

ISLR 4: Classification

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Logistic Regression: Stock Market

For this example, we use the `Smarket` stock market data from the `ISLR` package. As usual, lets load the library, data, and call a few common commands to get familiar with the data

```
library(ISLR)
data(Smarket)
```

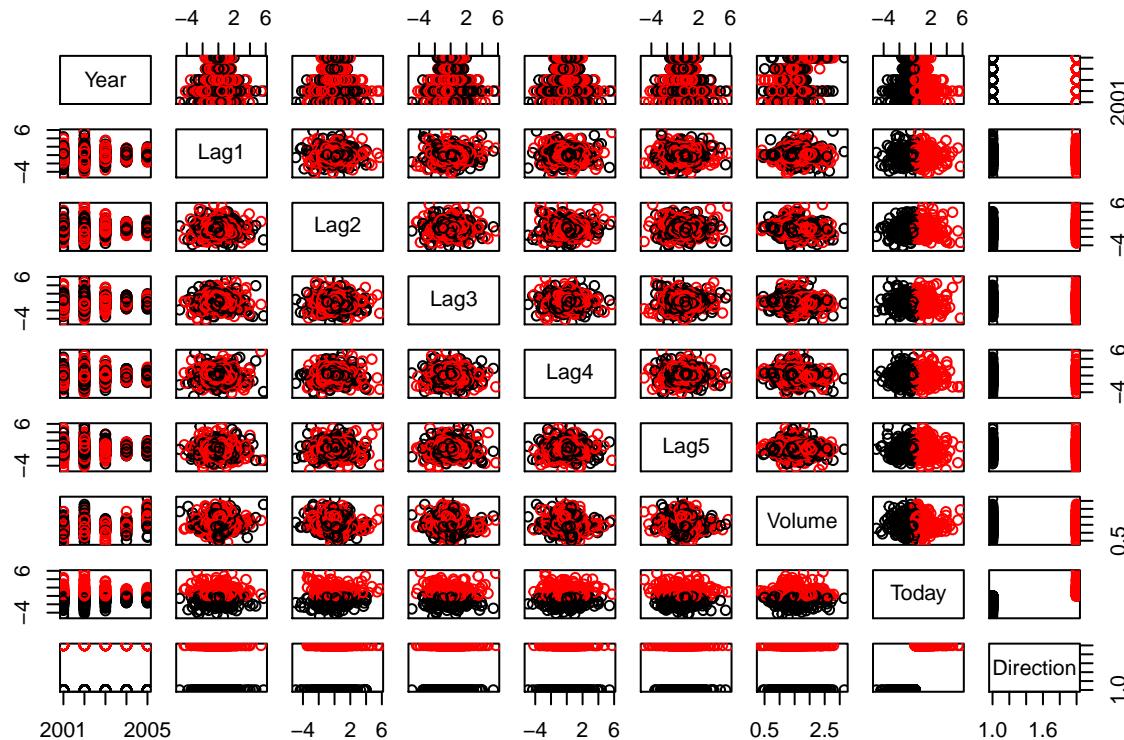
```
?Smarket
```

```
head(Smarket)
```

```
##   Year   Lag1   Lag2   Lag3   Lag4   Lag5 Volume Today Direction
## 1 2001  0.381 -0.192 -2.624 -1.055  5.010 1.1913  0.959      Up
## 2 2001  0.959  0.381 -0.192 -2.624 -1.055 1.2965  1.032      Up
## 3 2001  1.032  0.959  0.381 -0.192 -2.624 1.4112 -0.623     Down
## 4 2001 -0.623  1.032  0.959  0.381 -0.192 1.2760  0.614      Up
## 5 2001  0.614 -0.623  1.032  0.959  0.381 1.2057  0.213      Up
## 6 2001  0.213  0.614 -0.623  1.032  0.959 1.3491  1.392      Up
```

Lets make a plot with the `pairs` function.

```
pairs(Smarket, col = Smarket$Direction)
```



Since we are interested in classification, we will use the `glm` function on the specified model in a similar fashion to regression. However, lets set the `family` argument to “`binomial`” to run the logistic regression.

```
smarket_logistic <- glm(Direction ~ Lag1 + Lag2 + Lag3 + Lag4 + Lag5 + Volume,
                           data = Smarket, family = binomial)
```

```

summary(smarket_logistic)

##
## Call:
## glm(formula = Direction ~ Lag1 + Lag2 + Lag3 + Lag4 + Lag5 +
##      Volume, family = binomial, data = Smarket)
##
## Deviance Residuals:
##    Min     1Q Median     3Q    Max
## -1.446 -1.203  1.065  1.145  1.326
##
## Coefficients:
##             Estimate Std. Error z value Pr(>|z|)
## (Intercept) -0.126000  0.240736 -0.523   0.601
## Lag1        -0.073074  0.050167 -1.457   0.145
## Lag2        -0.042301  0.050086 -0.845   0.398
## Lag3         0.011085  0.049939  0.222   0.824
## Lag4         0.009359  0.049974  0.187   0.851
## Lag5         0.010313  0.049511  0.208   0.835
## Volume       0.135441  0.158360  0.855   0.392
##
## (Dispersion parameter for binomial family taken to be 1)
##
## Null deviance: 1731.2 on 1249 degrees of freedom
## Residual deviance: 1727.6 on 1243 degrees of freedom
## AIC: 1741.6
##
## Number of Fisher Scoring iterations: 3

```

Next, lets pass the `smarket_logistic` model to the `predict` function, and define the argument type as `response`. This will turn give us a vector of probabilities. We can view the first 5 and we see that basically, its about a 50/50 chance of

```

logistic_probs <- predict(smarket_logistic, type = "response")
logistic_probs[1:5]

```

```

##      1      2      3      4      5
## 0.5070841 0.4814679 0.4811388 0.5152224 0.5107812

```

We can turn these probabilities into classification by setting a threshold at 0.50 or 50%. the `ifelse` function is helpful for performing the classification and the `table` function for displaying the results.

```

logistic_pred <- ifelse(logistic_probs > 0.5, "Up", "Down")

```

```

table(logistic_pred, Smarket$Direction)

```

```

##
## logistic_pred Down Up
##                 Down 145 141
##                 Up   457 507

```

```

mean(logistic_pred==Smarket$Direction)

```

```

## [1] 0.5216

```

Make training and test set

While that was interesting, we used all the data available so we've probably over-fit the model. Lets subset the data to `train` the `logistic_probs` model on the data prior to 2005, and then run then test it on the data after 2005. We can do this by creating a logical index to identify values prior to 2005, and then use that index to subset the `Smarket` data.frame. Note, the `glm` function has a `subset` argument which you can use to directly pass the index to.

```
train <- Smarket$Year < 2005

smarket_logistic <- glm(Direction ~ Lag1 + Lag2 + Lag3 + Lag4 + Lag5 + Volume,
                           data = Smarket, family = binomial, subset = train)
```

The `predict` function does not have the `subset` argument, so one must use the `!` logical negation operator within the `Smarket` data.frame extraction brackets to indicate an interest in returning values which are the opposite of the index provided. In other words, use the `logistic_probs` model to make predictions on data after 2005.

```
logistic_probs <- predict(smarket_logistic, newdata = Smarket[!train,], type="response")
```

Finally, classify probabilities as either "Up" and "Down" and call the `table` function to create a confusion matrix as well as the `mean` function.

```
logistic_pred <- ifelse(logistic_probs > 0.5, "Up", "Down")

Direction_2005 <- Smarket$Direction[!train]

table(logistic_pred, Direction_2005)

##          Direction_2005
## logistic_pred Down Up
##      Down    77 97
##      Up      34 44

mean(logistic_pred == Direction_2005)

## [1] 0.4801587
```

Fit smaller model

Repeat the process with just `Lag1` and `Lag2` variables.

```
smarket_logistic <- glm(Direction~Lag1+Lag2, data=Smarket, family=binomial, subset=train)

logistic_probs <- predict(smarket_logistic, newdata=Smarket[!train, ], type = "response")

logistic_pred <- ifelse(logistic_probs > 0.5, "Up", "Down")

mean(logistic_pred == Direction_2005)

## [1] 0.5595238

class_table <- table(logistic_pred, Direction_2005)

class_table

##          Direction_2005
## logistic_pred Down Up
```

```

##           Down    35   35
##           Up     76 106
class_table[4]/sum(class_table[2,])

## [1] 0.5824176
predict(smarket_logistic, newdata=data.frame(Lag1=c(1.2,1.5), Lag2=c(1.1,-0.8)), type="response")

##          1         2
## 0.4791462 0.4960939

```

Linear Discriminant Analysis

Lets load Ripley's MASS package

```

library(MASS)
data(Smarket)

```

Again, we are going to try and predict the Smarket data by using the returns of the last two days on all data prior to 2005.

```

train <- Smarket$Year < 2005

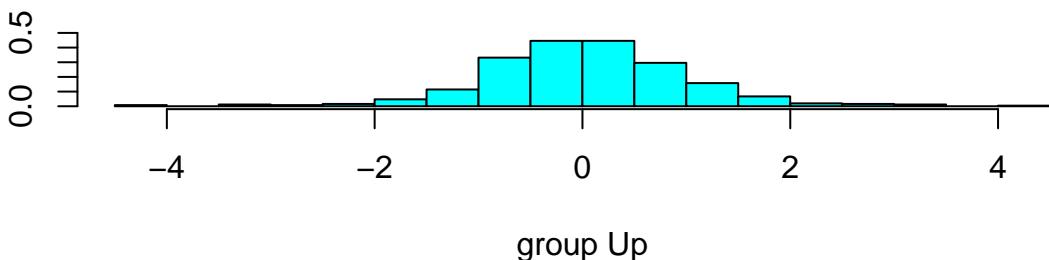
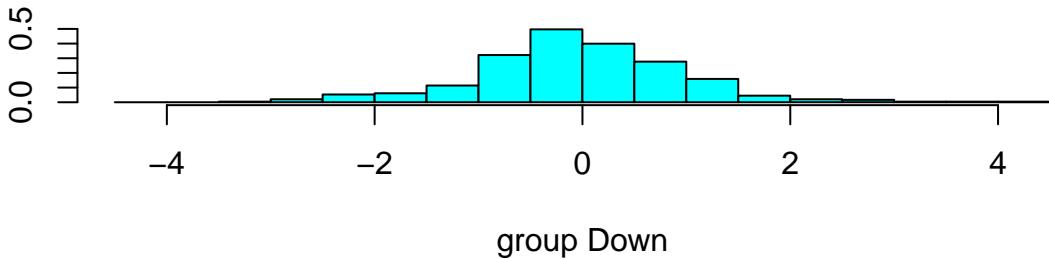
lda_Smarket <- lda(Direction ~ Lag1 + Lag2, data = Smarket, subset = train)

lda_Smarket

## Call:
## lda(Direction ~ Lag1 + Lag2, data = Smarket, subset = train)
##
## Prior probabilities of groups:
##       Down      Up
## 0.491984 0.508016
##
## Group means:
##             Lag1      Lag2
## Down  0.04279022  0.03389409
## Up   -0.03954635 -0.03132544
##
## Coefficients of linear discriminants:
##                 LD1
## Lag1 -0.6420190
## Lag2 -0.5135293

plot(lda_Smarket)

```



So lets see how we predict on year 2005 and the first 5 items of the prediction.

```
Smarket2005 <- subset(Smarket, Year==2005)

lda_pred <- predict(lda_Smarket, Smarket2005)

class(lda_pred)

## [1] "list"

data.frame(lda_pred)[1:5,]

##      class posterior.Down posterior.Up        LD1
## 999     Up      0.4901792   0.5098208  0.08293096
## 1000    Up      0.4792185   0.5207815  0.59114102
## 1001    Up      0.4668185   0.5331815  1.16723063
## 1002    Up      0.4740011   0.5259989  0.83335022
## 1003    Up      0.4927877   0.5072123 -0.03792892
```

We are interested in the `class` column, which is short for classification so lets create a confusion matrix with that. Linear Discriminant Analysis gives us a little bit better results than the logistic regression.

```
table(lda_pred$class, Smarket2005$Direction)

##
##          Down  Up
##  Down    35  35
##  Up      76 106
```

```
mean(lda_pred$class==Smarket2005$Direction)
## [1] 0.5595238
```

Quadratic Discriminant Analysis

And QDA performs both LDA, and logistic regression.

```
qda.fit <- qda(Direction ~ Lag1 + Lag2, data = Smarket, subset = train)

qda.fit

## Call:
## qda(Direction ~ Lag1 + Lag2, data = Smarket, subset = train)
##
## Prior probabilities of groups:
##     Down      Up
## 0.491984 0.508016
##
## Group means:
##           Lag1      Lag2
## Down  0.04279022 0.03389409
## Up   -0.03954635 -0.03132544
qda.class <- predict(qda.fit, Smarket2005)$class

table(qda.class, Direction_2005)

##          Direction_2005
## qda.class Down Up
##     Down    30 20
##     Up     81 121
mean(qda.class==Direction_2005)
## [1] 0.5992063
```

K-Nearest Neighbors

A simple, but very effective classification tool, we are going to use the `class` package to run k-nearest neighbors on the `Smarket` data.

```
library(class)
```

As usual, check out the documentation.

```
?knn
```

First, lets create a matrix, `Xlag` of the first and second lags of the `Smarket` returns and also define our `train` set. Pass them both to the `knn` function setting the `k` as 3 for the number of neighbors considered.

```
Xlag <- cbind(Smarket$Lag1, Smarket$Lag2)

train <- Smarket$Year < 2005
```

```
knn_pred <- knn(train = Xlag[train,], test = Xlag[!train,],
                  cl = Smarket$Direction[train], k = 3)
```

Produce the confusion Matrix.

```
table(knn_pred, Smarket$Direction[!train])
```

```
##  
## knn_pred Down Up  
##      Down   48 55  
##      Up     63 86  
mean(knn_pred == Smarket$Direction[!train])  
## [1] 0.531746
```