

Trends in Extreme Value Index

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Background

- Classic extreme value analysis assumes that the observations are i.i.d.
- Recent studies aim at dealing with the case when observations are drawn from different distributions.
- This paper considers a continuously changing extreme value index and try to estimate the functional extreme value index accurately.

Model Setting

- Consider a set of distributions $F_s(x)$ for $s \in [0, 1]$ and independent random variables $X_i \sim F_{\frac{i}{n}}(x)$ for $i = 1, \dots, n$.
- Here $F_s(x)$ is assumed to be continuous with respect to s and x . And assume that $F_s \in D_{\gamma(s)}$.
- This article considers the case that the function γ is positive and continuous on $[0, 1]$.
- The goal is to estimate the function γ and test the hypothesis that $\gamma = \gamma_0$ for some given function γ_0 .

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Methodology

- The idea for estimating $\gamma(s)$ locally is similar to the kernel density estimation.
- More specifically, use only observations X_i in the h -neighborhood of s , that is

$$i \in I_n(s) = \left\{ \left| \frac{i}{n} - s \right| \leq h \right\},$$

where $h := h(n)$ is the bandwidth such that as $n \rightarrow \infty$, $h \rightarrow \infty$ and $nh \rightarrow \infty$.

- Correspondingly, there will be $[2nh]$ observations for $s \in [h, 1 - h]$.

Local estimator

- To apply any known estimators for extreme value index, such as Hill estimator, choose an intermediate sequence $k = k(n)$ such that $k \rightarrow \infty, k/n \rightarrow 0$ as $n \rightarrow \infty$.
- Then one can use the top $[2kh]$ order statistics among the $[2nh]$ local observations in the h -neighborhood of s to estimate $\gamma(s)$.
- The local Hill estimator for $\gamma(s)$ is defined as follows. Rank the $[2nh]$ observations X_i with $i \in I_n(s)$ as $X_{1,[2nh]}^{(s)} \leq \dots \leq X_{[2nh],[2nh]}^{(s)}$. Then

$$\hat{\gamma}_H(s) := \frac{1}{[2kh]} \sum_{i \in I_n(s)} (\log X_i - \log X_{[2nh]-[2kh],[2nh]}^{(s)})^+.$$

Second order condition

To obtain the asymptotic theory, the following conditions are required.

First, the second order condition is assumed. Suppose there exists a continuous negative function $\rho(s)$ on $[0, 1]$ and a set of auxiliary function $A_s(t)$ that are continuous with respect to s , such that

$$\lim_{t \rightarrow \infty} \frac{\frac{U_s(tx)}{U_s(t)} - x^{\gamma(s)}}{A_s(t)} = x^{\gamma(s)} \frac{x^{\rho(s)} - 1}{\rho(s)}, \quad (3)$$

holds for $x > 1/2$ and uniformly for all $s \in [0, 1]$.

Conditions for k and h

Choose the intermediate sequence k and the bandwidth h as follows:

$$h = h_n \rightarrow 0, k = k_n \rightarrow \infty, k_n/n \rightarrow 0, \frac{k_n h_n}{|\log h_n|} \rightarrow \infty, \quad (4)$$

$$\Delta_{1,n} := \sqrt{k_n} \sup_{0 \leq s \leq 1} |A_s(\frac{n}{k_n})| \rightarrow 0 \quad (5)$$

$$\Delta_{2,n} := \sqrt{k_n} \log k_n \sup_{|s_1 - s_2| \leq 2h_n} |\gamma(s_1) - \gamma(s_2)| \rightarrow 0. \quad (6)$$

$$\Delta_{3,n} := \sup_{|s_1 - s_2| \leq h_n} \left| \frac{\frac{U_{s_1}(\frac{n}{k_n})}{U_{s_2}(\frac{n}{k_n})} - 1}{A_{s_2}(\frac{n}{k_n})} \right| \rightarrow 0 \quad (7)$$

Theorem 2.1: Asymptotical normality of the local estimator

Theorem (2.1)

Let X_1, X_2, \dots, X_n be independent random variables with distributions $X_i \sim F_{i/n}(x)$, where $F_s(x)$ is a set of distribution functions depends on $s \in [0, 1]$. Assume that $F_s(x)$ is continuous with respect to x and s and $F_s \in D_{\gamma(s)}$ where $\gamma(s)$ is a positive continuous function on $[0, 1]$. Assume conditions (3)-(7). Then as $n \rightarrow \infty$, we have that for all $s \in (0, 1)$,

$$\sqrt{2kh}(\hat{\gamma}_H(s) - \gamma(s)) \xrightarrow{d} N(0, \gamma^2(s)).$$

Main difficulties of the proofs

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Global Estimator

Next, consider testing the hypothesis that $\gamma(s) = \gamma_0(s)$ for all $s \in [0, 1]$.

- Although we are able to estimate the function γ locally, since the local estimators use only local observations, their asymptotic limits are obviously independent. **What does this mean?**
- In addition, the local estimator converges with a slow speed of convergence $1/\sqrt{2kh}$.
- To achieve the stated goal, we consider the estimation $\Gamma(s) = \int_0^s \gamma(u)du$ and test the equivalent hypothesis that $\Gamma = \Gamma_0$.

Global Estimator

- Consider a discretized version of $\hat{\gamma}_H(s) : \hat{\gamma}_H \left((2[\frac{s}{2h}] + 1)h \right)$.
- Define the estimator of $\Gamma(s)$ as the integral of the discretized version as follows: for all $0 \leq s \leq 1$,

$$\hat{\Gamma}_H(s) = \int_0^s \hat{\gamma}_H \left(\left(2 \left[\frac{u}{2h} \right] + 1 \right) h \right) du.$$

- Note that $\hat{\gamma}_H(s)$ is only defined for $s \leq 1 - h$.
- For $u > 1 - h$, we may have $(2[\frac{s}{2h}] + 1)h = (2[\frac{1}{2h}] + 1)h$. Then we extend the range of the estimator and define $\hat{\gamma}_H((2[\frac{s}{2h}] + 1)h) := \hat{\gamma}_H((2[\frac{s}{2h}] - 1)h)$

Asymptotic Properties of the Global Estimator

Theorem (2.2)

Assume the same conditions in Theorem 2.1. Then under a Skorokhod construction, there exists a series of Brownian motions $W_n(s)$ such that as $n \rightarrow \infty$,

$$\sup_{s \in [0,1]} \left| \sqrt{k} \left(\hat{\Gamma}_H(s) - \Gamma(s) \right) - \int_0^s \gamma(u) dW_n(u) \right| \xrightarrow{P} 0.$$

Sketch of the proofs

Testing Trends in Extreme Value Indices

The null hypothesis is $H_0 : \Gamma(s) = \Gamma_0(s)$ for all s .

Clearly, one may construct the Kolmogorov-Smirnov(KS) type test with the testing statistic defined as

$$T := \sup_{s \in [0,1]} \left| \hat{\Gamma}_H(s) - \Gamma_0(s) \right|.$$

Then by Theorem 2.2, under the null hypothesis H_0 ,

$$\sqrt{k}T \xrightarrow{d} \sup_{s \in [0,1]} \left| \int_0^s \gamma(u) dW(u) \right|.$$

Testing Trends in Extreme Value Indices

It is often of interest to test whether the extreme value index remains constant over time, that is, $H_0 : \gamma(s) = \gamma$ for all $s \in [0, 1]$ without specifying γ . In this case, one may use $\hat{\Gamma}_H(1)$ as an estimator of the constant extreme value index γ and define the testing statistic as

$$\tilde{T} := \sup_{s \in [0,1]} \left| \frac{\hat{\Gamma}_H(s)}{\hat{\Gamma}_H(1)} - s \right|.$$

It is straightforward to show under H_0 , as $n \rightarrow \infty$

$$\sqrt{k} \tilde{T} \xrightarrow{d} \sup_{s \in [0,1]} |B(s)|,$$

where $B(s)$ is a standard Brownian bridge defined on $[0,1]$.

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Simulation Setting

Run a simulation study to demonstrate the finite sample performance of the testing procedure using \tilde{T} .

- $m = 2000$ samples
- $n = 2000$ observations in each sample
- $k = 100, 200$
- $h = 0.025, 0.04$

For each sample, simulate the observations from the following data generating process

$$X_i = Z_i^{1/\gamma(i/n)}, i = 1, 2, \dots, n,$$

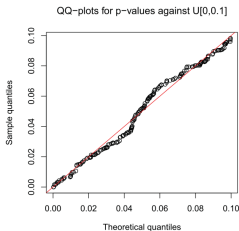
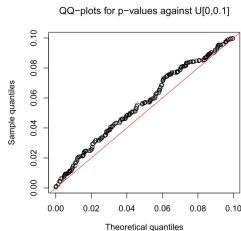
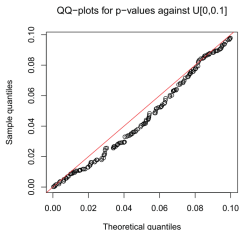
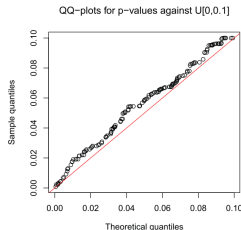
where $\{Z_i\}_{i=1}^n$ are iid observations from the standard Fréchet distribution.

Simulation Setting

For the function $\gamma(s)$ we consider

- either a linear trend as $\gamma(s) = 1 + bs$
- or a trend following the sin function as $\gamma(s) = 1 + c \sin(2\pi s)$.
- If $b = 0$ or $c = 0$, the two model resemble the iid case.
- Consider four alternative cases $b = 1, b = 2, c = 1/4$ and $c = 1/2$.

QQ plots for $b = 0$

(1) $k = 200$ $h = 0.025$  $h = 0.04$ (ii) $k = 100$ $h = 0.025$  $h = 0.04$ 

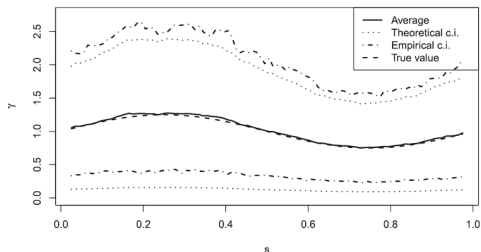
Rejection Rate

Table 1. Rejection rates in simulations: sample size $n = 5000$.

		$k = 200$		$k = 100$	
		α	$h = 0.025$	$h = 0.040$	
iid observations		0.1	0.104	0.117	0.092
		0.05	0.051	0.053	0.052
		0.01	0.011	0.010	0.013
Linear trend	$b = 1$	0.1	0.831	0.682	0.539
		0.05	0.731	0.559	0.407
		0.01	0.505	0.338	0.207
	$b = 2$	0.1	0.989	0.960	0.843
		0.05	0.970	0.917	0.743
		0.01	0.888	0.740	0.480
Sin trend	$c = 1/4$	0.1	0.500	0.696	0.254
		0.05	0.388	0.597	0.165
		0.01	0.195	0.385	0.064
	$c = 1/2$	0.1	0.991	0.999	0.850
		0.05	0.976	0.994	0.770
		0.01	0.921	0.984	0.533

Estimated varying extreme value index: sin trends

(i) $c = 1/4$



(ii) $c = 1/2$

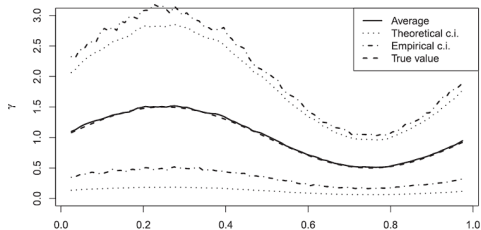


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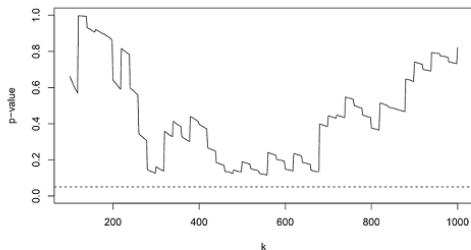
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Precipitation at Saint-Martin-de-Londres

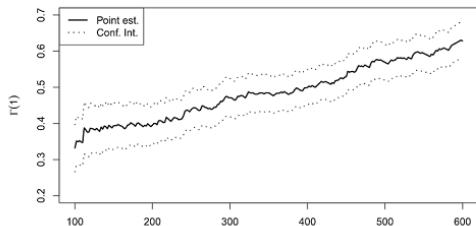
- A dataset consisting of the precipitation at Saint-Martin-de-Londres from 1976 to 2015, with 14,610 daily observations.
- Test the constancy of the extreme value indices over the entire period.
- Do not reject the null hypothesis under the 5
- Estimate the constant extreme value index by applying the Hill estimator to all observations, that is, estimating $\Gamma(1)$.

Testing the constancy of EVI:precipitation

(i) p-values



(ii) estimates of the extreme value index

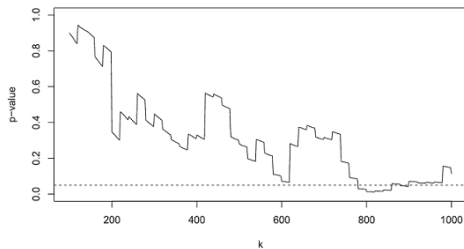


Application 2: loss Return of S&P 500

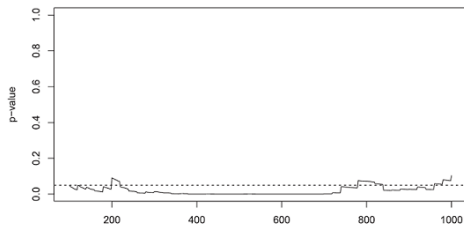
- S&P 500 index 1988-2012($n=6302$) & 1963-2012($n=12586$).
- Daily loss returns are defined as $X_t = \log(P_t/P_{t+1})$

Testing the constancy of EVI: S&P500

(i) 1988–2012



(ii) 1963–2012

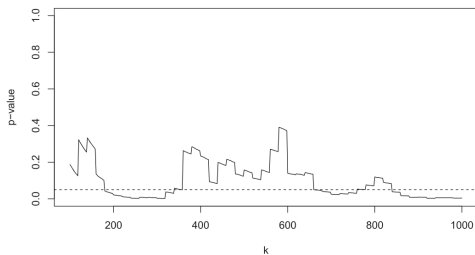


Serial Dependence

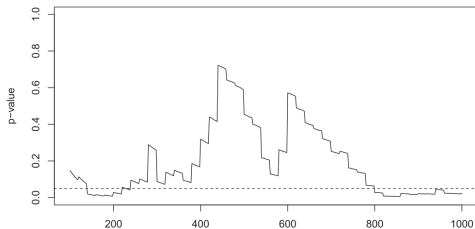
- Financial data such as stock returns exhibits serial dependence. Correspondingly, the critical value of the proposed test should be higher.
- By using the test based on assuming no serial dependence, we tend to over reject the null.
- Given that the analysis using the data from 1988 to 2012 did not reject the null, accounting for serial dependence may not alter the conclusion. However, the rejection result based on the data from 1963 to 2012 may suffer from the serial dependence issue.

Testing the constancy of EVI: S&P500

(i) odd days



(ii) even days



Thanks!