ETF 5500 Assignment 2

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Question 1

Part A

Here, we have a data matrix Y with a dimension of $n \times 3$ which has a mean of 0.

Equation 1 shows the equation of sample variance for a single variable y.

$$\text{Var}(y) = \frac{1}{n-1}\sum_{j=1}^{n}(y_{i,j} - \bar{y_i})^2 \tag{1}$$

Where,
y are the observations
$\bar{y}$ is the mean of the observations
n is the number of observations

While Equation 1 provides us with a singular value for a single variable, we would like to extend this idea for high dimensions in a matrix form. This matrix is called the variance-covariance matrix where every element in the diagonal provides us with the variance of the variable while every off-diagonal element provides us with the covariance of the variable with respect to another variable. This is given by Equation 2.

$$\text{Cov}(Y) = \frac{1}{n-1}((Y - \bar{Y})'(Y - \bar{Y}) \tag{2}$$

Where,

Y is the data matrix,
$\bar{Y}$ is the matrix containing the mean of each variable,
n is the number of observations in the data.

For a vector Y that has been demeaned ($\bar{Y} = 0$), the sample variance-covariance matrix S can be obtained through the following computation.

$$S = \text{Cov}(Y) = \frac{1}{n-1}(Y^T Y) \tag{3}$$

To maintain matrix conformability, the dimension of S will be a 3×3 matrix.

In order to define the covariance matric S as defined by Equation 3, we require the following quanities:

1. A data matrix Y with a mean of 0.
2. The total number of observations n which is given by the number of rows in Y.

Part B

An Eigen Value problem is linear in nature and defined by Equation 4.

$$Sw = \lambda w \tag{4}$$

Where,

$S =$ Covariance Matrix
$w =$ Eigen Vector
$\lambda =$ Eigen Value

As the Eigen Vector is a column vector, hence, to satisfy matrix conformability in Equation 4, the dimension of w must be a 3×1 vector.

Part C

We are given the linear combination as stated through Equation 5.

$$X = Y\beta \tag{5}$$

We know that Y is a $n \times 1$ vector and β is stated as a 3×1 vector. To obtain the Variance-Covariance matrix, we perform the following computations.

$$\text{Cov}(X) = \frac{1}{n-1} X' X$$

$$\implies \mathrm{Cov}(X) = \sum_{i=1}^{n} \frac{(Y_i\beta)^2}{n-1}$$

$$\implies \mathrm{Cov}(X) = \beta' \Big[\sum_{i=1}^{n} \frac{(Y_i)^2}{n-1}\Big] \beta$$

For a data matrix Y_i with mean $= 0$, the term $\sum_{i=1}^{n} \dfrac{(Y_i)^2}{n-1}$ is considered as the covariance and is denoted by S.

$$\boxed{\implies \mathrm{Cov}(X) = \beta' S \beta} \tag{6}$$

Equation 6 provides us with the final form of the variance-covariance matrix.

We know, the dimension of β' is 1×3 and that of β is 3×1. In order to maintain matrix conformability, the value dimension of the variance covariance matrix $\mathrm{Var}(X)$ will be 1×1. This suggests that the **resultant matrix is a scalar value.**

Exercise 2

The dimensions of the matrices of interest are as follows:

w is a 3×1 matrix
Y is a $n \times 3$ matrix
S is a 3×3 matrix
v is an arbitrary column vector with a dimension 3×1

In order to assess matrix multiplication conformability, **the number of columns in the first matrix should be equal to the number of rows in the second matrix.**

Part A

The matrix Y is a general matrix with $n \times 3$ dimension. The only condition when the product $w'Y$ will be conformable is for a specific condition, $n = 3$. However, a data matrix with only 3 dimensions and only 3 observations is highly unlikely.

As a result, this product is expected to be **non-conformable.**

Under the special condition when $n = 3$, the dimension of $w'Y$ matrix will be 1×3.

Part B

ww' will be a conformable matrix with dimension 3×3.

Part C

wv' will be a **conformable matrix** with a dimension \$ 3 $\times$3\$.

Part D

$S'Y$ matrix will be a **non-conformable matrix** since Y is an arbitrary column vector with no fixed dimension.

Part E

$Yw + v'$ is **not a conformable matrix** as the number of columns for matrix Y and the number of rows for matrix W are not identical. While adding the matrices, the dimensions of the two matrices must exactly match. This is however not the case here.

Exercise 3

We are given with the equation $X = YC'$

Where

$$C = \begin{bmatrix} w' \\ u' \end{bmatrix}$$

and is a 2×3 dimensional matrix.

w is the eigen vector of S corresponding to the largest eigen value while u is the eigen vector of S corresponding to the second-largest eigen value.

Performing a matrix multiplication to obtain X gives us a $n \times 2$ matrix where n is the number of observations.

Content of matrix X

The matrix multiplication performs a linear combination such that the data contained in matrix Y is now projected along the eigen vectors relating to the largest and the second-largest eigen value. **In the context of principal component analysis (PCA), X contains the data which is projected onto the top 2 principal components.**

Derivation for sample covariance of X

We know, the variance-covariance matrix is calculated as follows:

$$\text{Cov}(X) = \frac{(X'X)}{n-1}$$
$$\implies \text{Cov}(X) = \sum_{i=1}^{n} \frac{(YC')^2}{n-1}$$

$$\implies \text{Cov}(X) = C'\Big[\sum_{i=1}^{n} \frac{(Y_i)^2}{n-1}\Big]C$$

As previously defined in Equation 3, we can use the matrix S in the above equation as follows.

$$\boxed{\implies \text{Cov}(X) = C'SC} \tag{7}$$

Equation 7 is the expression of the sample variance-covariance matrix $\text{Cov}(X)$ in terms of C and S.

Exercise 4

Vectors w and u are said to be orthogonal when they are at complete right angles to each other. This means that performing a matrix dot product, $w \cdot u$ will **yield a result of 0.**

In the context of PCA, vectors w and u (also called principal components) are **uncorrelated** and capture unique signals in the data.

Proof that Cov(X) is a diagonal matrix

From Equation 7, we know that $\text{Cov}(X) = C'SC$.

Additionally, w and u are orthogonal.

Based on the spectral theorem, we can write the variance-covariance matrix S as follows.

$$S = \Sigma\lambda_i v_i v_i'$$

Where λ_i is an eigen value and v_i is an eigen vector corresponding to the eigen value.

So, based on the above information, we can write Equation 7 as follows.

$$\mathrm{Cov}(X) = \frac{1}{n-1} C^T (\lambda_w w w' + \lambda_u u u') C$$

$$\mathrm{Cov}(X) = \frac{1}{n-1} \begin{bmatrix} w' \\ u' \end{bmatrix} \quad (\lambda_w w w' + \lambda_u u u') \begin{bmatrix} w' u' \end{bmatrix} \tag{8}$$

All dot products between w and u reduce to 0 due to the orthogonality condition between the two vectors.

Additionally, for normalised vectors, $vv' = 1$. As a result, Equation 8 reduces to the following.

$$\mathrm{Cov}(X) = \frac{1}{n-1} (\lambda_w w + \lambda_u u) \tag{9}$$

Converting Equation 9 to the matrix form, we can write it as follows.

$$\mathrm{Cov}(X) = \frac{1}{n-1} \begin{bmatrix} \lambda_w & 0 \\ 0 & \lambda_u \end{bmatrix} \tag{10}$$

The final form of the variance-covariance matrix is diagonal, as shown in Equation 10 . The diagonal elements contain the eigen values λ_u and λ_w corresponding to the eigen vectors u and w from the sample covariance matrix S.

This diagonal structure arises from the orthogonality condition, which ensures that all off-diagonal elements representing covariances are zero.

Exercise 5

Here, we have observations give as follows.

$a = \frac{x_1}{\sqrt{\lambda_u}}$ and $b = \frac{x_2}{\sqrt{\lambda_u}}$

Z is a datamatrix consisting of the vectors a and b as shown below.

$$Z = \begin{bmatrix} a & b \end{bmatrix}$$

Now, the sample variance-covariance matrix Cov (Z) will be calculated as follows.

$$\mathrm{Cov}(Z) = \frac{1}{n-1} Z' Z$$

$$\text{Cov}(Z) = \frac{1}{n-1}\begin{bmatrix} a'a & a'b \\ b'a & b'b \end{bmatrix} \tag{11}$$

From @covmatfinal, we know that the variances of x_1 and x_2 are given by their eigen values. Using this result, we obtain the variances of the vectors a and b as follows.

$$\text{Var(a)} = \text{Var}\Big(\frac{x_1}{\sqrt{\lambda_w}}\Big)$$

Now, implementing the variance scaling rule Var(cX) $= c^2$Var(X) and utilising results from Equation 10 to the above equation, we get the result as follows.

$$\text{Var(a)} = \frac{1}{\lambda_w}\text{Var}(x_1)$$

$$\implies \text{Var(a)} = \frac{\lambda_w}{\lambda_w} = 1$$

Similary, we obtain the value of $\text{Var}(b) = 1$.

For a demeaned vector upon normalisation, we know that,

$$\begin{aligned} \text{Var(a)} &= \frac{1}{n-1}a'a \\ \implies \frac{1}{n-1}a'a &= 1 \\ \implies a^T a &= n-1 \end{aligned} \tag{12}$$

Similarly, $b^T b = n-1$

Next, we obtain the covariances between a and b.

$$\text{Cov}(a,b) = \text{Cov}(\frac{x_1}{\lambda_w}, \frac{x_2}{\lambda_u})$$

$$\implies \text{Cov}(a,b) = \frac{1}{\sqrt{\lambda_w \lambda_u}}\text{Cov}(x_1, x_2)$$

However, we know that our vectors x_1 and x_2 are the columns in the matrix X, representing the two principal components PC1 and PC2. Hence, x_1 and x_2 are uncorrelated and will have a covariance $\text{Cov}(x_1, x_2) = 0$.

As a result, we obtain the following.

$$\text{Cov}(a,b) = a'b = b'a = 0 \tag{13}$$

Replacing the relevant terms in Equation 11 by Equation 12 and Equation 13, we obtain the following result.

$$\operatorname{Cov}(Z) = \frac{1}{n-1}\begin{bmatrix} n-1 & 0 \\ 0 & n-1 \end{bmatrix}$$

$$\implies \operatorname{Cov}(Z) = \begin{bmatrix} 1 & 0 \\ 0 & 1 \end{bmatrix} = \mathbb{I} \tag{14}$$

As observed in Equation 14, the sample variance-covariance matrix of Z is an identity matrix.