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1. CONVENTIONS

- $X \sim f(x, \xi)$: a random variables X with the PDF $f(x, \xi)$.

2. GENERAL PROBABILITY THEORY

2.1. Random Variables

Definition 2.1. A **probability space** $(\Omega, \mathfrak{R}, \mathbb{P})$ is a triple of a set Ω and σ -additive measure \mathbb{P} with domain \mathfrak{R} , a σ -algebra defined on Ω , satisfying $\mathbb{P}(\Omega) = 1$ and $\mathbb{P}(\emptyset) = 0$.

A event can be represented as an element in Ω . A type of events can be abstracted as a subset $A \in \Omega$. The measure $\mathbb{P}(A)$ is called the probability of event A happens. If $\mathbb{P}(A) = 1$, we say that A will occurs almost surely.

Definition 2.2. A **random variable** X on $(\Omega, \mathfrak{R}, \mathbb{P})$ is a \mathfrak{R} -measurable function $X : \Omega \rightarrow \mathbb{R}$. The \mathfrak{R} -measurable here means:

$$X^{-1}(B) = \{\omega : \omega \in \Omega, X(\omega) \in B\} \in \mathfrak{R}, \quad (1)$$

where B is any Borel subset of \mathbb{R} .

A random variables is a function encoding events into real numbers for mathematical modeling purpose. Furthermore, as a random variable is a mapping from Ω to \mathbb{R} , it will natrually induce the following practical conception.

Definition 2.3. The **distribution measure** μ_X of X is a pushforward measure induced by X as $\mu_X(B) = X_*\mathbb{P} = \mathbb{P}\{X^{-1}(B)\}$, where B is any Borel subset of \mathbb{R} .

The **Radon-Nikodym's** theorem implies that there exists a non-negative function $f(x)$ bridged the distribution measure μ_X and the natural linear measure of \mathbb{R} as

$$\mu_X(B) = \int_B f(x)dx, \quad \forall B \in \mathbb{R}, \quad (2)$$

where the B is a Borel subset of \mathbb{R} . This function $f(X)$ is called the **probability density function** (PDF). A **cumulative distribution function**(CDF) $F(x)$ is defined as $F(x) = \mathbb{P}\{X \leq x\}$. Assum g is a measurable function and $g(x)f(x)$ is integrable, then

$$\int_{\mathbb{R}} g(x)d\mu_X = \int_{X^{-1}(\mathbb{R})} (g \circ X)(\omega)d\mathbb{P} = \int_{\mathbb{R}} g(x)f(x)dx. \quad (3)$$

To simplify, we assume that $X^{-1}(\mathbb{R}) = \Omega$ for any random variable defined on $(\Omega, \mathfrak{R}, \mathbb{P})$. Furthermore, suppose $G(x)$ is a function of X , and $f(x)$ is PDF of X , then

$$\int_{\Omega} G[X(\omega)]d\mathbb{P} = \int_{\mathbb{R}} G(x)f(x)dx, \quad (4)$$

if $G(x)f(x)$ is integrable over \mathbb{R} respect to the natural linear measure.

Definition 2.4. If a random vairable X is integrable, the **expectation** of X , denoted as $\mathbb{E}(X)$ is defined as

$$\mathbb{E}(X) = \int_{\Omega} X(\omega)d\mathbb{P}. \quad (5)$$

Based on the Eq.4, the expectation $\mathbb{E}(X)$ can be calculated from

$$\mathbb{E}(X) = \int_{\mathbb{R}} xf(x)dx. \quad (6)$$

Furthermore, a variance $\text{Var}X$ is defined as

$$\text{Var}X = \int_{\Omega} (X - \mathbb{E}X)^2d\mathbb{P}, \quad (7)$$

in an extreme case, if $\text{Var}X = 0$ implies that X convergence to $\mathbb{E}X$ by mean (another term we say X converges to $\mathbb{E}X$ almost surely).

Definition 2.5. A σ -algebra generated by a random variable X , denoted as $\sigma(X)$ is the collection of subsets $X^{-1}(B)$ where B is any Borel subset of \mathbb{R} . Since X is required to be \mathfrak{R} -measurable by definition, it follows $\sigma(X) \subseteq \mathfrak{R}$. Furthermore, suppose two σ -algebra

$\mathfrak{G}, \mathfrak{H} \subseteq \mathfrak{R}$, we called them are **independent** with each other if

$$\mathbb{P}(A \cap B) = \mathbb{P}(A)\mathbb{P}(B), \quad \forall A \in \mathfrak{G}, \forall B \in \mathfrak{H}. \quad (8)$$

We say two random variables X and Y are independent if $\sigma(X)$ and $\sigma(Y)$ are independent, denoted as $X \perp\!\!\!\perp Y$.

Definition 2.6. A **moment generating function** $M_X(t)$, $t \in \mathbb{R}$ for a random variable X is defined as $M_X(t) = \mathbb{E}e^{tX}$.

Theorem 2.1. The following properties of moment generating functions are straight forward:

1. $\mathbb{E}(X^n) = M_X^{(n)}(0)$, n th derivative of $M_X(t)$.
2. If $M_X(t) = M_Y(t)$, then $X = Y$.

2.2. Joint Probabilities and Independence

Definition 2.7. Given two random variables X, Y , the pair (X, Y) forms a mapping $X \times Y : \Omega \rightarrow \mathbb{R}^2$, the **joint probability measure** $\mu_{X,Y}$ is defined as a pushforward measure

$$\mu_{X,Y}(A \times B) = \mathbb{P}[(X \times Y)^{-1}(A \times B)], \quad \forall A \times B \in \mathfrak{B}(\mathbb{R}^2), \quad (9)$$

where $\mathfrak{B}(\mathbb{R}^2)$ represent all the Borel subsets of \mathbb{R}^2 and

$$(X \times Y)^{-1}(A \times B) = X^{-1}(A) \cap Y^{-1}(B), \quad (10)$$

Theorem 2.2. Suppose X, Y , then the following conditions are equivalent

1. $X \perp\!\!\!\perp Y$;
2. For the joint measure $\mu_{X,Y}(A \times B) = \mu_X(A)\mu_Y(B)$, $\forall A \times B \in \mathfrak{B}(\mathbb{R}^2)$
3. For the PDF $f_X(x)$, $f_Y(y)$ and $f_{X,Y}(x, y)$ or CDF $F_X(x)$, etc:

$$\begin{aligned} f_{X,Y}(a, b) &= f_X(a)f_Y(b), \quad \forall \text{a.e.}(a, b) \in \mathbb{R}^2, \\ F_{X,Y}(a, b) &= F_X(a)F_Y(b), \quad \forall (a, b) \in \mathbb{R}^2; \end{aligned} \quad (11)$$

4. For the joint moment generating function:

$$\mathbb{E}e^{uX+vY} = \mathbb{E}e^{uX}\mathbb{E}e^{vY}; \quad (12)$$

Proof. Assuming the condition satisfied, the 2nd condition comes immediately from the Eq. 8. Consequently, 3rd one holds as

$$F_{X,Y}(a, b) = \mu_{X,Y}([-\infty, a] \times [-\infty, b]). \quad (13)$$

The 2nd condition also implies that Fubini's theorem valid for any $h(x, y)$ integrable function and we have

$$\begin{aligned} \mathbb{E}h(x, y) &= \int_{\mathbb{R}^2} h(x, y) d\mu_{X,Y} \\ &= \int_{\mathbb{R}} \int_{\mathbb{R}} h(x, y) f_X(x) dx f_Y(y) dy. \end{aligned} \quad (14)$$

This leads to 4th condition holds. \square

Theorem 2.3. Suppose $X \sim f_X(x)$ and $Y \sim f_Y(y)$ are two independent variables, then the PDF of $Z = XY$ is given by the formula

$$f_Z(z) = \int_{-\infty}^{\infty} f_X(z/y) f_Y(y) \frac{dy}{|y|}. \quad (15)$$

Proof. To get the PDF of the Z , we first construct the CDF of Z as

$$\begin{aligned} \mathbb{P}(Z \leq z) &= \mathbb{P}(XY \leq z) \\ &= \mathbb{P}(XY \leq z, Y < 0) + \mathbb{P}(XY \leq z, Y \geq 0) \\ &= \mathbb{P}(X \geq z/Y, Y < 0) + \mathbb{P}(X \leq z/Y, Y \geq 0) \\ &= \left(\int_{-\infty}^0 \int_{z/y}^{\infty} + \int_0^{\infty} \int_{-\infty}^{z/y} \right) [f_X(x) f_Y(y) dx] dy. \end{aligned} \quad (16)$$

The PDF is obtained from differentiate the formula above with respect to z :

$$\int_0^{\infty} f_X(z/y) f_Y(y) \frac{dy}{y} - \int_{-\infty}^0 f_X(z/y) f_Y(y) \frac{dy}{y}. \quad (17)$$

\square

2.3. Information and Conditioning

For a given probability space $(\Omega, \mathfrak{R}, \mathbb{P})$, Ω suppose to contained all the possible events occur, and the σ -algebra \mathfrak{R} represents all the possible set to be distinguished, or measured by probability \mathbb{P} . The information about the event is ability to label the event with more details. This means that the more information we have, the smaller subset of Ω can be measured. Based on this idea, a σ -algebra $\mathfrak{G} \subseteq \mathfrak{R}$ stays for the limit we can measure under certain information condition.

Definition 2.8. Let \mathfrak{G} be a sub- σ -algebra of \mathfrak{R} in $(\Omega, \mathfrak{R}, \mathbb{P})$ and X is a non-negative or integrable random variable. The **conditoinal expectation** of X given condition \mathfrak{G} , denoted as $\mathbb{E}(X|\mathfrak{G})$, is any random variable satisfies

1. Measurability: $\mathbb{E}(X|\mathfrak{G})$ is \mathfrak{G} -measurable;
2. Partial average:

$$\int_A \mathbb{E}(X|\mathfrak{G})(\omega) d\mathbb{P}(\omega) = \int_A X(\omega) d\mathbb{P}(\omega), \quad \forall A \in \mathfrak{G}. \quad (18)$$

If $\mathfrak{G} = \sigma(W)$, a σ -algebra generated by random variable W , then we denoted $\mathbb{E}(X|W) := \mathbb{E}(X|\sigma(W))$.

The requiements in the definitions preserved the existance and the uniqueness of the $\mathbb{E}(X|\mathfrak{G})$. The Eq. 18 defined a new measure, denoted as $\mu_{X|\mathfrak{G}}$ on $(\Omega, \mathfrak{G}, \mathbb{P}|\mathfrak{G})$ where $\mathbb{P}|\mathfrak{G}$ is a restrict of \mathbb{P} to \mathfrak{G} . Based on the Radon-Nikodym theorem, it implies the existance of $\mathbb{E}(X|\mathfrak{G})$ which equal to the Radon-Nikodym derivative

$d\mu_X|_{\mathfrak{G}}/d\mathbb{P}|_{\mathfrak{G}}$. The uniqueness can be varified as follow: Assuming Y, Z are two variables satisfying the Eq. 18, and A is a set that $Y(a) \leq Z(a), \forall a \in A$, then the integral of $Z - Y$ should be non-negative, however,

$$\int_A \{Z(a) - Y(a)\} d\mathbb{P} = 0, \quad \forall A \in \mathfrak{G},$$

which implies that $Z = Y$ by mean (in other term, it is called $Z = Y$ almost surely).

Theorem 2.4. Let $(\Omega, \mathfrak{R}, \mathbb{P})$ be a probability space, X be a integrable random variable, and $\mathfrak{G}, \mathfrak{H}$ be sub- σ -algebra.

1. Linearity: Given integrable random variables X, Y and $a, b \in \mathbb{R}$, then

$$\mathbb{E}(aX + bY|\mathfrak{G}) = a\mathbb{E}(X|\mathfrak{G}) + b\mathbb{E}(Y|\mathfrak{G}). \quad (19)$$

2. If X, Y are integrable, XY is integrable as well, and X is \mathfrak{G} -measurable, then

$$\mathbb{E}(XY|\mathfrak{G}) = X\mathbb{E}(Y|\mathfrak{G}). \quad (20)$$

3. Suppose \mathfrak{H} is a σ -algebra that $\mathfrak{H} \subseteq \mathfrak{G}$, then

$$\mathbb{E}[(X|\mathfrak{G})|\mathfrak{H}] = \mathbb{E}(X|\mathfrak{H}). \quad (21)$$

4. If $\sigma(X) \perp \mathfrak{G}$, then

$$\mathbb{E}(X|\mathfrak{G}) = \mathbb{E}X \quad (22)$$

5. Jensen's inequality: If $\varphi(x)$ is a convex function, then

$$\mathbb{E}[\varphi(X)|\mathfrak{G}] \geq \varphi[\mathbb{E}(X|\mathfrak{G})]. \quad (23)$$

Proof. The linearity comes from the linearity properties of Lebesgue integral. For the 2nd point, it is enough to notice that

$$\int_A \mathbb{I}_B \mathbb{E}(Y|\mathfrak{G})(\omega) d\mathbb{P} = \int_{A \cap B} Y(\omega) d\mathbb{P} = \int_A \mathbb{I}_B Y(\omega) d\mathbb{P},$$

where $B \subseteq A \in \mathfrak{G}$. Any integrable X can be approximated by the summation of $\mathbb{I}_B, \forall B \in \mathfrak{G}$ monotonically. It follows that the integral converges which conclude this theorem. For the 3rd point, it is obvious by expanding two sides for the equation by the definition Eq.18.

To prove the 4th one, suppose $X = \mathbb{I}_B$ where $B \in \sigma(X)$, then

$$\int_A X(\omega) d\mathbb{P} = \mathbb{P}(A \cap B) = \mathbb{P}(A)\mathbb{P}(B) = \int_A \mathbb{E}X d\mathbb{P},$$

which conclude this theorem. The last point comes from the properties of a convex function $\varphi(x)$ that

$$\varphi(tx_1 + (1-t)x_2) \leq t\varphi(x_1) + (1-t)\varphi(x_2), \quad (24)$$

and this definition can be extend to

$$\varphi\left(\sum_{i=1}^n t_i x_i\right) \leq \sum_{i=1}^n t_i \varphi(x_i), \quad (25)$$

since, by induction, we assume the equation valid for $n-1$ case, and for n term case, it can be expended as

$$\begin{aligned} \varphi\left(\sum_{i=1}^n t_i x_i\right) &\leq t_n \varphi(x_n) + \frac{1}{1-t_n} \varphi\left(\sum_{i=1}^{n-1} \frac{t_i}{1-t_n} x_i\right), \\ &\leq \sum_{i=1}^n t_i \varphi(x_i), \end{aligned}$$

as the $\sum_{i=1}^{n-1} t_i/(1-t_n) = 1$. On the other hand, a expectation of X can be approximated by a sequence of simple function like $X_n = \sum x_n \mathbb{P}(A_{x_n})$ and $\sum \mathbb{P}(A_{x_n}) = 1$ by definition, where $A_{x_n} = X^{-1}[x_n, x_n + 1/n]$. These two points lead to this theorem. \square

Definition 2.9. A sequence of σ -algebra $\mathfrak{F}(t)$, ordered by a parameter t , is called a **Filtration** if $\mathfrak{F}(s) \subseteq \mathfrak{F}(t), \forall s \leq t$. Given a sequence of random variables $X(t)$ indexed by $t \in [0, T]$ is called an **Adapted Stochastic Process** if $X(t)$ is $\mathfrak{F}(t)$ -measurable $\forall t \in [0, T]$. A stochastic process $X(t)$ is called **Martingale** if

$$\mathbb{E}[X(t)|\mathfrak{F}(s)] = X(s), \quad \forall s \leq t \in [0, T]. \quad (26)$$

Furthermore, let $f(x), g(x)$ are both Borel-measurable functions, we call $X(t)$ as a **Markov Process** if

$$\mathbb{E}[f(X(t))|\mathfrak{F}(s)] = g(X(s)) \quad \forall s \leq t \in [0, T]. \quad (27)$$

3. DISTRIBUTIONS

3.1. Poisson Distribution

Definition 3.1 (Poisson assumption). Assume a integer valued random variable K with a PDF $g(k, h)$ where an parameter h satisfying the following assumption when $h \rightarrow 0$:

1. $g(1, h) = \lambda h + o(h)$;
2. $\sum_{k=2}^{\infty} g(k, h) = o(h)$;
3. $g(0, h)g(0, w) = g(0, h+w)$;
4. $g(x, w+h) = g(x, w)g(0, h) + g(x-1, w)g(1, h)$.

Then $g(x, w)$ is a **Poisson distribution**:

$$g(x, w) = \frac{1}{x!} (\mu)^x e^{-\mu}, \quad \mu = \lambda w \text{ and } x = 0, 1, 2, \dots \quad (28)$$

Proof. The $o(h)$ means that $\lim_{h \rightarrow 0} o(h)/h = 0$.

$$\begin{aligned} g(0, w+h) &= g(0, w)[1 - \lambda h - o(h)], \\ \frac{dg(0, w)}{dw} &= \lambda g(0, w), \\ g(0, w) &= ce^{-\lambda w}. \end{aligned}$$

Repeat the similar procedure to Eq.4, we get the formula:

$$\partial_w g(x, w) = -\lambda g(x, w) + \lambda g(x-1, w).$$

Using this equation, the conclusion can be approved by induction. \square

Suppose $g(x, h)$ is the probability of x changes in a interval with a width h , if it satisfies the Poisson's assumptions, it means that the event that changing of x depends only on the width of the interval and this probability can be approximated linearly when h is small enough. One example of many applications satisfying the Poisson's assumptions is that the atomic decay with time. In this case, $g(x, h)$ represents the number of decays x happened inside of time interval h .

Theorem 3.1. Suppose $X \sim \text{Poisson}(\mu)$, then

1. $\mathbb{E}(X) = \mu$ and $\text{Var}(X) = \mu^2$;
2. The moment generating function

$$M_X(t) = \exp[\mu(e^t - 1)]; \quad (29)$$

3. If $Y = \sum_i X_i$ where $X_i \sim \text{Poisson}(\mu_i)$ and $x_i \perp\!\!\!\perp x_j, \forall i \neq j$, then

$$Y \sim \text{Poisson}\left(\sum_i \mu_i\right). \quad (30)$$

Proof. We first prove the second point and the first one follows from the theorem 2.1. In fact

$$\mathbb{E}(e^{xt}) = \sum_{x=0}^{\infty} e^{xt} \frac{\mu^x e^{-\mu}}{x!} = \sum_{x=0}^{\infty} \frac{(\mu e^t)^x e^{-\mu}}{x!} = e^{\mu(e^t - 1)}.$$

\square

3.2. Normal distributions

Definition 3.2. A **normal distribution** with mean μ and variance σ^2 , denoted as $N(\mu, \sigma^2)$ is

$$N(\mu, \sigma^2)(x) = \frac{1}{\sqrt{2\pi}\sigma^2} \exp\left\{-\frac{(x-\mu)^2}{2\sigma^2}\right\}. \quad (31)$$

If a random variable $X \sim N(\mu, \sigma^2)$, this variable is called **Gaussian**. And we call X as **standard normal** variable if $X \sim N(0, 1)$. A random variable Y is called n -dimensional Gaussian random variable if $\mathbf{X} = (X_1, X_2, \dots, X_n)$, where $X_i \sim N(\mu_i, \sigma_i^2)$ and $X_i \perp\!\!\!\perp X_j, \forall i \neq j$.

Theorem 3.2. Assume $X_i \sim N(\mu_i, \sigma_i^2)$, $X_i \perp\!\!\!\perp X_j, \forall i \neq j$, $a_i \in \mathbb{R}$, and $Y = \sum_{i=1}^n a_i X_i$, then:

1. The moment generating function of X is $M_X(t) = \exp(\mu t + \sigma^2 t^2/2)$
2. The PDF of Y is

$$Y \sim N\left(\sum_{i=1}^n a_i \mu_i, \sum_{i=1}^n a_i^2 \sigma_i^2\right). \quad (32)$$

3. If $Z_i = (X_i - \mu_i)/\sigma_i$, then $Z_i \sim N(0, 1)$;
4. $Z_i^2 \sim \chi^2(1)$, and if $Y = \sum_{i=1}^n Z_i^2$, then $Y \sim \chi^2(n)$.

Proof. Just briefly draw the line of the proof:

1. It follows from the straight forward calculation of $\mathbb{E}(e^{Xt})$.
2. Consider $n = 2$ case, since X_i are independent, the moment generating function is

$$\begin{aligned} M_{a_1 X_1 + a_2 X_2}(t) &= M_{a_1 X_1}(t) M_{a_2 X_2}(t) \\ &= \exp\left[a_1 \mu_1 + a_2 \mu_2 + \frac{(a_1^2 \sigma_1^2 + a_2^2 \sigma_2^2) t^2}{2}\right], \end{aligned}$$

which is the same as the variable $Z \sim N(a_1 \mu_1 + a_2 \mu_2, a_1^2 \sigma_1^2 + a_2^2 \sigma_2^2)$. On the other hand, if we consider the PDF $f(cx)dx$ with substituting the x by $y = x/c$, the calculation leads to $g(y)dy$ where $g(y) = N(c\mu, c^2\sigma^2)$. It implies that $M_{a_i X_i}(t) = \exp(a_i \mu_i + a_i^2 \sigma_i^2/2)$.

3. Here we need to show that $X - c \sim N(\mu - c, \sigma^2)$ if $X \sim N(\mu, \sigma^2)$. In fact, shifting the integral center by a finite number won't affect the integral as the integral range is $[-\infty, +\infty]$.
4. We start from calculating $\mathbb{E}(e^{Z^2 t})$ for $Z \sim N(0, 1)$, then

$$\begin{aligned} \mathbb{E}(e^{Z^2 t}) &= \int_{-\infty}^{\infty} e^{z^2 t} e^{-z^2/2} \frac{dz}{\sqrt{2\pi}}, \\ &= \int_0^{\infty} e^{xt} \frac{x^{-\frac{1}{2}} e^{-x/2}}{\sqrt{2\pi}} dx, \end{aligned}$$

which is the mgf of $\chi^2(1) = \Gamma(1/2, 2)$. For the general case, notice that the volume $V_n(R)$ of a n -dimensional ball is

$$V_n(R) = \frac{\pi^{n/2} R^n}{\Gamma(n/2 + 1)}, \quad (33)$$

so that the mgf of $Y = \sum_i Z_i^2$ is

$$\begin{aligned} \mathbb{E}Y &= \prod_{i=1}^n \left\{ \int \frac{e^{-z_i^2/2 + z_i^2 t}}{\sqrt{2\pi}} dz_i \right\} \\ &= \int_0^{\infty} \frac{1}{(2\pi)^{n/2}} e^{-r^2/2 + r^2 t} \frac{\partial V_n(r)}{\partial r} dr, \quad (34) \\ &= \int_0^{\infty} \frac{\rho^{n/2-1} e^{-\rho/2}}{\Gamma(n/2) 2^{n/2}} e^{t\rho} d\rho, \end{aligned}$$

where I substituted R by $\rho = R^2$ and the final expression is the mgf of $\Gamma(n/2, 2) = \chi^2(n)$. \square

3.3. Γ and χ^2 distributions

Definition 3.3. A Gamma distribution $\Gamma(\alpha, \beta)$, $\alpha, \beta > 0$ is defined as

$$\begin{aligned}\Gamma(\alpha, \beta)(x) &= \frac{x^{\alpha-1} e^{-x/\beta}}{\Gamma(\alpha) \beta^\alpha} \Theta(x), \\ \Gamma(\alpha) &= \int_0^\infty \frac{x^{\alpha-1} e^{-x/\beta}}{\Gamma(\alpha) \beta^\alpha} dx,\end{aligned}\quad (35)$$

where $\Theta(x)$ is a step function $\Theta(x) = 1, \forall x \geq 0$ and $\Theta(x) = 0, \forall x < 0$.

Theorem 3.3. Given a variable $X \sim \Gamma(\alpha, \beta)$, we have

1. The mgf $M_X(t) = (1 - \beta t)^{-\alpha}$ for $t < \beta^{-1}$;
2. $\mathbb{E}X = \alpha\beta$ and $\text{Var}X = \alpha\beta^2$;
3. Suppose $X_i \sim \Gamma(\alpha_i, \beta)$ and $Y = \sum_i X_i$, then

$$Y \sim \Gamma\left(\sum_{i=1}^n \alpha_i, \beta\right). \quad (36)$$

Proof. To validate the 1st equation

$$\begin{aligned}\mathbb{E}e^{Xt} &= \int_0^\infty \frac{x^{\alpha-1} e^{(-x/\beta + xt)}}{\Gamma(\alpha) \beta^\alpha} dx, \\ &= \int_0^\infty \frac{x^{\alpha-1} e^{-x/\beta'}}{\Gamma(\alpha) \beta'^\alpha} dx, \\ &= (1 + \beta' t)^\alpha \\ &= (1 - t\beta)^{-\alpha}, \quad t\beta < 1,\end{aligned}\quad (37)$$

where $1/\beta' = t + 1/\beta > 0$. Then the expectation and variance follows immediately. The 3rd point is obvious from checking mgf $M_Y(t) = \prod_i M_{X_i}(t)$. \square

Definition 3.4. If $X \sim \Gamma(n/2, 2)$, $n \in \mathbb{Z}^+$ (positive integer), we say it is a χ^2 -distribution denoted as $X \sim \chi^2(n)$. $\mathbb{E}X = n$, $\text{Var}(X) = 2n$ from the theorem 3.3.

4. MAXIMUM LIKELIHOOD METHODS

4.1. Maximum Likelihood Estimation

Definition 4.1. Consider the case that $X \sim f(x; \theta)$ where θ is a parameter, a n -triple $\mathbf{x} = (x_1, \dots, x_n)$ represents n samples over X at a fix parameter value $\theta = \theta_0$ (turth). The **likelihood function** $L(\theta; \mathbf{x})$ is defined as

$$L(\theta; \mathbf{x}) = \prod_{i=1}^n f(x_i; \theta). \quad (38)$$

A **log likelihood function** $l(\theta; \mathbf{x})$ is

$$l(\theta; \mathbf{x}) = \log L(\theta; \mathbf{x}) = \sum_{i=1}^n \log f(x_i; \theta). \quad (39)$$

An estimator $\hat{\theta} = \hat{\theta}(\mathbf{x})$ is called the **Maximum Likelihood Estimator** (MLE) of θ if

$$\hat{\theta} = \text{Argmax } L(\theta; \mathbf{x}), \quad (40)$$

means that $L(\theta; \mathbf{x})$ achieves its maximum at $\hat{\theta}$. It implies that MLE satisfies the equation $\partial l(\theta)/\partial \theta = 0$.

Definition 4.2. (Regularity Conditions) Given a PDF $f(x; \theta)$ with the set Θ as the domain of θ , the regularity conditions for this PDF are

1. Distinctive: $f(x; \theta) \neq f(x; \theta')$ if $\theta \neq \theta'$;
2. The support of $f(x; \theta)$ independnt on θ ;
3. The θ_0 is a interior point of Θ .

Theorem 4.1. Suppose $X \sim f(x, \theta)$ and true parameter θ_0 with samples \mathbf{x} satisfy the regularity condition R1 and R2, then

$$\lim_{n \rightarrow \infty} P_{\theta_0}[L(\theta_0; \mathbf{x}) > L(\theta; \mathbf{x})] = 1, \quad \forall \theta \neq \theta_0. \quad (41)$$

Furthermore, if they satisfy all R1 to R3, then the solution $\hat{\theta}$ of the likelihood equation $\partial l(\theta)/\partial \theta = 0$ or $\partial L(\theta)/\partial \theta = 0$ converges to the truth θ_0 in probability.

5. STOCHASTIC PROCESSES

5.1. Brownian Motion

Definition 5.1. Given a space $(\Omega, \mathfrak{A}, \mathbb{P})$ and a given increments $0 = t_0 < t_1 < \dots < t_n$, a continuous function $W(t), t \in [0, \infty)$, with $W(0) = 0$ is called a **Brownian motion** if it satisfies any one of the follow three condition:

1. $D(t_i) \perp\!\!\!\perp D(t_j), \forall i \neq j$ and $D(t_i) \sim N(0, t_i - t_{i-1})$ where $D(t_i) = W(t_i) - W(t_{i-1})$;
2. $\mathbb{E}\mathbf{W} = \mathbf{0}$ and $\text{Var}\mathbf{W} = \mathbf{\Sigma}$, where \mathbf{W} is a jointly normal distribution $\mathbf{W} = (W_1, \dots, W_n)$ and

$$\begin{aligned}\mathbf{\Sigma} &= \begin{bmatrix} \mathbb{E}[W^2(t_1)], & \mathbb{E}[W(t_1)W(t_2)], & \dots & \mathbb{E}[W(t_1)W(t_n)] \\ \mathbb{E}[W(t_2)W(t_1)], & \mathbb{E}[W^2(t_2)], & \dots & \mathbb{E}[W(t_2)W(t_n)] \\ \vdots & \vdots & \ddots & \vdots \\ \mathbb{E}[W(t_n)W(t_1)] & \mathbb{E}[W(t_n)W(t_2)], & \dots & \mathbb{E}[W^2(t_n)] \end{bmatrix} \\ &= \begin{bmatrix} t_1, & t_1, & \dots & t_1 \\ t_1, & t_2, & \dots & t_2 \\ \vdots & \vdots & \dots & \vdots \\ t_1, & t_2, & \dots & t_n \end{bmatrix}.\end{aligned}\quad (42)$$

3. The mgf of \mathbf{W} is

$$\mathbb{E} \left(\sum_{i=1}^n u_i W_i \right) = \exp \left\{ \sum_{k=0}^{n-1} \left(\sum_{j=k+1}^n u_j \right)^2 (t_{k+1} - t_k) \right\}. \quad (43)$$

Proof. We first show that for $s \leq t$:

$$\begin{aligned} \mathbb{E}[W(s)W(t)] &= \mathbb{E}[W(s)(W(t) - W(s))] + \mathbb{E}[W^2(s)] \\ &= \mathbb{E}[W^2(s)] = \mathbb{E}[(W(s) - W(0))^2] \\ &= \text{Var}W^2(s) = s, \end{aligned} \quad (44)$$

where the assumption $D(t) \perp\!\!\!\perp W(s), \forall t \geq s$ used. Furthermore, $\mathbb{E}[W(s)W(t)] = \mathbb{E}[W(t)W(s)] = s, \forall t \geq s$. This proved the Eq.42. The same trick can be used repeatedly to derive the mgf above. \square

Theorem 5.1. Suppose the sequence of $0 = t_0 \leq t_1 \leq \dots \leq t_n$ and $W(t_i), t_i \in [0, T]$ is a Brownian motion, $D(t_i) = W(t_i) - W(t_{i-1}), i = 1, 2, \dots$ and define

$$\int_0^T [dW(t)]^2 = \lim_{\max(dt) \rightarrow 0} \sum_{i=1}^n [D(t_i)]^2, \quad (45)$$

where $\max(dt)$ is the maximum of $t_i - t_{i-1}$, for all $i = 1, 2, \dots$. Then

$$\int_0^T [dW(t)]^2 = T \quad \text{almost surely.} \quad (46)$$

Proof. It is easy to verify the following equation by using the definition $\text{Var}D(t_i) = t_i - t_{i-1}$:

$$\mathbb{E} \int_0^T [dD(t)]^2 = T, \quad (47)$$

then the proof left is to show $\text{Var} \left(\int_0^T [dD(t)]^2 \right) = 0$. Note that

$$\begin{aligned} \text{Var} \int_0^T [dW(t)]^2 &= \mathbb{E} \left(\int_0^T [dW(t)]^2 - T \right)^2, \\ &= \lim_{\max(dt) \rightarrow 0} \sum_{\{t_i\}} \left\{ \mathbb{E}[D(t_i)]^4 - 2dt_i \mathbb{E}[D(t_i)]^2 + (dt_i)^2 \right\}, \\ &= \lim_{\max(dt) \rightarrow 0} \sum_{\{t_i\}} 2(dt_i)^2 = 0. \end{aligned}$$

The last step comes from the fact that $\int_0^T (dt)^2 \leq dT \int_0^T dt \rightarrow 0$. The second last step comes from the $\mathbb{E}[D(t_i)]^4 = M_D^{(4)}(0) = 3(t_i - t_{i-1})$, where $M_D(t)$ is the mgf of $D(t_i)$. Again it leads to 0 as requiring $\max(dt) \rightarrow 0$. \square

The theorem above can be summarized as

$$\begin{aligned} dW(t)dW(t) &= dt + o(dt), \\ dW(t)dt &\sim o(dt), \\ dt dt &\sim o(dt). \end{aligned} \quad (48)$$

It implies that only the first quantities are need to be considered in an integral, the rest can be disregarded.

6. STOCHASTIC CALCULUS

6.1. Itô Integral

1. Itô Integral of Simple Functions

Definition 6.1. Given a probability Brownian motion $W(t)$ with a filter $\mathcal{F}(t)$, and $f(t)$ which is a $\mathcal{F}(t)$ -measurable simple function. The **Itô integral** $I(T)$ for the simple function $f(t)$, the values are discrete in the interval $(t_0 = 0, \dots, t_n = T)$, is defined as

$$I(T) = \int_0^T f(t)dW(t) = \sum_{i=0}^{n-1} f(t_i)[W(t_{i+1}) - W(t_i)]. \quad (49)$$

Theorem 6.1. Itô integral have the following properties

1. **Linearity:** For $c \in \mathbb{R}$ and another $\mathcal{F}(t)$ -measurable simple function $g(t)$, $c \int_0^T f(t)dt = \int_0^T cf(t)dt$ and $\int_0^T [f(t) + g(t)]dt = \int_0^T f(t)dt + \int_0^T g(t)dt$;
2. **Adapted:** $I(t)$ is continuous and $\mathcal{F}(t)$ -measurable;
3. $I(t)$ is a **martingale**;
4. **Itô isometry:** $\mathbb{E}I^2(t) = \mathbb{E} \int_0^t f^2(u)du$;
5. **Quadratic variation:** $[I, I](t) = \int_0^t f^2(u)du$.

Proof. Itô isometry: Expanding the integral, we get

$$\begin{aligned} &\mathbb{E} \left\{ \int_0^T f(t)dW(t) \right\}^2 \\ &= \mathbb{E} \left\{ \sum_i f(t_i)^2 dW^2(t_i) \right\} + \sum_{i>j} f(t_i)f(t_j) \mathbb{E}[D(t_i)]\mathbb{E}[D(t_j)] \\ &= \mathbb{E} \left\{ \sum_i f(t_i)^2 dt_i \right\} = \int_0^T f(t)^2 dt. \end{aligned}$$

The second term above vanishes due to the property 1 in Def. 5.1 and the $dW^2 = dt$ used in the first term. **Conitnuity:** For a given t , we can always find a small enough dt such that

$$I(t+dt) - I(t) = f(t)[dW(t+dt) - dW(t)]$$

and the continuity is the consequence from the fact that $\lim_{dt \rightarrow 0} dW(t) \rightarrow 0$. \square

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