

# Syndicate 5 Statistical Learning Problem Set #1

May 21, 2021

## Question 3

Our first model is the same as Q2 except with the *Education* variable now grouped into three bins based on the likely degree attained. This is to make the regression easier to interpret. The resultant regression is quite good with an Adjusted  $R^2$  of 0.954 but we still have many insignificant predictors. However, before removing these, we want to use the second model to avoid any of the common pitfalls of regression.

Looking at a correlation matrix of numeric variables, we can see that *Rating* and *Limit* are extremely highly correlated and may give us multicollinearity issues. We conducted a Wald test to see if these predictors are jointly useful in predicting *Balance*.

$$H_0 : \beta_{Rating} = \beta_{Limit}$$

$$H_1 : \beta_{Rating} \neq \beta_{Limit}$$

The Wald test gives us a p-value of 0.062 which is not enough evidence to suggest that coefficients for *Rating* and *Limit* are jointly useful (at the 5% level). We decided to keep *Rating* and drop *Limit* for our second model since it is more likely to dictate the value for each *Limit* than vice versa, and thus more useful.

Before constructing our second model, we first looked at the residuals from Q2 and we see some non-linear patterns in *Income* and *Rating* so we chose to include squared terms for our second model. We considered the possibility of interaction terms for this regression however, we couldn't see any likely case the effect of a statistically significant independent variable on the dependent variable would depend on another (statistically significant) independent variable. This model is again quite good with an Adjusted  $R^2$  of 0.963, and our new terms being statistically significant (interestingly, with the omission of *Limit*, *Cards* is no longer statistically significant), but we still have many insignificant coefficients which we can drop to simplify the regression at little cost to accuracy.

Thus our third model only has significant terms (all significant at the 1% level) and maintains the same very high Adjusted  $R^2$  of 0.963 with the Residual Std. Error only increasing slightly (88.081 to 88.218). While both model 2 and 3 have similar accuracy, model 3 is preferred due to having fewer terms and thus being easier to interpret.

$$\text{Final Model: } Balance_i = -329.576 - 6.238Income_i - 0.021Income_i^2 + 2.471Rating_i + 0.002Rating_i^2 - 0.0729Age_i + 428.341Student_i$$

Table 1: Correlation Matrix (numeric data only)

	Income	Limit	Rating	Cards	Age	Balance
Income	1	0.792	0.791	-0.018	0.175	0.464
Limit	0.792	1	0.997	0.010	0.101	0.862
Rating	0.791	0.997	1	0.053	0.103	0.864
Cards	-0.018	0.010	0.053	1	0.043	0.086
Age	0.175	0.101	0.103	0.043	1	0.002
Balance	0.464	0.862	0.864	0.086	0.002	1

Table 2: Wald Test for Rating and Limit

Wald stat	p-value
3.487	0.062

## Residual Plots

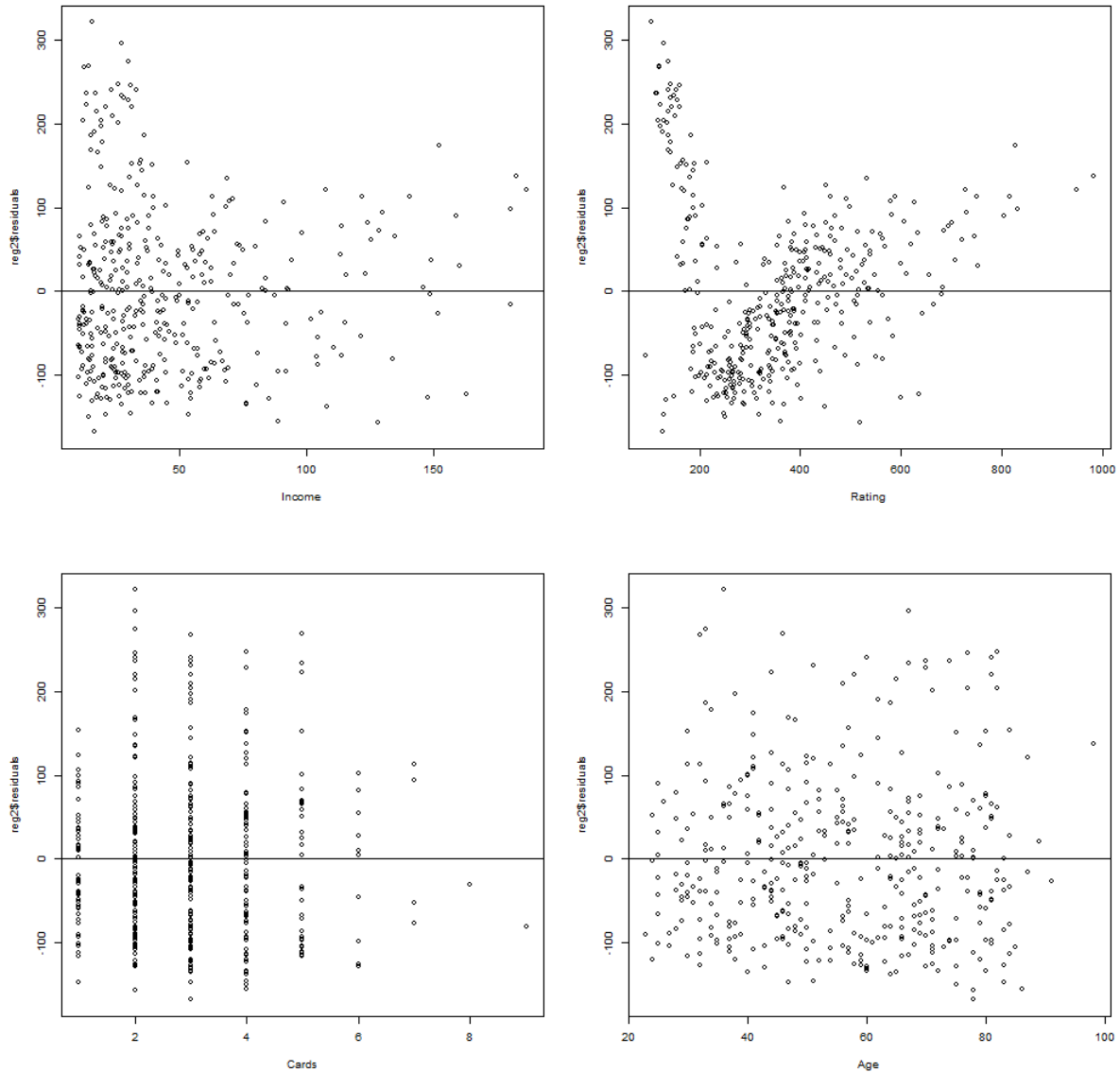


Table 3: Model Selection

	<i>Dependent variable:</i>		
	Balance		
	(1)	(2)	(3)
Income	−7.816*** (0.235)	−6.283*** (0.488)	−6.238*** (0.486)
Limit	0.189*** (0.033)		
I(Income^2)		−0.021*** (0.003)	−0.021*** (0.003)
Rating	1.166** (0.491)	2.481*** (0.136)	2.471*** (0.136)
I(Rating^2)		0.002*** (0.0002)	0.002*** (0.0002)
Cards	17.760*** (4.346)	2.825 (3.255)	
Age	−0.598** (0.295)	−0.714*** (0.263)	−0.729*** (0.261)
Edu_BinsBachelors	6.884 (11.901)	5.757 (10.604)	
Edu_BinsPost-Grad	−5.565 (12.329)	−9.563 (11.000)	
GenderFemale	−10.894 (9.925)	−9.118 (8.845)	
StudentYes	426.109*** (16.774)	429.092*** (14.920)	428.341*** (14.755)
MarriedYes	−8.535 (10.361)	−12.380 (9.195)	
EthnicityAsian	15.965 (14.157)	20.348 (12.593)	
EthnicityCaucasian	10.027 (12.217)	13.903 (10.902)	
Constant	−497.360*** (29.040)	−339.084*** (30.994)	−329.576*** (26.542)
Observations	400	400	400
R <sup>2</sup>	0.955	0.964	0.964
Adjusted R <sup>2</sup>	0.954	0.963	0.963
Residual Std. Error	98.853 (df = 387)	88.081 (df = 386)	88.218 (df = 393)
F Statistic	686.991*** (df = 12; 387)	806.545*** (df = 13; 386)	1,740.723*** (df = 6; 393)

Note:

\*p&lt;0.1; \*\*p&lt;0.05; \*\*\*p&lt;0.01