

Ito Integral

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Abstract

Just some notes about the Ito integral, along with some preliminary information about Riemann and Riemann-Stieltjes integration. Summarised from various places online, including but not limited to:

- <https://www.youtube.com/watch?v=vHn1M6pUAWg>
- <http://www.columbia.edu/~ks20/FE-Notes/4700-07-Notes-Ito.pdf>

1 Preliminaries

1.1 Riemann integration

For a regular non-stochastic function (black line in figure 1), you can use Riemann integration to approximate the integral. This approach involves:

- Divide range of integration into set of subintervals $P = \{t_0, t_1, t_2, \dots, t_n\}$
- Over all subintervals, calculate the lower and upper Riemann sums which represent the areas of the rectangles of width equal to the subinterval, and heights equal to the minimum and maximum function value in that interval (see figure 1):
 - Lower sum: $L = \sum_{i=1}^n \min\{f(t_i)\} \cdot (t_i - t_{i-1})$
 - Upper sum: $U = \sum_{i=1}^n \max\{f(t_i)\} \cdot (t_i - t_{i-1})$
- For a given function and a small number of partitions, the lower sum will be smaller than the upper sum.
- As the number of partitions increases, the values of the two sums will converge toward each other (if the integral exists).

- When the values of the sums intersect, that value is taken to be the Riemann integral of that function over the relevant limits.

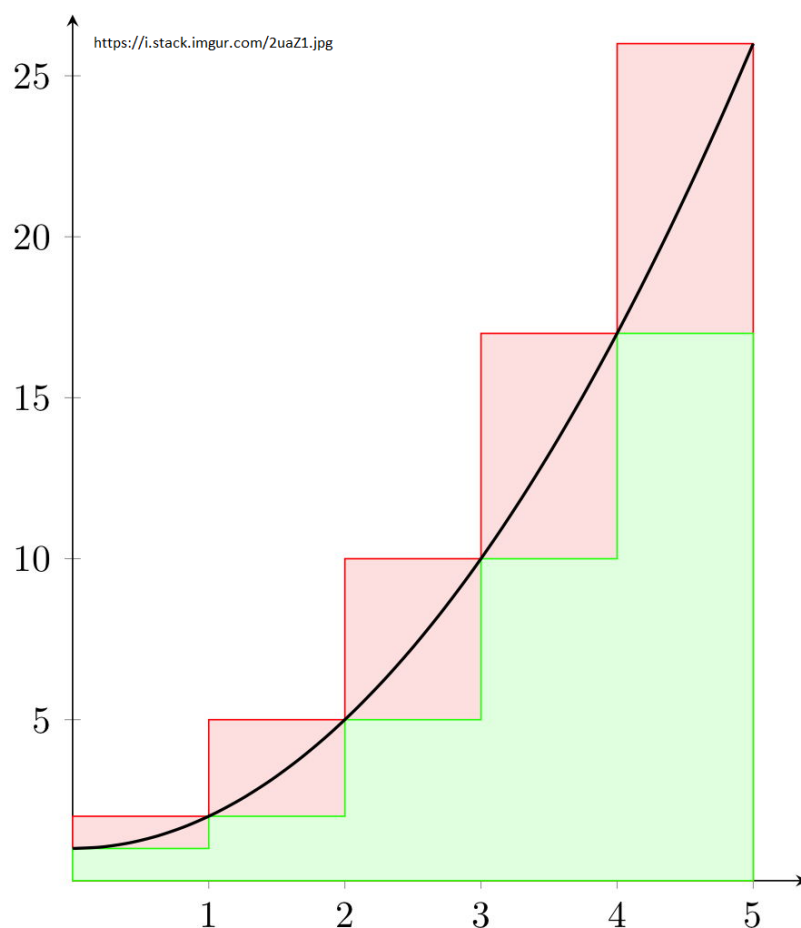


Figure 1: Lower (green) and upper (red) Riemann sums of a function (black)

1.2 Riemann-Stieltjes integration

This is a generalisation of Riemann integration, but where Riemann uses fixed subintervals of $(t_i - t_{i-1})$ as the integrator (dt), the Stieltjes approach uses a monotonic function instead.

Now the analogous lower and upper sums are:

$$L = \sum_{i=1}^n \min\{f(t_i)\} \cdot (g(t_i) - g(t_{i-1})) \quad (1)$$

$$U = \sum_{i=1}^n \max\{f(t_i)\} \cdot (g(t_i) - g(t_{i-1})) \quad (2)$$

where $g(t_i) > g(t_{i-1})$ when $t_i > t_{i-1}$

Imagine a 3D plot of $f(t)$ vs $g(t)$ vs t such as in figure 2.

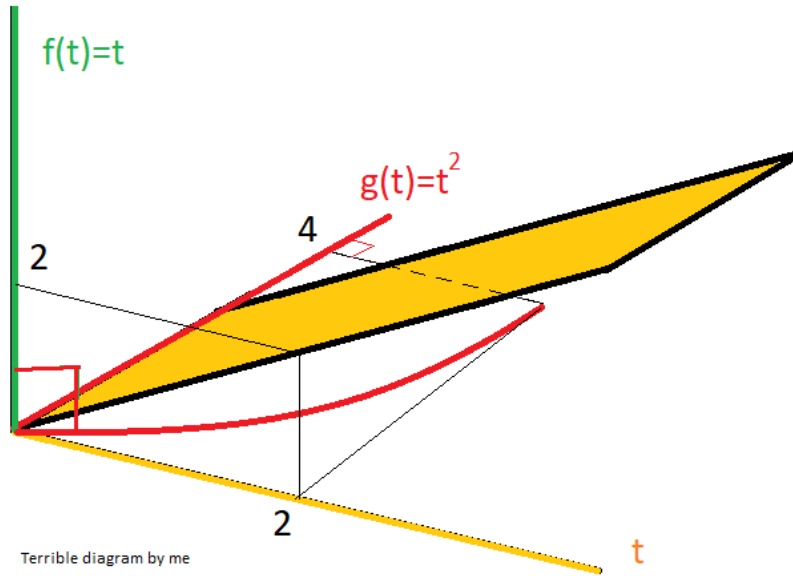


Figure 2: Stieltjes framework with the integrand $f(t) = t$ and integrator $g(t) = t^2$.

The lower sum will be the value of $f(t = 0) = 0$ multiplied by the corresponding change in value of $g(t)$. This will be zero. The upper sum will be the max value of $f(t)$ over the range of $[0, 2]$ which is $f(2) = 2$ multiplied by the change in value of integrator: $g(t_i) - g(t_{i-1}) = 2^2 - 0^2 = 4$, giving a final result of 8.

Same logic as above applies when increasing the number of partitions until the upper and lower sums intersect, which represents the value of the integral (if it exists). Note that when adding more partitions, the should be

placed at equally spaced values of the integrator $g(t)$. In this example with $g(t) = t^2$, the half way point would be half the max value of $g(t)$ which is 4, evaluated at the corresponding value of t . This would be $t = \sqrt{2}$.

2 Brownian motion as integrator

2.1 Riemann-Stieltjes approach

The above Stieltjes approach doesn't translate to using Brownian motion as the integrator because of its fractal and zig-zaggy nature. These factors make proofs of convergence difficult and motivate the choice for a different kind of integration: One using 'simple functions'

More formally, if you were to try and integrate standard brownian motion as

$$\int_0^t B_s dB_s \quad (3)$$

you would partition the integral into the n relevant subintervals and try to find the Riemann-Stieltjes sums:

$$S_n^1(t) = \sum_{i=1}^n B(t_{i-1}) \cdot (B(t_i) - B(t_{i-1})) \quad (4)$$

$$S_n^2(t) = \sum_{i=1}^n B(t_i) \cdot (B(t_i) - B(t_{i-1})) \quad (5)$$

Now if the Riemann-Stieltjes integral exists, $S_n^1(t) - S_n^2(t) \rightarrow 0$ as the largest subinterval shrank to zero: $\max\{t_i - t_{i-1}\} \rightarrow 0$. But multiplying out the argument of the sums above, and observing that disjoint time interval brownian terms are independent hence multiply to zero, we see

$$S_n^1(t) - S_n^2(t) = \sum_{i=1}^n (B_{t_i} - B_{t_{i-1}})^2 > 0 \quad (6)$$

and as shown in the quadraticVariation folder, the expectation of $B_{t_i} - B_{t_{i-1}}$ is $t_i - t_{i-1}$, the sum of which is just equal to the time horizon t :

$$\mathbb{E} [S_n^1(t) - S_n^2(t)] = \sum_{i=1}^n t_i - t_{i-1} = t \neq 0 \quad (7)$$

meaning that the sums don't converge, and the Riemann-Stieltjes integral does not exist for a Brownian motion process.

2.2 Simple functions approach

3 Definition

Ito integral is defined as:

$$\int_0^t X_a \, dB_s \approx \lim_{k \rightarrow \infty} \sum_{i=1}^k X(t_{i-1}) \cdot (B_{t_i} - B_{t_{i-1}}) \quad (8)$$