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978-0-521-81129-3 - Stochastic Integration with Jumps

Klaus Bichteler

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Stochastic Integration with Jumps

Stochastic processes with jumps and random measures are gaining importance as drivers in applications like financial mathematics and signal processing. This book develops the stochastic integration theory for both integrators (semimartingales) and random measures from a common point of view.

Highlights feature the DCT and Egoroff's theorem, as well as comprehensive analogs to results from ordinary integration theory, for instance, previsible envelopes and an algorithm computing the stochastic integrals of càglàd integrands pathwise.

An integrator under P is continuous as a map into L^q for any finite q , provided that P is replaced with a suitable probability, and there is control of the transition; this extends to random measures when $q = 2$. This has the consequence that every integrator is controlled by some previsible process in much the same way a Wiener process is controlled by time t . The previsible controller furnishes Picard norms that reduce SDEs to simple (global) fixed-point problems with an easy stability theory and numerical pathwise approximation schemes.

Full proofs are given for all results, and motivation is stressed throughout. A large appendix contains most of the analysis that readers will need as a prerequisite. A comprehensive reference list and an index of notation are also provided. Extra material is available from the book's Web site at <http://www.ma.utexas.edu/users/cup>.

This will be an invaluable reference for graduate students and researchers in mathematics, physics, electrical engineering, and finance who need to use stochastic differential equations.

Klaus Bichteler is a Professor of Mathematics at the University of Texas at Austin. He received his Ph.D. in physics from Hamburg University in 1965. He has written extensively on general relativity, representation theory, integration, probability, and Malliavin calculus.

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Volume 89

Stochastic Integration with Jumps

- 27 N. H. Bingham, C. M. Goldie and J. L. Teugels *Regular Variation*
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**In memoriam
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ENCYCLOPEDIA OF MATHEMATICS AND ITS APPLICATIONS

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KLAUS BICHTELER

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Contents

Preface	xi
Chapter 1 Introduction	1
1.1 Motivation: Stochastic Differential Equations	1
The Obstacle 4, Itô's Way Out of the Quandary 5, Summary: The Task Ahead 6	
1.2 Wiener Process	9
Existence of Wiener Process 11, Uniqueness of Wiener Measure 14, Non-Differentiability of the Wiener Path 17, Supplements and Additional Exercises 18	
1.3 The General Model	20
Filtrations on Measurable Spaces 21, The Base Space 22, Processes 23, Stopping Times and Stochastic Intervals 27, Some Examples of Stopping Times 29, Probabilities 32, The Sizes of Random Variables 33, Two Notions of Equality for Processes 34, The Natural Conditions 36	
Chapter 2 Integrators and Martingales	43
Step Functions and Lebesgue–Stieltjes Integrators on the Line 43	
2.1 The Elementary Stochastic Integral	46
Elementary Stochastic Integrands 46, The Elementary Stochastic Integral 47, The Elementary Integral and Stopping Times 47, L^p -Integrators 49, Local Properties 51	
2.2 The Semivariations	53
The Size of an Integrator 54, Vectors of Integrators 56, The Natural Conditions 56	
2.3 Path Regularity of Integrators	58
Right-Continuity and Left Limits 58, Boundedness of the Paths 61, Redefinition of Integrators 62, The Maximal Inequality 63, Law and Canonical Representation 64	
2.4 Processes of Finite Variation	67
Decomposition into Continuous and Jump Parts 69, The Change-of-Variable Formula 70	
2.5 Martingales	71
Submartingales and Supermartingales 73, Regularity of the Paths: Right-Continuity and Left Limits 74, Boundedness of the Paths 76, Doob's Optional Stopping Theorem 77, Martingales Are Integrators 78, Martingales in L^p 80	
Chapter 3 Extension of the Integral	87
Daniell's Extension Procedure on the Line 87	
3.1 The Daniell Mean	88
A Temporary Assumption 89, Properties of the Daniell Mean 90	
3.2 The Integration Theory of a Mean	94
Negligible Functions and Sets 95, Processes Finite for the Mean and Defined Almost Everywhere 97, Integrable Processes and the Stochastic Integral 99, Permanence Properties of Integrable Functions 101, Permanence Under Algebraic and Order Operations 101, Permanence Under Pointwise Limits of Sequences 102, Integrable Sets 104	

3.3	Countable Additivity in p -Mean	106
	The Integration Theory of Vectors of Integrators 109	
3.4	Measurability	110
	Permanence Under Limits of Sequences 111, Permanence Under Algebraic and Order Operations 112, The Integrability Criterion 113, Measurable Sets 114	
3.5	Predictable and Previsible Processes	115
	Predictable Processes 115, Previsible Processes 118, Predictable Stopping Times 118, Accessible Stopping Times 122	
3.6	Special Properties of Daniell's Mean	123
	Maximality 123, Continuity Along Increasing Sequences 124, Predictable Envelopes 125, Regularity 128, Stability Under Change of Measure 129	
3.7	The Indefinite Integral	130
	The Indefinite Integral 132, Integration Theory of the Indefinite Integral 135, A General Integrability Criterion 137, Approximation of the Integral via Partitions 138, Pathwise Computation of the Indefinite Integral 140, Integrators of Finite Variation 144	
3.8	Functions of Integrators	145
	Square Bracket and Square Function of an Integrator 148, The Square Bracket of Two Integrators 150, The Square Bracket of an Indefinite Integral 153, Application: The Jump of an Indefinite Integral 155	
3.9	Itô's Formula	157
	The Doléans–Dade Exponential 159, Additional Exercises 161, Girsanov Theorems 162, The Stratonovich Integral 168	
3.10	Random Measures	171
	σ -Additivity 174, Law and Canonical Representation 175, Example: Wiener Random Measure 177, Example: The Jump Measure of an Integrator 180, Strict Random Measures and Point Processes 183, Example: Poisson Point Processes 184, The Girsanov Theorem for Poisson Point Processes 185	
Chapter 4	Control of Integral and Integrator	187
4.1	Change of Measure — Factorization	187
	A Simple Case 187, The Main Factorization Theorem 191, Proof for $p > 0$ 195, Proof for $p = 0$ 205	
4.2	Martingale Inequalities	209
	Fefferman's Inequality 209, The Burkholder–Davis–Gundy Inequalities 213, The Hardy Mean 216, Martingale Representation on Wiener Space 218, Additional Exercises 219	
4.3	The Doob–Meyer Decomposition	221
	Doléans–Dade Measures and Processes 222, Proof of Theorem 4.3.1: Necessity, Uniqueness, and Existence 225, Proof of Theorem 4.3.1: The Inequalities 227, The Previsible Square Function 228, The Doob–Meyer Decomposition of a Random Measure 231	
4.4	Semimartingales	232
	Integrators Are Semimartingales 233, Various Decompositions of an Integrator 234	
4.5	Previsible Control of Integrators	238
	Controlling a Single Integrator 239, Previsible Control of Vectors of Integrators 246, Previsible Control of Random Measures 251	
4.6	Lévy Processes	253
	The Lévy–Khintchine Formula 257, The Martingale Representation Theorem 261, Canonical Components of a Lévy Process 265, Construction of Lévy Processes 267, Feller Semigroup and Generator 268	

Chapter 5 Stochastic Differential Equations	271
5.1 Introduction	271
First Assumptions on the Data and Definition of Solution 272, Example: The Ordinary Differential Equation (ODE) 273, ODE: Flows and Actions 278, ODE: Approximation 280	
5.2 Existence and Uniqueness of the Solution	282
The Picard Norms 283, Lipschitz Conditions 285, Existence and Uniqueness of the Solution 289, Stability 293, Differential Equations Driven by Random Measures 296, The Classical SDE 297	
5.3 Stability: Differentiability in Parameters	298
The Derivative of the Solution 301, Pathwise Differentiability 303, Higher Order Derivatives 305	
5.4 Pathwise Computation of the Solution	310
The Case of Markovian Coupling Coefficients 311, The Case of Endogenous Coupling Coefficients 314, The Universal Solution 316, A Non-Adaptive Scheme 317, The Stratonovich Equation 320, Higher Order Approximation: Obstructions 321, Higher Order Approximation: Results 326	
5.5 Weak Solutions	330
The Size of the Solution 332, Existence of Weak Solutions 333, Uniqueness 337	
5.6 Stochastic Flows	343
Stochastic Flows with a Continuous Driver 343, Drivers with Small Jumps 346, Markovian Stochastic Flows 347, Markovian Stochastic Flows Driven by a Lévy Process 349	
5.7 Semigroups, Markov Processes, and PDE	351
Stochastic Representation of Feller Semigroups 351	
Appendix A Complements to Topology and Measure Theory	363
A.1 Notations and Conventions	363
A.2 Topological Miscellanea	366
The Theorem of Stone–Weierstraß 366, Topologies, Filters, Uniformities 373, Semi-continuity 376, Separable Metric Spaces 377, Topological Vector Spaces 379, The Minimax Theorem, Lemmas of Gronwall and Kolmogoroff 382, Differentiation 388	
A.3 Measure and Integration	391
σ -Algebras 391, Sequential Closure 391, Measures and Integrals 394, Order-Continuous and Tight Elementary Integrals 398, Projective Systems of Measures 401, Products of Elementary Integrals 402, Infinite Products of Elementary Integrals 404, Images, Law, and Distribution 405, The Vector Lattice of All Measures 406, Conditional Expectation 407, Numerical and σ -Finite Measures 408, Characteristic Functions 409, Convolution 413, Liftings, Disintegration of Measures 414, Gaussian and Poisson Random Variables 419	
A.4 Weak Convergence of Measures	421
Uniform Tightness 425, Application: Donsker's Theorem 426	
A.5 Analytic Sets and Capacity	432
Applications to Stochastic Analysis 436, Supplements and Additional Exercises 440	
A.6 Suslin Spaces and Tightness of Measures	440
Polish and Suslin Spaces 440	
A.7 The Skorohod Topology	443
A.8 The L^p -Spaces	448
Marcinkiewicz Interpolation 453, Khintchine's Inequalities 455, Stable Type 458	

Cambridge University Press

978-0-521-81129-3 - Stochastic Integration with Jumps

Klaus Bichteler

Frontmatter

[More information](#)

x

Contents

A.9 Semigroups of Operators	463
Resolvent and Generator 463, Feller Semigroups 465, The Natural Extension of a Feller Semigroup 467	
Appendix B Answers to Selected Problems	470
References	477
Index of Notations	483
Index	489
Answers	http://www.ma.utexas.edu/users/cup/Answers
Full Indexes	http://www.ma.utexas.edu/users/cup/Indexes
Errata	http://www.ma.utexas.edu/users/cup/Errata

Preface

This book originated with several courses given at the University of Texas. The audience consisted of graduate students of mathematics, physics, electrical engineering, and finance. Most had met some stochastic analysis during work in their field; the course was meant to provide the mathematical underpinning. To satisfy the economists, driving processes other than Wiener process had to be treated; to give the mathematicians a chance to connect with the literature and discrete-time martingales, I chose to include driving terms with jumps. This plus a predilection for generality for simplicity's sake led directly to the most general stochastic Lebesgue–Stieltjes integral.

The spirit of the exposition is as follows: just as having finite variation and being right-continuous identifies the useful Lebesgue–Stieltjes distribution functions among all functions on the line, are there criteria for processes to be useful as “random distribution functions.” They turn out to be straightforward generalizations of those on the line. A process that meets these criteria is called an *integrator*, and its integration theory is just as easy as that of a deterministic distribution function on the line – provided Daniell's method is used. (This proviso has to do with the lack of convexity in some of the target spaces of the stochastic integral.)

For the purpose of error estimates in approximations both to the stochastic integral and to solutions of stochastic differential equations we define various *numerical sizes of an integrator* Z and analyze rather carefully how they propagate through many operations done on and with Z , for instance, solving a stochastic differential equation driven by Z . These size-measurements arise as generalizations to integrators of the famed Burkholder–Davis–Gundy inequalities for martingales. The present exposition differs in the ubiquitous use of numerical estimates from the many fine books on the market, where convergence arguments are usually done in probability or every once in a while in Hilbert space L^2 . For reasons that unfold with the story we employ the L^p -norms in the whole range $0 \leq p < \infty$. An effort is made to furnish reasonable estimates for the universal constants that occur in this context.

Such attention to estimates, unusual as it may be for a book on this subject, pays handsomely with some new results that may be edifying even to the expert. For instance, it turns out that every integrator Z can be controlled

by an increasing previsible process much like a Wiener process is controlled by time t ; and if not with respect to the given probability, then at least with respect to an equivalent one that lets one view the given integrator as a map into Hilbert space, where computation is comparatively facile. This *previsible controller* obviates prelocal arguments [91] and can be used to construct Picard norms for the solution of stochastic differential equations driven by Z that allow growth estimates, easy treatment of stability theory, and even *pathwise algorithms* for the solution. These schemes extend without ado to *random measures*, including the previsible control and its application to stochastic differential equations driven by them.

All this would seem to lead necessarily to an enormous number of technicalities. A strenuous effort is made to keep them to a minimum, by these devices: everything not directly needed in stochastic integration theory and its application to the solution of stochastic differential equations is either omitted or relegated to the Supplements or to the Appendices. A short survey of the beautiful “General Theory of Processes” developed by the French school can be found there.

A *warning concerning the usual conditions* is appropriate at this point. They have been replaced throughout with what I call the *natural conditions*. This will no doubt arouse the ire of experts who think one should not “tamper with a mature field.” However, many fine books contain erroneous statements of the important Girsanov theorem – in fact, it is hard to find a correct statement in unbounded time – and this is traceable directly to the employ of the usual conditions (see example 3.9.14 on page 164 and 3.9.20). In mathematics, correctness trumps conformity. The natural conditions confer the same benefits as do the usual ones: path regularity (section 2.3), section theorems (page 437 ff.), and an ample supply of stopping times (*ibidem*), without setting a trap in Girsanov’s theorem.

The students were expected to know the basics of point set topology up to Tychonoff’s theorem, general integration theory, and enough functional analysis to recognize the Hahn–Banach theorem. If a fact fancier than that is needed, it is provided in appendix A, or at least a reference is given.

The exercises are sprinkled throughout the text and form an integral part. They have the following appearance:

Exercise 4.3.2 This is an exercise. It is set in a smaller font. It requires no novel argument to solve it, only arguments and results that have appeared earlier. Answers to some of the exercises can be found in appendix B. Answers to most of them can be found in appendix C, which is available on the web via <http://www.ma.utexas.edu/users/cup/Answers>.

I made an effort to index every technical term that appears (page 489), and to make an index of notation that gives a short explanation of every symbol and lists the page where it is defined in full (page 483). Both indexes appear in expanded form at <http://www.ma.utexas.edu/users/cup/Indexes>.

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Frontmatter
[More information](#)

Preface

xiii

<http://www.ma.utexas.edu/users/cup/Errata> contains the errata. I plead with the gentle reader to send me the errors he/she found via email to kbi@math.utexas.edu, so that I may include them, with proper credit of course, in these errata.

At this point I recommend reading the conventions on page 363.