

week08-01-markov

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2 Week 8

3 Stochastic matrices & Markov Chains

3.1 Probability, power iteration, and stochastic matrices

A vector $\mathbf{v} = [v_1 \ v_2 \ \cdots \ v_n]^T \in \mathbb{R}^n$ will be said to be a *probability vector* if all of its entries v_i satisfy $v_i \geq 0$ and if

$$[1 \ 1 \ \cdots \ 1] \cdot \mathbf{v} = \sum_{i=1}^n v_i = 1.$$

Let $A = [a_{ij}] \in \mathbb{R}^{n \times n}$. We say that A is a *stochastic matrix* if $a_{ij} \geq 0$ for all i, j and if

$$[1 \ 1 \ \cdots \ 1] \cdot A = [1 \ 1 \ \cdots \ 1];$$

in words, A is a stochastic matrix if each column of A is a probability vector.

Notice that if \mathbf{v} is a probability vector, and A is a stochastic matrix, then $A\mathbf{v}$ is again a probability vector.

Indeed, by the definitions we have

$$[1 \ 1 \ \cdots \ 1] \cdot A \cdot \mathbf{v} = [1 \ 1 \ \cdots \ 1] \cdot \mathbf{v} = 1$$

As a consequence if A and B are stochastic $n \times n$ matrices, then also AB is stochastic. In particular, A^m is stochastic for all $m \geq 0$.

3.2 Eigenvalues of stochastic matrices

Proposition: Let A be a stochastic matrix.

- a) A has an eigenvector with eigenvalue 1.
- b) Let λ be any eigenvalue of a A . Then $|\lambda| \leq 1$.
- c) If \mathbf{w} is an eigenvector of A with eigenvalue λ satisfying $\lambda \neq 1$ then $[1 \ 1 \ \cdots \ 1] \mathbf{w} = 0$.

Sketch:

For a), note that taking transposes and applying the definition, we find that

$$A^T \cdot [1 \ 1 \ \cdots \ 1]^T = [1 \ 1 \ \cdots \ 1]^T;$$

thus $[1 \ 1 \ \dots \ 1]^T$ is an eigenvector for A^T with eigenvalue 1. Since the matrices A and A^T have the same characteristic polynomial and hence the same eigenvalues, the assertion **a)** now follows.

Since all entries a_{ij} of A satisfy $0 \leq a_{ij} \leq 1$, assertion **b)** is a consequence of [Gershgorin's Theorem](#).

3.3 Proof of c):

On one hand, we have

$$[1 \ 1 \ \dots \ 1] \lambda \mathbf{w} = \lambda ([1 \ 1 \ \dots \ 1] \mathbf{w})$$

On the other hand, since A is stochastic we have

$$[1 \ 1 \ \dots \ 1] A \mathbf{w} = [1 \ 1 \ \dots \ 1] \mathbf{w};$$

since $A \mathbf{w} = \lambda \mathbf{w}$ and since $\mathbf{w} \neq \mathbf{0}$, we conclude that

$$[1 \ 1 \ \dots \ 1] \mathbf{w} = \lambda [1 \ 1 \ \dots \ 1] \mathbf{w}.$$

Since $\lambda \neq 1$ by assumption, this is only possible if $[1 \ 1 \ \dots \ 1] \mathbf{w} = 0$, as asserted.

3.4 Power iteration for stochastic matrices

Let A be a stochastic matrix, and *suppose* that the eigenvalue $\lambda = 1$ has multiplicity one. This means that the *1-eigenspace* has dimension 1.

More concretely, this means that $A - \mathbf{I}_n$ has rank $n - 1$.

Remark: If A has n distinct eigenvalues, then the each eigenspace has dimension 1.

We have the following:

3.5 Corollary

Suppose that the stochastic matrix A is diagonalizable, and that the *1-eigenspace* of A has dimension 1. Let \mathbf{v} be an eigenvector for A with eigenvalue 1, and set $c = [1 \ 1 \ \dots \ 1] \mathbf{v}$. Then $\mathbf{w} = \frac{\mathbf{v}}{c}$ is a probability vector, and

$$A^m \rightarrow B \quad \text{as } m \rightarrow \infty$$

for a stochastic matrix B . Each column of B is equal to \mathbf{w} .

Sketch:

For $1 \leq i \leq n$, the i -th column of B may be computed as

$$\lim_{m \rightarrow \infty} A^m \mathbf{e}_i$$

where \mathbf{e}_i is the i -th standard basis vector.

Let $\mathbf{v} = \mathbf{v}_1, \dots, \mathbf{v}_n$ be linearly independent eigenvectors for A .

When $j > 1$, the eigenvalue for \mathbf{v}_j is < 1 by assumption, and it follows from the preceding results that $\begin{bmatrix} 1 & 1 & \dots & 1 \end{bmatrix} \cdot \mathbf{v}_j = 0$ for $j > 1$.

Fix $1 \leq i \leq n$ and consider the expression

$$\mathbf{e}_i = \sum_{j=1}^n c_j \mathbf{v}_j.$$

Since $\begin{bmatrix} 1 & 1 & \dots & 1 \end{bmatrix} \mathbf{e}_i \neq 0$, it follows that $c_1 \neq 0$. Thus a result proved in the previous notebook shows that $\lim_{m \rightarrow \infty} A^m \mathbf{e}_i$ is a non-zero multiple of \mathbf{w} .

Since B is stochastic, each column of B is a probability vector, and must coincide with \mathbf{w} .

3.6 Markov Chains

Let's pause to recap our *state-machine* point-of-view.

We consider a system with a list of *states*. The system undergoes transitions, which we take to be given by probabilities.

We represent the system by a directed graph. Each state determines a node. A directed edge between two nodes $a \rightarrow b$ labeled with $p = p_{a,b}$ indicates that if the system is currently in state a , it will transform to state b with probability p .

Thus for each node a , the sum of the probabilities on the edges $a \rightarrow b$ must be 1:

$$\sum_{(a \rightarrow b)} p_{a,b} = 1$$

The resulting matrix $P = (p_{a,b})_{a,b}$ has the property that its column-sums are all equal to 1. Thus P is a *stochastic matrix*.

Let G be the directed graph attached to our probabilistic state-machine as before. We will refer to G as a *transition diagram*, and we call the *system* described by G a *Markov chain*.

3.7 Diagram properties

Let G be the transition diagram of a Markov chain.

Definition: G is *strongly connected* if for each pair of nodes a, b , there is sequence of directed edges e_1, \dots, e_m connecting a to b .

Remark: If P is the corresponding stochastic matrix, one often says that P is *irreducible* when the transition diagram G is *strongly connected*.

3.8 Example:

The following graph is not *strongly connected*.

```
[1]: from graphviz import Digraph
    from itertools import product
```

```

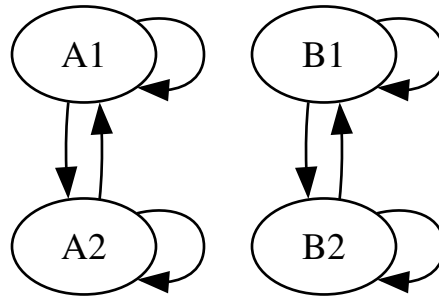
g = Digraph()

for i in ["A","B"]:
    for j in [1,2]:
        g.node(f"{i}-{j}")
    for (j,k) in product([1,2],[1,2]):
        g.edge(f"{i}-{j}",f"{i}-{k}")

g

```

[1]:



3.9 Example:

The following graph appears to be “connected” at least in some sense, but is not *strongly connected*.

Note that there is no path from the node 5 to the node 1, for example.

```

[2]: h = Digraph()

I = [1,2,3,4]

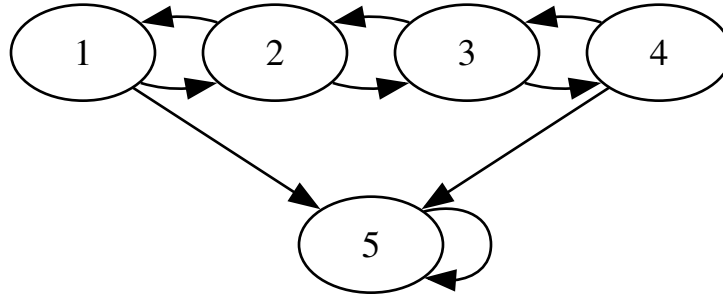
with h.subgraph() as c:
    c.attr(rank="same")
    for i in I:
        c.node(f"{i}")
    for (j,k) in [(i,j) for (i,j) in product(I,I) if i == j+1 or i == j-1]:
        h.edge(f"{j}",f"{k}")

h.edge(f"1",f"5")
h.edge(f"4",f"5")
h.edge(f"5",f"5")

h

```

[2]:



3.10 Cycles

A *cycle* of length n in a transition diagram is a sequence e_1, \dots, e_n of edges for which that initial node of e_1 is equal to the terminal node of e_n .

Here is an example of a cycle of length 5:

```
[3]: import numpy as np

def cycle(n=5, labels=None):
    if labels==None:
        labels= n*[1]
    cyc = Digraph()
    cyc.attr(rankdir='LR')
    I = list(range(n))

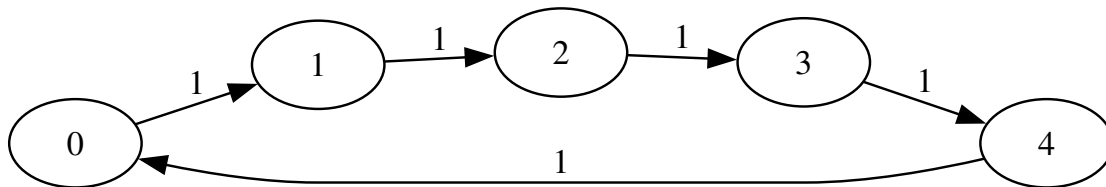
    for i in I:
        cyc.node(f"{i}")

    for i in I:
        cyc.edge(f"{i}", f"{np.mod(i+1,n)}", f"{labels[i]}")

    return cyc

cycle()
```

[3]:



3.11 Aperiodic

Given a transition diagram G , consider all possible cycles in G .

A transition diagram is said to be *aperiodic* if no integer $n > 1$ divides the length of each cycle.

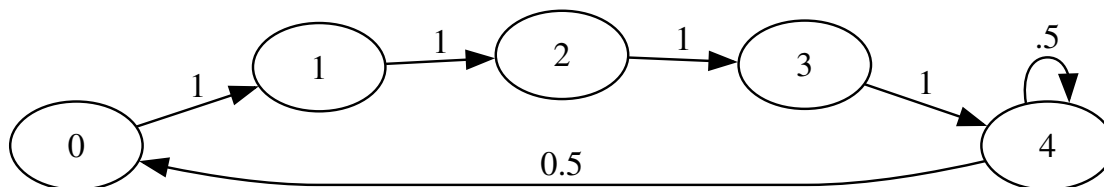
In other language, the diagram G is aperiodic if the greatest common divisor of the lengths of the cycles in G is equal to 1.

Example: The preceding graph G with 5 nodes is not *aperiodic* since every cycle has length a multiple of 5.

Example: The following graph *is* aperiodic, since it contains a cycle of length 1.

```
[4]: acycle = cycle(labels=[1,1,1,1,.5])
      acycle.edge("4","4",".5")
      acycle
```

[4]:



3.12 Theorem: (Perron-Frobenius)

Let G be a transition diagram for a Markov chain, and suppose that G is strongly connected and aperiodic. Let P be the corresponding stochastic matrix. The multiplicity of the eigenvalue $\lambda = 1$ for P is 1 – i.e.

$$\dim \text{Null}(P - I_n) = 1.$$

All other eigenvalues λ satisfy $|\lambda| < 1$.

There is a 1-eigenvector \mathbf{v} which is a probability vector.

3.13 Corollary

- $\lim_{m \rightarrow \infty} P^m$ is a matrix for which each column is equal to \mathbf{v} .
- If \mathbf{w} is a vector for which $[1 \ 1 \ \dots \ 1] \mathbf{w} > 0$, then $\lim_{m \rightarrow \infty} P^m \mathbf{w}$ is a positive multiple of \mathbf{v} .

4 Financial market example

Recall this example from a previous *problem session*.

Consider the state of a financial market from week to week.

- by a *bull market* we mean a week of generally rising prices.

- by a *bear market* we mean a week of generally declining prices.
- by a *recession* we mean a general slowdown of the economy.

Empirical observation shows for each of these three states what the probability of the state for the subsequent week, as follows:

	<i>bull</i>	<i>bear</i>	<i>recession</i>
followed by bull	0.90	0.15	0.25
followed by bear	0.075	0.80	0.25
followed by recession	0.025	0.05	0.50

In words, the first col indicates that if one has a bull market, then 90% of the time the next week is a bull market, 7.5% of the time the next week is a bear market, and 2.5% of the time the next week is in recession.

4.1 matrix

The matrix A describing the state transformations is a stochastic matrix.

```
[8]: ones = np.ones(3)

A = np.array([[0.90 , 0.15 , 0.25],
              [0.075, 0.80 , 0.25],
              [0.025, 0.05 , 0.50]])

ones @ A
```

```
[8]: array([1.00, 1.00, 1.00])
```

A has 3 distinct eigenvalues:

```
[10]: ##
e_vals, e_vecs = npl.eig(A)

e_vals
```

```
[10]: array([1.00, 0.74, 0.46])
```

In particular, it follows that the 1-eigenspace of A has dimension 1.

A 1-eigenvector is given by

```
[12]: v = e_vecs[:,0]
v
```

```
[12]: array([0.89, 0.45, 0.09])
```

Rescaling v to make a probability vector, we indeed see that $A^m \rightarrow [\mathbf{w} \ \mathbf{w} \ \mathbf{w}]$.

```
[29]: float_formatter = "{:.4f}".format
      np.set_printoptions(formatter={'float_kind':float_formatter})

      w = (1/sum(v,0))*v

      B=npl.matrix_power(A,200)

      print(f"w = \n\n{w}\n\nA^200 = \n\n{B}")
```

w =

```
[0.6250 0.3125 0.0625]
```

A²⁰⁰ =

```
[[0.6250 0.6250 0.6250]
 [0.3125 0.3125 0.3125]
 [0.0625 0.0625 0.0625]]
```

4.2 Interpretation:

Recall that A describes the state transitions for a financial market.

The interpretation here means that *in the long run*, there is a 62.5 % chance of a bull market, a 31.25 % chance of a bear market, and a 6.25% chance of a recession.