Def | rv $X_1, \ldots, X_n$ → sample mean of $(X_1, \ldots, X_n)$ is $\bar{X}_n = \frac{1}{n}\sum_{i=1}^{n} X_i$.

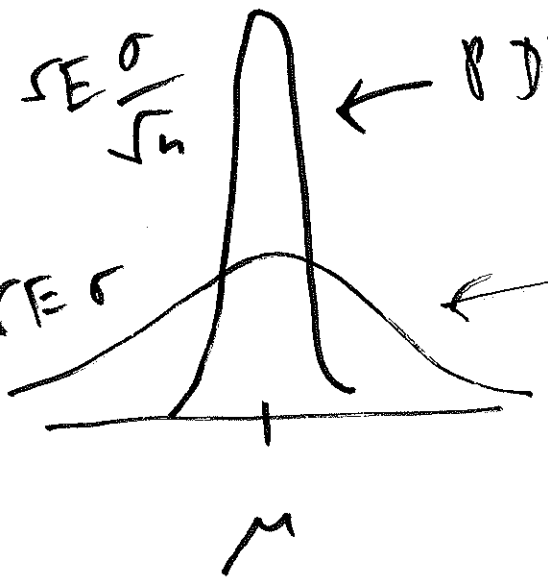
Consequences, continued | ⑤ $\left\{ X_i \overset{IID}{\sim} N(\mu, \sigma^2) \quad (i = 1, \ldots, n) \right\}$

→ $\bar{X}_n \sim N\left(\mu, \frac{\sigma^2}{n}\right)$ | ∴ $SD(\bar{X}_n) = \frac{\sigma}{\sqrt{n}}$

Because $E(\bar{X}_n) = \mu$, $\bar{X}_n$ is an unbiased estimator of μ

Def | In frequentist statistics, the standard deviation (SD) of an estimator $\hat{\theta}$ (rv) of a parameter θ is called the standard error $SE(\hat{\theta})$ of $\hat{\theta}$.

So if you use $\bar{X}_n$ as an estimate of μ, $SE(\bar{X}_n) = \frac{\sigma}{\sqrt{n}} \to 0$ as $n \to \infty$



This is the basis of most of frequentist statistical inference

As $n \uparrow$, $\bar{X}_n$ gets better as an estimate of μ, at a $\sqrt{n}$ rate; this is called the Square Root Law.

Unfortunately, this means that to cut the $SE(\bar{X}_n)$ in half, you have to quadruple the sample size.

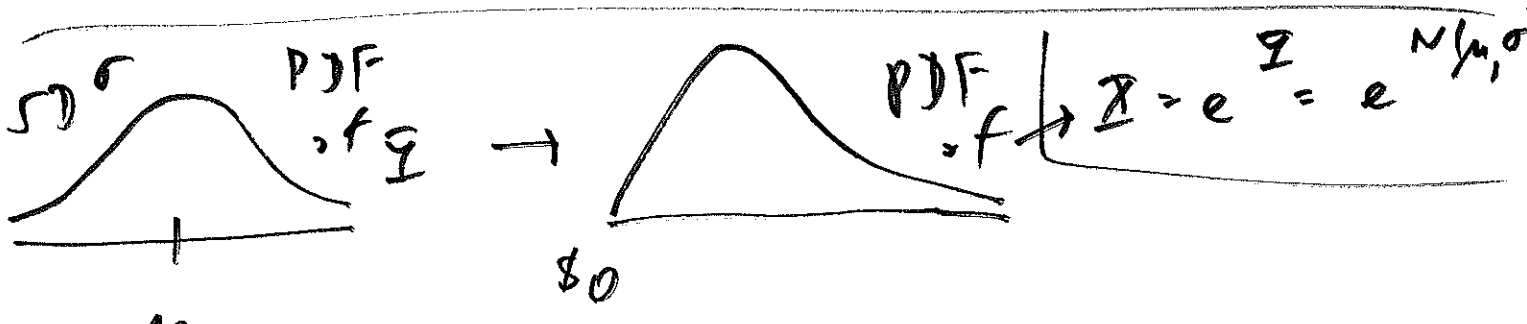
Log normal Distribution

(This distribution is mis-named (1900); it should be called the Exponential-Normal distribution, but we're stuck with a bad name.)

Def.

$X > 0$

If $Y = \log(X) \sim N(\mu, \sigma^2)$, people say that $X \sim$ Log Normal (μ, σ^2).



$X \sim$ Log Normal (μ, σ^2)

$Y = \log(X) \sim N(\mu, \sigma^2)$

Can get MGF of X from MGF of Y

MGF of X is $\psi_X(t) = \exp(\mu t + \frac{1}{2}\sigma^2 t^2)$

But by definition $\psi_X(t) = E(e^{tX}) = E(e^{t \log X})$

$= E(X^t)$, so we can read the moments of X directly from the MGF of X

$E(X) = \psi_X(1)$

$= \exp(\mu + \frac{\sigma^2}{2})$

$V(X) = \psi_X(2) - [\psi_X(1)]^2$

$= \exp(2\mu + \sigma^2)[e^{\sigma^2} - 1]$.

Famous case study

Pricing stock options, continued

1 share of a stock, current price S_0 (known constant). Heroic assumption: price

u time units in the future will be

$$S_u = S_0 e^{Z_u}, \quad Z_u \sim N(\mu u, \sigma^2 u).$$

Can write $S_0 e^{Z_u} = e^{Z_u + \log(S_0)}$. Now

$$\left[Z_u + \log(S_0)\right] \sim N(\mu u + \log(S_0), \sigma^2 u),$$

so $S_u \sim \text{LogNormal}[\mu u + \log(S_0), \sigma^2 u]$.

Consider a single time horizon u;

heroic assumption reworded →

$$S_u = S_0 \exp\left[\mu u + (\sigma\sqrt{u}) \cdot Z_1\right], \quad Z_1 \sim N(0,1)$$

we need to price the option to buy 1 share of this stock for price q at time u.

Use risk-neutral pricing or in the previous discussion: force present value $E(S_u) \triangleq S_0$.

Let time scale of u be in years; let the risk-free (continuous-compounding) interest rate be r/year;

then present value of S_u is $e^{-ru} \cdot E(S_u)$.

But by heroic lognormal assumption,

$$E(S_u) = S_0 \exp\left(\mu u + \frac{\sigma^2 u}{2}\right)$$

Set S_0 equal to

result is $\mu = r - \frac{\sigma^2}{2}$

$$e^{-ru} S_0 \exp\left(\mu u + \frac{\sigma^2 u}{2}\right)$$

for risk-neutral pricing.

Value of option at time u will be $h(S_u)$, where $h(s) = \{s-\xi \text{ if } s > \xi;\ 0 \text{ else}\}$.

With $\mu = r - \frac{\sigma^2}{2}$, $h(S_u) > 0$ iff

$$Z_1 > \frac{\log\left(\frac{\xi}{S_0}\right) - \left(r - \frac{\sigma^2}{2}\right)u}{\sigma\sqrt{u}} \triangleq c$$

Now a nasty integral arises: risk-neutral price of option is the present value of $E[h(S_u)]$, which is

$$e^{-ru} E[h(S_u)] = e^{-ru} \int_c^\infty \left[S_0 e^{\left(r-\frac{\sigma^2}{2}\right)u + \sigma z\sqrt{u}} - \xi\right] \frac{1}{\sqrt{2\pi}} \exp\left(-\frac{z^2}{2}\right) dz$$

Careful calculation reveals the following (famous) formula:

$$\boxed{S_0 \Phi(\sigma\sqrt{u} - c) - q e^{-ru} \Phi(-c)}$$ is

the risk-neutral price of the option,

where $c = \dfrac{\log\left(\frac{q}{S_0}\right) - \left(r - \frac{\sigma^2}{2}\right)u}{\sigma\sqrt{u}}$ ← This formula was derived in 1973 by

("Black-Scholes" formula)

Gamma Distribution

($\alpha, \beta > 0$) X has the Gamma dist. with parameters (α, β), with $X \sim \Gamma(\alpha, \beta)$ or $X \sim \text{Gamma}(\alpha, \beta)$ → X continuous on $(0, \infty)$ with

(American economist) → Fischer Black (1938-1995) died of throat cancer

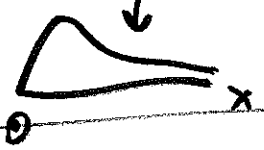
and

Myron Scholes (1941-) ← (Canadian-American economist)

↑ won Nobel prize in Economics for this work in 1997, together with Robert Merton (1944-) (American economist)

2003

PDF $f_X(x|\alpha,\beta) = \frac{\beta^\alpha}{\Gamma(\alpha)} x^{\alpha-1} e^{-\beta x} \underbrace{I(x>0)}_{\text{support of } X}$ (*)



α is called a shape parameter in the $\Gamma(\alpha,\beta)$ family because it governs things like skewness of the dist. β is related to the scale of the distribution, which measures how spread out the dist. is. $\Gamma(\alpha)$ is the Gamma function, invented to deal with integrals of functions like (*) above:

$$\Gamma(\alpha) \triangleq \int_0^\infty x^{\alpha-1} e^{-x} dx$$

has no anti-derivative in closed form

$\Gamma(\alpha)$ turns out to be a continuous generalization of the factorial function, because $\left(\begin{matrix} n \text{ positive} \\ \text{integer} \end{matrix}\right) \rightarrow \Gamma(n) = (n-1)!$

$\Gamma(\alpha) \rightarrow \infty$ really quickly as $\alpha \rightarrow \infty$, so it's better to evaluate the Gamma PDF on the log scale and then exponentiate:

$$\frac{\beta^\alpha}{\Gamma(\alpha)} x^{\alpha-1} e^{-\beta x} = \exp\left[\alpha \ln(\beta) - \ln\Gamma(\alpha) + (\alpha-1)\ln(x) - \beta x \right]$$

Another way to tame $\Gamma(x)$ is with a Stirling's approximation: $\Gamma(x) \doteq \sqrt{2\pi}\, x^{x-\frac{1}{2}} e^{-x}$ for large x

so that $\ln \Gamma(x) \doteq \frac{1}{2}\ln(2\pi) + (x-\frac{1}{2})\ln x - x$.

$X \sim \Gamma(\alpha, \beta)$ | $\psi_X(t) = \left(1 - \frac{t}{\beta}\right)^{-\alpha}$ for $t < \beta$

so $E(X) = \frac{\alpha}{\beta}$ and $V(X) = \frac{\alpha}{\beta^2}$ | $SD(X) = \frac{\sqrt{\alpha}}{\beta}$

Alternative expression: $\psi_X(t) = \left(\frac{\beta}{\beta - t}\right)^{\alpha}$ for $t < \beta$

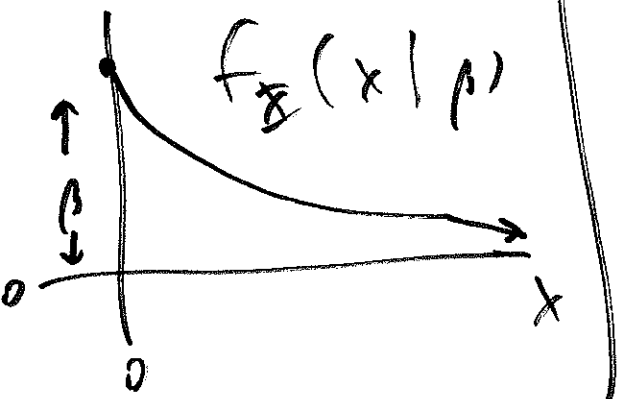
Special case of $\Gamma(\alpha, \beta)$: with $\alpha = 1$ the PDF is

$$f_X(x|\beta) = \beta e^{-\beta x} I(x > 0)$$

But this is just our old friend the Exponential distribution.

$X \sim \text{Exponential}(\beta)$ $\quad \psi_X(t) = \frac{\beta}{\beta - t}, \; t < \beta$

$E(X) = \frac{1}{\beta}$ $\quad V(X) = \frac{1}{\beta^2}$ $\quad SD(X) = \frac{1}{\beta}$



Notice that the Exponential distribution has SD equal to $\frac{1}{\beta}$; this suggests it's related somehow to the Poisson dist.

Theorem Suppose that arrivals (events) occur according to a Poisson process with rate β per unit time. Set T_k = time until k^{th} arrival, $k = 1, 2, \ldots$ and define

$$Y_1 = T_1 - 0$$
$$Y_2 = T_2 - T_1$$
$$\ldots$$
$$Y_k = T_k - T_{k-1} \text{ for } k = 2, 3, \ldots$$

The T_i are called the inter-arrival times.

Then it turns out that $T_i \overset{IID}{\sim}$ Exponential(β)

The Exponential dist. is also related to the Geometric dist., in that they both have a memory less property

Theorem

$X \sim$ Exponential(β); $t > 0$, $h > 0$

$\rightarrow P(X \geq t+h \mid X \geq t) = P(X \geq h)$

Example X = time (from initial use) until a manufactured product fails (e.g., light bulb)

$F_X(x) = P(X \leq x)$ $\quad$ $1 - F_X(x) = P(X > x)$

$= P($"system survives" at least to time $x)$

For this reason, $1 - F_X(x)$ is called the survival function $S_X(x) = 1 - F_X(x)$ in medicine and the reliability function $R_X(x) = 1 - F_X(x)$ in engineering.

Earlier we showed that for $X \sim \text{Exponential}(\beta)$ $\Rightarrow$ $F_X(x) = 1 - e^{-\beta x}$ for $x > 0$

So $S_X(x) = R_X(x) = e^{-\beta x}$ for this dist.

The instantaneous failure rate or hazard rate function is defined to be $H_X(x) = \dfrac{f_X(x)}{S_X(x)}$

This gives $\dfrac{f_X(x)}{R_X(x)} = P(\text{failure in interval } (x, x+\epsilon) \mid \text{survival to time } x)$ for small ϵ

Notice that if $X \sim \text{Exponential}(\beta)$

then $H_X(x) = \dfrac{\beta e^{-\beta x}}{e^{-\beta x}} = \beta \left(\dfrac{\text{Constant in}}{x} \right)$

---

the Exponential is the only failure rate distribution with constant hazard. Returning to the earlier result that $X \sim \text{Exponential}(\beta)$,

$\rightarrow P(X \geq t+h \mid X \geq t) = P(X \geq h)$,

for all $t > 0$, $h > 0$

this says that if the product has survived to time t, the chance it will survive to time $(t+h)$ is the same as the original chance of surviving from time 0 to time h; ie., "the system doesn't remember how long it's survived" (this often makes the Exponential unrealistic in practice)

Consequences ① $X_i \overset{IID}{\sim} \text{Exponential}(\beta)$ $(i = 1, \dots, n)$,

then

$Y_1 = \min(X_1, \dots, X_n) \sim \text{Exponential}(n\beta)$.

Beta Distribution $\alpha, \beta > 0$ $X \sim \text{Beta}(\alpha, \beta) \leftrightarrow$

$$f_X(x) = \frac{\Gamma(\alpha+\beta)}{\Gamma(\alpha)\Gamma(\beta)} x^{\alpha-1}(1-x)^{\beta-1}.$$

$I(0 < x < 1)$ ← support of X

The name comes from the normalizing constant: the function $x^{\alpha-1}(1-x)^{\beta-1}$ has no closed-form anti-derivative, so people just made Γ

Definition For all $\alpha > 0$, $\beta > 0$

$$B(\alpha, \beta) \triangleq \int_0^1 x^{\alpha-1}(1-x)^{\beta-1}\,dx$$

B ← beta function

Can show that $B(\alpha,\beta) = \dfrac{\Gamma(\alpha)\Gamma(\beta)}{\Gamma(\alpha+\beta)}$.

(α,β) jointly control the shape of the Beta(α,β) dist.

$X \sim \text{Beta}(\alpha,\beta)$ $\quad$ $\psi_X(t) = 1 + \sum_{k=1}^{\infty}\left(\prod_{r=0}^{k-1}\dfrac{\alpha+r}{\alpha+\beta+r}\right)\dfrac{t^k}{k!}$ (yuck)

$E(X) = \dfrac{\alpha}{\alpha+\beta}$ $\quad$ $V(X) = \left(\dfrac{\alpha}{\alpha+\beta}\right)\left(\dfrac{\beta}{\alpha+\beta}\right)\left(\dfrac{1}{\alpha+\beta+1}\right)$

Case study

(Castaneda v. Partida continued)

$n = 220$ grand jurors chosen from ([redacted]) eligible population of Hidalgo County, Texas, which was 79.1% Mexican-American, but only $s = 100$ selected grand jurors were Mexican-American; let's summarize the information in a Bayesian fashion about evidence of discrimination.

Data S = # Mexican-American chosen in jury selection of $n = 220$ people

Unknown θ = actual probability of an eligible Mexican-American person being chosen $(0 < \theta < 1)$

Sampling Model $(S \mid \theta) \sim \text{Binomial}(n, \theta)$,

i.e., $f_{S|\theta}(s|\theta) = p(S=s|\theta) = \binom{n}{s} \theta^s (1-\theta)^{n-s} \cdot I(s=0,1,\ldots,n)$

Bayesian approach ① Information internal to dataset about θ summarized by the likelihood (un-normalized) density, defined to be $\boxed{\ell(\theta|s) = c\, p(S=s|\theta)}$, c an arbitrary positive constant — just think of $p(S=s|\theta)$ as a function of θ for fixed s.

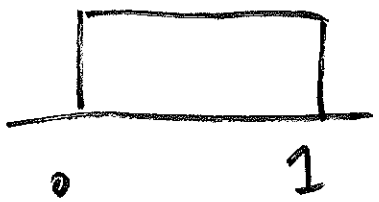
Here $\ell(\theta|s) = c\binom{n}{s}\theta^s(1-\theta)^{n-s}$ could be absorbed into c since does not depend on θ

$= c\,\theta^s(1-\theta)^{n-s}$

(2) Information external to dataset about θ summarized by the prior density $f_\Theta(\theta)$.

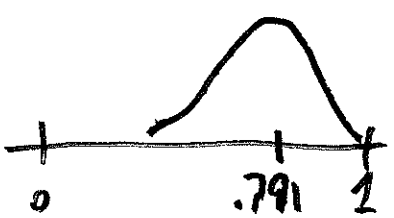
Here are some possibilities for the prior, depending on your (information) knowledge base:

(a) neutral prior $\theta \sim \text{Uniform}(0,1)$



this dist. embodies the information {θ could be anywhere between 0 and 1, with no value favored}

(b) Let the district attorney some slack prior



this prior gives the DA the benefit of the doubt

when you're uncertain about what prior to use, write down all the reasonable priors & do a sensitivity analysis (use each prior essentially one by one & see if posterior answer is the same)

---

(3) Combine internal & external information

with Bayes' Theorem

$$f_{\Theta|S}(\theta|s) = c \cdot f_{\Theta}(\theta) \cdot f(\theta|s)$$

posterior (information) = (normalizing constant) · (prior information) · (likelihood information)

Here

$$f_{\Theta|S}(\theta|s) = c\, f_{\Theta}(\theta)\, \theta^{s}(1-\theta)^{n-s}$$

Rev. Bayes himself published back in 1760

that if you take $f_\Theta(\theta) = c\,\theta^{\text{power}}(1-\theta)^{\text{power}}$ then the product of 2 such densities is another such density, meaning that the posterior would have the same form as the prior & likelihood, making calculating easier

Moreover, we already know the name of densities that look like $\theta^{\text{power}}(1-\theta)^{\text{power}}$: the Beta distributions

$X \sim \text{Beta}(\alpha, \beta)$ $(\alpha > 0, \beta > 0) \rightarrow$

$f_X(x) = c\,\theta^{\alpha-1}(1-\theta)^{\beta-1}$

as our prior PDF

So let's take $f_{\Theta(it)}(\theta) = c\,\theta^{\alpha-1}(1-\theta)^{\beta-1}$

in the lawsuit case study; then

$$f_{\Theta|S}(\theta|s) = c\left[\theta^{\alpha-1}(1-\theta)^{\beta-1}\right]\left[\theta^{s}(1-\theta)^{n-s}\right]$$

$= c\ \theta^{(\alpha+s)-1}(1-\theta)^{((\beta+n-s)-1)} = \text{Beta}(\alpha+s, \beta+n-s)$

So the prior-to-posterior updating looks like this:

↑ "Beta dist. is conjugate to the Binomial likelihood"

$\theta \sim \text{Beta}(\alpha, \beta)$

$(s|\theta) \sim \text{Binomial}(n, \theta)$

$\Rightarrow (\theta|s) \sim \text{Beta}(\alpha+s, \beta+n-s)$

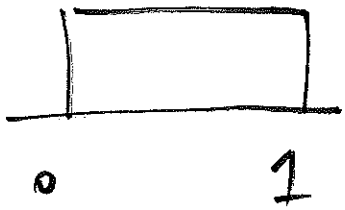
$s = 100$

$n = 220$

How choose (α, β)?

(a) Neutral prior

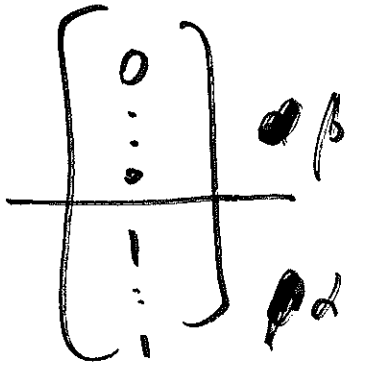
but $\text{Uniform}(0,1) = \theta^{1-1}(1-\theta)^{1-1}$



So $\theta \sim \text{Uniform}(0,1) \leftrightarrow \theta \sim \text{Beta}(1,1)$

(b) cut DA slack prior

There's an extremely useful thing that happens with conjugate priors:



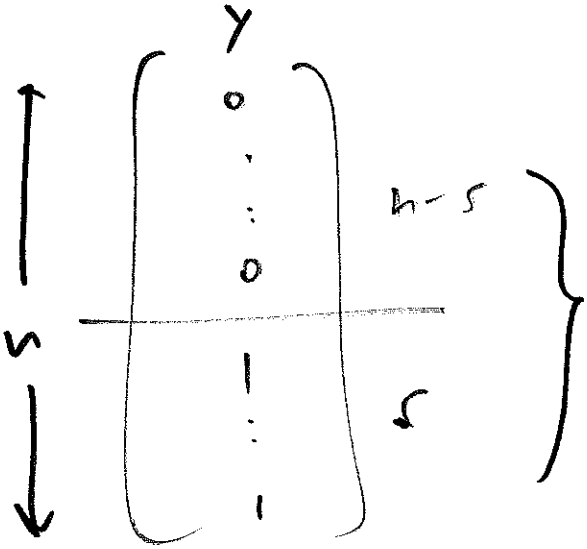
mean $\frac{\alpha}{\alpha+\beta}$

pseudo data

prior effective sample size $(\alpha+\beta)$

Beta prior distribution acts like a dataset with α 1s & β 0s

with the property that if you do a Bayesian analysis with the Beta(α,β) prior and I do a frequentist analysis on the dataset with $(\alpha+s)$ 1s and $(\beta+n-s)$ 0s formed by merging the prior & sample datasets, we'll get the same results.



mean $\bar{y} = \frac{s}{n}$

sample data

data set sample size n

(b) cut the DA slack prior

mean of Beta(α, β) dist. is $\frac{\alpha}{\alpha+\beta}$; set this equal to 0.791

Suppose I want to put in prior information equivalent to a prior sample size $\frac{1}{10}$ as big as the data sample size (507); set

$$(\alpha+\beta) = \frac{1}{10} n = 22$$

Solve: $\alpha = 17.4$, $\beta = 4.6$

$n = 220$

$s = 100$

likelihood is

$$c\,\theta^{s}(1-\theta)^{n-s} = c\,\theta^{(s+1)-1}(1-\theta)^{(n-s+1)-1}$$

$$= \text{Beta}(s+1,\ n-s+1) \text{ dist}$$

(101) (121)

(a) Neutral prior: Beta(1,1)

prior sample size 2

posterior is Beta$(\alpha+s,\ \beta+n-s)$

(101) (121)

(same as likelihood)

(b) Cut DA slack prior

Beta(17.4, 4.6) prior
(α, β)

posterior is Beta($\alpha+s$, $\beta+n-s$)

220 → $\alpha+s$ = 117.4

100 → $\beta+n-s$ = 124.6

prior	posterior mean	posterior SD
neutral	0.455	0.0333
cut DA slack	0.485	0.0321

Posterior mean of θ is $\frac{\alpha+s}{\alpha+\beta+n}$

Posterior SD is $\sqrt{\left(\frac{\alpha+s}{\alpha+\beta+n}\right)\left(\frac{\beta+n-s}{\alpha+\beta+n}\right)\left(\frac{1}{\alpha+\beta+n+1}\right)}$

The no-discrimination rate of 0.791 is

$\frac{0.791-0.455}{0.0333} = 10.1$ posterior SDs away from posterior expectation

under the neutral prior and

$$\frac{0.791 - 0.485}{0.0321} \doteq 9.5 \text{ posterior SDs}$$

away from posterior expectation under the cut-DA-slack prior;

There was Q.E.D. discrimination

Multinomial Distributions (back to discrete)

You're contemplating a population that contains elements of $k \geq 2$ types (e.g., {Democrat, Republican, Libertarian, Independent, Green, other}).

Suppose the proportion of elements of type i is $\hat{p}_i$ with $\sum_{i=1}^{k} p_i = 1$; $\underline{p} = (p_1, \ldots, p_k)$.

You take an IID sample of size n from this pop.; X_i = # elements of type i in your sample; $\sum_{i=1}^{k} X_i = n$.

Can show that the vector $\underset{\sim}{X} = (X_1, \ldots, X_k)$ has PMF

$$f_{\underset{\sim}{X}|n,\underset{\sim}{p}}(\underset{\sim}{x}|n,\underset{\sim}{p}) = \begin{cases} \binom{n}{x_1,\ldots,x_k} p_1^{x_1} \cdots p_k^{x_k} & \text{if } \sum_{i=1}^{k} x_i = n \\ 0 & \text{else} \end{cases}$$

where $\left(\sum_{i=1}^{k} p_i = 1\right)$

$$\binom{n}{x_1,\ldots,x_k} \triangleq \frac{n!}{x_1!\, x_2! \cdots x_k!}$$ is the multinomial coefficient

---

This is called the multinomial $(n, \underset{\sim}{p})$ distribution.

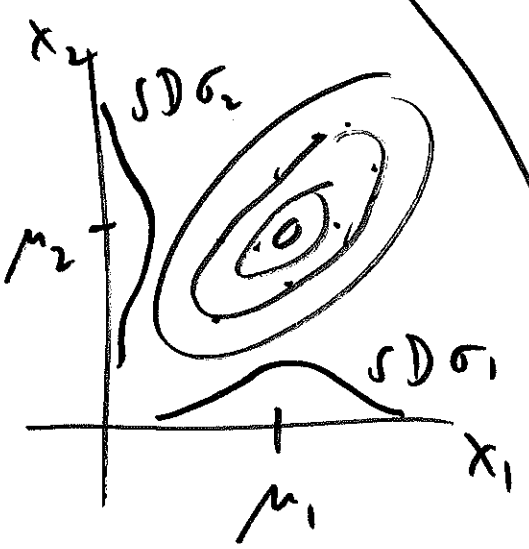
$E(X_i) = np_i$ | $V(X_i) = np_i(1-p_i)$

(just like binomial) | But now something new:

$C(X_i, X_j) = -np_ip_j$ | negatively correlated because $\sum_{i=1}^{k} X_i = n$.

Bivariate Normal Dist. | Can build a 2-dimensional (bivariate) version of the Normal dist. as follows:

$Z_1, Z_2 \overset{IID}{\sim} N(0,1)$



correlation ρ

Specify 5 parameters:

$-\infty < \mu_1 < +\infty$	$0 < \sigma_1 < \infty$
$-\infty < \mu_2 < +\infty$	$0 < \sigma_2 < \infty$

$-1 < \rho < +1$

Now build $(\underset{\sim}{X}_1, \underset{\sim}{X}_2)$ with the transformation $\underset{\sim}{X}_1 = \mu_1 + \sigma_1 \underset{\sim}{Z}_1$

$$\underset{\sim}{X}_2 = \sigma_2 \left[\rho \underset{\sim}{Z}_1 + \sqrt{1-\rho^2}\, \underset{\sim}{Z}_2 \right] + \mu_2$$

The joint PDF of $\underset{\sim}{X} = (\underset{\sim}{X}_1, \underset{\sim}{X}_2)$ is

then $$f_{\underset{\sim}{X}_1, \underset{\sim}{X}_2}(x_1, x_2) = \frac{1}{2\pi\sqrt{1-\rho^2}\,\sigma_1\sigma_2} \cdot \exp\left\{ \right.$$

$$-\frac{1}{2(1-\rho^2)} \left[\left(\frac{x_1-\mu_1}{\sigma_1} \right)^2 - 2\rho \left(\frac{x_1-\mu_1}{\sigma_1} \right)\left(\frac{x_2-\mu_2}{\sigma_2} \right) \right.$$

standard units

$$\left. \left. + \left(\frac{x_2-\mu_2}{\sigma_2} \right)^2 \right] \right\}$$

This is the Bivariate Normal $(\mu_1, \mu_2, \sigma_1, \sigma_2, \rho)$ dist.

Easy to show that $E(X_1) = \mu_1$,

$E(X_2) = \mu_2$, $V(X_1) = \sigma_1^2$, $V(X_2) = \sigma_2^2$,

$\rho(X_1, X_2) = \rho$. Consequences of this def.

① $(X_1, X_2) \sim$ Bivariate Normal $\longrightarrow$

(X_1, X_2 : independent) $\longleftrightarrow$ (X_1, X_2 uncorrelated)

we already knew the $\rightarrow$ direction in general; what's new here is that correlation 0 implies independence if $(X_1, X_2) \sim$ Bivariate Normal.

② $(X_1, X_2) \sim$ Bivariate Normal $(\mu_1, \mu_2, \sigma_1, \sigma_2, \rho)$

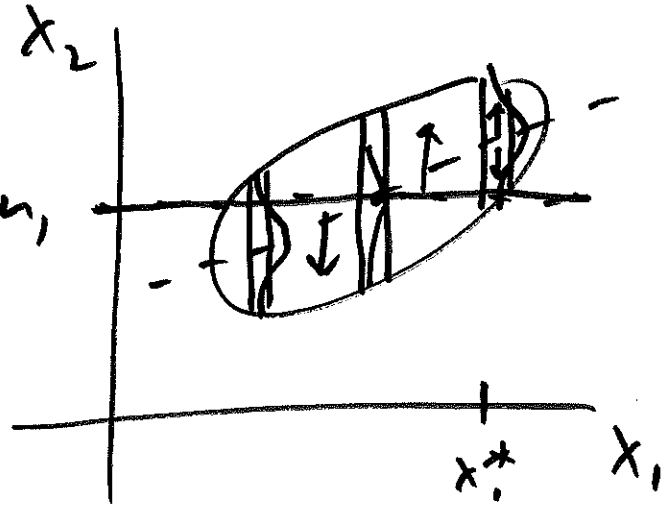
→ conditional distribution of X_2 given that $X_1 = x_1$ is (univariate) normal with mean $E(X_2 \mid x_1) =$

$$\mu_2 + \rho \frac{\sigma_2}{\sigma_1}(x_1 - \mu_1)$$

and variance $V(X_2 \mid x_1) = (1 - \rho^2)\sigma_2^2$

above result ② says that if (X_1, X_2) are Bivariate Normal then the distributions of X_2 given $X = x_1^*$ in all of the vertical strips are also normal

Galton, revisited



conditional

And the means of all these normal distributions in the vertical strips are connected together by Galton's

regression line $\hat{x}_2 = \mu_2 + \rho\frac{\sigma_2}{\sigma_1}(x_1 - \mu_1)$.

This line has slope $\beta_1 = \rho\frac{\sigma_2}{\sigma_1}$ and "y"-intercept $\beta_0 = \mu_2 - \beta_1\mu_1$. Moreover, $\hat{x}_2 = \beta_0 + \beta_1 x_1$

we can now quantify an earlier insight:

ignore x_1, predict $(\hat{x}_2)_{\text{no } x_1} = \mu_2 = E(X_2)$

(root mean squared error) (RMSE) of this prediction is $\sqrt{V(X_2)} = \sigma_2$

Use x_1 to predict x_2

$$\text{pred.2t}\,(\hat{x}_2)_{\substack{\text{use}\\ x_1}} = E(X_2 \mid X_1 = x_1)$$

$$= \mu_2 + \rho\frac{\sigma_2}{\sigma_1}(x_1 - \mu_1)$$

RMSE of this prediction is $\sqrt{V(X_2 \mid x_1)} = \sigma_2\sqrt{1-\rho^2}$

Since $-1 < \rho < 1$, $\sigma_2\sqrt{1-\rho^2} \leq \sigma_2$

with equality only when $\rho = 0$.

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(3) $(X_1, X_2) \sim$ BivariateNormal $(\mu_1, \mu_2, \sigma_1, \sigma_2, \rho)$,

$Y = a_1X_1 + a_2X_2 + b$, (a_1, a_2, b) arbitrary constants

$\rightarrow Y \sim N(a_1\mu_1 + a_2\mu_2 + b,\ a_1^2\sigma_1^2 + a_2^2\sigma_2^2 + 2a_1a_2\rho\sigma_1\sigma_2)$.

Large Random Samples

(DS ch. 6)

You draw an IID random sample $X_1, \ldots, X_n$ from a population, with the goal of estimating the population mean $\mu = E(X_i)$.

We've already seen that, from a root mean squared error point of view, the sample mean $\bar{X}_n = \frac{1}{n}\sum_{i=1}^{n} X_i$ is the best you can do (in the absence of prior information).

It would be nice if $\bar{X}_n$ approached the right answer μ as n increases; how to quantify that idea?

Two inequality that help

Markov inequality

Suppose X is a non-negative r.v., i.e. $P(X \geq 0) = 1$ then for all real $t > 0$, $P(X \geq t) \leq \frac{E(X)}{t}$ ⊛

(Attributed to Andrey Markov (1856-1922), a Russian mathematician who did pioneering work on stochastic processes)

⊛ says that, if $E(X)$ is fixed, you can't move more & more probability out into the right tail beyond a certain point.

25 Aug 17

Laplace
↕
Bortels → Lobachevsky → Bradmon → Chebyshev → Markov → Voronoy → Sierpiński → Neyman → Lehmann → Draper

ex. $E(X) = 1$, X non-negative $\rightarrow$

$P(X \geq 100) \leq \frac{1}{100}$ The inequality is sharp, meaning that the upper bound $\frac{E(X)}{t}$ on $P(X \geq t)$ is attainable, ⊛

ex. $E(X) = 1$, X-nonnegative $\rightarrow$ put probability 0.99 on $X = 0$ and 0.01 on 100

⊛ but most of the time (i.e., for most distributions) it's a crude upper bound.

(30 May 19)

Can apply Markov inequality to the r.v. $Y = (X - E(X))^2$ to get