Sufficiency Conditions (SOSC). For smooth functions SOSC involve the second derivatives, which explains its name.
2. When Necessary Conditions are Sufficient: The necessary conditions are sufficient for optimality of the objective function of a maximization problem is a concave function, the inequality constraints are continuously differentiable convex functions, and the equality constraints are affine functions.
3. The Type 1 Invex Functions: The broader class of functions in which the KKT conditions guarantee global optimality are the so-called Type 1 **invex** **functions** (Martin (1985), Hanson (1999)).
4. Second Order Sufficiency Conditions Formulation: For smooth non-linear optimization problems the second order sufficiency conditions are given as follows. Consider , , and that find a local minimum using the Karush-Kuhn-Tucker conditions above. With such that the strict complementary condition is held at , i.e.

for all

such that

the following equation must hold:

If the above condition is strictly met, the function is a strict constrained local minimum.

**KKT Conditions Application - Economics**

1. KKT Models as Theoretical Tools: Often in mathematical economics the KKT approach is used in theoretical models in order to obtain qualitative results.
2. Minimum Profit Constraint Revenue Maximization: Consider a firm that maximizes its sales revenue subject to a minimum profit constraint. Letting be the quantity of output produced – this is to be chosen - be the sales revenue with a positive first derivative and with a zero value at zero output, be the production cost with a positive first derivative and with a non-negative value at zero output, and be the positive minimal acceptable level of profit, then the problem is a meaningful one if the revenue function levels off so it is eventually less steep than the cost function.
3. Application of the KKT Condition: The problem can be expressed in the following minimization form: Minimize subject to

and the KKT conditions are

1. Revenue Growth vs. Cost Growth: Since

would violate the minimum profit constraint

must hold, and hence the third condition implies that the first condition holds with equality. Solving that equality gives

1. Impact of the Minimum Profit Constraint: Because it was given that and are strictly positive, the inequality along with the non-negativity condition on is positive and so the revenue-maximizing firm operates at a level of output at which the marginal revenue is less than the marginal cost - a result that is of interest because it contrasts the behavior of a profit maximizing firm which operates at a level at which they are equal.

**KKT Conditions Application – Value Function**

1. Equality/Inequality Function Space Constraints: Reconsidering the optimization problem as a maximization problem with constant inequality constraints Maximize subject to
2. Definition of the Value Function: The value function is defined as

subject to

So, the domain of is

for some

1. Interpretation of and : Give this definition each coefficient is the rate at which the value of the function increases as increases. Thus, if each is interpreteed as a resource constraint the coefficients indicate how much increasing the resource increases the optimum value of . This interpretation is especially important in economics and is used, for example, in utility maximization problems.

**Generalizations**

1. KKT Extensions – Fritz John Conditions: With an extra constant multiplier which may be zero, in front of the KKT stationary conditions turn into

which are called the Fritz John conditions.

1. KKT Class as FONC Support: The KKT conditions belong to the wider class of the First Order Necessary Conditions (FONC) which allow for non-smooth functions using sub-derivatives.

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**Interior Point Method**

**Motivation, Background, and Literature Survey**

1. Definition of Interior Point Methods: Interior Point Methods (also known as *barrier methods*) are a class of algorithms that solves linear and non-linear convex optimization problem (Interior Point Method (Wiki)).
2. John von Neumann’s Early Approach: John von Neumann suggested an interior point method of linear programming that was neither a polynomial time method not an efficient method in practice (Dantzig and Thapa (2003)). In fact, it turned out to be slower in practice than the simplex method which is not a polynomial time method.
3. Karmarkar’s Extension to the Simplex Method: Karmarkar (1984) developed a method for linear programming called the Karmarkar’s algorithm which runs in provably polynomial time, and is also very efficient in practice. It enabled solutions to linear programming problems that were beyond the capabilities of the simplex method.
4. Traversal across the Feasible Region: Contrary to the Simplex method Karmarkar’s algorithm reaches the best solution by traversing the interior of the feasible region. The method can be generalized to convex programming based on a self-concordant barrier function used to encode the convex set.
5. Transformation of the Convex Function: Any convex optimization problem can be transformed into minimizing (or maximizing) a linear function over a convex set by converting to an epigraph form (Boyd and van den Berghe (2004)). The idea of encoding the feasible set using a barrier and designing barrier methods was studied by Anthony V. Fiacco, Garth P. McCormick, and others in the early ‘60s. These ideas were mainly developed for general non-linear programming, but they were later abandoned due to the presence of more competitive methods for this class of problems (e.g., sequential quadratic programming).
6. Barriers to Encode Convex Set: Yuri Nesterov and Arkadi Nemirovskii came up with a special class of such barriers that can be used to encode any convex set. They provide guarantees that the number of iterations of the algorithm is bounded by a polynomial in the dimension and as well for the accuracy of the solution (Wright (2004)).
7. Interior Point Methods with Barriers: Karmarkar’s breakthrough re-vitalized the study of interior point methods and barrier problems showing that it was possible to create an algorithm for linear programming characterized by polynomial time complexity, and, moreover, that was competitive with the simplex method. Already Khachiyan’s ellipsoid method was a polynomial time algorithm; however, it was too slow to be of practical interest.
8. Interior Point Method Sub-classes: The class of primal dual path-following interior point methods is considered the most successful. Mehrotra’s predictor-corrector algorithm provides the basis for most implementations of this class of methods (Mehrotra (1992), Potra and Wright (2000)).

**Interior Point Methodology and Algorithm**

1. Principle, Concept, and Approach Methodology: The main idea behind interior point methods is to iterate inside of the feasible set and progressively approach the boundary – if the minimum does lie on the boundary. This is done by transforming the original problem into a sequence of unconstrained optimization problems in which the objective function uses a *barrier function* that goes to at the boundaries of the feasible region. By reducing the strength of the barrier at each subsequent optimization the sequence of minima approach arbitrarily closely toward the minimum of the original problem.
2. Objective Function with Logarithmic Barriers: For the inequality constrained problem

such that

is modified to obtain a *barrier function*

1. Impact of the Barrier Strength Parameter: Since the logarithm goes to as its argument approaches the modified barrier function becomes arbitrarily large as approaches the boundaries of the feasible region. The parameter gives the barrier “strength”. Its significance is that as approaches the optimum of approaches the optimum of . More precisely if optimizes and

then

1. Gradient of the Barrier Function: Newton’s method is employed to find the minimum of The gradient is
2. Numerical Stability Close to the Boundary: One concern is that as proceeds closer and closer to the boundary the numerical stability of the unconstrained optimization problem becomes worse and worse because the denominator approaches zero. Thus, it would be very challenging to apply the gradient descent to a small tolerance.
3. Use of KKT Type Multipliers: Therefore, another set of KKT multiplier like variables

with

is introduced. So, in the space, one seeks the root of the equation

subject to the equality

for

1. Stability of the Modified Solution: This set of equations is far more numerically stable than

near the boundary. Note the similarity between these equations and the KKT equations. In fact, if were one gets the KKT equations except with the equalities stripped away.

1. Objective/Constraint Function - Partial Derivatives: To find a root where both of the functions are satisfied the Newton’s method is applied. To do so one needs the partial derivatives of the above functions.

for

1. Variate/Constraint Multipliers newton Increment: At the current iterate the Newton step is derived from the following system of equations.

where denotes the Hessian

evaluated at , denotes the vector of ’s, denotes the matrix whose column is , produces a square matrix whose diagonal is the vector , and denotes the vector of all 1’s.

1. Variate Retention inside Feasible Region: Solving this system of equations provides a search direction that is then update via line search to avoid divergence. Note that to keep drifting out of the feasible set one must enforce for all the condition

or equivalently

during the line search.

1. Progressive Reduction of the Barrier Strength: Once the unconstrained search has converged may be reduced (e.g., by multiplication by a small number) and the optimization can begin again. There is a trade-off in the convergence thresholds for each unconstrained search; too small and the algorithm must perform a lot of work even when is high; but too large and the sequence of unconstrained optima does not converge quickly. A more balanced approach is to choose the threshold proportional to .
2. Application to Non-Convex Functions: The formulation above did not explicitly require that the problem be convex. Interior point methods can certainly be used in general non-convex problems, but like any local optimization problem they are not guaranteed to a minimum. Furthermore, computing the Hessian matrix is quite often expensive.
3. Use in Linear/Quadratic Problems: They do, however, work quiet well in convex problems. For example, in quadratic programming the Hessian is constant, and in linear programming the Hessian is zero.
4. Initialization at a Feasible Point: The interior point method must be initialized at an interior point, or else the barrier function is undefined. To find the initial feasible point the following optimization may be used.

such that

If the problem is feasible then the optimal will all be . It is easy to find an initial set of for any given simply by setting

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**Portfolio Selection with Cardinality and Bound Constraints**

**Synopsis**

1. Portfolio Selection Problem – Formulation/Solution: Tadonki and Vial (2004) formulate and solve the portfolio selection problem with transaction costs and bound constraints on both the number of selected assets and the range of the corresponding investments.
2. Objective Function Risk/Return Tradeoff: The problem is to find a set of assets and the corresponding investment levels that suit the trade-off between risk and reward.
3. Combinatorial Mixed Integer Quadratic Problem: The underlying model results in a mixed integer quadratic problem. Tadonki and Vial (2004) show that the bound constraints on the investment yields a difficult combinatorial problem.
4. Feasibility Handling through Virtual Variable: To overcome this feasibility problem. Tadonki and Vial (2004) add a virtual variable that will remain selected if and only if the problem is infeasible.
5. Optimal Solution Greedy Heuristic Approximation: They propose a powerful greedy heuristic that provides a good approximation of the optimal solution in an affordable computation time.
6. Branch and Bound Global Solution: The algorithm for finding a global solution is a standard branch and bound processing.
7. Combining Heuristics with Cutting Planes: Tadonki and Vial (2004) use a cutting plane routine to solve the generic problem, and the heuristic to find potential upper bounds.
8. Test Runs on Benchmark Problems: Experimental results on a set of benchmark problems shows that the algorithm is quite efficient.

**Introduction**

1. Mean-Variance Portfolio Selection Formulation: The classical approach to the portfolio selection problem (Constantinides and Malliaris (1995)) is the Markowitz mean-variance formulation (Markowitz (1952, 1959)). The mean and the variance of a portfolio’s return represent the benefit and the risk associated with the investment.
2. Standard Quadratic Convex Programming Problem: The approach boils down to a simple convex quadratic programming problem that is easily solved by standardized toolkits (CPLEX (2019), MOSEK (2019)). Various other aspects of the problem have also been studied by a number of authors (Mossin (1968), Samuelson (1969), Hakansson (1971), Zariphopoulou (1992), Li and Ng (2000), Zhou and Li (2000)).
3. Extensions to the Standard Framework: The problem can be considered with special properties; bounds on the total investment, fixed amount of investment, pre-determined set of assets, and lower/upper bounds on risk/rewards.
4. Accommodation of Discrete Portfolio Selection: In addition, in order to capture the realism of portfolio selection, a number of discrete constraints have been considered by different authors (Jobst, Horniman, Lucas, and Mitra (2001)), in particular, the *cardinality constraint*, which enables to take into account the expected number of assets in the portfolio.
5. Bounds on the Number of Assets: Jobst, Horniman, Lucas, and Mitra (2001) have studied the case where the number of assets to be selected is fixed. This chapter considers an upper bound instead.
6. Approaches for Handling Cardinality Constraints: For investors, the cardinality constraint is important for monitoring and control purposes. Chang, Meade, Beasley, and Sharaiha (1999) have proposed heuristics – genetic algorithm, tabu search, and simulated annealing – to solve for the cardinality constraint.
7. Lower Bounds on Invested Assets: Investors also use the so-called *buy-in thresholds*, which specifies the minimum investment level, and therefore eliminates small trades in the selection.
8. Upper Bounds on Invested Assets: This chapter also considers *buy-in limit*, which specifies the maximum investment level on an asset (Bienstock (1996), Lee and Mitchell (1997)). It is obvious that bounding the investments has an impact on the number of selected assets.
9. The Round-Lot Investment Constraint: Another interesting constraint is the round-lot constraint, which are discrete number is the assets taken as the basic units of the selection. The size of the portfolio is the integer linear combination of the round-lots. The feasibility problem coming from the round-lot constraints has been established to be NP-complete (Mansini and Speranza (1999)).
10. Incorporating Fixed Transaction Cost Constraint: This chapter extends the base mean-variance portfolio model by considering three special constraints. First, a transaction cost is assumed on each item. Prior treatments of these costs include Adcock and Meade (1994) and Young (1998).
11. Total Number of Assets Bound: Second, a bound on the total number of assets in the portfolio is imposed.
12. Lower and Upper Asset Bounds: Third, a lower and an upper limit is considered on the total number of items in the portfolio.
13. Mixed Integer Quadratic Programming Problem: The resulting mathematical problem is a quadratic mixed integer program.
14. Feasibility Handling via Virtual Barrier: The restriction on the investment levels yields a feasibility problem, which is another issue to consider. The standard approach to overcome this problem is to add a free virtual with a NULL reward and a high transaction cost.
15. Heuristics Approach for the Solution: Tadonki and Vial (2004) develop a heuristic that gives a good approximation of the problem in its generic form. The heuristic is used at different level trees of the branch-and-bound process to obtain upper bounds.
16. Analytic Center Cutting Plane Solver: The node problem is solved using an analytic center cutting planes solver named PROXACCPM (Gondzio, du Merle, Sarkissian, and Vial (1996)).
17. Organization of the Chapter: The chapter is organized as follows. The first section presents the formulation of the problem as it is considered in this treatment. This is followed by a complexity analysis of the problem.
18. Bender Decomposition and Greedy Heuristic: The Bender decomposition approach is presented in the next section, followed by the Tadonki and Vial (2004) greedy heuristic.
19. Cutting Plane Algorithm and Performance: The next section describes the cutting plane algorithm and its performance on the generic problem.
20. Chvatal-Gomory Cuts and Variants: This is followed by a presentation of the Chvatal-Gomory cuts and some variants.
21. Branching Rule and Node Selection: The penultimate section describes the branching rule and the node selection used in Tadonki and Vial (2004).
22. Discussion of Results and Conclusions: Computational Results are then presented, and the chapter is concluded in the final section.

**Problem Formulation**

1. Covariance Matrix and the Returns Vector: Let be the variance-covariance matrix among the assets, and let be the vector of the expected returns of the assets.
2. Asset Weights as the Decision Vector: The decision variable respresents the fractional share of each asset in the portfolio. By definition, belongs to the simplex, that is, where and
3. Lower and Upper Bounds Vector: The lower and the upper bounds on the investment are given by the positive vectors and denote the diagonal matrix with the main diagonal and , repectively.
4. Number of Assets Bound and the Transaction Cost: Finally, the fixed relative transaction cost is given by the positive vector and is a positive integer to bound the number of assets in the portfolio.
5. Objective Function and Constrains: To complete the formulation of the problem, the binary variables are introduced. The problem is:
6. Solving for the Optimal Allocation: The purpose of this chapter is to provide an efficient routine to solve the portfolio allocation problem based on the above formulation setup. The focus will be on a *Bender decomposition* approach together with a branch and bound technique.

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