

Exercises and Solutions for **An Introduction to
Stochastic Differential Equations**

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September 2021

Abstract

Problem 1 Show, using the formal manipulations for Ito's chain rule, that

$$Y(t) := e^{W(t) - \frac{t}{2}}$$

solves the stochastic differential equation

$$\begin{cases} dY &= Y dW \\ Y(0) &= 1. \end{cases}$$

(Hint: If $X(t) := W(t) - \frac{t}{2}$, then $dX = -\frac{dt}{2} + dW$.)

Solution of Problem 1 According to the Ito's chain rule: since function $X(t) := W(t) - \frac{t}{2}$ satisfies the equation $dX = -\frac{dt}{2} + dW$, for $Y(t) = \exp(X(t))$, it holds that:

$$dY = \left(e^X \cdot \left(-\frac{1}{2} \right) + \frac{1}{2} \cdot e^X \right) dt + e^X dW = 0 + Y dW = Y dW.$$

Also, it's easy to verify that $Y(0) = 1$. Therefore, the solution

$$Y(t) := e^{W(t) - \frac{t}{2}}$$

actually solves the SDE we want.

Problem 2 Show that,

$$S(t) = s_0 e^{\sigma W(t) + \left(\mu - \frac{\sigma^2}{2} \right) t}$$

solves

$$\begin{cases} dS &= \mu S dt + \sigma S dW \\ S(0) &= s_0. \end{cases}$$

Solution of Problem 2 Again we use the Ito's chain rule: for function $X(t) := W(t) + \frac{\mu - \sigma^2/2}{\sigma} t$, we have:

$$dX = dW + \frac{\mu - \sigma^2/2}{\sigma} dt.$$

Therefore, for function $S(t) = s_0 e^{\sigma X(t)}$, it holds that:

$$\begin{aligned} dS &= \left(\sigma s_0 e^{\sigma X(t)} \cdot \frac{\mu - \sigma^2/2}{\sigma} + \frac{1}{2} \cdot \sigma^2 s_0 e^{\sigma X(t)} \right) dt + \sigma s_0 e^{\sigma X(t)} dW \\ &= \mu s_0 e^{\sigma X(t)} dt + \sigma s_0 e^{\sigma X(t)} dW = \mu S dt + \sigma S dW. \end{aligned}$$

Also, it's easy to verify that $S(0) = s_0$, which comes to our conclusion.

Problem 3 (1) Let (Ω, μ, P) be a probability space and let $A_1 \subseteq A_2 \subseteq \dots \subseteq A_n \subseteq \dots$ be events. Show that

$$P\left(\bigcup_{n=1}^{\infty} A_n\right) = \lim_{m \rightarrow \infty} P(A_m).$$

(Hint: Look at the disjoint events $B_n := A_{n+1} - A_n$.)

(2) Likewise, show that if $A_1 \supseteq A_2 \supseteq \dots \supseteq A_n \supset \dots$, then

$$P\left(\bigcap_{n=1}^{\infty} A_n\right) = \lim_{m \rightarrow \infty} P(A_m).$$

Solution of Problem 3

(1) Consider the disjoint events $B_n = A_{n+1} - A_n$, then we know that these events are disjoint since for $\forall m < n$, it holds that:

$$B_m = A_{m+1} - A_m \subseteq A_{m+1} \subseteq A_n, \quad A_{n+1} - A_n = B_n \cap A_n = \emptyset,$$

so we can conclude that $B_m \cap B_n = \emptyset$, which means $\{B_n\}$ are disjoint events. Also, we have $\bigcup_{n=1}^{\infty} A_n = \bigcup_{n=0}^{\infty} B_n$. It is because for $\forall x \in \bigcup_{n=1}^{\infty} A_n$, there exists a smallest k such that $x \in A_k \Rightarrow x \in A_k - A_{k-1} = B_k \subseteq \bigcup_{n=0}^{\infty} B_n$, which leads to

$$\bigcup_{n=1}^{\infty} A_n \subseteq \bigcup_{n=0}^{\infty} B_n.$$

On the other hand, for $\forall x \in \bigcup_{n=0}^{\infty} B_n$, there exists k such that $x \in B_k \subseteq A_{k+1} \subseteq \bigcup_{n=1}^{\infty} A_n$, which leads to

$$\bigcup_{n=1}^{\infty} A_n \supseteq \bigcup_{n=0}^{\infty} B_n.$$

Therefore, we conclude that $\bigcup_{n=1}^{\infty} A_n = \bigcup_{n=0}^{\infty} B_n$. Also, notice that $A_m = B_0 \cup B_1 \cup \dots \cup B_{m-1}$, which leads to

$$P(A_m) = \sum_{n=0}^{m-1} P(B_n).$$

Here, we use the countable additivity of $P(\cdot)$ under disjoint events $\{B_n\}$. Finally, it holds that:

$$P\left(\bigcup_{n=1}^{\infty} A_n\right) = P\left(\bigcup_{n=0}^{\infty} B_n\right) = \sum_{n=0}^{\infty} P(B_n) = \lim_{m \rightarrow \infty} \sum_{n=0}^{m-1} P(B_n) = \lim_{m \rightarrow \infty} P(A_m)$$

In the final step, we use the fact that the sequence $p_m := \sum_{n=0}^{m-1} P(B_n) = P(A_m)$ is non-decreasing and upper bounded by 1, and therefore it converges.

(2) Similarly, we have $A_1^c \subseteq A_2^c \subseteq \dots \subseteq A_n^c \subseteq \dots$. By using the conclusion of (1), we have:

$$P\left(\bigcap_{n=1}^{\infty} A_n\right) = 1 - P\left(\bigcup_{n=1}^{\infty} A_n^c\right) = 1 - \lim_{m \rightarrow \infty} P(A_m^c) = \lim_{m \rightarrow \infty} P(A_m),$$

which comes to our conclusion.

Problem 4 Let Ω be any set and \mathcal{A} any collections of subsets of Ω . Show that there exists a unique smallest σ -algebra μ of subsets of Ω containing \mathcal{A} . We call μ the σ -algebra generated by \mathcal{A} . (Hint: Take the intersection of all the σ -algebras containing \mathcal{A} .)

Solution of Problem 4 Obviously, there exists a σ -algebra containing \mathcal{A} (for example, 2^Ω itself). Now, we take the intersection of all the σ -algebras containing \mathcal{A} , denoted by μ . In order to prove that there exists a unique smallest σ -algebra μ of subsets of Ω containing \mathcal{A} , we only need to prove that the intersection of all σ -algebras is also a σ -algebra of Ω containing \mathcal{A} . On one hand, since all the σ -algebras considered by us contain \mathcal{A} , so their intersection μ also contains \mathcal{A} . On the other hand,

- For all σ -algebra S that contains \mathcal{A} , we have $\emptyset \in S$ by the definition of σ -algebra. Therefore, the intersection holds $\emptyset \in \mu$ obviously.
- For $\forall A \in \mu$, we have $A \in S$ for any σ -algebra S that contains \mathcal{A} , so it holds that $A^c \in S$. Therefore, we have $A^c \in \mu$.
- For $A_1, A_2, \dots \in \mu$, we know that for any σ -algebra S that contains \mathcal{A} , $\bigcup_{i=1}^{+\infty} A_i \in S$. Therefore:

$$\bigcup_{i=1}^{+\infty} A_i \in \mu.$$

After combining all the items above, we know that μ is also a σ -algebra of Ω containing \mathcal{A} , which comes to our conclusion.

Problem 5 Show that if A_1, A_2, \dots, A_n are events, then

$$\begin{aligned} P\left(\bigcup_{i=1}^n A_i\right) &= \sum_{i=1}^n P(A_i) - \sum_{1 \leq i < j \leq n} P(A_i \cap A_j) \\ &\quad + \sum_{1 \leq i < j < k \leq n} P(A_i \cap A_j \cap A_k) \\ &\quad - \dots + (-1)^n P(A_1 \cap A_2 \cap \dots \cap A_n). \end{aligned}$$

(Hint: Do the case $n = 2$ first and then the general case by induction.)

Solution of Problem 5 We use the method of induction. When $n = 2$, we know that:

$$P(A \cup B) = P(A) + P((A \cup B) - A) = P(A) + P(B - (A \cap B)) = P(A) + P(B) - P(A \cap B).$$

Suppose the condition holds for n , then for $n + 1$, we have:

$$\begin{aligned} P(A_1 \cup A_2 \cup \dots \cup A_{n+1}) &= P((A_1 \cup A_2 \cup \dots \cup A_n) \cup A_{n+1}) \\ &= P(A_1 \cup A_2 \cup \dots \cup A_n) + P(A_{n+1}) - P((A_1 \cup A_2 \cup \dots \cup A_n) \cap A_{n+1}) \\ &= P(A_{n+1}) + \sum_{i=1}^n P(A_i) - \sum_{1 \leq i < j \leq n} P(A_i \cap A_j) + \dots + (-1)^n P(A_1 \cap A_2 \cap \dots \cap A_n) \end{aligned}$$

$$\begin{aligned}
& - P((A_1 \cap A_{n+1}) \cup (A_2 \cap A_{n+1}) \cup \dots \cup (A_n \cap A_{n+1})) \\
& = P(A_{n+1}) + \sum_{i=1}^n P(A_i) - \sum_{1 \leq i < j \leq n} P(A_i \cap A_j) + \dots + (-1)^n P(A_1 \cap A_2 \cap \dots \cap A_n) \\
& \quad - \sum_{i=1}^n P(A_i \cap A_{n+1}) + \sum_{1 \leq i < j \leq n} P((A_i \cap A_{n+1}) \cap (A_j \cap A_{n+1})) - \dots \\
& \quad - (-1)^n P((A_1 \cap A_{n+1}) \cap (A_2 \cap A_{n+1}) \cap \dots \cap (A_n \cap A_{n+1})) \\
& = \sum_{i=1}^{n+1} P(A_i) - \sum_{1 \leq i < j \leq n+1} P(A_i \cap A_j) + \dots + (-1)^{n+1} P(A_1 \cap A_2 \cap \dots \cap A_{n+1}),
\end{aligned}$$

which completes the induction and comes to our conclusion.

Problem 6 Let $X = \sum_{i=1}^k a_i \chi_{A_i}$ be a simple random variable, where the real numbers a_i are distinct, the events A_i are pairwise disjoint, and $\Omega = \bigcup_{i=1}^k A_i$. Let $\mu(X)$ be the σ -algebra generated by X .

- (1) Describe precisely which sets are in $\mu(X)$.
- (2) Suppose the random variable Y is $\mu(X)$ -measurable. Show that Y is constant on each set A_i .
- (3) Show that therefore Y can be written as a function of X .

Solution of Problem 6

- (1) Since the real numbers a_i are distinct, we can assume that

$$a_1 < a_2 < \dots < a_k$$

without loss of generality. We are going to prove that $\mu(X) = \sigma(\{A_i : i \in [k]\})$ which is the σ -algebra generated by the pairwise disjoint events A_i . On one hand, notice that: $\forall i \in [k]$,

$$A_i = \{X = a_i\} \in \mu(X) \Rightarrow \sigma(\{A_i : i \in [k]\}) \subseteq \mu(X).$$

On the other hand, for any $B \in \mathcal{B}(\mathbb{R})$, we have:

$$\{X \in B\} = \bigcup_{a_i \in B} A_i \in \sigma(\{A_i : i \in [k]\}),$$

which leads to:

$$\mu(X) = \sigma(\{X \in B\}) \subseteq \sigma(\{A_i : i \in [k]\}).$$

To sum up, $\mu(X) = \sigma(\{A_i : i \in [k]\})$, which means all the sets in $\mu(X)$ are $\bigcup_{i \in S} A_i$ for some $S \subseteq [k]$.

- (2) Random variable Y is $\mu(X)$ -measurable. Then, for any $B \in \mathcal{B}(\mathbb{R})$, it holds that event $\{Y \in B\} \in \mu(X)$. From the conclusion of (1), we know that

$$\mu(X) = \left\{ \bigcup_{i \in S} A_i : S \subseteq [k] \right\}.$$

Now we suppose that Y is not constant on each set A_i . Without loss of generality, we assume Y is not constant on A_1 , then there exists $x, y \in A_1$ such that $Y(x) < Y(y)$. Consider the event $E = \{Y = Y(x)\} \in \mu(X)$, then $x \in E$ but $y \notin E$. Since E must be the union of some A_i -s, from $x \in E$, we know that $A_1 \subseteq E$. From $y \notin E$, we know that $A_1 \cap E = \emptyset$, which contradict with each other. Therefore, Y must be constant on each set A_i .

(3) According to the conclusion of (2), we can assume that Y equals to constant b_i on the set A_i . Then:

$$Y = \sum_{i=1}^k b_i \chi_{A_i}.$$

Therefore, Y can be written as $f(X)$ where $f(a_i) = b_i$ for $\forall i \in [k]$, which comes to our conclusion.

Problem 7 Verify:

$$\begin{aligned} \int_{-\infty}^{\infty} e^{-x^2} dx &= \sqrt{\pi}, \quad \frac{1}{\sqrt{2\pi\sigma^2}} \int_{-\infty}^{\infty} x e^{-\frac{(x-m)^2}{2\sigma^2}} dx = m, \\ \frac{1}{\sqrt{2\pi\sigma^2}} \int_{-\infty}^{\infty} (x-m)^2 e^{-\frac{(x-m)^2}{2\sigma^2}} dx &= \sigma^2. \end{aligned}$$

Solution of Problem 7 For the first conclusion, we consider the following equation: denote $S = \int_{-\infty}^{\infty} e^{-x^2} dx$, then:

$$\begin{aligned} S^2 &= \int_{-\infty}^{\infty} e^{-x^2} dx \cdot \int_{-\infty}^{\infty} e^{-y^2} dy = \int_{\mathbb{R}^2} e^{-(x^2+y^2)} dx dy \\ &= \int_0^{+\infty} \int_{-\pi}^{\pi} e^{-r^2} r \cdot dr d\theta = \pi \cdot \int_0^{+\infty} e^{-r^2} \cdot 2r dr = \pi \cdot \int_0^{+\infty} e^{-r^2} dr^2 = \pi. \end{aligned}$$

It is obvious that $S > 0$, therefore $S = \sqrt{\pi}$. For the following two equations, let $x = m + \sqrt{2}\sigma y$, then:

$$\begin{aligned} \frac{1}{\sqrt{2\pi\sigma^2}} \int_{-\infty}^{\infty} x e^{-\frac{(x-m)^2}{2\sigma^2}} dx &= \frac{1}{\sqrt{\pi}} \int_{-\infty}^{\infty} (m + \sqrt{2}\sigma y) e^{-y^2} dy \\ &= \frac{m}{\sqrt{\pi}} \int_{-\infty}^{\infty} e^{-y^2} dy + \frac{\sqrt{2}\sigma}{\sqrt{\pi}} \int_{-\infty}^{\infty} y e^{-y^2} dy = m + 0 = m. \end{aligned}$$

Here, we use the conclusion of $\int_{-\infty}^{\infty} e^{-y^2} dy = \sqrt{\pi}$ and the fact that $y e^{-y^2}$ is an odd function, whose integral over \mathbb{R} must be 0.

$$\begin{aligned} \frac{1}{\sqrt{2\pi\sigma^2}} \int_{-\infty}^{\infty} (x-m)^2 e^{-\frac{(x-m)^2}{2\sigma^2}} dx &= \frac{1}{\sqrt{\pi}} \int_{-\infty}^{\infty} 2\sigma^2 y^2 e^{-y^2} dy \\ &= \frac{\sigma^2}{\sqrt{\pi}} \int_{-\infty}^{\infty} y \cdot 2y e^{-y^2} dy = \frac{\sigma^2}{\sqrt{\pi}} \int_{-\infty}^{\infty} -y d e^{-y^2} = \frac{\sigma^2}{\sqrt{\pi}} \cdot \left(-y e^{-y^2} \Big|_{-\infty}^{\infty} + \int_{-\infty}^{\infty} e^{-y^2} dy \right) \\ &= \frac{\sigma^2}{\sqrt{\pi}} \cdot \sqrt{\pi} = \sigma^2. \end{aligned}$$

Here, we again use the equation $\int_{-\infty}^{\infty} e^{-y^2} dy = \sqrt{\pi}$.

Problem 8 Suppose A and B are independent events in some probability space. Show that A^c and B are independent. Likewise, show that A^c and B^c are independent.

Solution of Problem 8 Since A and B are independent events, we have:

$$P(A \cap B) = P(A)P(B).$$

Therefore, we have the following two equations:

$$P(A^c \cap B) = P(B) - P(A \cap B) = P(B) - P(A)P(B) = (1 - P(A))P(B) = P(A^c)P(B).$$

$$\begin{aligned} P(A^c \cap B^c) &= 1 - P(A \cup B) = 1 - P(A) - P(B) + P(A \cap B) = 1 - P(A) - P(B) + P(A)P(B) \\ &= (1 - P(A))(1 - P(B)) = P(A^c) \cdot P(B^c). \end{aligned}$$

These two equations conclude that A^c and B are independent. Also, A^c and B^c are independent.

Problem 9 Suppose we have three cards: one is red on both sides, one is red on one side and white on the other side, and one is white on both sides.

- (1) Pick a card and then one of its sides at random. What is the probability it is red?
- (2) Given that the side of the card is red, what is the probability that the other side is red?

Solution of Problem 9

- (1) We denote R as red and W as white, then:

$$P(R) = P(RR) \cdot 1 + P(RB) \cdot \frac{1}{2} + P(BB) \cdot 0 = \frac{1}{3} + \frac{1}{6} = \frac{1}{2}.$$

The probability of red side is $\frac{1}{2}$.

- (2) By using Bayes' formula, we have:

$$P(RR|R) = \frac{P(RR) \cdot P(R|RR)}{P(RR) \cdot P(R|RR) + P(RB) \cdot P(R|RB) + P(BB) \cdot P(R|BB)} = \frac{1/3}{1/3 + 1/6 + 0} = \frac{2}{3}.$$

The probability for the other side to be red is $\frac{2}{3}$.

Problem 10 Suppose that A_1, A_2, \dots, A_m are disjoint events, each of positive probability, such that $\Omega = \bigcup_{j=1}^m A_j$. Prove Bayes' formula:

$$P(A_k|B) = \frac{P(B|A_k)P(A_k)}{\sum_{j=1}^m P(B|A_j)P(A_j)}$$

for $k = 1, 2, \dots, m$ provided $P(B) > 0$.

Solution of Problem 10 Since A_1, A_2, \dots, A_m all have positive probabilities, so:

$$P(B|A_j)P(A_j) = P(B \cap A_j).$$

Also, they are disjoint and $\bigcup_{j=1}^m A_j = \Omega$, which leads to $\{B \cap A_j\}_{j \in [m]}$ are also disjoint and $\bigcup_{j=1}^m (B \cap A_j) = B \cap \Omega = B$. Therefore:

$$\frac{P(B|A_k)P(A_k)}{\sum_{j=1}^m P(B|A_j)P(A_j)} = \frac{P(B \cap A_k)}{\sum_{j=1}^m P(B \cap A_j)} = \frac{P(B \cap A_k)}{P(B)} = P(A_k|B),$$

which comes to our conclusion. Here, we used the additivity of probability measures.

Problem 11 During one fall semester 105 women applied to Miskatonic University, of whom 76 were accepted, and 400 men applied, of whom 230 were accepted. During the subsequent spring semester, 300 women applied, of whom 100 were accepted, and 112 men applied, of whom 21 were accepted. Calculate numerically:

- (a) the probability of a female applicant being accepted during the fall,
 - (b) the probability of a male applicant being accepted during the fall,
 - (c) the probability of a female applicant being accepted during the spring,
 - (d) the probability of a male applicant being accepted during the spring.
- Consider now the total applicant pool for both semesters together and calculate.
- (e) the probability of a female applicant being accepted,
 - (f) the probability of a male applicant being accepted.
- Are the university's admission policies biased towards females or towards males?

Solution of Problem 11

- (a) $76/105 = 0.7238$.
- (b) $230/400 = 0.5750$.
- (c) $100/300 = 0.3333$.
- (d) $21/112 = 0.1875$.
- (e) $(100 + 76)/(300 + 105) = 0.4346$.
- (f) $(230 + 21)/(400 + 112) = 0.4902$.

Although in each semester, the probability of acceptance of females is higher than males, the university's admission policies biased towards males.

Problem 12 Let X be a real-valued, $\mathcal{N}(0, 1)$ random variable, and set $Y := X^2$. Calculate the density g of the distribution function for Y .

(Hint: You must find g so that $P(-\infty < Y \leq a) = \int_{-\infty}^a g dy$ for all a .)

Solution of Problem 12 Notice that $Y = X^2 \geq 0$ always holds, which means $P(Y < 0) = 0$. For $\forall t \geq 0$, we have:

$$P(-\infty < Y \leq t) = P(X^2 \leq t) = P(-\sqrt{t} \leq X \leq \sqrt{t}) = \int_{-\sqrt{t}}^{\sqrt{t}} \frac{1}{\sqrt{2\pi}} \exp\left(-\frac{x^2}{2}\right) dx = 2\phi(\sqrt{t}).$$

where $\phi(u) = \int_0^u \frac{1}{\sqrt{2\pi}} \exp\left(-\frac{x^2}{2}\right) dx$. Then: $\phi'(u) = \frac{1}{\sqrt{2\pi}} \exp\left(-\frac{u^2}{2}\right)$. Now, we can conclude that, the density function for distribution Y is:

$$g(t) = \frac{d}{dt} 2\phi(\sqrt{t}) = \frac{\frac{1}{\sqrt{2\pi}} \cdot \exp(-t/2)}{\sqrt{t}} = \frac{\exp(-t/2)}{\sqrt{2\pi t}} \quad (t \geq 0).$$

To sum up, the density function is:

$$g(t) = \frac{\exp(-t/2)}{\sqrt{2\pi t}} \cdot \mathbb{I}[t > 0].$$

Problem 13 Take $\Omega = [0, 1] \times [0, 1]$, with \mathcal{U} the Borel sets and P Lebesgue measure. Let $g : [0, 1] \rightarrow \mathbb{R}$ be a continuous function. Define the random variables

$$X_1(\omega) := g(x_1), X_2(\omega) := g(x_2) \quad \text{for } \omega = (x_1, x_2) \in \Omega.$$

Show that X_1 and X_2 are independent and identically distributed.

Solution of Problem 13 For $\forall A \in \mathcal{B}(\mathbb{R})$, we have:

$$P(X_1 \in A) = P(g^{-1}(A) \times [0, 1]) = P([0, 1] \times g^{-1}(A)) = P(X_2 \in A).$$

Here, since g is a continuous function, we know that $g^{-1}(A) \in \mathcal{B}([0, 1])$. Therefore, X_1 and X_2 are identically distributed. Next, we are going to prove that they are independently distributed. For $\forall A, B \in \mathcal{B}(\mathbb{R})$, we have:

$$P(X_1 \in A, X_2 \in B) = P(g^{-1}(A) \times g^{-1}(B)) = P'(g^{-1}(A)) \times P'(g^{-1}(B)) = P(X_1 \in A) \cdot P(X_2 \in B),$$

where P' is the Lebesgue measure on \mathbb{R} . Therefore, we can conclude that X_1 and X_2 are independently distributed.

Problem 14 Let $f : [0, 1] \rightarrow \mathbb{R}$ be continuous and define the Bernstein polynomial

$$b_n(x) := \sum_{k=0}^n f\left(\frac{k}{n}\right) \binom{n}{k} x^k (1-x)^{n-k}.$$

Prove that $b_n \rightarrow f$ uniformly on $[0, 1]$ as $n \rightarrow \infty$, by providing the details for the following steps.

(1) Since f is uniformly continuous, for each $\varepsilon > 0$ there exists $\delta(\varepsilon) > 0$ such that $|f(x) - f(y)| \leq \varepsilon$ if $|x - y| \leq \delta(\varepsilon)$.

(2) Given $x \in [0, 1]$, take a sequence of independent random variables X_k such that $P(X_k = 1) = x, P(X_k = 0) = 1 - x$. Write $S_n = X_1 + X_2 + \dots + X_n$. Then $b_n(x) = \mathbb{E}f\left(\frac{S_n}{n}\right)$.

(3) Therefore

$$\begin{aligned} |b_n(x) - f(x)| &\leq \mathbb{E} \left| f\left(\frac{S_n}{n}\right) - f(x) \right| \\ &= \int_A \left| f\left(\frac{S_n}{n}\right) - f(x) \right| dP + \int_{A^c} \left| f\left(\frac{S_n}{n}\right) - f(x) \right| dP, \end{aligned}$$

for $A := \{\omega \in \Omega \mid |\frac{S_n}{n} - x| \leq \delta(\varepsilon)\}$.

(4) Then show that

$$|b_n(x) - f(x)| \leq \varepsilon + \frac{2M}{\delta(\varepsilon)^2} \cdot V\left(\frac{S_n}{n}\right) = \varepsilon + \frac{2M}{n\delta(\varepsilon)^2} V(X_1),$$

for $M = \max |f|$. Conclude that $b_n \rightarrow f$ uniformly.

Solution of Problem 14

(1) For any $\varepsilon > 0, x \in [0, 1]$, there exists $\delta_x > 0$ such that $|u - x| < \delta_x \Rightarrow |f(u) - f(x)| \leq \varepsilon/2$. Then: $\cup_{x \in [0, 1]} (x - \delta_x, x + \delta_x) \supseteq [0, 1]$. According to the Heine-Borel Covering Theorem: there exists a finite sub-covering. We denote it by $(a_1, b_1), (a_2, b_2), \dots, (a_n, b_n)$. Let $\delta = \min_{i,j} \{|a_i - b_j| > 0\}$, then for $\forall x, y \in [0, 1]$ such that $|x - y| < \delta$, they belong to the same interval, which leads to $|f(x) - f(y)| \leq \varepsilon$, and it comes to our conclusion.

(2) Notice that:

$$\begin{aligned} \mathbb{E}f\left(\frac{S_n}{n}\right) &= f\left(\frac{k}{n}\right) \cdot P(\{\text{There are } k \text{ 1-s and } n - k \text{ 0-s in } X_1, X_2, \dots, X_n\}) \\ &= f\left(\frac{k}{n}\right) \cdot \binom{n}{k} x^k (1 - x)^{n-k} = b_n(x), \end{aligned}$$

which comes to our conclusion.

(3) Notice that for any random variable X , we have:

$$-\mathbb{E}|X| \leq \mathbb{E}X \leq \mathbb{E}|X| \Rightarrow |\mathbb{E}X| \leq \mathbb{E}|X|.$$

Therefore:

$$\begin{aligned} |b_n(x) - f(x)| &= |\mathbb{E}[f(S_n/n) - f(x)]| \leq \mathbb{E}\left|f\left(\frac{S_n}{n}\right) - f(x)\right| \\ &= \int_A \left|f\left(\frac{S_n}{n}\right) - f(x)\right| dP + \int_{A^c} \left|f\left(\frac{S_n}{n}\right) - f(x)\right| dP, \end{aligned}$$

for $A := \{\omega \in \Omega \mid |\frac{S_n}{n} - x| \leq \delta(\varepsilon)\}$.

(4) If $\omega \in A$, we have: $|\frac{S_n}{n} - x| \leq \delta(\varepsilon) \Rightarrow |f(\frac{S_n}{n}) - f(x)| \leq \varepsilon$. Therefore:

$$\int_A \left|f\left(\frac{S_n}{n}\right) - f(x)\right| dP \leq \varepsilon \cdot P(A) \leq \varepsilon.$$

On the other hand,

$$\begin{aligned} \int_{A^c} \left|f\left(\frac{S_n}{n}\right) - f(x)\right| dP &\leq 2M \cdot P(A^c) \leq 2M \cdot \mathbb{E} \frac{(\frac{S_n}{n} - x)^2}{\delta(\varepsilon)^2} \\ &= \frac{2M}{\delta(\varepsilon)^2} V\left(\frac{S_n}{n}\right) = \frac{2M}{n\delta(\varepsilon)^2} V(X_1). \end{aligned}$$

After adding up the two inequalities above, we have:

$$\|b_n - f\|_\infty \leq \varepsilon + \frac{2M}{n\delta(\varepsilon)^2} V(X_1).$$

Then we have:

$$\lim_{n \rightarrow \infty} \|b_n - f\|_\infty \leq \varepsilon.$$

Since $\varepsilon > 0$ can be any positive real number, we have:

$$\lim_{n \rightarrow \infty} \|b_n - f\|_\infty = 0,$$

which comes to our conclusion.

Problem 15 Let X and Y be independent random variables, and suppose that f_X and f_Y are the density functions for X, Y . Show that the density function for $X + Y$ is

$$f_{X+Y}(z) = \int_{-\infty}^{\infty} f_X(z-y)f_Y(y)dy.$$

(Hint: If $g : \mathbb{R} \rightarrow \mathbb{R}$, we have

$$\mathbb{E}[g(X+Y)] = \int_{-\infty}^{\infty} \int_{-\infty}^{\infty} f_{X,Y}(x,y)g(x+y)dxdy,$$

where $f_{X,Y}$ is the joint density function of X, Y .)

Solution of Problem 15 Notice that,

$$\mathbb{E}[g(X+Y)] = \int_{-\infty}^{\infty} \int_{-\infty}^{\infty} f_{X,Y}(x,y)g(x+y)dxdy.$$

Let $Z = X + Y$, then:

$$\begin{aligned} \int_{-\infty}^{\infty} g(z) \cdot f_Z(z)dz &= \mathbb{E}[g(X+Y)] = \int_{-\infty}^{\infty} \int_{-\infty}^{\infty} f_{X,Y}(x,y)g(x+y)dxdy \\ &= \int_{-\infty}^{\infty} \int_{-\infty}^{\infty} f_X(x)f_Y(y) \cdot g(x+y)dxdy = \int_{-\infty}^{\infty} \int_{-\infty}^{\infty} f_Y(y)f_X(z-y)g(z)dzdy \\ &= \int_{-\infty}^{\infty} g(z) \left(\int_{-\infty}^{\infty} f_Y(y)f_X(z-y)dy \right) dz. \end{aligned}$$

Here, we use the fact that X, Y are independent random variables and we also use the coordinate change of integration. Since g can be any function on Z , we can conclude that:

$$f_{X+Y}(z) = \int_{-\infty}^{\infty} f_Y(y)f_X(z-y)dy,$$

which comes to our conclusion.

Problem 16 Let X and Y be two independent positive random variables, each with density

$$f(x) = \begin{cases} e^{-x} & \text{if } x \geq 0 \\ 0 & \text{if } x < 0 \end{cases}.$$

Find the density of $X + Y$.

Solution of Problem 16 Notice that for $\forall z \geq 0$, we have:

$$\begin{aligned} P(X + Y \leq z) &= \mathbb{E}[X + Y \leq z] = \mathbb{E}_Y[\mathbb{E}[X + Y \leq z] | Y] = \mathbb{E}_Y P(X \leq z - Y) \\ &= \int_0^z e^{-y} dy \cdot \int_0^{z-y} e^{-x} dx = \int_0^z e^{-y} (1 - e^{-(z-y)}) dy = 1 - e^{-z} - ze^{-z} = 1 - (z + 1)e^{-z}. \end{aligned}$$

After taking derivative over z , we know that the density of $X + Y$ is:

$$g(z) = ze^{-z} \quad (z \geq 0).$$

Problem 17 Show that

$$\lim_{n \rightarrow \infty} \int_0^1 \int_0^1 \dots \int_0^1 f\left(\frac{x_1 + x_2 + \dots + x_n}{n}\right) dx_1 dx_2 \dots dx_n = f\left(\frac{1}{2}\right)$$

for each continuous function f .

(Hint: Let X_1, X_2, \dots, X_n be independent random variables, each of which has density function $f_i(x) = 1$ if $0 \leq x \leq 1$ and $= 0$ otherwise. Then $P\left(\left|\frac{X_1 + X_2 + \dots + X_n}{n} - \frac{1}{2}\right| > \varepsilon\right) \leq \frac{1}{\varepsilon^2} V\left(\frac{X_1 + X_2 + \dots + X_n}{n}\right) = \frac{1}{12\varepsilon^2 n}$.)

Solution of Problem 17 Let X_1, X_2, \dots, X_n be independent random variables, each of which follows the uniform distribution over $[0, 1]$. Then, we only need to prove that:

$$\lim_{n \rightarrow \infty} \mathbb{E}f\left(\frac{X_1 + X_2 + \dots + X_n}{n}\right) = f(1/2).$$

As we know that:

$$P\left(\left|\frac{X_1 + X_2 + \dots + X_n}{n} - \frac{1}{2}\right| > \varepsilon\right) \leq \frac{1}{\varepsilon^2} V\left(\frac{X_1 + X_2 + \dots + X_n}{n}\right) = \frac{1}{12\varepsilon^2 n}.$$

Since f is continuous function, f is bounded on the closed interval $[0, 1]$, which means there exists $L > 0$ such that $|f(x) - f(1/2)| < L$ holds for $\forall x \in [0, 1]$. Also, f is continuous at $1/2$. Therefore, for $\forall \varepsilon > 0$, there exists $\delta > 0$ such that $|x - 1/2| < \delta \Rightarrow |f(x) - f(1/2)| < \varepsilon$. Then:

$$P\left(\left|f\left(\frac{X_1 + X_2 + \dots + X_n}{n}\right) - f(1/2)\right| > \varepsilon\right) \leq P\left(\left|\frac{X_1 + X_2 + \dots + X_n}{n} - \frac{1}{2}\right| > \delta\right) \leq \frac{1}{12\delta^2 n},$$

which leads to:

$$\left|\mathbb{E}f\left(\frac{X_1 + X_2 + \dots + X_n}{n}\right) - f(1/2)\right| \leq \varepsilon + \frac{L}{12\delta^2 n}.$$

Let $n \rightarrow \infty$:

$$\lim_{n \rightarrow \infty} \left| \mathbb{E}f \left(\frac{X_1 + X_2 + \dots + X_n}{n} \right) - f(1/2) \right| \leq \varepsilon.$$

Since ε can be any positive real number, we can finally conclude that:

$$\lim_{n \rightarrow \infty} f \left(\frac{X_1 + X_2 + \dots + X_n}{n} \right) = f(1/2).$$

Problem 18 Prove that:

- (1) $\mathbb{E}[\mathbb{E}[X|\mathcal{V}]] = \mathbb{E}[X]$.
- (2) $\mathbb{E}[X] = \mathbb{E}[X|\mathcal{W}]$, where $\mathcal{W} = \{\emptyset, \Omega\}$ is the trivial σ -algebra.

Solution of Problem 18 According to the definition of conditional expectation, we know that $\mathbb{E}[X|\mathcal{V}]$ is a random variable on Ω such that $\mathbb{E}[X|\mathcal{V}]$ is \mathcal{V} -measurable and $\int_A X dP = \int_A \mathbb{E}[X|\mathcal{V}] dP$ for all $A \in \mathcal{V}$.

- (1) $\mathbb{E}[\mathbb{E}[X|\mathcal{V}]] = \int \mathbb{E}[X|\mathcal{V}] d\mu = \int X d\mu = \mathbb{E}[X]$.
- (2) Since $\mathcal{W} = \{\emptyset, \Omega\}$ is the trivial σ -algebra, and random variable $\mathbb{E}[X|\mathcal{W}]$ is \mathcal{W} -measurable, which means $\mathbb{E}[X|\mathcal{W}]$ is a constant variable. By the conclusion of (1), we have:

$$\mathbb{E}[X|\mathcal{W}] = \mathbb{E}[X],$$

which comes to our conclusion.

Problem 19 Let X, Y be two real-valued random variables and suppose their joint distribution function has the density $f(x, y)$. Show that

$$\mathbb{E}[X|Y] = \Phi(Y) \text{ a.s.}$$

for

$$\Phi(y) = \frac{\int_{-\infty}^{\infty} x f(x, y) dx}{\int_{-\infty}^{\infty} f(x, y) dx}.$$

Solution of Problem 19 According to the definition of conditional expectation, we know that: for all $A \in \mathcal{U}(Y)$,

$$\int_A X dP = \int_A \mathbb{E}[X|Y] dP = \int_A \Phi(Y) dP.$$

For any Borel subset of \mathbb{R} , denoted by B , let $A = \{Y \in B\} \in \mathcal{U}(Y)$:

$$\int_A X dP = \int_{\omega} \chi_B(Y) X dP = \int_{-\infty}^{\infty} \int_B x f(x, y) dy dx.$$

$$\int_A \Phi(Y) dP = \int_{-\infty}^{\infty} \int_B \Phi(y) f(x, y) dy dx.$$

After switching the order of integrals, we know that:

$$\int_{-\infty}^{\infty} x f(x, y) dx = \int_{-\infty}^{\infty} \Phi(y) f(x, y) dx = \Phi(y) \int_{-\infty}^{\infty} f(x, y) dx.$$

It directly leads to

$$\Phi(y) = \frac{\int_{-\infty}^{\infty} xf(x, y)dx}{\int_{-\infty}^{\infty} f(x, y)dx},$$

which comes to our conclusion.

Problem 20 A smooth function $\Phi : \mathbb{R} \rightarrow \mathbb{R}$ is called convex if $\Phi''(x) \geq 0$ for all $x \in \mathbb{R}$.

(1) Show that if Φ is convex, then:

$$\Phi(y) \geq \Phi(x) + \Phi'(x)(y - x) \quad \text{for all } x, y \in \mathbb{R}.$$

(2) Show that

$$\Phi\left(\frac{x+y}{2}\right) \leq \frac{1}{2}\Phi(x) + \frac{1}{2}\Phi(y) \quad \text{for all } x, y \in \mathbb{R}.$$

(3) A smooth function $\Phi : \mathbb{R}^n \rightarrow \mathbb{R}$ is called convex if the matrix $D^2\Phi = ((\Phi_{x_i x_j}))$ is nonnegative definite for all $x \in \mathbb{R}^n$. (This means that $\sum_{i,j=1}^n \Phi_{x_i x_j} \xi_i \xi_j \geq 0$ for all $\xi \in \mathbb{R}^n$.) Prove that

$$\Phi(y) \geq \Phi(x) + D\Phi(x) \cdot (y - x),$$

$$\Phi\left(\frac{x+y}{2}\right) \leq \frac{1}{2}\Phi(x) + \frac{1}{2}\Phi(y)$$

for all $x, y \in \mathbb{R}^n$.

Solution of Problem 20

(1) Notice that, by using Lagrangian Theorem

$$\Phi(y) - \Phi(x) = \Phi'(x')(y - x)$$

holds for some $x' = x + t(y - x)$ ($t \in [0, 1]$). Then:

$$\Phi(y) - \Phi(x) - \Phi'(x)(y - x) = (y - x)(\Phi'(x') - \Phi'(x)) = (y - x)(x' - x)\Phi''(x'') = t(y - x)^2\Phi''(x'').$$

Since $t \geq 0$ and $\Phi''(x'') \geq 0$, we can conclude that:

$$\Phi(y) \geq \Phi(x) + \Phi'(x)(y - x).$$

(2) By using Lagrangian Theorem, there exists $t_1, t_2 \in [0, 1/2]$, such that:

$$\Phi\left(\frac{x+y}{2}\right) - \Phi(x) = \Phi'(x + t_1(y - x)) \cdot \frac{y - x}{2},$$

$$\Phi(y) - \Phi\left(\frac{x+y}{2}\right) = \Phi'(y - t_2(y - x)) \cdot \frac{y - x}{2}.$$

Therefore, we have:

$$\begin{aligned} \frac{1}{2}\Phi(x) + \frac{1}{2}\Phi(y) - \Phi\left(\frac{x+y}{2}\right) &= \frac{y-x}{4} \cdot [\Phi'(y - t_2(y - x)) - \Phi'(x + t_1(y - x))] \\ &= \frac{(1 - t_1 - t_2)(y - x)^2}{4} \cdot \Phi''(x'') \geq 0, \end{aligned}$$

since $1 - t_1 - t_2 \geq 0$ and $\Phi''(x'') \geq 0$, which comes to our conclusion.

(3) Notice that:

$$\begin{aligned} \Phi(y) - \Phi(x) - D\Phi(x) \cdot (y - x) &= \int_0^1 \langle D\Phi(x + t(y - x)), y - x \rangle dt - D\Phi(x) \cdot (y - x) \\ &= \int_0^1 \langle D\Phi(x + t(y - x)) - D\Phi(x), y - x \rangle dt = \int_0^1 dt \int_0^t (y - x)^\top D^2\Phi(x + t'(y - x)) \cdot (y - x) dt' \geq 0, \end{aligned}$$

which comes to our conclusion. Then, by using this inequality, we have:

$$\begin{aligned} \Phi(x) - \Phi\left(\frac{x + y}{2}\right) &\geq -D\Phi\left(\frac{x + y}{2}\right) \cdot \frac{y - x}{2}, \\ \Phi(y) - \Phi\left(\frac{x + y}{2}\right) &\geq D\Phi\left(\frac{x + y}{2}\right) \cdot \frac{y - x}{2}. \end{aligned}$$

After adding them up, we obtain that:

$$\Phi\left(\frac{x + y}{2}\right) \leq \frac{1}{2}\Phi(x) + \frac{1}{2}\Phi(y).$$

Problem 21

(1) Prove Jensen's Inequality:

$$\Phi(\mathbb{E}X) \leq \mathbb{E}(\Phi(X)),$$

for a random variable $X : \Omega \rightarrow \mathbb{R}$, where Φ is convex. (Hint: Use assertion (3) from the previous exercise.)

(2) Prove the conditional Jensen Inequality:

$$\Phi(\mathbb{E}(X|\mathcal{V})) \leq \mathbb{E}(\Phi(X)|\mathcal{V}).$$

Solution of Problem 21

(1) According to the assertion (3) of the previous exercise, we have:

$$\Phi(X) - \Phi(\mathbb{E}(X)) \geq D\Phi(\mathbb{E}(X)) \cdot (X - \mathbb{E}X).$$

Therefore, after taking the expectation, it holds that:

$$\mathbb{E}\Phi(X) - \Phi(\mathbb{E}(X)) \geq D\Phi(\mathbb{E}(X)) \cdot \mathbb{E}(X - \mathbb{E}X) = 0,$$

which comes to our conclusion.

(2) Again by using assertion (3), we know that:

$$\Phi(X) - \Phi(\mathbb{E}(X|\mathcal{V})) \geq D\Phi(\mathbb{E}(X|\mathcal{V})) \cdot (X - \mathbb{E}(X|\mathcal{V})).$$

By taking conditional expectation $p(\cdot|\mathcal{V})$:

$$\mathbb{E}(\Phi(X)|\mathcal{V}) - \Phi(\mathbb{E}(X|\mathcal{V})) \geq D\Phi(\mathbb{E}(X|\mathcal{V})) \cdot \mathbb{E}(X - \mathbb{E}(X|\mathcal{V})|\mathcal{V}) = 0,$$

which comes to our conclusion.

Problem 22 Let $W(\cdot)$ be a one-dimensional Brownian motion. Show that

$$\mathbb{E}[W^{2k}(t)] = \frac{(2k)!t^k}{2^k k!} \quad (t > 0).$$

Solution of Problem 22 According to the property of Brownian motions, $W(t) \sim \mathcal{N}(0, t)$. Therefore:

$$\mathbb{E}[W^{2k}(t)] = \mathbb{E}_{z \sim \mathcal{N}(0,1)}(\sqrt{t}z)^{2k} = t^k \cdot \mathbb{E}[z^{2k}] = t^k(2k-1)!! = \frac{(2k)!t^k}{2^k k!},$$

which comes to our conclusion.

Problem 23 Show that if $W(\cdot)$ is an n -dimensional Brownian motion, then so are:

- (1) $W(t+s) - W(s)$ for all $s \geq 0$.
- (2) $cW(t/c^2)$ for all $c > 0$. (Brownian scaling)

Solution of Problem 23

(1) For any $k \in [n]$, $W^k(t)$ is a one-dimensional Brownian motion, then $W^k(t+s) - W^k(s)$ is a Gaussian process and

$$\mathbb{E}[(W^k(u+s) - W^k(s))(W^k(v+s) - W^k(s))] = \min(u+s, v+s) - \min(u+s, s) - \min(v+s, s) = \min(u, v),$$

which means $W^k(t+s) - W^k(s)$ is also a one-dimensional Brownian motion. Also $\{W^k(t+s) - W^k(s)\}_{k \in [n]}$ are independent. Therefore, $W(t+s) - W(s)$ is a Brownian motion.

(2) For any $k \in [n]$, $W^k(t)$ is a one-dimensional Brownian motion, then $cW^k(t/c^2)$ is a Gaussian process and

$$\mathbb{E}[cW(u/c^2) \cdot cW(v/c^2)] = c^2 \min(u/c^2, v/c^2) = \min(u, v).$$

So $cW(t/c^2)$ is a one-dimensional Brownian motion. Also $\{cW^k(t/c^2)\}_{k \in [n]}$ are independent. Therefore, $cW(t/c^2)$ is a Brownian motion.

Problem 24 Let $W(\cdot)$ be a one-dimensional Brownian motion, and define

$$\overline{W}(t) = \begin{cases} tW\left(\frac{1}{t}\right) & \text{for } t > 0 \\ 0 & \text{for } t = 0 \end{cases}.$$

Show that $\overline{W}(t) - \overline{W}(s)$ is $\mathcal{N}(0, t-s)$ for times $0 \leq s \leq t$. ($\overline{W}(\cdot)$ also has independent increments and so is a one-dimensional Brownian motion. You do not need to show this.)

Solution of Problem 24 For times $0 \leq s \leq t$, we know that:

$$\overline{W}(t) - \overline{W}(s) = tW\left(\frac{1}{t}\right) - sW\left(\frac{1}{s}\right) = (t-s)W\left(\frac{1}{t}\right) - s\left(W\left(\frac{1}{s}\right) - W\left(\frac{1}{t}\right)\right).$$

Notice that $0 < \frac{1}{t} \leq \frac{1}{s}$, and so $W\left(\frac{1}{t}\right)$ are independent with $W\left(\frac{1}{s}\right) - W\left(\frac{1}{t}\right)$. We know that:

$$W\left(\frac{1}{t}\right) \sim \mathcal{N}(0, 1/t), \quad W\left(\frac{1}{s}\right) - W\left(\frac{1}{t}\right) \sim \mathcal{N}(0, 1/s - 1/t).$$

Therefore, $\overline{W}(t) - \overline{W}(s)$ follows the zero-centered Gaussian distribution with its variance

$$(t-s)^2 \cdot \frac{1}{t} + s^2 \cdot \left(\frac{1}{s} - \frac{1}{t} \right) = t-s.$$

To sum up, we conclude that $\overline{W}(t) - \overline{W}(s) \sim \mathcal{N}(0, t-s)$.

Problem 25 Define $X(t) := \int_0^t W(s)ds$, where $W(\cdot)$ is a one-dimension Brownian motion. Show that

$$\mathbb{E}[X^2(t)] = \frac{t^3}{3} \quad \text{for each } t > 0.$$

Solution of Problem 25 The Brownian motion can be written as: $W(t) = \sum_{k=0}^{+\infty} A_k s_k(t)$. Therefore:

$$X(t) = \sum_{k=0}^{+\infty} A_k \int_0^t s_k(s)ds := \sum_{k=0}^{+\infty} A_k U_k(t).$$

Then, since $\{A_k\}$ are independent random variables sampled from standard Gaussian. Therefore:

$$\mathbb{E}[X^2(t)] = \sum_{k=0}^{+\infty} U_k^2(t).$$

Notice that:

$$\begin{aligned} \sum_{k=0}^{+\infty} U_k^2(t) &= \sum_{k=0}^{+\infty} \int_0^t \int_0^t s_k(x)s_k(y)dx dy = \int_0^t \int_0^t \left[\sum_{k=0}^{+\infty} s_k(x)s_k(y) \right] dx dy \\ &= \int_0^t \int_0^t \min(x, y) dx dy = 2 \cdot \int_0^t x dx \int_x^t dy = 2 \int_0^t x(t-x)dx = 2 \left(\frac{t^3}{2} - \frac{t^3}{3} \right) = \frac{t^3}{3}, \end{aligned}$$

which comes to our conclusion.

Problem 26 Define $X(t)$ as in the previous exercise. Show that

$$\mathbb{E}e^{\lambda X(t)} = e^{\frac{\lambda^2 t^3}{6}} \quad \text{for each } t > 0.$$

(Hint: $X(t)$ is a Gaussian random variable, the variance of which we know from the previous exercise.)

Solution of Problem 26 From the exercise above, we know that $X(t) = \sum_{k=0}^{+\infty} A_k U_k(t)$. Then:

$$\begin{aligned} \mathbb{E}e^{\lambda X(t)} &= \prod_{k=0}^{+\infty} \mathbb{E}e^{\lambda A_k U_k(t)} = \prod_{k=0}^{+\infty} \exp\left(-\frac{\lambda^2 U_k(t)^2}{2}\right) \\ &= \exp\left(-\frac{\lambda^2 \sum_{k=0}^{+\infty} U_k(t)^2}{2}\right) = e^{-\frac{\lambda^2 t^3}{6}}. \end{aligned}$$

Here, we use the conclusion from the previous exercise.

Problem 27 Define $U(t) := e^{-t}W(e^{2t})$, where $W(\cdot)$ is a one-dimensional Brownian motion. Show that

$$\mathbb{E}[U(t)U(s)] = e^{-|t-s|} \quad \text{for all } -\infty < s, t < \infty.$$

Solution of Problem 27 Without loss of generality, we can assume that $s \leq t$. Then:

$$\begin{aligned} \mathbb{E}[U(t)U(s)] &= e^{-t-s} \cdot \mathbb{E}[W(e^{2t})W(e^{2s})] = e^{-t-s} \cdot \mathbb{E}[W(e^{2s})^2 + W(e^{2s}) \cdot (W(e^{2t}) - W(e^{2s}))] \\ &= e^{-t-s} \cdot (e^{2s} + 0) = e^{-t+s} = e^{-|t-s|}, \end{aligned}$$

which comes to our conclusion. Here, we use the fact that $W(x) \sim \mathcal{N}(0, x)$ for all $x \geq 0$ and $W(x) - W(y) \sim \mathcal{N}(0, x - y)$ for all $0 < y < x$ which is independent of $W(y)$.

Problem 28 Let $W(\cdot)$ be a one-dimensional Brownian motion. Show that

$$\lim_{m \rightarrow \infty} \frac{W(m)}{m} = 0 \quad \text{almost surely.}$$

(Hint: Fix $\varepsilon > 0$ and define the event $A_m := \left\{ \left| \frac{W(m)}{m} \right| \geq \varepsilon \right\}$. Then $A_m = \{|X| \geq \sqrt{m}\varepsilon\}$ for the $\mathcal{N}(0, 1)$ random variable $X = \frac{W(m)}{\sqrt{m}}$. Apply the Borel-Cantelli Lemma.)

Solution of Problem 28 Notice that, the event $\left\{ \lim_{m \rightarrow \infty} \frac{W(m)}{m} \neq 0 \right\}$ is equivalent to the event that there exists $\delta > 0$ such that there are infinitely many m -s satisfy $\left| \frac{W(m)}{m} \right| > \delta$, which means:

$$E := \left\{ \lim_{m \rightarrow \infty} \frac{W(m)}{m} \neq 0 \right\} = \lim_{k \rightarrow \infty} E_k$$

where

$$E_k = \left\{ \text{There are infinitely many } m\text{-s satisfy } \left| \frac{W(m)}{m} \right| > \frac{1}{k} \right\}.$$

Notice that

$$E_k = \lim_{m \rightarrow \infty} \sup \left\{ \left| \frac{W(m)}{m} \right| > \frac{1}{k} \right\}.$$

According to the fact that $W(m) \sim \mathcal{N}(0, m)$, we have:

$$P\left(\left| \frac{W(m)}{m} \right| > \frac{1}{k}\right) = P\left(\left| \frac{W(m)}{\sqrt{m}} \right| > \frac{\sqrt{m}}{k}\right) = \tilde{\Phi}\left(\frac{\sqrt{m}}{k}\right) \leq \exp\left(-\frac{m}{2k^2}\right).$$

Then their sum:

$$\sum_{m=1}^{\infty} P\left(\left| \frac{W(m)}{m} \right| > \frac{1}{k}\right) \leq \sum_{m=1}^{\infty} \exp\left(-\frac{m}{2k^2}\right) = \frac{1}{1 - \exp(-1/2k^2)},$$

which means the infinite sum actually converges. By using Borel-Cantelli Lemma, we know that:

$$P(E_k) = \left(\lim_{m \rightarrow \infty} \sup \left\{ \left| \frac{W(m)}{m} \right| > \frac{1}{k} \right\} \right) = 0,$$

and then:

$$P(E) = \lim_{k \rightarrow \infty} P(E_k) = 0 \quad \Rightarrow \quad P(\overline{E}) = 1,$$

which comes to our conclusion.

Problem 29 (1) Let $0 < \gamma \leq 1$. Show that $f : [0, T] \rightarrow \mathbb{R}^n$ is uniformly Hölder continuous with exponent γ , it is also uniformly Hölder continuous with each exponent $0 < \delta < \gamma$.
(2) Show that $f(t) = t^\gamma$ is uniformly Hölder continuous with exponent γ on the interval $[0, 1]$.

Solution of Problem 29 (1) Since f is uniformly Hölder continuous with exponent γ , we have:

$$\|f(x) - f(y)\| \leq K|x - y|^\gamma$$

holds for $\forall x, y \in [0, T]$ and a constant K . Then if $|x - y| \leq 1$, we have: $|x - y|^\gamma \leq |x - y|^\delta$, which directly leads to

$$\|f(x) - f(y)\| \leq K|x - y|^\delta.$$

If $|x - y| > 1$, we have: $|x - y|^\gamma = |x - y|^{\gamma-\delta} \cdot |x - y|^\delta \leq T^{\gamma-\delta} \cdot |x - y|^\delta$. To sum up, for $\forall x, y \in [0, T]$, it holds that:

$$\|f(x) - f(y)\| \leq K \max(1, T^{\gamma-\delta})|x - y|^\delta,$$

which comes to our conclusion.

(2) We only need to prove that for $\forall x, y \in [0, 1]$, it uniformly holds that:

$$|x^\gamma - y^\gamma| < K|x - y|^\gamma$$

for some constant K . Without loss of generality, we can assume that $0 \leq y \leq x \leq 1$. Let $\delta = x - y$, then we need to prove that:

$$g(y) := (y + \delta)^\gamma - y^\gamma < K\delta^\gamma$$

for some constant K . Since $\gamma \in (0, 1]$, we have:

$$g'(y) = \gamma \cdot ((y + \delta)^{\gamma-1} - y^{\gamma-1}) \leq 0.$$

It means g is a decreasing function. Therefore:

$$g(y) \leq g(0) = \delta^\gamma$$

holds for $\forall y$. We can make $K = 2$ and it comes to our conclusion.

Problem 30 Let $0 < \gamma < \frac{1}{2}$. We showed in Chapter 3 that if $W(\cdot)$ is a one-dimensional Brownian motion, then for almost every ω there exists a constant K , depending on ω , such that

$$|W(t, \omega) - W(s, \omega)| \leq K|t - s|^\gamma \quad \text{for all } 0 \leq s, t \leq 1.$$

Show that there does not exist a constant K such that it holds for almost all ω .

Solution of Problem 30 Assume there exists a constant K such that it holds for almost all ω . Then:

$$\begin{aligned} 1 &= \mathbb{P}_\omega [|W(t, \omega) - W(s, \omega)| \leq K|t - s|^\gamma \quad \forall 0 \leq s, t \leq 1] \leq \mathbb{P}_\omega [|W(1, \omega) - W(0, \omega)| \leq K] \\ &= \mathbb{P}_\omega [|W(1, \omega)| \leq K] = 1 - 2\tilde{\phi}(K). \end{aligned}$$

which leads to a contradiction.

Problem 31 Prove that if $G, H \in \mathbb{L}^2(0, T)$, then:

$$\mathbb{E} \left(\int_0^T G dW \int_0^T H dW \right) = \mathbb{E} \left(\int_0^T GH dt \right).$$

(Hint: $2ab = (a+b)^2 - a^2 - b^2$.)

Solution of Problem 31 Notice that:

$$\mathbb{E} \left(\int_0^T G dW + \int_0^T H dW \right)^2 = \|G + H\|_2^2, \quad \mathbb{E} \left(\int_0^T G dW \right)^2 = \|G\|_2^2, \quad \mathbb{E} \left(\int_0^T H dW \right)^2 = \|H\|_2^2.$$

Therefore: we have

$$\mathbb{E} \left(\int_0^T G dW \int_0^T H dW \right) = \frac{1}{2} (\|G + H\|_2^2 - \|G\|_2^2 - \|H\|_2^2) = \langle G, H \rangle = \int_0^T GH dt,$$

which comes to our conclusion.

Problem 32 Let (Ω, \mathcal{U}, P) be a probability space, and take $\mathcal{F}(\cdot)$ to be a filtration of σ -algebras. Assume X to be an integrable random variable, and define $X(t) := \mathbb{E}[X|\mathcal{F}(t)]$ for times $t \geq 0$. Show that $X(\cdot)$ is a martingale.

Solution of Problem 32 According to the definition of martingale, we know that $\mathcal{F}(t) \supseteq \mathcal{F}(s)$ when $t > s$. So for $\forall t > s$, it holds that:

$$\mathbb{E}[X(t)|\mathcal{F}(s)] = \mathbb{E}[\mathbb{E}[X|\mathcal{F}(t)]|\mathcal{F}(s)] = \mathbb{E}[X|\mathcal{F}(t) \cap \mathcal{F}(s)] = \mathbb{E}[X|\mathcal{F}(s)] = X(s),$$

which shows us that $\{X(t)\}$ is a martingale.

Problem 33 Show directly that $I(t) := W^2(t) - t$ is a martingale.

(Hint: $W^2(t) = (W(t) - W(s))^2 - W^2(s) + 2W(t)W(s)$. Take the conditional expectation with respect to $\mathcal{W}(S)$, the history of $W(\cdot)$, and then condition with respect to the history of $I(\cdot)$.)

Solution of Problem 33 Notice that $W^2(t) = (W(t) - W(s))^2 - W^2(s) + 2W(t)W(s)$, then:

$$\mathbb{E}[W^2(t) - t|\mathcal{W}(s)] = (t - s) + W^2(s) - t = W^2(s) - s,$$

holds for $\forall t > s$, which means $\mathbb{E}[I(t)|\mathcal{W}(s)] = I(s)$. Then, we need to take condition with respect to the history of $I(\cdot)$. Since the conditional expectation above only depends on $W^2(s)$, so:

$$\mathbb{E}[W^2(t) - t|\mathcal{W}^2(s)] = W^2(s) - s,$$

which leads to:

$$\mathbb{E}[I(t)|\mathcal{I}(s)] = I(s).$$

It shows us that $I(t)$ is a martingale.

Problem 34 Suppose $X(\cdot)$ is a real-valued martingale and $\Phi : \mathbb{R} \rightarrow \mathbb{R}$ is convex. Assume also that $\mathbb{E}(|\Phi(X(t))|) < \infty$ for all $t \geq 0$. Show that $\Phi(X(\cdot))$ is a submartingale. (Hint: Use the conditional Jensen Inequality.)

Solution of Problem 34 Since $X(\cdot)$ is a real-valued martingale, we have: for $\forall t > s$

$$\mathbb{E}(X(t)|\mathcal{F}(s)) = X(s).$$

Then, by using conditional Jensen Inequality, we have:

$$\mathbb{E}(\Phi(X(t))|\mathcal{F}(s)) \geq \Phi(\mathbb{E}(X(t)|\mathcal{F}(s))) = \Phi(X(s)).$$

Therefore, $\Phi(X(\cdot))$ is a submartingale.

Problem 35 Use the Itô chain rule to show that $Y(t) := e^{\frac{t}{2}} \cos(W(t))$ is a martingale.

Solution of Problem 35 By using the Itô chain rule, let $X(t) = W(t)$, we know that: $dX(t) = dW(t)$. Then: $dY(t) = du(X, t)$ where $u(X, t) = e^{t/2} \cos X$. Therefore,

$$\begin{aligned} dY(t) &= du(X, t) = (u_t + \frac{1}{2}u_{xx})dt + u_x dW = \left(\frac{1}{2}e^{t/2} \cos X - \frac{1}{2}e^{t/2} \cos X \right) dt - e^{t/2} \sin W(t) dW \\ &= -e^{t/2} \sin W(t) dW, \end{aligned}$$

which shows us that $Y(t)$ is a martingale.

Problem 36 Let $\mathbf{W}(\cdot) = (W^1, \dots, W^n)$ be an n -dimensional Brownian motion, and write $Y(t) := |\mathbf{W}(t)|^2 - nt$ for times $t \geq 0$. Show that $Y(\cdot)$ is a martingale. (Hint: Compute dY .)

Solution of Problem 36 We are going to compute $dY(t)$. Since $dW^2 = 2WdW + dt$, so it's easy for us to compute that:

$$dY(t) = \sum_{i=1}^N d(W^i(t))^2 - ndt = \sum_{i=1}^N [2W^i(t)dW^i(t) + dt] - ndt = \sum_{i=1}^N 2W^i(t)dW^i(t),$$

which shows us that $Y(t)$ is a martingale.

Problem 37 Show that

$$\int_0^T W^2 dW = \frac{1}{3}W^3(T) - \int_0^T W dt$$

and

$$\int_0^T W^3 dW = \frac{1}{4}W^4(T) - \frac{3}{2} \int_0^T W^2 dt.$$

Solution of Problem 37

(1) By using the Itô's chain rule, we know that:

$$dW^3 = 3W^2 dW + 3W dt.$$

Therefore:

$$W^3(T) = \int_0^T dW^3(t) = 3 \int_0^T W^2 dW + 3 \int_0^T W dt \Rightarrow \int_0^T W^2 dW = \frac{1}{3} W^3(T) - \int_0^T W dt,$$

which comes to our conclusion.

(2) Again by using the Itô's chain rule, we know that:

$$dW^4 = 4W^3 dW + 6W^2 dt.$$

Therefore:

$$W^4(T) = \int_0^T dW^4(t) = 4 \int_0^T W^3 dW + 6 \int_0^T W^2 dt \Rightarrow \int_0^T W^3 dW = \frac{1}{4} W^4(T) - \frac{3}{2} \int_0^T W^2 dt,$$

which comes to our conclusion.

Problem 38 Recall from the text that

$$Y := e^{\int_0^t g dW - \frac{1}{2} \int_0^t g^2 ds}$$

satisfies

$$dY = gY dW.$$

Use this to prove

$$\mathbb{E} \left(e^{\int_0^T g dW} \right) = e^{\frac{1}{2} \int_0^T g^2 ds}.$$

Solution of Problem 38 Define $F = \int_0^t g dW - \frac{1}{2} \int_0^t g^2 ds$, then we know that:

$$dF = -\frac{1}{2} g^2 dt + g dW.$$

Since $Y = e^F$, we have:

$$dY = e^F dF + \frac{1}{2} e^F g^2 dt = e^F g dW = gY dW.$$

Then, we can conclude that $Y(t)$ is a martingale, which leads to the fact that:

$$\mathbb{E}Y(t) = \mathbb{E}Y(0) = 1 \Rightarrow \mathbb{E} \left(e^{\int_0^T g dW} \right) = e^{\frac{1}{2} \int_0^T g^2 ds}.$$

Problem 39 Let $u = u(x, t)$ be a smooth solution of the backwards diffusion equation

$$u_t + \frac{1}{2} u_{xx} = 0,$$

and suppose $W(\cdot)$ is a one-dimensional Brownian motion. Show that for each time $t > 0$

$$\mathbb{E}(u(W(t), t)) = u(0, 0).$$

Solution of Problem 39 Let $Y(t) = u(W(t), t)$. By using Itô's chain rule, we know that:

$$dY = u_x dW + u_t dt + \frac{1}{2} u_{xx} dt = u_x dW + (u_t + \frac{1}{2} u_{xx}) dt = u_x dW.$$

Therefore, $Y(t)$ is a martingale, which leads to:

$$\mathbb{E}u(W(t), t) = \mathbb{E}Y(t) = Y(0) = u(0, 0).$$

Problem 40 Calculate $\mathbb{E}(B^2(t))$ for the Brownian bridge $B(\cdot)$, and show in particular that $\mathbb{E}(B^2(t)) \rightarrow 0$ as $t \rightarrow 1^-$.

Solution of Problem 40 We have already known that the Brownian bridge has the following formulation:

$$B(t) = (1-t) \int_0^t \frac{1}{1-s} dW(s).$$

Then, we can obtain that:

$$\mathbb{E}[B^2(t)] = (1-t)^2 \cdot \int_0^t \frac{1}{(1-s)^2} ds = (1-t)^2 \cdot \left(\frac{1}{1-t} - 1 \right) = t(1-t).$$

Furthermore, it's obvious to verify that when $t \rightarrow 1^-$, $\mathbb{E}[B^2(t)] = t(1-t) \rightarrow 0$, which comes to our conclusion.

Problem 41 Let X solve the Langevin equation, and suppose that X_0 is an $\mathcal{N}(0, \frac{\sigma^2}{2b})$ random variable. Show that

$$\mathbb{E}[X(s)X(t)] = \frac{\sigma^2}{2b} e^{-b|t-s|}.$$

Solution of Problem 41 According to the formulation of the solution for the Langevin equation, we have:

$$X(t) = e^{-bt} X_0 + \sigma \int_0^t e^{-b(t-c)} dW(c), \quad X(s) = e^{-bs} X_0 + \sigma \int_0^s e^{-b(s-c)} dW(c).$$

Without loss of generality, we assume that $t > s$, then:

$$\mathbb{E}[X(t)X(s)] = e^{-b(t+s)} \mathbb{E}X_0^2 + \sigma^2 \cdot \mathbb{E} \left[\int_0^t e^{-b(t-c)} dW(c) \cdot \int_0^s e^{-b(s-c)} dW(c) \right]$$

since the other two terms have expectation 0. Then:

$$\begin{aligned} & \mathbb{E} \left[\int_0^t e^{-b(t-c)} dW(c) \cdot \int_0^s e^{-b(s-c)} dW(c) \right] \\ &= \mathbb{E} \left[\int_0^s e^{-b(t-c)} dW(c) \cdot \int_0^s e^{-b(s-c)} dW(c) + \int_s^t e^{-b(t-c)} dW(c) \cdot \int_0^s e^{-b(s-c)} dW(c) \right] \\ &= \int_0^s e^{-b(t+s-2c)} dc + 0 = \frac{e^{-b(t-s)} - e^{-b(t+s)}}{2b}. \end{aligned}$$

Also, $\mathbb{E}X_0^2 = \frac{\sigma^2}{2b}$. To sum up, we finally obtain that:

$$\mathbb{E}[X(s)X(t)] = \frac{\sigma^2}{2b} e^{-b(t-s)} = \frac{\sigma^2}{2b} e^{-b|t-s|}.$$

Problem 42 (1) Consider the ODE

$$\begin{cases} \dot{x} &= x^2 & (t > 0) \\ x(0) &= x_0. \end{cases}$$

Show that if $x_0 > 0$, the solution "blows up to infinity" in finite time.

(2) Next, look at the ODE

$$\begin{cases} \dot{x} &= x^{1/2} & (t > 0) \\ x(0) &= 0. \end{cases}$$

Show that this problem has infinitely many nonnegative solutions.

(Hint: $x \equiv 0$ is a solution. Find also a solution which is positive for times $t > 0$, and then combine these solutions to find ones which are zero for some time and then become positive.)

Solution of Problem 42

(1) Notice that $\dot{x} = x^2 \geq 0$, which means $x(t)$ is a monotonic function and therefore $x(t) \geq x(0) = x_0 > 0$ holds for all $t \geq 0$. Since:

$$\frac{dx}{dt} = x^2 \Rightarrow \frac{dx}{x^2} = dt \quad \int_0^T \frac{dx(t)}{x(t)^2} = T,$$

where we used $x(t) > 0$. Then we have:

$$\frac{1}{x_0} - \frac{1}{x(T)} = T \Rightarrow x(T) = \frac{x_0}{1 - Tx_0}$$

holds for all $T > 0$. Therefore, this solution blows up to infinity at $T = \frac{1}{x_0}$, which is a finite time.

(2) Consider the following functions:

$$x_s(t) = \begin{cases} 0 & \text{when } 0 \leq t \leq s \\ \frac{(t-s)^2}{2} & \text{when } t > s \end{cases}.$$

Here $s > 0$. Then, we notice that for $\forall s > 0$, function $x_s(t)$ satisfies the given ODE, and it is non-negative, which comes to our conclusion.

Problem 43 (1) Use the substitution $X = u(W)$ to solve the SDE

$$\begin{cases} dX &= -\frac{1}{2}e^{-2X}dt + e^{-X}dW \\ X(0) &= x_0 \end{cases}.$$

(2) Show that the solution blows up at a finite, random time.

Solution of Problem 43

(1) We use the substitution $X = u(W)$, then:

$$dX = u'(W(t))dW(t) + \frac{1}{2}u''(W(t))dt.$$

We need:

$$u' = e^{-u}, u'' = -e^{-2u}, u(0) = x_0.$$

Then $u(t) = \ln(t + e^{x_0})$. To sum up, the solution of the SDE is:

$$X(t) = \ln(W(t) + e^{x_0}).$$

(2) The blowup time is the following stopping time $\tau = \min\{t : W(t) = -e^{x_0}\}$. For any positive integer n , define the event $E_n := \{\tau \geq n\}$. Then: by using Reflection Theorem, we know that:

$$\mathbb{P}\{E_n\} = \mathbb{P}\{|W(n)| < e^{x_0}\} = 2\Phi\left(\frac{e^{x_0}}{\sqrt{n}}\right).$$

Also, it is obvious that $E_1 \supseteq E_2 \supseteq \dots$, and when $n \rightarrow \infty$, we have:

$$\lim_{n \rightarrow \infty} \mathbb{P}\{E_n\} = 0,$$

which means:

$$0 = \mathbb{P}\left\{\lim_{n \rightarrow \infty} E_n\right\} = \mathbb{P}\{E\}$$

where $E := \{\tau = +\infty\}$. It means the solution blows up at time τ , which is a random time. With probability 1, this time is finite.

Problem 44 Solve the SDE $dX = -Xdt + e^{-t}dW$.

Solution of Problem 44 We use the substitution $X = e^{-t}W(t) + f(t)$, then:

$$dX = -e^{-t}W(t)dt + e^{-t}dW(t) + f'(t)dt = e^{-t}dW(t) + (-e^{-t}W(t) + f'(t))dt.$$

Now we just need $f(t) = -f'(t) \Rightarrow f(t) = Ae^{-t}$. To sum up, the solution of the SDE is:

$$X = e^{-t}W(t) + Ae^{-t},$$

where $A = X(0)$ can be any real constant.

Problem 45 Let $\mathbf{W} = (W^1, W^2, \dots, W^n)$ be an n -dimensional Brownian motion and write

$$R := |\mathbf{W}| = \left(\sum_{i=1}^n (W^i)^2\right)^{1/2}.$$

Show that R solves the stochastic Bessel equation

$$dR = \frac{n-1}{2R}dt + \sum_{i=1}^n \frac{W^i}{R}dW^i.$$

Solution of Problem 45 Denote function $F : \mathbb{R}^n \rightarrow \mathbb{R}$ as $F(x) := \|x\|_2$. Then:

$$F'_k(x) = \frac{x_k}{\|x\|_2}, \quad F''_{kk}(x) = \frac{\|x\|_2^2 - x_k^2}{\|x\|_2^3}.$$

According to Itô's chain rule, it holds that:

$$dR = \frac{1}{R} \sum_{i=1}^n W^i dW^i + \frac{1}{2R^3} \sum_{i=1}^n (R^2 - x_k^2) dt = \sum_{i=1}^n \frac{W^i}{R} dW^i + \frac{nR^2 - R^2}{2R^3} dt = \frac{n-1}{2R} dt + \sum_{i=1}^n \frac{W^i}{R} dW^i,$$

which comes to our conclusion.

Problem 46 (1) Show that $\mathbf{X} = (\cos(W), \sin(W))$ solves the system of SDE

$$\begin{cases} dX^1 &= -\frac{1}{2}X^1 dt - X^2 dW \\ dX^2 &= -\frac{1}{2}X^2 dt + X^1 dW \end{cases}.$$

(2) Show also that if $\mathbf{X} = (X^1, X^2)$ is any other solution, then $|\mathbf{X}|$ is constant in time.

Solution of Problem 46

(1) We only need to verify the SDE solution.

$$dX^1 = d\cos(W) = -\sin(W)dW - \frac{1}{2}\cos(W)dt = -X^2 dW - \frac{1}{2}X^1 dt.$$

$$dX^2 = d\sin(W) = \cos(W)dW - \frac{1}{2}\sin(W)dt = X^1 dW - \frac{1}{2}X^2 dt.$$

(2) Denote $F = (X^1)^2 + (X^2)^2$, then:

$$\begin{aligned} dF &= 2X^1 dX^1 + (X^2)^2 dt + 2X^2 dX^2 + (X^1)^2 dt \\ &= 2X^1(-X^2 dW - \frac{1}{2}X^1 dt) + 2X^2(X^1 dW - \frac{1}{2}X^2 dt) + F dt \\ &= -F dt + F dt = 0 \end{aligned}$$

Therefore, $F = |\mathbf{X}|^2$ is constant in time, which leads to the fact that $|\mathbf{X}|$ is also constant in time.

Problem 47 Solve the system

$$\begin{cases} dX^1 &= dt + dW^1 \\ dX^2 &= X^1 dW^2, \end{cases}$$

where $\mathbf{W} = (W^1, W^2)$ is a Brownian motion.

Solution of Problem 47 From the first equation, we easily know that

$$X^1 = t + W^1(t) + c_1$$

where c_1 can be any real constant. Then, X^2 satisfies:

$$dX^2 = (t + c_1 + W^1(t))dW^2.$$

We can simply write down the following formulation:

$$X^2 = c_1 W^2(t) + c_2 + \int_0^t (s + W^1(s))dW^2(s).$$

To sum up, the solution of the SDE is:

$$\begin{cases} X^1 &= t + W^1(t) + c_1 \\ X^2 &= c_1 W^2(t) + c_2 + \int_0^t (s + W^1(s))dW^2(s). \end{cases}$$

Problem 48 Solve

$$\begin{cases} dX^1 &= X^2 dt + dW^1 \\ dX^2 &= X^1 dt + dW^2. \end{cases}$$

Solution of Problem 48 Denote $W_1 := \frac{W^1+W^2}{\sqrt{2}}, W_2 := \frac{W^1-W^2}{\sqrt{2}}$. Also, we denote $X = X_1 + X_2, Y = X_1 - X_2$. Then, $\{W_1(t)\}, \{W_2(t)\}$ are Brownian motions. After adding the two equations above, we obtain that:

$$dX = X dt + \sqrt{2}dW_1,$$

which is a Langevin equation. The solution is:

$$X = e^t \left(c_1 + \sqrt{2} \int_0^t e^{-s} dW_1(s) \right) = e^t \left(c_1 + \int_0^t e^{-s} dW^1(s) + \int_0^t e^{-s} dW^2(s) \right).$$

Similarly, after subtracting the two equations above, we obtain that:

$$dY = -Y dt + \sqrt{2}dW_2,$$

which is also a Langevin equation. The solution is:

$$Y = e^{-t} \left(c_2 + \sqrt{2} \int_0^t e^s dW_2(s) \right) = e^{-t} \left(c_2 + \int_0^t e^s dW^1(s) - \int_0^t e^s dW^2(s) \right).$$

Therefore, the solution of this SDE is:

$$\begin{cases} X^1 &= \frac{c_1 e^t + c_2 e^{-t}}{2} + \int_0^t \frac{e^{t-s} + e^{s-t}}{2} dW^1(s) + \int_0^t \frac{e^{t-s} - e^{s-t}}{2} dW^2(s) \\ X^2 &= \frac{c_1 e^t - c_2 e^{-t}}{2} + \int_0^t \frac{e^{t-s} - e^{s-t}}{2} dW^1(s) + \int_0^t \frac{e^{t-s} + e^{s-t}}{2} dW^2(s). \end{cases}$$

Problem 49 Solve

$$\begin{cases} dX &= \frac{1}{2} \sigma'(X) \sigma(X) dt + \sigma(X) dW \\ X(0) &= 0 \end{cases}$$

where W is a one-dimensional Brownian motion and σ is a smooth, positive function.

(Hint: Let $f(x) := \int_0^x \frac{dy}{\sigma(y)}$ and set $g := f^{-1}$, the inverse function of f . Show that $X = g(W)$.)

Solution of Problem 49 Denote function $f(x) := \int_0^x \frac{dy}{\sigma(y)}$ and $Y = f(X)$. Then $Y(0) = 0$ and

$$\begin{aligned} dY &= f'(X)dX + \frac{1}{2}f''(X) \cdot \sigma^2(X)dt = \frac{1}{\sigma(X)}dX - \frac{\sigma'(X)}{2\sigma^2(X)} \cdot \sigma^2(X)dt \\ &= \frac{1}{2}\sigma'(X)dt + dW - \frac{1}{2}\sigma'(X)dt = dW. \end{aligned}$$

Since $Y(0) = 0$, we have: $Y(t) = W(t)$. Therefore, the solution of the SDE is:

$$X = f^{-1}(Y) = g(W).$$