Stochastic Differential Equations
Problem Set 1
Brownian Motion: Construction and Basic Properties

1.1 Let

$$\varphi : \mathbb{R} \to \mathbb{R}_+, \qquad \varphi(x) := \frac{1}{\sqrt{2\pi}} e^{-x^2/2}, \quad \text{be the standard normal density function,}$$

$$\Phi : \mathbb{R} \to [0,1], \quad \Phi(x) := \int_{-\infty}^{x} \varphi(y) dy, \quad \text{be the standard normal distribution function.}$$

Prove that for any $x > 0$

$$\left(\frac{1}{x} - \frac{1}{x^3} \right) \varphi(x) < 1 - \Phi(x) < \frac{1}{x} \varphi(x).$$

Hint: Compare the derivatives.

1.2 For every $n \in \mathbb{N}$ let $X_1^{(n)}, X_2^{(n)}, \dots, X_n^{(n)}$ be i.i.d. normal random variables with

$$\mathbf{E}\left(X_j^{(n)}\right) = 0, \qquad \mathbf{Var}\big(X_j^{(n)}\big) = \frac{1}{n}, \qquad j = 1, \dots, n.$$

Define the stochastic process $t \mapsto B^{(n)}(t)$, $t \in [0,1]$ as follows:

$$B^{(n)}(t) := \sum_{j=1}^{\lfloor nt \rfloor} X_j^{(n)}.$$

(a) Compute the expectations and covariances

$$\mathbf{E}\left(B^{(n)}(t)\right) = ?, \qquad \mathbf{Cov}\big(B^{(n)}(t), B^{(n)}(s)\big) = ?, \qquad s, t \in [0,1],$$

and their limits as $n \to \infty$.

(b) What is the joint distribution of the random variables $\{B^{(n)}(t) : t \in [0,1]\}$?

(c) Let

$$\delta_n := \max\left\{ \left| B^{(n)}(t+) - B^{(n)}(t-) \right| : t \in [0,1] \right\}.$$

(In plain words: δ_n is the largest jump discontinuity of the process $\{B^{(n)}(t) : t \in [0,1]\}$.)
Prove that for any fixed $\varepsilon > 0$,

$$\lim_{n\to\infty} \mathbf{P}\left(\delta_n \geq \varepsilon\right) = 0.$$

Hint: Note that $\delta_n = \max_{1\leq j\leq n} \left| X_j^{(n)} \right|$ and use the upper bound from problem 1.1.

1.3 For every $n \in \mathbb{N}$ let $Y_1^{(n)}, Y_2^{(n)}, \ldots, Y_n^{(n)}$ be i.i.d. Poisson random variables with parameter $1/n$. So,

$$\mathbf{E}\left(Y_j^{(n)}\right) = \frac{1}{n}, \qquad \mathbf{Var}\big(Y_j^{(n)}\big) = \frac{1}{n}, \qquad j = 1, \ldots, n.$$

Define the stochastic process $t \mapsto B^{(n)}(t)$, $t \in [0,1]$ as follows:

$$Z^{(n)}(t) := \sum_{j=1}^{\lfloor nt \rfloor} \left(Y_j^{(n)} - \frac{1}{n} \right).$$

(a) Compute the expectations and covariances

$$\mathbf{E}\left(Z^{(n)}(t)\right) = ?, \qquad \mathbf{Cov}\big(Z^{(n)}(t), Z^{(n)}(s)\big) = ?, \qquad s, t \in [0,1],$$

and their limits as $n \to \infty$.

(b) What is the joint distribution of the random variables $\{Z^{(n)}(t) : t \in [0,1]\}$? Explain in plain words.

(c) Let

$$\delta_n := \max\left\{ \left| Z^{(n)}(t+) - Z^{(n)}(t-) \right| : t \in [0,1] \right\}.$$

(In plain words: δ_n is the largest jump discontinuity of the process $\{Z^{(n)}(t) : t \in [0,1]\}$.)
Compute, for $\varepsilon > 0$ fixed,

$$\lim_{n\to\infty} \mathbf{P}\left(\delta_n \geq \varepsilon\right).$$

Hint: Note that $\delta_n = \max_{1\leq j\leq n} \left| Y_j^{(n)} \right|$ and use all you know about Poisson random variables.

1.4 Interpret the results of problems 1.2, respectively, 1.3.

1.5 (a) Let $Y_1, Y_2, \dots, Y_n$ be random variables with $\mathbf{E}(Y_j) = 0$ and $\mathbf{Cov}\big(Y_i, Y_j\big) =: c_{i,j}$. Assume that the covariance matrix $C := (c_{i,j})_{i,j=1}^n$ is non-degenerate, $\det(C) \neq 0$. Prove that the random variables $Y_1, Y_2, \dots, Y_n$ are *jointly Gaussian* if and only if there exist i.i.d. $\mathcal{N}(0,1)$-distributed random variables $X_1, X_2, \dots, X_n$ and real coefficients $(a_{i,j})_{i,j=1}^n$ such that

$$Y_i = \sum_{j=1}^n a_{ij} X_j.$$

Hint: Express the matrix $A = (a_{i,j})_{i,j=1}^n$ from the covariance matrix $C = (c_{i,j})_{i,j=1}^n$.

(b) Let $t \mapsto B(t)$ be standard $1d$ Brownian motion and $0 \leq t_1 \leq t_2 \leq \cdots \leq t_n$. Explain why it follows from the definition of Brownian motion (i.e. independent and Gaussian increments) that the random variables $B(t_1), B(t_2), \dots, B(t_n)$ have jointly Gaussian distribution.

(c) Determine the covariance matrix of the random variables $B(t_1), B(t_2), \dots, B(t_n)$.

1.6 Let $t \mapsto B(t)$ be standard $1d$ Brownian motion. Prove that the following processes are also standard $1d$ Brownian motions:

(a) The rescaled process: $X(t) := a^{-1/2} B(at)$, where $a > 0$ is fixed parameter.

(b) The time reversed process: $Y(t) := tB(1/t)$.

(c) The backwards process: $Z(t) := B(T) - B(T-t)$, where $T > 0$ is fixed and $t \in [0, T]$.

Hint: Prove that the processes $X(t), Y(t), Z(t)$ are Gaussian and compute their covariances.

1.7 For $j = 1, \dots, n$, let $t \mapsto B_j(t)$, be independent $1d$ Brownian motions with variance σ_j^2, and a_j fixed real numbers. Prove that the process $t \mapsto Z(t) := \sum_{j=1}^n a_j B_j(t)$ is also a $1d$ Brownian motion. Determine the variance of the process $Z(t)$.

1.8 Let $t \mapsto B(t)$ be standard $1d$ Brownian motion. Determine (without painful computations) the conditional probability

$$\mathbf{P}\big(B(2) > 0 \bigm| B(1) > 0\big).$$

1.9 Show that $1d$ Brownian motion changes sign infinitely many times in any time interval $[0, \delta]$ of positive length δ.

1.10 The *Brownian meander* process.

(a) Let $\varepsilon > 0$ be fixed. Using the *reflection principle* prove that for any $x > 0$, $t > 0$

$$\mathbf{P}\big(B(t) \geq x - \varepsilon \mid \min_{0\leq s\leq t} B(s) \geq -\varepsilon\big) = \frac{\Phi((-x+\varepsilon)/\sqrt{t}) - \Phi((-x-\varepsilon)/\sqrt{t})}{2\Phi(\varepsilon/\sqrt{t}) - 1}. \qquad (*)$$

(b) Letting $\varepsilon \to 0$ in the previous formula prove that the conditional density of $B(t)$, given $\{B(s) \geq 0 : s \in [0, t]\}$ is

$$\frac{x}{t} \exp\{-x^2/(2t)\} 1\!\!1_{\{x>0\}}.$$

Remark: Note that the probability of the condition is zero (see problem 1.9). So, strictly speaking, the conditional distribution doesn't make sense. Indeed, let us *define* the conditional probabilities as

$$\mathbf{P}\big(B(t) \in A \mid B(s) \geq 0 : s \in [0, t]\big) := \lim_{\epsilon \searrow 0} \mathbf{P}\big(B(t) \in A \mid \min_{0\leq s\leq t} B(s) \geq -\varepsilon\big).$$

Brownian motion conditioned to stay positive in this sense is called *Brownian meander.*

1.11 On the Hilbert space $\mathcal{L}^2([0, 1], dx)$ define the self-adjoint compact (actually: Hilbert-Schmidt) operator

$$Kf(t) := \int_0^1 \min\{t, s\} f(s) ds.$$

Prove that

$$\lambda_n = \frac{4}{\pi^2(2n-1)^2}, \qquad \psi_n(t) = \sqrt{2}\sin\left(\frac{\pi(2n-1)}{2}t\right), \qquad n = 1, 2, \dots$$

are eigenvalues and eigenvectors of the operator K.

1.12 Let ξ be a standard normal random variable and define, for $\lambda < 1$

$$\psi(\lambda) := \log \mathbf{E}\left(\exp\{\lambda(\xi^2 - 1)/2\}\right).$$

Prove that

$$\psi(\lambda) = -\frac{1}{2}\left(\log(1-\lambda) + \lambda\right),$$

and investigate the analytic properties of the function $\psi(\cdot)$ (convexity, minima, asymptotes, ...). Plot the graph of the function $\lambda \mapsto \psi(\lambda)$.

1.13 Show that the function

$$\phi : \mathbb{R}_+ \times \mathbb{R} \to \mathbb{R}, \qquad \phi(t,x) := \frac{1}{\sqrt{t}}\varphi\left(\frac{x}{\sqrt{t}}\right)$$

solves the heat equation

$$\partial_t \phi(t,x) = \frac{1}{2}\partial_x^2 \phi(t,x).$$

1.14 Exercise 1 implies that if ξ is a standard Gaussian random variable and $x \geq 1$, then

$$\mathbf{P}\left(|X| \geq x\right) \leq \sqrt{\frac{2}{\pi}} e^{-\frac{x^2}{2}}.$$

Use this to show that if $\xi_1, \xi_2, \ldots$ are i.i.d. standard Gaussian, then, with probability 1, the event $\{|\xi_n| > 2\ln n\}$ occurs for at most finitely many n-s.

1.15 *Paul Lévy construction of the Wiener process.* **Second version: wrong constants corrected – sorry.** In a possible construction of the Wiener process (or Brownian motion) on $[0,1]$ we define a sequence of piecewise linear continuous random functions so that we first define f_n at dyadic rationals that are multiples of $\frac{1}{2^n}$, inheriting every second value (at multiples of $\frac{1}{2^{n-1}}$) form f_{n-1}, and setting the values at the remaining points (of the form $\frac{2k-1}{2^n}$) to be the average of the two neighbouring values, plus an independent Gaussian random value with mean 0 and variance $\frac{1}{2^{n+1}}$. Then we extend f_n to $[0,1]$ piecewise linearly.

Formally: we take independent standard Gaussian random variables ξ_0 and $\xi_{n,k}$ where $n = 1, 2, \ldots$ and $k = 1, 2, \ldots, 2^{n-1}$. Then

- In the 0th step we fix $f_0(0) = 0$ and $f_0(1) = \xi_0$. We connect these two values linearly.
- In the 1st step we leave $f_1(0) = f_0(0)$ and $f_1(1) = f_0(1)$, but also set $f_1(\frac{1}{2}) = f_0(\frac{1}{2}) + \frac{1}{2}\xi_{1,1}$. We connect these three values linearly.
- …in the nth step we leave $f_n\left(\frac{k}{2^{n-1}}\right) = f_{n-1}\left(\left(\frac{k}{2^{n-1}}\right)\right.$ for $k = 0, 1, \ldots, 2^{n-1}$, but also set $f_n\left(\frac{k-\frac{1}{2}}{2^{n-1}}\right) = f_{n-1}\left(\frac{k-\frac{1}{2}}{2^{n-1}}\right) + \frac{1}{\sqrt{2^{n+1}}}\xi_{n,k}$ for $k = 1, \ldots, 2^{n-1}$. We connect these $2^n + 1$ values linearly.

Notice that, in this construction, the difference $g_n := f_{n+1} - f_n$ is the sum of 2^n "tent" maps with disjoint supports and i.i.d. Gaussian "heights".

(a) Use the statement of Exercise 14 to show that, with probability 1, the series

$$\lim_{n\to\infty} f_n = f_0 + \sum_{n=0}^{\infty} g_n$$

is uniformly absolutely convergent.

(b) Check that the limit is a Wiener process.

1.16 *(Based on Exercise 8.1.3. from [1].)* Let $B(t)$ be a standard Brownian motion (Wiener process). Fix $t > 0$ and for $n = 0, 1, 2, \ldots$ let

$$V_n = \sum_{m=0}^{2^n-1} \left(B\left(\frac{m+1}{2^n}t\right) - B\left(\frac{m}{2^n}t\right)\right)^2.$$

Calculate the expectation and the variance of V_n. Use the Borel-Cantelli lemma to show that $V_n \to t$ almost surely as $n \to \infty$.

References

[1] Durrett, R. *Probability: Theory and Examples.* **4th** edition, Cambridge University Press (2010)