

# Time Series: A First Course with Bootstrap Starter

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## Lesson 1: Takes and tools

### Takes

### Links to JD+

algorithms, doc and related training

### Overview in book

#### R skills

- plots
- simulating random V
- regression on time
- auto reg, with proper init

In “bis” versions I add - my questions - pb of bivariate normal - - more code - links to other refs - hints of proof

## Lesson 2-1: Random Vectors

- A time series sample is a finite stretch of realizations, i.e., a vector.
- A vector of random variables is called a random vector:  $\underline{X} = [X_1, \dots, X_n]'$ .

### Mean and Covariance

- The mean of  $\underline{X}$  is a vector, each of whose components is the expectation of the corresponding random variable:  $\mathbf{E}[X_i]$ .
- The covariance matrix of  $\underline{X}$  has entries given by the covariance between the corresponding components of the random vector:  $\text{Cov}[X_j, X_k]$ .
- The covariance matrix  $\text{Cov}[\underline{X}]$  of a random vector is non-negative definite and symmetric. Its eigenvalues are real and non-negative.

### Affine Transforms

- $\underline{Y} = A\underline{X} + \underline{b}$  is an affine transform of  $\underline{X}$ .
- If  $\mathbf{E}\underline{X} = \underline{\mu}$  and  $\text{Cov}[\underline{X}] = \Sigma$ , then  $\mathbf{E}\underline{Y} = A\underline{\mu} + \underline{b}$  and  $\text{Cov}[\underline{Y}] = A\Sigma A'$ .

### Covariance Decomposition

- We can decompose a symmetric matrix  $\Sigma$  as

$$\Sigma = P\Lambda P'$$

for an orthogonal matrix  $P$  (i.e.,  $P' = P^{-1}$ ), and where  $\Lambda$  is a diagonal matrix consisting of the real eigenvalues of  $\Sigma$ .

- A symmetric non-negative definite matrix  $\Sigma$  can be decomposed as  $\Sigma = BB'$ , and  $B$  is called a square root (it is not unique). One such square root is the *Cholesky* factor.
- If  $\underline{Z}$  has i.i.d. components with mean zero and variance one, then  $\underline{X} = B\underline{Z} + \underline{\mu}$  is a random vector with mean  $\underline{\mu}$  and covariance matrix  $BB'$ .

## Simulation Example

- Simulate a bivariate random vector with mean  $[1, 2]$  and covariance matrix

$$\Sigma = \begin{bmatrix} 2 & 1 \\ 1 & 4 \end{bmatrix}.$$

```
Sigma <- rbind(c(2,1),c(1,4))
mu <- c(1,2)
B <- t(chol(Sigma)) # t to get lower triangular
z <- matrix(rnorm(2*100),nrow=2) # 2 vecteurs de 100 obs
x <- B %*% z + mu
print(colMeans(t(x)))
```

```
## [1] 0.8538547 1.7369677
```

```
print(var(t(x)))
```

```
##           [,1]      [,2]
## [1,] 2.169217 1.346937
## [2,] 1.346937 3.652506
```

## Gaussian Random Vectors

- A random vector  $\underline{Y}$  is Gaussian with mean  $\underline{\mu}$  and non-singular covariance matrix  $\Sigma$  if its joint pdf is

$$p_{\underline{Y}}(\underline{y}) = (2\pi)^{-n/2} (\det \Sigma)^{-1/2} \exp\{-(\underline{y} - \underline{\mu})' \Sigma^{-1} (\underline{y} - \underline{\mu})/2\}.$$

- Denoted by writing  $\underline{Y} \sim \mathcal{N}(\underline{\mu}, \Sigma)$ .
- An affine transformation of a Gaussian vector is still Gaussian. In particular, sub-vectors are Gaussian.
- We can decorrelate a Gaussian random vector:  $\underline{X} = B^{-1}\underline{Y}$  has  $\text{Cov}[\underline{X}] = B^{-1}\Sigma B^{-1'} = 1_n$ , the identity matrix.
- The quadratic form

$$(\underline{Y} - \underline{\mu})' \Sigma^{-1} (\underline{Y} - \underline{\mu})$$

has a  $\chi^2$  distribution on  $n$  degrees of freedom.

# Lesson 2-2: Stochastic Processes

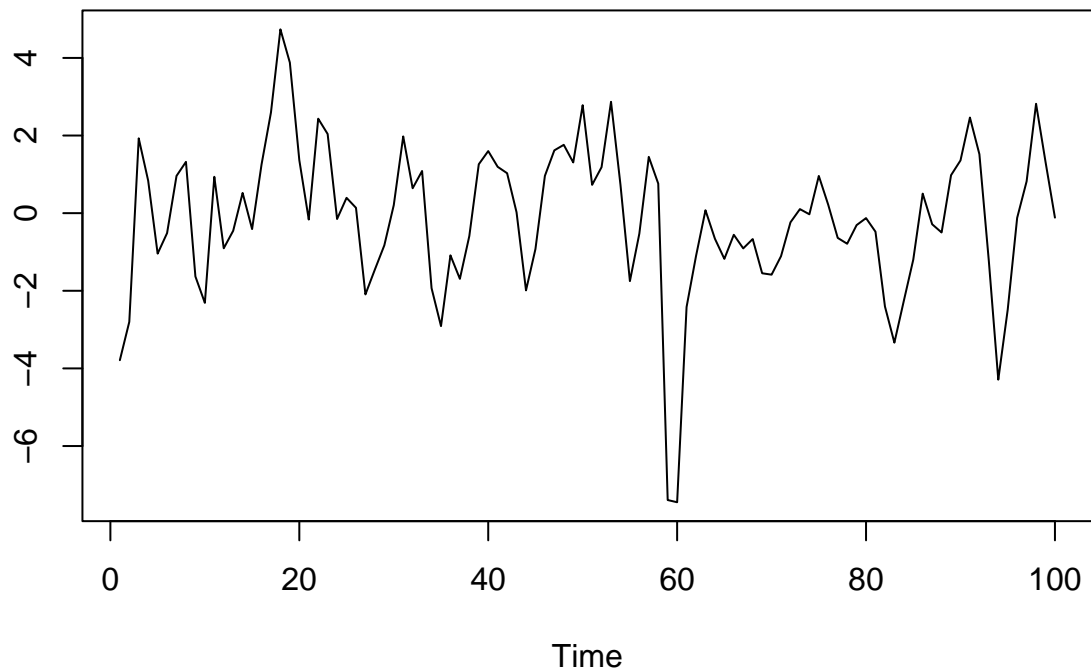
- A collection of random variables indexed by time is called a *stochastic process*, denoted as  $\{X_t\}$ . The curly brackets let us know  $\{X_t\}$  is the process, whereas  $X_t$  is a single random variable (at time  $t$ ).
- Usually time is  $t \in \mathbf{Z}$ , the integers.
- There are also continuous-time stochastic processes (another subject).

## Realization is Sample Path

- A random variable  $X_t$  has realization  $x_t$ .
- Example:  $X_t \sim \mathcal{N}(0, 1)$  has realization -0.5604756.
- Put this together for all  $t \in \mathbf{Z}$ , and the realization is called the *sample path*.

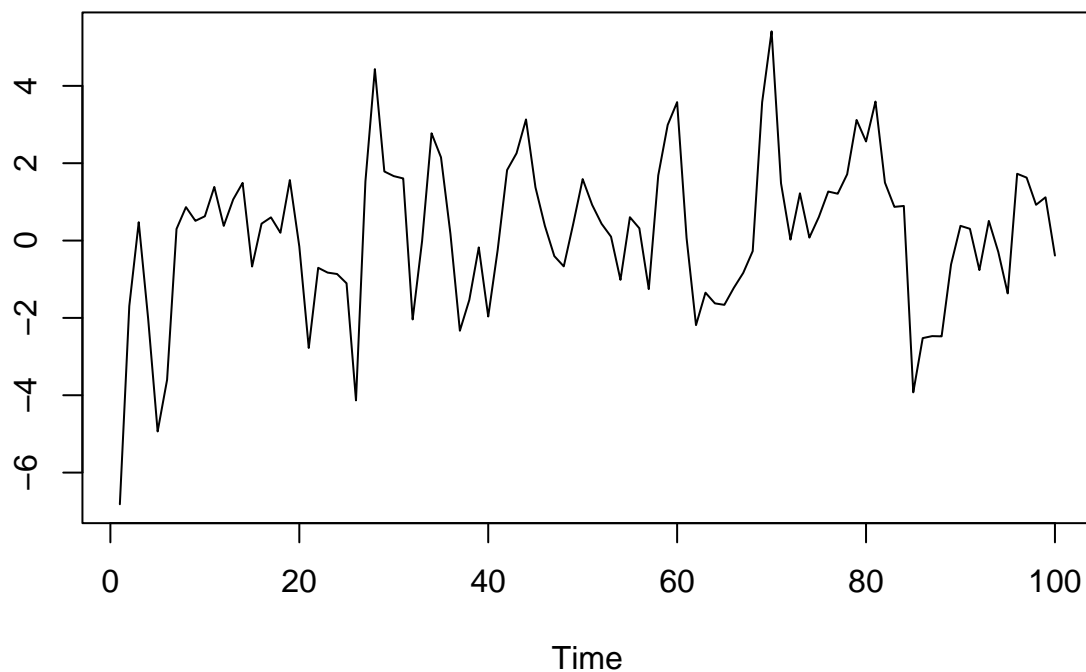
## Example: Heavy-tailed Sample Path

```
set.seed(777)
n <- 100
z <- rt(n+1,df=4) # heavy-tailed input
theta <- .8
x <- z[-1] + theta*z[-(n+1)]
plot(ts(x),xlab="Time",ylab="")
```



- As usual, we connect the dots when graphing the sample path.
- Here is another realization, or sample path, of the same stochastic process.

```
set.seed(888)
n <- 100
z <- rt(n+1,df=4)      # heavy-tailed input
theta <- .8
x <- z[-1] + theta*z[-(n+1)]
plot(ts(x),xlab="Time",ylab="")
```

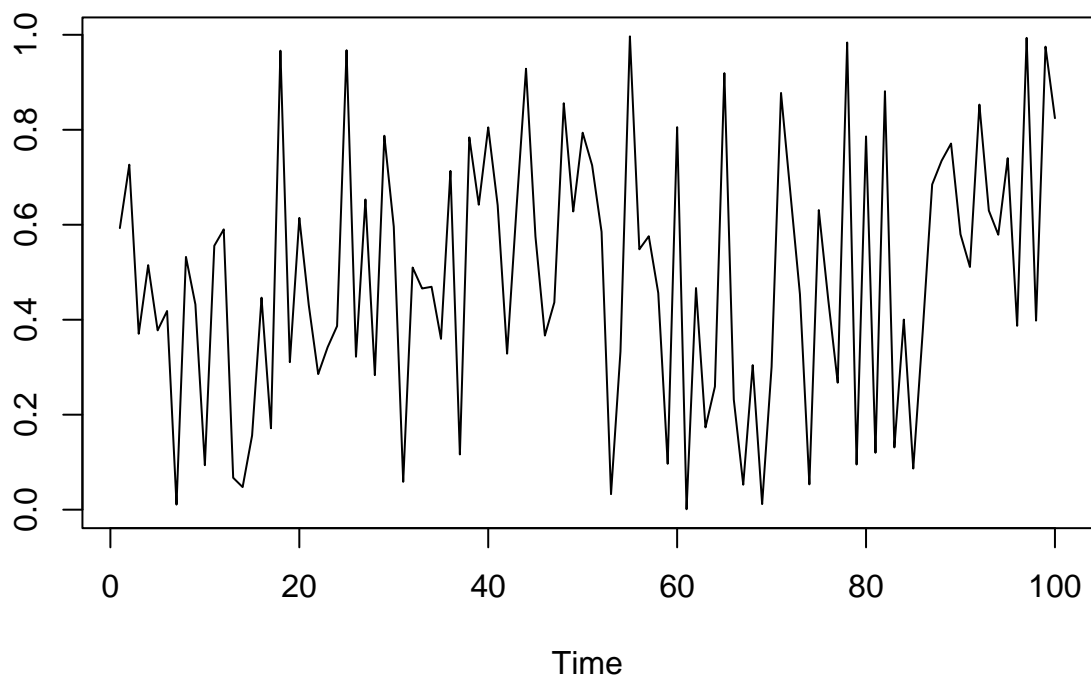


## Common Examples of Stochastic Processes

### Example 2.2.8. Process A: i.i.d.

- An i.i.d. process, where each  $X_t$  has the same distribution and is independent of the rest.

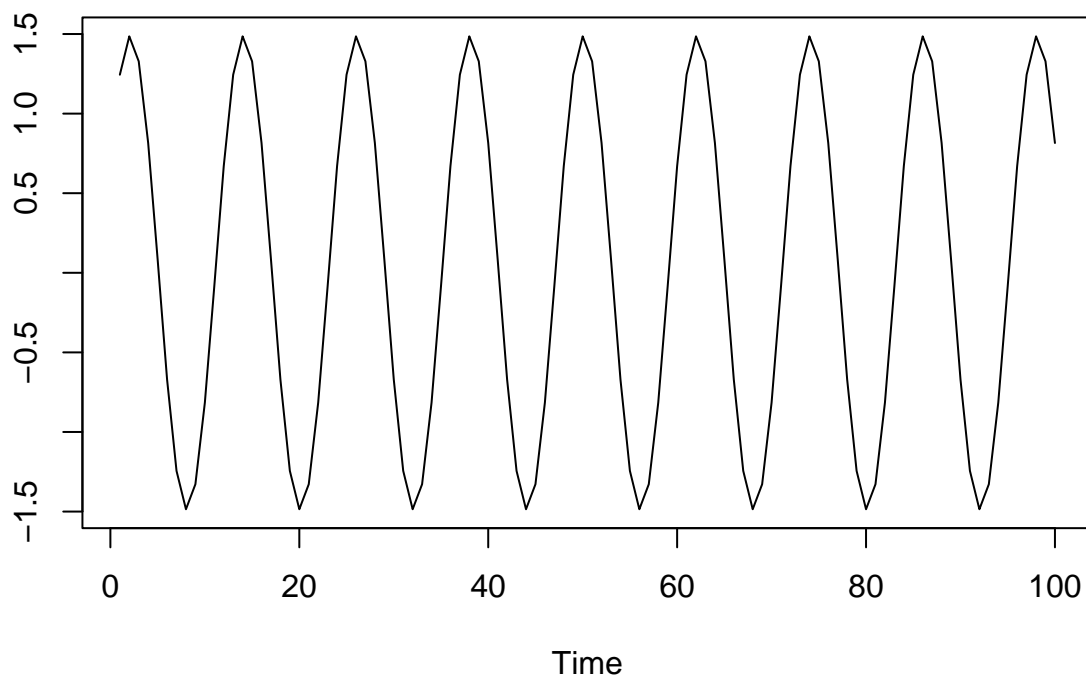
```
set.seed(111)
n <- 100
x <- runif(n)
plot(ts(x), xlab="Time", ylab="")
```



#### Example 2.2.9. Process B: Cosine

- Suppose  $X_t = A \cos(\vartheta t + \Phi)$ , where  $\vartheta$  is given, and  $A$  and  $\Phi$  are independent random variables.

```
n <- 100
set.seed(222)
A <- rnorm(1)
set.seed(223)
phi <- 2*pi*runif(1)
lambda <- pi/6
set.seed(224)
x <- A*cos(seq(1,n)*lambda + phi)
plot(ts(x),xlab="Time",ylab="")
```



**Example 2.2.12. Process E: Random Walk**

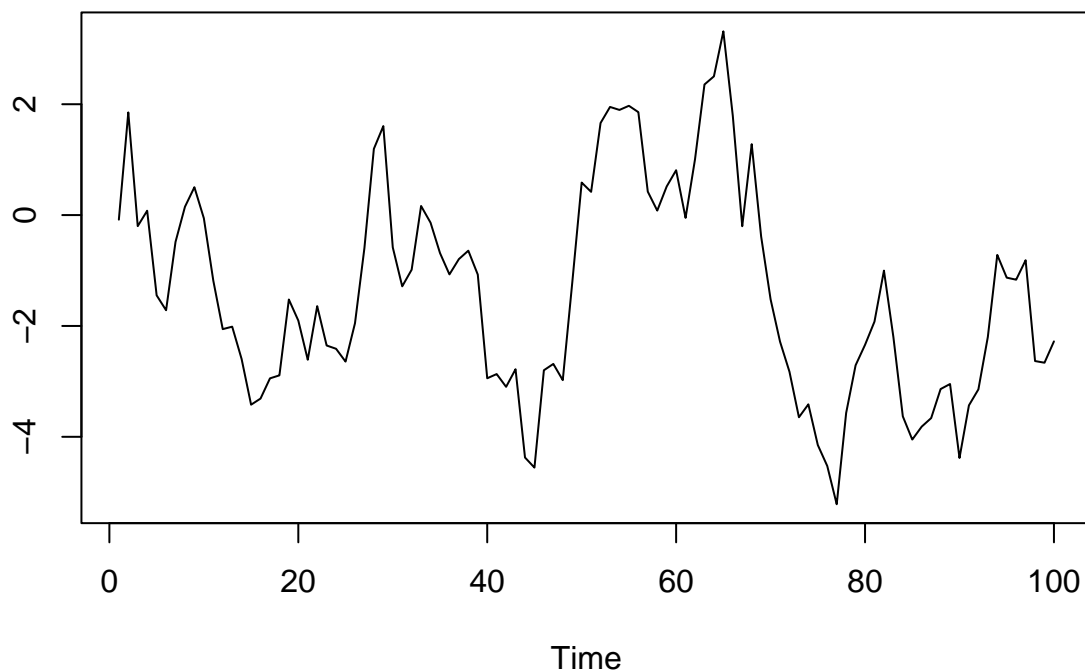
- Suppose  $X_t$  is current location on a straight line, and we step forward or backward at time  $t + 1$ . Let the step size be given by random variable  $Z_{t+1}$ , independent of where we are. Then our new location is

$$X_{t+1} = X_t + Z_{t+1}.$$

This is called a *random walk*.

- We can initialize with  $X_0 = 0$ , for example.

```
set.seed(333)
n <- 100
z <- rnorm(n)
x <- rep(0,n)
x0 <- 0
x[1] <- x0 + z[1]
for(t in 2:n) { x[t] <- x[t-1] + z[t] }
plot(ts(x),xlab="Time",ylab="")
```



## Lesson 2-3: Stationarity

- We want to generalize the concept of *identical distribution* to a stochastic process.

### Marginal Distributions

- First marginals are just the  $X_t$  random variables' distributions.
- Second marginals are joint distributions for all pairs  $(X_t, X_s)$ .
- Third marginals are joint distributions for all triplets, etc.

### Same First Marginals

- Saying  $\{X_t\}$  has same first marginal is same as saying they are identically distributed.
- Sometimes called *First Order Stationary*.
- In particular, all means are the same:  $\mathbf{E}[X_t] = \mathbf{E}[X_s]$  for all  $t, s$ .

### Second Marginals Under Shift

- Suppose all pairs have the same distribution when shifted:

$$(X_1, X_2) \sim (X_2, X_3) \sim (X_3, X_4) \dots$$

- Then second marginal distribution only depends on lag  $h$ , i.e., distribution of  $(X_t, X_{t-h})$  does not depend on  $t$ .
- Sometimes called *Second Order Stationary*.



- Then the product mean (the covariance) depends only on lag:

$$\mathbf{E}[X_t X_{t-h}].$$

It does not depend on  $t$ .

### Example: Visualizing Stationarity

- We generate 100 simulations of a Gaussian AR(1), and generate a scatterplot of  $(X_1, X_2)$
- We repeat with  $(X_3, X_4)$

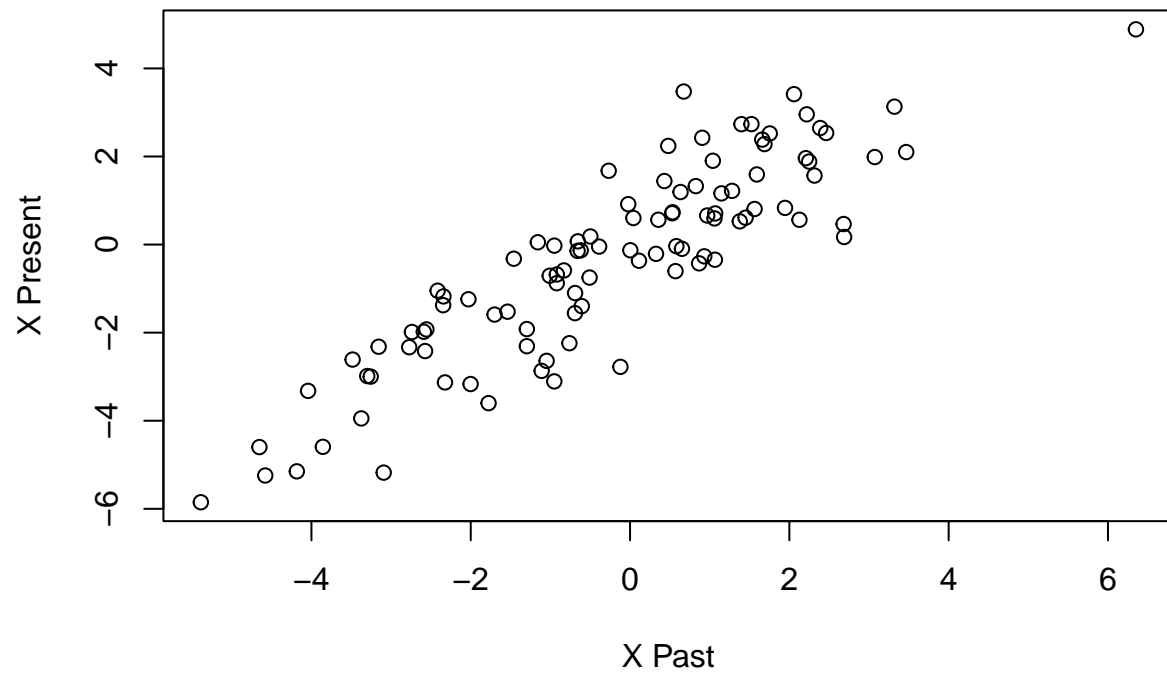
```
x1 <- NULL
x2 <- NULL
x3 <- NULL
x4 <- NULL

for(i in 1:100) {

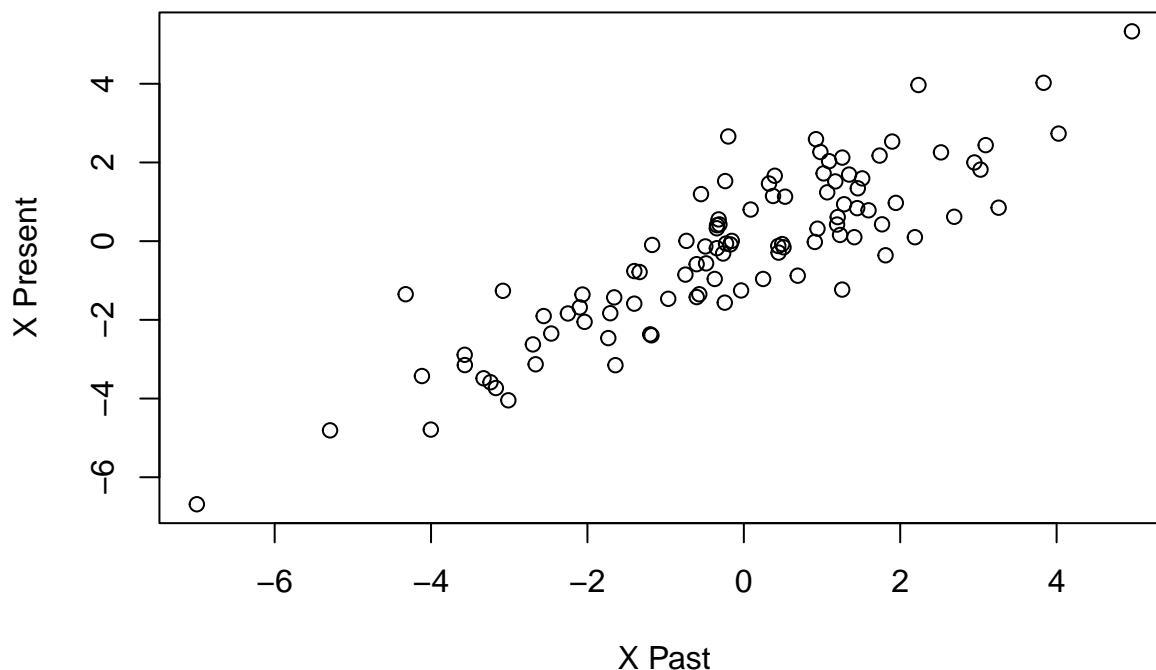
  z <- rnorm(10)
  x <- rep(0,10)
  phi <- .9
  x0 <- rnorm(1)/sqrt(1-phi^2)
  x[1] <- phi*x0 + z[1]
  for(t in 2:10) { x[t] <- phi*x[t-1] + z[t] }

  x1 <- c(x1,x[1])
  x2 <- c(x2,x[2])
  x3 <- c(x3,x[3])
  x4 <- c(x4,x[4])
}

plot(x2,x1,xlab="X Past",ylab="X Present")
```



```
plot(x4,x3,xlab="X Past",ylab="X Present")
```



## Lesson 2-4: Autocovariance

- Now we study the autocovariance function.

### Strict and Weak Stationarity

- Strict stationarity: all marginals (of all orders) are time shift invariant.
- Weak stationarity: the time series has finite variance, constant mean  $\mu$ , and covariance only depends on lag  $h$ :

$$\gamma(h) = \text{Cov}[X_t, X_{t-h}] = \mathbf{E}[X_t X_{t-h}] - \mu^2.$$

This function is called the **autocovariance**.

- So the variance is  $\gamma(0)$ .
- The **autocorrelation** is

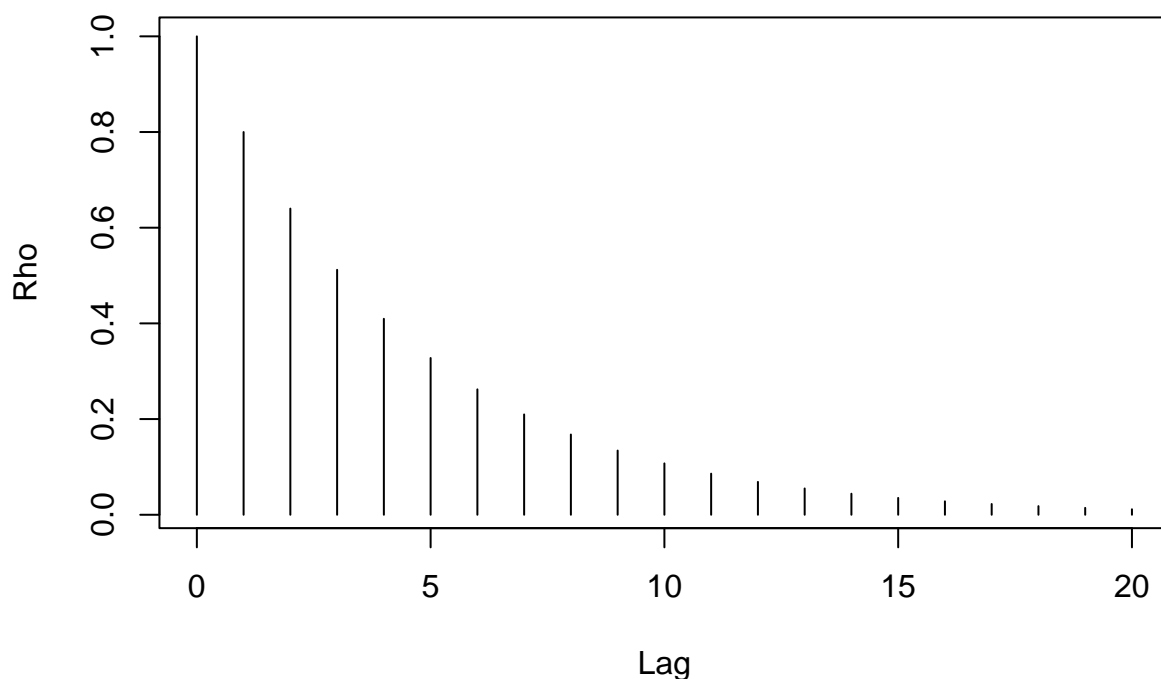
$$\rho(h) = \frac{\gamma(h)}{\gamma(0)}.$$

- Weak stationarity is sometimes called *covariance stationarity*.

### Example: Autocorrelation of an AR(1)

- We plot  $\rho(h)$  versus  $h$  (on x-axis).

```
phi <- .8
rho <- phi^seq(0,20)
plot(ts(rho,start=0),xlab="Lag",ylab="Rho",type="h")
```



## White Noise

- A key example is a *white noise* stochastic process.
- This is any weakly stationary process  $\{Z_t\}$  with mean zero such that  $\gamma(h) = 0$  for  $h \neq 0$ .
- Written compactly as  $Z_t \sim \text{WN}(0, \sigma^2)$ , where  $\sigma^2 = \gamma(0)$  is the variance, and the mean is  $\mu = 0$ .

## Covariance Matrix of Sample Vector

- The time series variables corresponding to a sample are  $X_1, \dots, X_n$ , which can be put into a random vector  $\underline{X}$ .
- The covariance matrix of  $\underline{X}$  is denoted by  $\Gamma_n$  when the stochastic process is weakly (or strictly) stationary. The entry in row  $j$  and column  $k$  is

$$\Gamma_n(j, k) = \text{Cov}[X_j, X_k] = \gamma(k - j).$$

This only depends on the difference between row and column index! Such a matrix is constant along diagonals, and is called *Toeplitz*.

```
rho <- .8
gamma <- rho*seq(0,5)/(1-rho^2)
gamma_mat <- toeplitz(gamma)
gamma_mat
```

```
##           [,1]      [,2]      [,3]      [,4]      [,5]      [,6]
## [1,] 2.777778 2.222222 1.777778 1.422222 1.137778 0.910222
## [2,] 2.222222 2.777778 2.222222 1.777778 1.422222 1.137778
## [3,] 1.777778 2.222222 2.777778 2.222222 1.777778 1.422222
```

```
## [4,] 1.422222 1.777778 2.222222 2.777778 2.222222 1.777778
## [5,] 1.137778 1.422222 1.777778 2.222222 2.777778 2.222222
## [6,] 0.910222 1.137778 1.422222 1.777778 2.222222 2.777778
```

## Properties of Autocovariance

1.  $\gamma(0) \geq 0$
2.  $\gamma(h) = \gamma(-h)$
3.  $|\gamma(h)| \leq \gamma(0)$ .
4.  $\gamma(h)$  is a non-negative definite sequence.

This last property means that  $\Gamma_n$  is a non-negative definite matrix for all  $n$ . (Recall from multivariate analysis: covariance matrices are non-negative definite, and are positive definite if all eigenvalues are positive.)

## Lesson 2-5: Autoregression and Moving Average

- Examples of weakly stationary stochastic process.

### Example 2.5.1. AR(1) Process

- Let  $Z_t \sim \text{i.i.d.}(0, \sigma^2)$  and  $\{X_t\}$  defined via

$$X_t = \phi X_{t-1} + Z_t$$

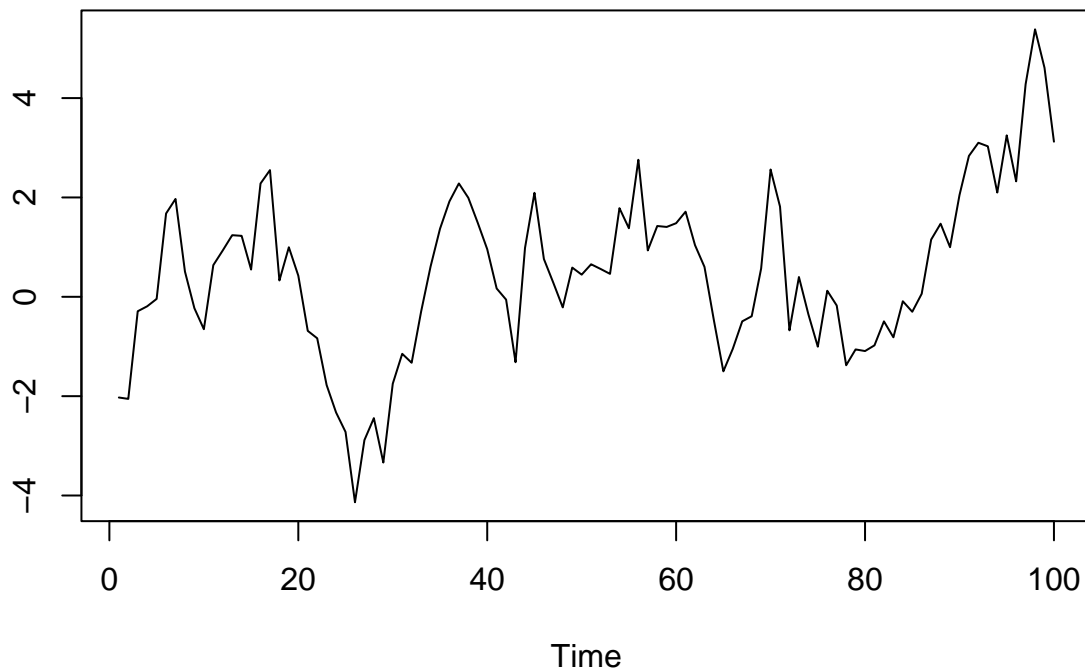
for  $t \geq 1$ , where  $|\phi| < 1$ .

- This is a recursion, called an *order 1 autoregression*, or AR(1).
- How to define  $X_0$ ? If  $X_0 \sim (0, \sigma^2/(1 - \phi^2))$ , then  $\{X_t\}$  is weakly stationary and

$$\gamma(h) = \sigma^2 \frac{\phi^{|h|}}{1 - \phi^2}.$$

Formula only makes sense when  $|\phi| < 1$ . This is a *stationarity condition*.

```
n <- 100
set.seed(123)
z <- rnorm(n)
x <- rep(0, n)
phi <- .9
x0 <- rnorm(1)/sqrt(1-phi^2)
x[1] <- phi*x0 + z[1]
for(t in 2:n) { x[t] <- phi*x[t-1] + z[t] }
plot(ts(x), xlab="Time", ylab="")
```



### Example 2.5.5. MA(1) Process

- Let  $Z_t \sim \text{i.i.d.}(0, \sigma^2)$  and  $\{X_t\}$  defined via

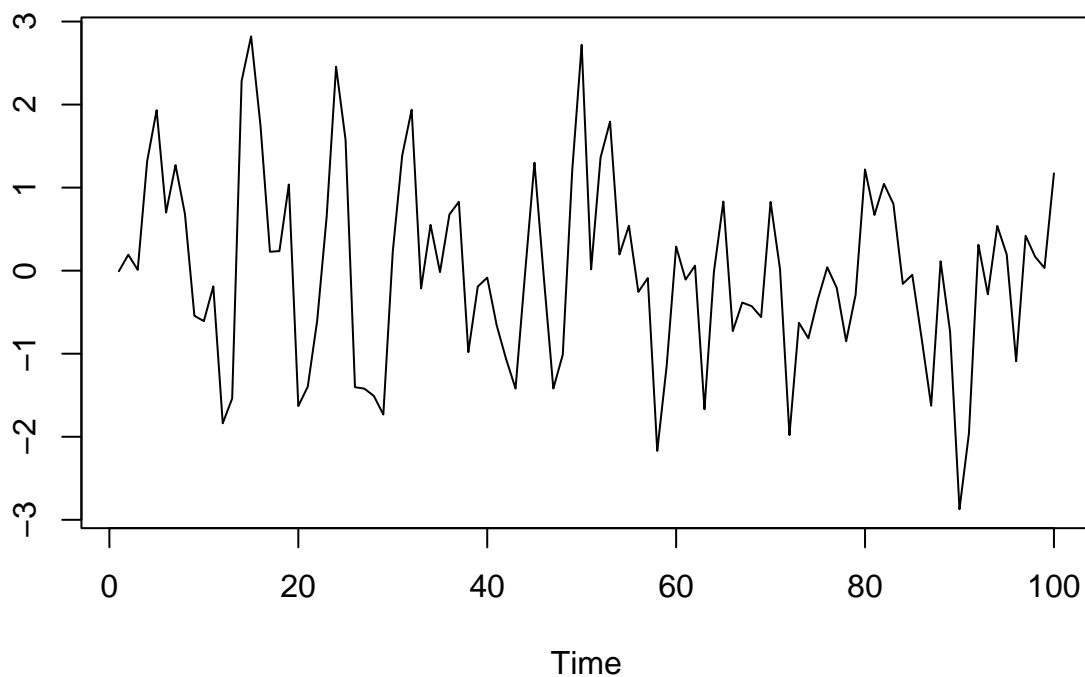
$$X_t = Z_t + \theta Z_{t-1}$$

for  $t \geq 1$ , where  $\theta$  is any real number.

- This process is called an *order 1 moving average*, or MA(1).
- It is weakly stationary, with

$$\gamma(h) = \begin{cases} (1 + \theta^2)\sigma^2 & \text{if } h = 0 \\ \theta\sigma^2 & \text{if } h = \pm 1 \\ 0 & \text{if } |h| > 1. \end{cases}$$

```
set.seed(777)
n <- 100
z <- rnorm(n+1)      # Gaussian input
theta <- .8
x <- z[-1] + theta*z[-(n+1)]
plot(ts(x), xlab="Time", ylab="")
```



### Example 2.5.6. MA(2) Process

- Let  $Z_t \sim \text{i.i.d.}(0, \sigma^2)$  and  $\{X_t\}$  defined via

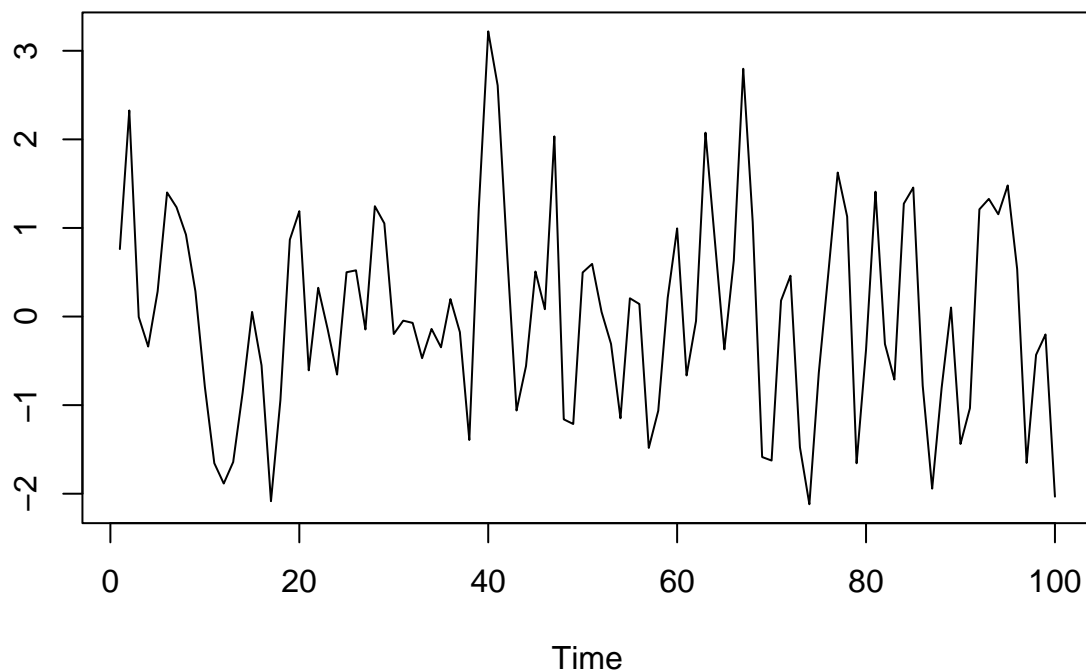
$$X_t = Z_t + \theta_1 Z_{t-1} + \theta_2 Z_{t-2}$$

for  $t \geq 2$ , where  $\theta_1, \theta_2$  are any real numbers.

- This process is called an *order 2 moving average*, or MA(2).
- It is weakly stationary, with

$$\gamma(h) = \begin{cases} (1 + \theta_1^2 + \theta_2^2)\sigma^2 & \text{if } h = 0 \\ (\theta_1 + \theta_1\theta_2)\sigma^2 & \text{if } h = \pm 1 \\ \theta_2\sigma^2 & \text{if } h = \pm 2 \\ 0 & \text{if } |h| > 2. \end{cases}$$

```
set.seed(555)
n <- 100
z <- rnorm(n+2)      # Gaussian input
theta1 <- .9
theta2 <- .2
x <- z[-c(1,2)] + theta1*z[-c(1,n+2)] + theta2*z[-c(n+1,n+2)]
plot(ts(x),xlab="Time",ylab="")
```



## Lesson 2-6: White Noise Processes

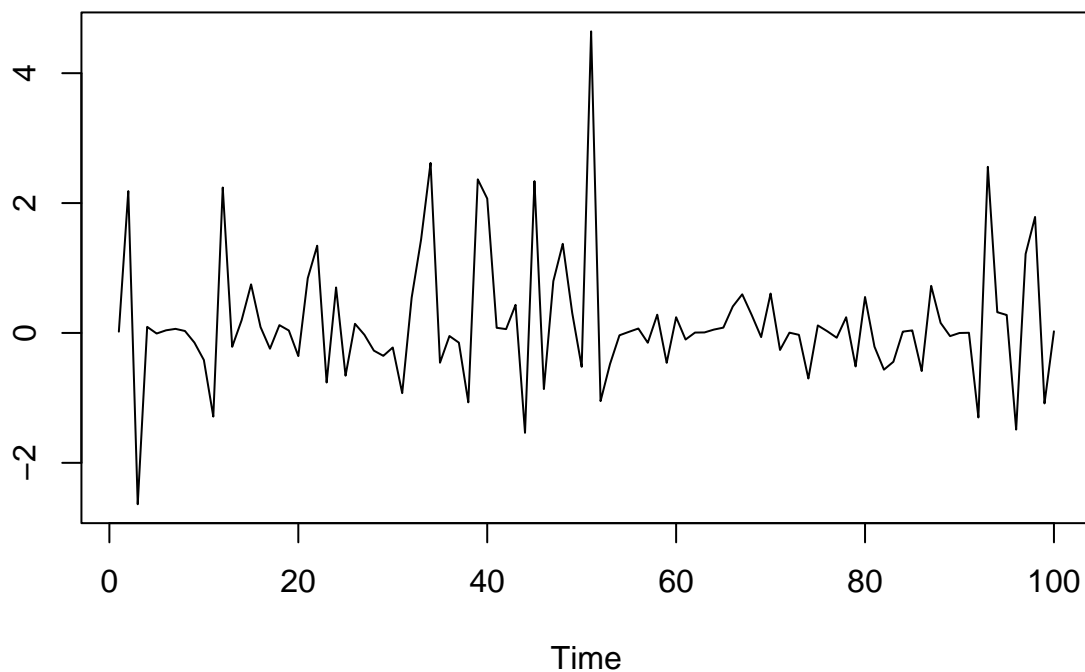
- *White noise* is a fundamental building block for time series models.
- Any  $\{X_t\}$  i.i.d. with mean zero and variance  $\sigma^2$  is a  $WN(0, \sigma^2)$ .
- Here we provide three examples of white noise.

### Example 2.6.1. Dependent White Noise

- Consider  $X_t = Z_t \cdot Z_{t-1}$ , where  $Z_t$  is i.i.d.  $N(0, 1)$ .
- Then  $X_t \sim WN(0, 1)$ , but  $\{X_t\}$  is not i.i.d.

```
n <- 101
z <- rnorm(n)
x <- z[-n]*z[-1]
plot(ts(x), xlab="Time", ylab="")
```





```
#acf(x)
```

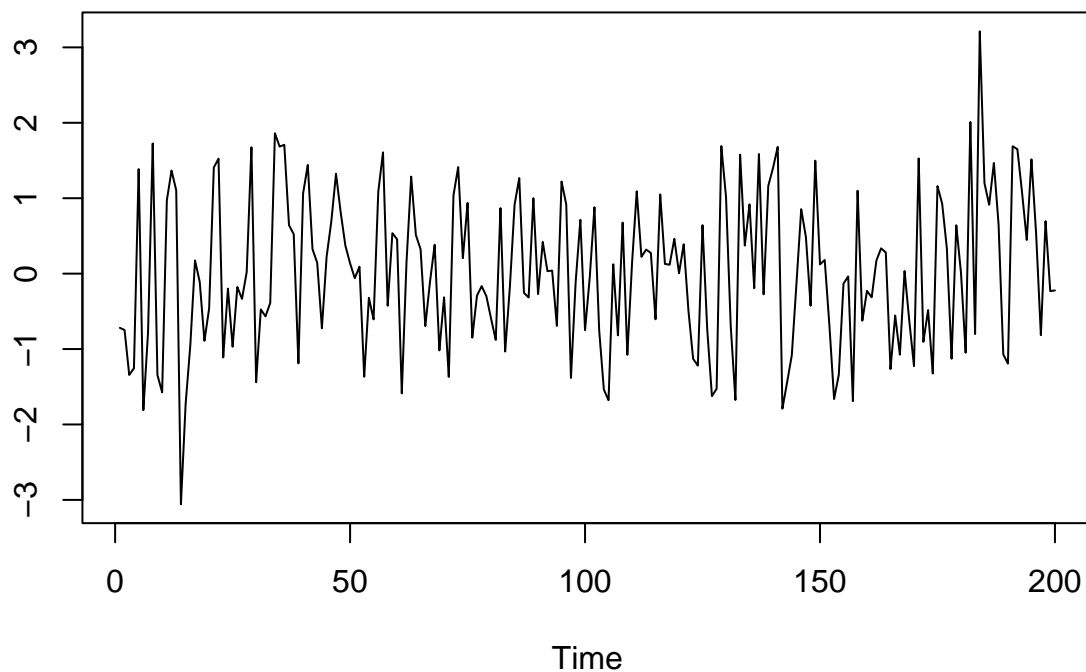
### Example 2.6.2. Non-identically Distributed White Noise

- Let  $\{Y_t\}$  and  $\{Z_t\}$  be independent of each other. Set  $Z_t$  i.i.d.  $N(0, 1)$  and  $Y_t$  i.i.d. uniform on  $(-\sqrt{3}, \sqrt{3})$ . Let

$$X_t = \begin{cases} Z_t & t \text{ even} \\ Y_t & t \text{ odd} \end{cases}$$

- Then  $X_t \sim \text{WN}(0, 1)$ , although the process is not stationary (since the marginal distribution depends on  $t$ ).

```
n <- 100
z <- rnorm(n)
y <- runif(n, -3^(1/2), 3^(1/2))
x <- matrix(t(cbind(y,z)), ncol=1)
plot(ts(x), xlab="Time", ylab="")
```

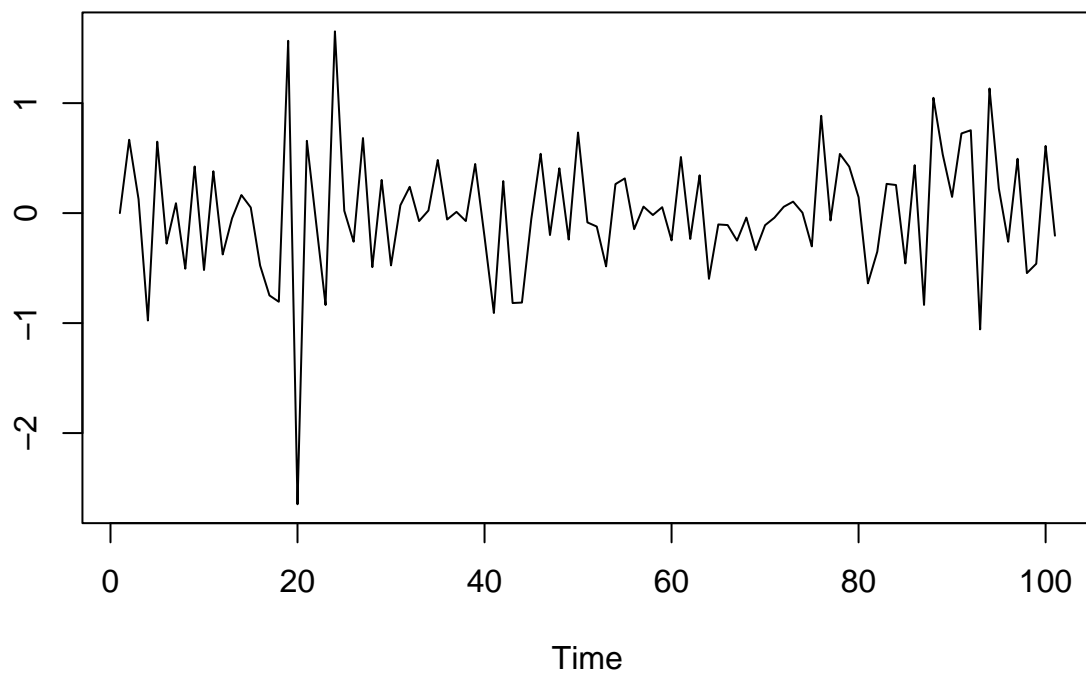


```
#acf(x)
```

### Example 2.6.3. ARCH Process

- Model of Engel (1982), a Nobel laureate.
- Set  $Z_t$  i.i.d.  $N(0, 1)$ , and  $X_t = Z_t \sqrt{\alpha + \beta X_{t-1}^2}$ .
- Then  $X_t \sim \text{WN}(0, \alpha/(1 - \beta))$ .

```
n <- 101
z <- rnorm(n)
alpha <- .2
beta <- .3
x <- 0
for(t in 2:n) { x <- c(x,z[t]*sqrt(alpha + beta*x[t-1]^2)) }
plot(ts(x),xlab="Time",ylab="")
```



$\#acf(x)$