



# Time Series Analysis and Forecasting

## Seminar 0: Fundamentals



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## Seminar Structure

### Seminar structure:

1. **Multiple Choice Quiz** – Knowledge check
2. **True/False** – Conceptual checks
3. **Calculation Exercises** – Applied practice
4. **AI-Assisted Exercise** – Critical thinking
5. **Summary** – Key takeaways

## Quiz 1: Time Series Basics

### Question

Which of the following is NOT a characteristic of time series data?

- A. Observations are ordered in time
- B. Consecutive observations are usually correlated
- C. Observations are independent and identically distributed
- D. Data has a natural temporal ordering

*Answer on next slide...*

## Quiz 1: Answer

Answer: C – Observations are independent and identically distributed

**Question:** Which is NOT a characteristic of time series data?

- A. Observations are ordered in time ✗
- B. Consecutive observations are usually correlated ✗
- C. **Observations are independent and identically distributed** ✓
- D. Data has a natural temporal ordering ✗

- ☐ Time series observations are **dependent** (autocorrelated), not independent
- ☐ The i.i.d. assumption is fundamental to cross-sectional analysis but is **violated** in time series
- ☐ This temporal dependence requires **specialized methods**

## Quiz 2: Decomposition

### Question

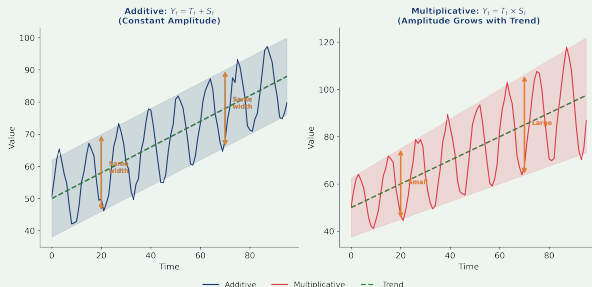
When should you use multiplicative decomposition instead of additive?

- A. When the seasonal pattern has constant amplitude
- B. When the variance of the series is stable over time
- C. When seasonal fluctuations grow proportionally with the level
- D. When the series has no trend component

*Answer on next slide...*

## Quiz 2: Answer

Answer: C – When seasonal fluctuations grow proportionally with the level



- ☐ **Multiplicative:**  $X_t = T_t \times S_t \times \varepsilon_t$  — seasonal amplitude scales with the level
- ☐ **Additive:**  $X_t = T_t + S_t + \varepsilon_t$  — constant amplitude

## Quiz 3: Exponential Smoothing

### Question

In Simple Exponential Smoothing with  $\alpha = 0.9$ , what happens?

- A. Forecasts are very smooth and stable
- B. Recent observations have very little weight
- C. Forecasts react quickly to recent changes
- D. The forecast is essentially a long-term average

*Answer on next slide...*

### Quiz 3: Answer

Answer: C – Forecasts react quickly to recent changes

With  $\alpha = 0.9$ :  $\hat{X}_{t+1} = 0.9X_t + 0.1\hat{X}_t$

- ☐ **High**  $\alpha$  (e.g. 0.9): 90% weight on the last observation
  - ▶ Forecasts very responsive to new data
- ☐ **Low**  $\alpha$  (e.g. 0.1): smoother, more stable forecasts
  - ▶ Averages over more history



## Quiz 4: Moving Averages

### Question

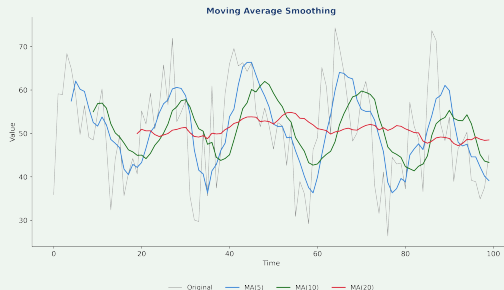
A centered moving average of order 5 (MA-5) uses which observations to estimate the trend at time  $t$ ?

- A.  $X_t, X_{t+1}, X_{t+2}, X_{t+3}, X_{t+4}$
- B.  $X_{t-4}, X_{t-3}, X_{t-2}, X_{t-1}, X_t$
- C.  $X_{t-2}, X_{t-1}, X_t, X_{t+1}, X_{t+2}$
- D.  $X_{t-1}, X_t, X_{t+1}$

*Answer on next slide...*

## Quiz 4: Answer

Answer: C –  $X_{t-2}, X_{t-1}, X_t, X_{t+1}, X_{t+2}$



- **Centered MA:** uses  $(k - 1)/2$  observations on each side of  $t$
- **MA-5:** 2 before +  $t$  + 2 after  $\Rightarrow$  larger window = smoother

## Quiz 5: Forecast Evaluation

### Question

Which metric is most appropriate for comparing forecast accuracy across series with different scales?

- A. Mean Absolute Error (MAE)
- B. Root Mean Squared Error (RMSE)
- C. Mean Absolute Percentage Error (MAPE)
- D. Mean Squared Error (MSE)

*Answer on next slide...*

## Quiz 5: Answer

Answer: C – Mean Absolute Percentage Error (MAPE)

$MAPE = \frac{100}{n} \sum \left| \frac{e_t}{X_t} \right|$  expresses errors as **percentages**.

- ☐ MAE, RMSE, MSE are **scale-dependent** (units of  $X_t$ )
- ☐ MAPE is **scale-independent** (always in %)
- ☐ Caveat: MAPE becomes unstable when  $X_t \approx 0$

 TSA\_ch0\_forecast\_eval

## Quiz 6: Cross-Validation

### Question

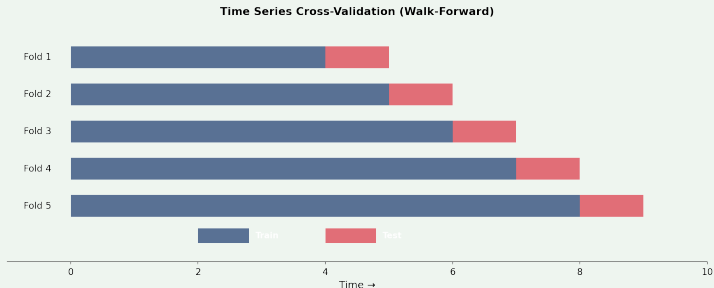
Why can't we use standard k-fold cross-validation for time series?

- A. Time series data is too small
- B. It would violate temporal ordering (future predicting past)
- C. Cross-validation is always invalid
- D. Time series doesn't need validation

*Answer on next slide...*

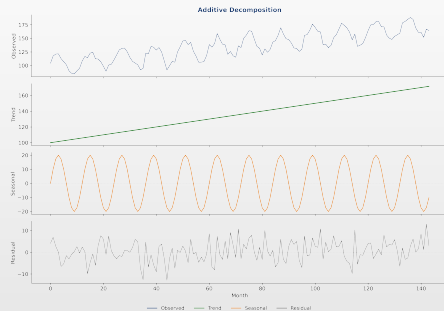
## Quiz 6: Answer

Answer: B – It would violate temporal ordering



**Principle:** future data cannot be used to predict the past! Rolling/expanding window CV is recommended.

## Visual: Time Series Decomposition



### Decomposition Components

■ **Trend:** long-term movement    **Seasonality:** periodic pattern    **Residual:** random noise

## True or False? — Questions

Statement	T/F?
1. SES forecasts are flat (constant for all horizons).	?
2. RMSE penalizes large errors more than MAE.	?
3. Multiplicative decomposition requires positive data.	?
4. A larger $\alpha$ means more smoothing.	?
5. The test set is used for hyperparameter tuning.	?
6. Seasonal naive uses the value from one season ago.	?
7. MAPE can be infinite if actual values are zero.	?



## True or False? — Answers

Statement	T/F	Explanation
1. SES forecasts are flat (constant for all horizons).	T	No trend
2. RMSE penalizes large errors more than MAE.	T	Squared errors
3. Multiplicative decomposition requires positive data.	T	Cannot $\times$ negative
4. A larger $\alpha$ means more smoothing.	F	Large $\alpha$ = less smooth
5. The test set is used for hyperparameter tuning.	F	Use validation!
6. Seasonal naive uses the value from one season ago.	T	$\hat{X}_{t+h} = X_{t+h-m}$
7. MAPE can be infinite if actual values are zero.	T	Division by zero

## Exercise 1: Simple Exponential Smoothing

### Problem

- ▣ **Data:**  $X = [10, 12, 11, 14, 13]$  with  $\alpha = 0.3$ ,  $\hat{X}_1 = 10$
- ▣ **Calculate:** a) Forecasts  $\hat{X}_2$  through  $\hat{X}_6$ ; b) MAE and RMSE
- ▣ **Formula:**  $\hat{X}_{t+1} = \alpha X_t + (1 - \alpha)\hat{X}_t$

### Solution

$t$	1	2	3	4	5	6
$X_t$	10	12	11	14	13	?
$\hat{X}_t$	10	10	10.6	10.72	11.70	<b>12.09</b>

- ▣ **MAE** = 1.745    **RMSE** = 2.04

## Exercise 2: Error Metrics

### Problem

- ▣ **Data:**  $X = [100, 110, 105, 120]$ ,  $\hat{X} = [95, 108, 110, 115]$
- ▣ **Calculate:** MAE, MSE, RMSE, MAPE

### Solution

- ▣ **Errors:**  $e = [5, 2, -5, 5]$
- ▣ **MAE**  $= (|5| + |2| + |-5| + |5|)/4 = 4.25$
- ▣ **MSE**  $= (25 + 4 + 25 + 25)/4 = 19.75$
- ▣ **RMSE**  $= \sqrt{19.75} = 4.44$
- ▣ **MAPE**  $= 25 \times (0.05 + 0.018 + 0.048 + 0.042) = 3.95\%$

## Exercise 3: Seasonal Indices

### Problem

- ▣ **Data:** Seasonal indices:  $S = [0.85, 1.05, 0.90, 1.20]$ , Trend Q4:  $T = 1000$
- ▣ **Calculate:** a) Verify normalization. b) Q4 forecast. c) Deseasonalize  $X_{Q4} = 1150$

### Solution

- ▣ **a) Normalization:**  $\sum S_i = 0.85 + 1.05 + 0.90 + 1.20 = 4.00 \checkmark$
- ▣ **b) Forecast:**  $\hat{X}_{Q4} = 1000 \times 1.20 = \mathbf{1200}$
- ▣ **c) Deseasonalization:**  $X_{deseasonalized} = 1150/1.20 = \mathbf{958.33}$  (below trend)

## AI Exercise: Critical Thinking

Prompt to test in ChatGPT / Claude / Copilot

"Using yfinance, download SPY data. Decompose it and forecast the next year using exponential smoothing. Which model is best? Show me the results."

**Exercise:**

1. Run the prompt in an LLM of your choice and critically analyze the response.
2. Does the AI choose additive or multiplicative decomposition? Is the choice justified?
3. Check how it evaluates the models — does it use train or test RMSE?
4. Look at the smoothing parameters ( $\alpha$ ,  $\beta$ ,  $\gamma$ ). Are values near 1.0 a problem?
5. Does the code properly split data into train/test, or does it evaluate on training data?

**Warning:** AI-generated code may run without errors and look professional. *That does not mean it is correct.*

## Summary: Chapter 0

### Key Concepts

1. **Time series:** temporally ordered observations, with dependence (autocorrelation)
2. **Decomposition:** additive ( $X_t = T_t + S_t + \varepsilon_t$ ) vs multiplicative ( $X_t = T_t \times S_t \times \varepsilon_t$ )
3. **Exponential smoothing:** SES, Holt, Holt-Winters — parameter  $\alpha$  controls reactivity
4. **Forecast evaluation:** MAE, RMSE, MAPE — the choice depends on context
5. **Seasonality:** seasonal indices, forecasting and deseasonalization

Questions?

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- ▣ Franke, J., Härdle, W.K., & Hafner, C.M. (2019). *Statistics of Financial Markets*, 4th ed., Springer.

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### Modern Approaches and Machine Learning

- ▣ Nielsen, A. (2019). *Practical Time Series Analysis*, O'Reilly Media.
- ▣ Petropoulos, F., et al. (2022). *Forecasting: Theory and Practice*, International Journal of Forecasting.
- ▣ Makridakis, S., Spiliotis, E., & Assimakopoulos, V. (2020). The M4 Competition, International Journal of Forecasting.

### Online Resources and Code

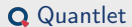
- ▣ **Quantlet**: <https://quantlet.com> — Code repository for statistics
- ▣ **Quantinar**: <https://quantinar.com> — Quantitative methods learning platform
- ▣ **GitHub TSA**: [https://github.com/QuantLet/TSA/tree/main/TSA\\_ch0](https://github.com/QuantLet/TSA/tree/main/TSA_ch0) — Python code for this seminar



# Thank You!

## Questions?

Seminar materials are available at: <https://danpele.github.io/Time-Series-Analysis/>



Quantlet



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