7. Eliminating Trends

Thursday, January 20, 2022 6:02 PM

§1.5 in book

Classical Decomposition Model

A lot of data $\{x_t\}$ don't look stationary, often due

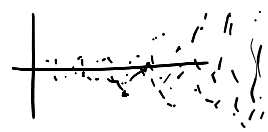
to a trend

and/or seasonality / periodicity ↖ eg. weather

and/or heteroscedasticity

$\underbrace{\text{heteroscedasticity}}_{\text{variance isn't constant}}$

trend (mean isn't constant)



variance increases over time

(There are many ways to be nonstationary, these are just common ones)

① heteroscedasticity

Not our focus but important

Often taken care of by preprocessing data : $Y_t = f(X_t)$

f is a variance-stabilizing transform. See §6.2 in our book

Ex. Box-Cox transformation

$f_0(X_t) = \log(X_t)$ (appropriate if $X_t > 0$ and σ increases linearly w/ mean)

or

$f_\lambda(X_t) = \frac{1}{\lambda}(X_t^\lambda - 1)$ $(X_t \geq 0,\ \lambda > 0)$

$\lambda = 1/2$ common

② seasonality and trend

classical decomposition model is the following additive model

$$X_t = m_t + s_t + Y_t$$

Y_t ← stochastic term, stationary — we'll learn how to model and forecast this later in the course

m_t: trend (slowly changing)

s_t: seasonal component — not random (so trivial to forecast)

OR Box-Jenkins differencing

Difference $(\tilde{X}_t = X_t - X_{t-1})$ repeatedly until left with a stationary residual.

Estimating trend (ignore s_t for now), §1.5.1

without loss of generality

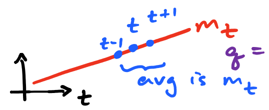
$(*)$ $\quad X_t = m_t + Y_t$, $\quad$ wlog $\mathbb{E}[Y_t] = 0$ since otherwise incorporate into m_t

Method 1 Smoothing (estimates m_t but doesn't build a model for it)

- Smoothing with a filter (i.e. convolution)

  eg. finite moving avg. filter, pick $q \in \{1, 2, 3, \ldots\}$

  $$W_t := \frac{1}{2q+1} \sum_{j=-q}^{q} X_{t-j}$$



  Why? Expect $W_t \approx m_t$ if m_t is roughly linear, since $\mathbb{E}[Y_t] = 0$

  In general, use a low-pass filter
  e.g. Spencer 15-pt. filter "passes" polynomials of degree ≤ 3.

  Don't let q be too large or else 1) boundary issues become serious
  2) overfit, incorporate too much in m_t

  You can also do filtering in the frequency domain (using FFT)
  (aka spectral smoothing) $\quad$ Fast Fourier Transform

- Exponential Smoothing, pick $\alpha \in [0, 1]$

  estimate m_t by $\hat{m}_t := \begin{cases} X_1 & t = 1 \\ \alpha X_t + (1-\alpha)\hat{m}_{t-1} & t \geq 2 \end{cases}$

  Compared to 2-sided filters, this lets you forecast into the future

Method 2 Regression / polynomial fitting

Assume $m_t = a_0 + a_1 t + a_2 t^2$ (or other degree polynomial)
and fit coefficients $\{a_0, a_1, a_2\}$ via least-squares

In R, use lm package

Method 3 Differencing

Nice since doesn't require you to specify a model for m_t and only has 1 parameter: how many repetitions

Define the backshift operator B as $BX_t := X_{t-1}$

and lag-1 difference operator ∇ as

$$\nabla X_t := X_t - X_{t-1} = (1 - B) X_t$$

really identity I

We'll see these again

then $B^2 X_t = B(BX_t)$
$= B(X_{t-1})$
$= X_{t-2}$ i.e. $B^j X_t := X_{t-j}$

and similarly $\nabla^j X_t = \nabla(\nabla^{j-1} X_t)$. $B^0 = \nabla^0 = \underset{\text{identity}}{I}$

Can manipulate ∇ and B like usual polynomial variables

e.g. $\nabla^2 = (1-B)(1-B) = 1 - 2B + B^2$

so $\nabla^2 X_t = X_t - 2X_{t-1} + X_{t-2}$

Technique:

$W_t = \nabla^k X_t$, k chosen so that W_t looks stationary

$W_t \approx \text{const} + \nabla^k Y_t$, i.e., trend m_t reduced to a constant

Why?

let $m_t = a_0 + a_1 \cdot t$

$\nabla m_t = (a_0 + a_1 \cdot t) - (a_0 + a_1 (t-1))$
$= a_1$

∇^k reduces a degree $\leq k$ polynomial to a constant