

# **A Asymptotics of Stationary and Nonstationary AR(1) Processes with Multiple Structural Breaks in Mean**

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## **Abstract**

This study provides the asymptotic distributions of the least squares estimator (LSE) of an AR(1) process in the presence of structural breaks in the mean when the break sizes and the break durations are assumed to be generated by ergodic stationary processes. We further examine the special case where the process has a unit root. When there is a finite number of structural breaks, (1) the rate of convergence to the limiting distribution becomes much slower than when there is no structural break, (2) the persistence level tends to increase depending on the break sizes and the break durations, and (3) there exist multiple asymptotic results for the case of unit root. We propose a feasible unit root test with a new limiting distribution that is more robust than the DF test in detecting a unit root. The analysis is also extended to the case of an infinite number of structural breaks.

**Keywords:** AR(1), Unit Root, Structural Breaks, Asymptotic Properties, The Dicky-Fuller (DF) test, The Least Squares Estimator (LSE)

**JEL Classification:** C12, C13

# 1 Introduction

The seminal study of Perron (1989) shows that unit roots are less likely to be rejected when the data generating process is stationary about a broken linear trend. Subsequently a huge literature has evolved addressing the issue of unit root tests in the presence of structural breaks (see, *inter alia*, Perron, 1990; Zivot and Andrews, 1992; Bai, Lumsdaine, and Stock, 1998; Bai and Perron, 1998). Most of these studies investigate the effects of structural breaks in nonstationary processes such as trend stationary or unit root processes. They show that structural breaks could cause an  $I(1)$  process to be even more persistent, and that stationarity is easily confused with unit root when there are breaks.<sup>1</sup>

Despite the huge literature the asymptotic properties of the estimated coefficients of stationary processes and unit root processes have not yet been proposed in the presence of multiple structural breaks. Most analytical results in structural breaks assume one or two breaks in a series. The effects of multiple breaks on a process can be investigated using simulations, which becomes relatively easier with the recent computing development in software and hardware. This could help us understand the effects of structural breaks, but may not enhance our knowledge in this area.

Our study provides the asymptotic distributions of the LSE of the AR parameter of stationary processes and unit root processes in the presence of multiple structural breaks in mean, highlighting an important topic in econometrics - unit root tests in the presence of structural breaks. The following two cases are also investigated; the number of structural breaks is (1) fixed regardless of the sample size or (2) proportional to the sample size.

For this purpose, we use a simple zero mean AR(1) process as the data generating process (DGP). Although this DGP is simple and restrictive, we will show in this paper that the asymptotic property of the LSE of the AR parameter of the zero mean AR process are indeed complicated in the presence of multiple structural breaks. This could be a reason why asymptotic properties of a process in the presence of multiple breaks

have not yet been proposed in the literature. The asymptotic results with more generalised processes could be less intuitive and appealing, if they become too complicated and thus simulations may be required to investigate the asymptotic properties.

The contribution of this paper is twofold. The first is to examine the asymptotic properties of the LSE of an AR(1) process when there are structural breaks generated by ergodic stationary processes. We show that the limiting distributions we derive for the LSE of the AR parameter are neither the usual Gaussian distribution nor the asymptotic distribution we obtain when the DGP has a unit root. The LSE without considering the structural breaks is not asymptotically consistent with the true AR parameter. The convergence rate becomes much slower than when there is no structural break and the bias depends on the ratio of break size. Multiple asymptotic results are obtained when the DGP has a unit root. Second, we propose a feasible structural break unit root test which is independent of any nuisance parameter with a new limiting distribution. This test is shown to be robust against the alternatives of stationarity with structural breaks in the mean or a unit root without structural breaks for DGPs in our framework. Thus, this test can reject the null of unit root in the presence of structural breaks when the alternative of stationarity or unit root without structural breaks is true.

This paper is organized as follows. In the next section, we investigate the effects of structural breaks in the mean. We first propose our DGP and underlying assumptions. Then, given our DGP, we derive the asymptotic properties of the LSE of the AR parameter in the presence of structural breaks in the mean. Section 3 contains brief concluding remarks.

## 2 The Asymptotics of the LSE of the AR parameter in the Presence of Multiple Breaks

### 2.1 Data Generating Processes and Assumptions

The DGP reflects what we are interested in, i.e., the type of structural breaks and processes. Following the work of Perron (1989) many studies investigate the effects of structural breaks on various types of nonstationary processes. A simple DGP used by Engle and Smith (1999), Diebold and Inoue (2001), and Granger and Hyung (2004) is the occasional breaks in mean plus noise model:

$$\begin{aligned} z_t &= c_t^* + \xi_t, \\ c_t^* &= c_{t-1}^* + I_t \epsilon_t, \end{aligned} \tag{1}$$

where  $\xi_t \sim IID(0, \sigma^2)$ ,  $\epsilon_t \sim IID(0, \sigma_\epsilon^2)$ , and  $I_t$  is an indicator variable which equals 1 with probability ( $p$ ) and is independent of  $\epsilon_t$ . It follows that  $Tp$  is the expected number of structural breaks in the sample.

Note that shocks in  $c_t^*$  are accumulated over time whenever  $I_t = 1$ , and thus by definition, the process in (1) is non-stationary. To keep the process stationary  $p$  should decrease with the sample size ( $T$ ). Diebold and Inoue (2001) and Granger and Hyung (2004) show how long memory can be obtained by making  $p$  a hyperbolically decaying function of  $T$ . This type of DGP may be appropriate for level data, in particular when  $\epsilon_t$  is allowed to have a positive mean so that  $z_t$  tends to increase over time.

In this study, we choose a simple  $AR(1)$  process as the DGP and assume that the mean has multiple structural breaks. By allowing the AR parameter to be one, we also investigate the effects of structural breaks on unit root processes. More general DGPs such as ARMA processes with seasonal dummies are desirable. However it is likely that the asymptotic distribution of the LSE of the AR parameters becomes too complicated and thus less intuitive. We shall focus on a simple  $AR(1)$  process in this study, and

leave the case of general DGPs for future studies.

The AR(1) process with structural breaks in mean (SBMs), is similar to (1) except that  $c_t^*$  does not follow a unit root process but moves around zero. Using the same notation as in (1), we propose the following AR process with SBMs

$$\begin{aligned} z_t &= c_t + \phi z_{t-1} + \xi_t, \\ c_t &= (1 - I_t)c_{t-1} + I_t \epsilon_t, \end{aligned} \tag{2}$$

where  $\xi_t$  is an ergodic martingale difference sequence (MDS) which satisfy  $E[\xi_t | \mathcal{F}_{t-1}] = 0$ ,  $E[\xi_t^2 | \mathcal{F}_{t-1}] = \sigma^2$ , where  $\mathcal{F}_{t-1}$  is an information filtration generated by  $\{c_0, z_0, \epsilon_0, \xi_0, \dots, c_{t-1}, z_{t-1}, \epsilon_{t-1}, \xi_{t-1}\}$ , and

$$E[|\xi_t| \mathbf{1}_{(|\xi_t| > a|\alpha_n|^{-1})} | \mathcal{F}_{t-1}] \xrightarrow{P} 0, \tag{3}$$

where the sequence  $|\alpha_n| \rightarrow |\alpha^*| < 1$  as  $n \rightarrow \infty$  for some  $a \in (0, 1]$ . If all the moments of  $\xi_t$  are finite and  $a = 1$ , then by the Markov and Holder inequalities,

$$E[|\xi_t| \mathbf{1}_{(|\xi_t| > |\alpha_n|^{-1})} | \mathcal{F}_{t-1}] \leq |\alpha_n|^r E[|\xi_t|^r] = o(1)$$

as  $n, r \rightarrow \infty$ . Thus, (3) is obviously satisfied;  $\epsilon_t$  in (2) is an ergodic stationary process with the stationary distribution  $F_\epsilon(\bullet)$  which has zero mean and variance  $\sigma_\epsilon^2$ .

The sequence of ergodic martingale differences includes the sequence of independently and identically distributed random variables as a special case. However, the results in our paper can be shown to hold under a fairly general assumption as used in Phillips (1988), namely that  $\{\epsilon_t, \xi_t\}$  is strong mixing, though we do not use the strong mixing assumption for the innovation processes because our analytical results may not be necessarily improved given the complicated nature of this assumption.

For a given sample size  $T$ , we assume that there are  $K$  different means in the sample, i.e.,  $Tp = K - 1$ . The process  $c_t$  follows a renewal - reward process where renewal and

reward are assumed to be independent. The break size  $c_t$  is a reward at renewal. The break point series,  $T(1) + 1, T(1) + T(2) + 1, \dots, \sum_{k=1}^{K-1} T(k) + 1$  are realizations of a renewal process where  $T(k)$  is the number of observations in the  $k$ -th sub-AR process, and  $\sum_{k=1}^K T(k) = T$ . Let  $\tau_k$  denote the fraction of the sample such that  $T(k) = [T\tau_k]$ , where  $[\bullet]$  is the largest integer that is less or equal to  $\bullet$ . It is easy to show that  $\sum_{i=1}^K [T\tau_i] = [T \sum_{i=1}^K \tau_i] = T$  since  $\sum_{i=1}^K \tau_i = 1$ . Therefore, the true trajectory of the mean process as defined in (2) is given as follows

$$c_k = c_{t_k} \left( = \epsilon_{\sum_{i=1}^{k-1} [T\tau_i] + 1} \right), \quad \forall t_k \in \left\{ \sum_{i=1}^{k-1} [T\tau_i] + 1, \sum_{i=1}^k [T\tau_i] \right\}. \quad (4)$$

Note that as in Bai and Perron (1998)  $\tau_k$  needs to be asymptotically distinct. In order to investigate the asymptotic behaviour of the LSE of the AR parameter in the presence of structural breaks, we need the following assumptions.

**Assumption 1** For a given  $K \in (0, \infty]$ , the duration process  $\tau_k$  is an ergodic process independent of  $\epsilon_t$  and  $\xi_t$ . The sample paths of  $\tau_k$  satisfy  $\tau_K = 1 - \sum_{k=1}^{K-1} \tau_k$ ,  $E(\tau_k^2) = \sigma_\tau^2(K)$  and  $E(\tau_k^3) = \lambda_\tau(K) > 0$ .  $\tau_k$  has the stationary distribution  $F_\tau(\bullet)$ .

Note that  $\tau_k > 0 \forall k$ , and thus the non-central skewness of  $\tau_k$  is always positive. Since  $\tau_k$  generally decreases as  $K$  increases,  $\sigma_\tau^2(K)$  and  $\lambda_\tau(K)$  are decreasing functions of  $K$ .

**Assumption 2**  $p = O(T^{-1})$  such that  $\lim_{T \rightarrow \infty} Tp = K - 1$ .

Assumption 2 is useful for investigating the asymptotic properties of a process with a small number of structural breaks in large samples. Many studies such as Diebold and Inoue (2001), Leipus and Surgailis (2003), and Granger and Hyung (2004) allow  $p \rightarrow 0$  to explain long memory with structural breaks in similar processes to equation (1). The assumption says that  $T(k)$  tends to increase with  $T$  so that the number of structural breaks remains finite. However, as explained in Diebold and Inoue (2001) and Granger



and Hyung (2004), this sample size-dependent probability may not reflect reality. In general as  $T$  increases  $K$  is also expected to increase as in the following assumption.

**Assumption 3**  $K = O(T)$  such that  $\lim_{T \rightarrow \infty} \frac{K-1}{T} = p$ .

We note however that the probability of breaks is usually small and thus  $K$  may be still small even if  $T$  increases to a large number, and thus the asymptotic results with Assumption 3 in this study should be interpreted with care. Nevertheless the assumption is useful for the investigation of the effects of structural breaks since it provides much simplified asymptotic results.

**Assumption 4** The changing points  $z_{\sum_{i=1}^k [T\tau_i]+1}$  have finite first and second order moments, i.e.,  $E\left(z_{\sum_{i=1}^k [T\tau_i]+1}\right) < \infty$  and  $E\left(z_{\sum_{i=1}^k [T\tau_i]+1}^2\right) < \infty$ .

Assumption 4 is equivalent to  $\left|z_{\sum_{i=1}^k [T\tau_i]+1}\right| < \infty$  and  $z_{\sum_{i=1}^k [T\tau_i]+1}^2 < \infty$  almost sure. This follows from the Borel-Cantelli lemma. Since

$$\sum_{K=1}^{\infty} P\left\{\omega : \left(\left|z_{\sum_{i=1}^k [T\tau_i]+1}\right| \geq K\right)\right\} < \sum_{K=1}^{\infty} \frac{E\left|z_{\sum_{i=1}^k [T\tau_i]+1}\right|^2}{K^2} < \infty,$$

then

$$\begin{aligned} P\left\{\bigcap_{n=1}^{\infty} \bigcup_{K=n}^{\infty} \left[\omega : \left(\left|z_{\sum_{i=1}^k [T\tau_i]+1}\right| \geq K\right)\right]\right\} &= P\left\{\omega : \left(\left|z_{\sum_{i=1}^k [T\tau_i]+1}\right| \geq \infty\right)\right\} \\ &= 0. \end{aligned}$$

Thus,  $\left|z_{\sum_{i=1}^k [T\tau_i]+1}\right| < \infty$  is almost sure (a.s.), and similarly we can prove that  $z_{\sum_{i=1}^k [T\tau_i]+1}^2 < \infty$  a.s.

The effect of structural breaks in the mean of an AR(1) process on the persistence level can be investigated when the structural breaks are disregarded. The misspecified zero mean AR(1) process is given by

$$z_t = \varphi z_{t-1} + \eta_t, \tag{5}$$

where  $\eta_t \sim IID(0, \sigma_\eta^2)$ . Our concern here is the effects of changes in  $c_t$  around zero on the LSE of  $\varphi$  ( $\hat{\varphi}$ ). In our study, these effects are investigated for both a stationary autoregressive process ( $|\phi| < 1$ ) and a unit root process ( $\phi = 1$ ).

## 2.2 Stationary Case

Here the AR parameter of the true DGP is assumed to be less than one, i.e.,  $|\phi| < 1$ .

**Theorem 1** *Under Assumptions 2 and 4, the asymptotic conditional distribution of the LSE of  $\varphi$  of the misspecified model in (5) for the true DGP in (2) is given by*

$$\hat{\varphi} - \phi \Big|_{\{\tau_k, c_k\}_{k=1}^K} \xrightarrow{W} \frac{A}{B} = \mathcal{A}, \quad (6)$$

where

$$A = \sum_{k=1}^K c_k \tau_k \left( \frac{c_k}{1 - \phi} + \frac{\sigma}{\sqrt{1 - \phi^2}} W_k(1) \right),$$

$$B = \sum_{k=1}^K \tau_k \left( \frac{c_k}{1 - \phi} + \frac{\sigma}{\sqrt{1 - \phi^2}} W_k(1) \right)^2,$$

and  $W_k(1)$  is standard Brownian motion and  $\xrightarrow{W}$  denotes convergence in distribution (or weak convergence). The LHS of (6) is the bias conditional on a sample path of  $(\tau_k, \epsilon_t)$ .

**Proof.** See the Appendix. ■

The rate of convergence decreases due to SBMs in a surprising way. When there are SBMs in a stationary AR(1) process,  $\hat{\varphi} - \phi = O_p(1)$  and  $\hat{\varphi} - \phi = o_p(T^{-\alpha}) \forall \alpha > 0$  whereas  $\hat{\varphi} - \phi = o_p(T^{-1/2})$  when there is no SBM in the AR(1) process. This property is also different from that of the unit root case where the limiting distribution of  $(\hat{\varphi} - 1)$  is asymmetric but converges at rate of  $T^{-1}$ . The support of the limiting distribution of  $\hat{\varphi} - \phi$  is the entire real line since  $B$  is always positive whilst  $A$  can take any value of

the entire real line. Therefore, in the presence of SBMs  $\hat{\varphi} - \phi$  does not converge to zero whereas it is not the case when there is no SBM.

The LSE is not consistent with the true AR parameter and is positively biased in mean. As opposed to the usual case where the limiting distribution of  $\sqrt{T}(\hat{\varphi} - \phi)$  is symmetric around zero, the limiting distribution of  $\hat{\varphi} - \phi$  is asymmetric around a positive value since the denominator in (6) contains a  $\chi^2(1)$  random variable and the numerator includes a positive component  $\frac{c_k^2}{1-\phi}$ . By taking expectations the unconditional distribution of the bias can be obtained;

$$\mathcal{L}(\hat{\varphi} - \phi|P) \implies \int_{\sum_{k=1}^K \tau_k = 1}^{(0,1)^K} \int_{\mathbb{R}^K} \mathbb{P}(\mathcal{A}|\{\tau_k, c_k\}_{k=1}^K) \prod_{k=1}^K dF_\epsilon(c_k) dF_\tau(\tau_k),$$

where  $\mathcal{L}(X|P)$  denotes the distribution of  $X$  when  $X$  is defined on the probability space with the probability distribution  $P$ ;  $\mathbb{P}$  is the conditional distribution of  $\mathcal{A}$ .

The limiting conditional distribution depends on the parameters  $c_k$ ,  $\tau_k$  and  $\sigma$ , which are break size, break duration and the volatility of the error term in the AR process, respectively. When  $\phi$  is large and negative the value of  $\mathcal{A}$  is influenced by Brownian motion relatively more than the break size  $c_k$  because of the different weights on these components, e.g.,  $\frac{1}{1-\phi}$  and  $\frac{1}{1-\phi^2}$  respectively. Therefore break sizes are weighted more for a large positive  $\phi$  and the asymmetric patterns in  $\mathcal{A}$  between positive and negative values of  $\phi$  are expected.

The result in Theorem 1 is obtained with the assumption that the number of structural breaks ( $K$ ) does not increase in proportion to the sample size ( $T$ ). We now adopt Assumption 3 to obtain the limits of  $\hat{\varphi} - \phi$  when  $T \rightarrow \infty$  and  $K \rightarrow \infty$ .

**Proposition 1** *Let us suppose that*

$$\sum_{k=1}^K \frac{c_k^\alpha}{k^\alpha} < +\infty \text{ for some } \alpha \in (0, 2]. \quad (7)$$

Then under Assumptions 1, 3, and 4,

$$\hat{\varphi} - \phi \xrightarrow{P} \frac{V}{\frac{V}{1-\phi} + \frac{1}{1+\phi}} \geq 0, \quad (8)$$

where  $V = \sigma_\epsilon^2/\sigma^2$ . When  $V > \frac{(1-\phi)^2}{(1+\phi)^2}$ , the bias decreases.

**Proof.** See the Appendix. ■

Proposition 1 confirms what has been observed in many previous studies mainly by simulations; the LSE tends to be more persistent than  $\phi$  suggests. For example Granger and Hyung (2004) show that persistence level increases with the magnitude of breaks. Our results show that it is the relative break size to error term that increases the bias. When the volatilities of break size and error term increase simultaneously with the same ratio, the bias does not change. These results can explain why it is hard to find persistence in asset returns even if there exist structural breaks. This is because asset returns are highly volatile relative to the magnitude of structural breaks (see Getmansky, Lo, and Makarov, 2003 for example).

The bias decreases when  $V > \frac{(1-\phi)^2}{(1+\phi)^2}$ . The right hand side of this inequality shows that as  $\phi \rightarrow 1$ ,  $\frac{(1-\phi)^2}{(1+\phi)^2} \rightarrow 0$  and thus, *ceteris paribus*, we have  $V > \frac{(1-\phi)^2}{(1+\phi)^2}$ . Although  $\hat{\varphi}$  is positively biased in the presence of SBMs, the bias decreases as  $\phi \rightarrow 1$  and eventually becomes zero. On the other hand as  $\phi \rightarrow -1$ ,  $\frac{(1-\phi)^2}{(1+\phi)^2} \rightarrow \infty$  and thus the bias increases. However, the magnitude of the bias depends on the value of  $V$ . For example for small  $V$ ,  $\hat{\varphi} - \phi \xrightarrow{P} 0$  as  $\phi \rightarrow -1$ , while  $\hat{\varphi} - \phi \xrightarrow{P} 1.8$  when  $\phi = -0.8$  for large  $V$ . In general the bias in  $\hat{\varphi}$  lies between 0 and 2.

When  $\phi = 0$ , the DGP is a mean plus noise process whose mean occasionally changes.

**Theorem 2** *With Assumptions 2 and 4, the asymptotic conditional distribution of the LSE of  $\varphi$  in the misspecified model in (5) for the true DGP in (2) when  $\phi = 0$  is given by*

$$\hat{\varphi} \Big|_{\{\tau_k, c_k\}_{k=1}^K} \xrightarrow{a.s.} \frac{\sum_{k=1}^K \tau_k c_k^2}{\sum_{k=1}^K \tau_k c_k^2 + \sigma^2} \quad (9)$$

Again under Assumptions 3 and 4 we have

$$\hat{\phi} \xrightarrow{a.s.} \frac{V}{V+1}. \quad (10)$$

**Proof.** See the Appendix. ■

Although there are some similarities between Theorems 1 and 2, the asymptotic result in (9) cannot be obtained from Theorem 1 by simply putting  $\phi = 0$ . The convergence in (9) and (10) is “almost sure” which is stronger than the convergence in probability in (8). Again  $\hat{\phi}$  is asymmetric because of  $c_k^2$ . Equation (10) shows that the asymptotic positive bias increases with  $V$ . When break sizes are relatively large so that  $V(= \sigma_\epsilon^2/\sigma^2)$  increases,  $\hat{\phi}$  increases even if the DGP is mean plus noise process. However the process does not become a nonstationary process since  $0 \leq \frac{\sum_{k=1}^K \tau_k c_k^2}{\sum_{k=1}^K \tau_k c_k^2 + \sigma^2} < 1$  almost sure. Therefore contrary to the arguments of Campos et al. (1996), a stationary process with structural breaks in the mean is not necessarily a unit root though the persistence level of this process increases, and the DF test is biased toward accepting a stationary process with breaks in mean.

### 2.3 Non-stationary Case

In this section the true DGP is assumed to follow a unit root process (i.e.,  $\phi = 1$ ) with structural breaks in mean;

$$z_t = (1 - I_t)c_{t-1} + I_t\epsilon_t + z_{t-1} + \xi_t. \quad (11)$$

The DGP is similar to ‘model (B)’ of Perron (1989) and those used by Leybourne et al. (1998) and Kim et al (2000). Leybourne et al. (1998) and Kim et al. (2000) show that the unit root null hypothesis is spuriously rejected when the true break in the series is relatively early or soon after the assumed break. This is partially because the DF test always converges under the null of a unit root whether or not the break occurs; and

this makes it difficult to distinguish between a unit root with SBMs and a unit root without SBMs (see Leybourne et al., 1998). Hence, when the durations of breaks are considerable so that the influence of breaks in the limiting distribution is significant, the DF test can reject the null of unit root more often than in the conventional case. Our analysis extends their research in the presence of multiple breaks.

Again, the misspecified AR model in (5) is estimated and the limiting distributions of the LSE of the AR parameter for  $z_t$  are derived.

**Theorem 3** *When the DGP follows (11), under Assumptions 2 and 4 the LSE of  $\varphi$  for the misspecified model in (5) has the following limiting conditional distributions:*

$$\text{Case 1: } \quad \hat{\varphi} - 1 = o_p(1), \text{ or} \quad (12)$$

$$\text{Case 2: } \quad T^{3/2}(\hat{\varphi} - \gamma(T)) \Big|_{\{\tau_k, c_k\}_{k=1}^K} \xrightarrow{W} \frac{\sigma \sum_{k=1}^K c_k \int_0^{\tau_k} s dW_{2k}(s)}{\sum_{k=1}^K \frac{c_k^2(\tau_k)^3}{3}} = \mathcal{B}, \text{ or} \quad (13)$$

$$\text{Case 3: } \quad T(\hat{\varphi} - 1) \Big|_{\{\tau_k, c_k\}_{k=1}^K} \xrightarrow{W} \frac{\sum_{k=1}^K \left[ \frac{c_k^2(\tau_k)^2}{2} - c_{k-1}^2(\tau_{k-1})^2 \right]}{\sum_{k=1}^K \frac{c_k^2(\tau_k)^3}{3}} = \mathcal{C}, \quad (14)$$

$$\text{where } \gamma(T) = \frac{\sum_{k=1}^K \left\{ \sum_{T(k-1)+2}^{T(k)} z_{t_k-1}^2 + c_k \sum_{T(k-1)+2}^{T(k)} z_{t_k-1} \right\}}{\sum_{k=1}^K \left\{ z_{T(k-1)}^2 + \sum_{T(k-1)+2}^{T(k)} z_{t_k-1}^2 \right\}} \text{ and } \lim_{T \rightarrow \infty} \gamma(T) = 1.$$

**Proof.** See the Appendix for proof. ■

By taking expectations, the limiting unconditional distributions of the biases as defined in (13) and (14) are given by

$$\begin{aligned} \mathcal{L}(T^{3/2}(\hat{\varphi} - \gamma(T))|P) &\implies \int_{\sum_{k=1}^K \tau_k=1}^{(0,1)^K} \int_{\mathbb{R}^K} \mathbb{P}(\mathcal{B}|\{\tau_k, c_k\}_{k=1}^K) \prod_{k=1}^K dF_\epsilon(c_k) dF_\tau(\tau_k), \quad (15) \\ \mathcal{L}(T(\hat{\varphi} - 1)|P) &\implies \int_{\sum_{k=1}^K \tau_k=1}^{(0,1)^K} \int_{\mathbb{R}^K} \mathbb{P}(\mathcal{C}|\{\tau_k, c_k\}_{k=1}^K) \prod_{k=1}^K dF_\epsilon(c_k) dF_\tau(\tau_k) \end{aligned}$$

respectively.

When the DGP follows a unit root process with SBMs, we have three different limiting distributions. As in Kim et al. (2004), the limiting distributions display a wide

range of different characteristics, and the asymptotic properties of  $\hat{\phi} - 1$  are achieved by using various normalizing terms. When  $\hat{\phi} - 1$  is normalized by 1 (the first case),  $\hat{\phi}$  is the consistent estimate of the unit root. However,  $\hat{\phi}$  converges to unit much slower than that in the standard unit root process. The second case shows that the LSE is biased; the convergence rate is very fast, i.e.,  $T^{-3/2}$ . The third case shows that the convergence rate is  $T^{-1}$ , the rate of the conventional DF test. Case 3 shows that the order of structural breaks matters when there are multiple breaks in the series. This is consistent with Leybourne et al. (1998) and Kim et al. (2000) who show that the rejection of the unit root null hypothesis depends on where the true break in the series lies.

It is well-known that without structural breaks in the DGP, the conventional DF unit root test based on the statistics  $T(\hat{\phi} - 1)$  is consistent for the null hypothesis  $H_0 : \phi = 1$  against the alternative  $H_1 : \phi < 1$  since the test is convergent under the null whilst divergent under the alternative at a rate proportional to  $T^{1/2}$ . Thus, the DF test has power against the alternative hypothesis. However, when there are SBMs, the DF test could diverge under the null hypothesis at a rate proportional to  $T^{1/2}$  in view of Case 2. This implies that under the null and the alternative the DF test could diverge. As a result, the DF test is not robust to SBMs as conjectured in Leybourne et al. (1998).

An immediate question is whether we can distinguish unit root or stationary process without SBMs from unit root with SBMs. This hypothesis can effectively be written as  $H_0 : \{\phi = 1 \text{ and } c_k \neq c_j \forall k \neq j\}$  and  $H_1 : \{\phi = 1 \text{ and } c_k = 0 \forall k\} \cup \{\phi < 1\}^2$ , and the test for the null against the alternative can be constructed based on  $T^{3/2}(\hat{\phi} - \gamma(T))$  in which  $\tau_k$ ,  $c_k$  and  $K$  can be estimated consistently by the method of Bai and Perron (1998). Since it is straightforward to verify that the test is convergent under the null and divergent under the alternative, the test is consistent, and consequently it has power against the alternative  $H_1$ .

Therefore using the consistency of the test based on  $T^{3/2}(\hat{\phi} - \gamma(T))$ , we could resolve the spurious rejection of the DF test in the presence of SBMs by using the following two

stage procedure: First, use the test based on  $T^{3/2}(\hat{\varphi} - \gamma(T))$  to test the unit root. Second, if the test based on  $T^{3/2}(\hat{\varphi} - \gamma(T))$  rejects the null then the set of remaining alternatives is  $\{\phi < 1\} \cup \{\phi = 1 \text{ and } c_k = 0 \forall k\}$  which are then tested by the conventional DF test. Furthermore, as the limiting unconditional distribution in (15) does not depend on any nuisance parameter except for the number of regimes ( $K$ ), thus the null is an intersection hypothesis, i.e.,  $H_0 : \bigcap_{\substack{K \in \Gamma \\ \Gamma \neq \emptyset}} \{\phi = 1 \text{ for a given number of breaks } K\}$ . The test rejects the null if  $T^{3/2}(\hat{\varphi} - \gamma(T))$  is too small, thus the rejection region of the test is

$$\bigcup_{\substack{K \in \Gamma \\ \Gamma \neq \emptyset}} \{T^{3/2}(\hat{\varphi} - \gamma(T)) \Big|_{\{\tau_k, c_k\}_{k=1}^K} < R\} = \inf_{\substack{K \in \Gamma \\ \Gamma \neq \emptyset}} \{T^{3/2}(\hat{\varphi} - \gamma(T)) \Big|_{\{\tau_k, c_k\}_{k=1}^K}\} < R,$$

where  $R$  is a critical value. Therefore, the test is efficient with the limiting distribution

$$\int_{(0,1)^{|\Gamma|}} \int_{\mathbb{R}^{|\Gamma|}} \mathbb{P} \left( \inf_{\substack{K \in \Gamma \\ \Gamma \neq \emptyset}} \left( \mathcal{B} \Big|_{\{\tau_k, c_k\}_{k=1}^K}, \sum_{k=1}^K \tau_k = 1 \right) \right) \prod_{k=1}^{|\Gamma|} dF_\epsilon(c_k) dF_\tau(\tau_k),$$

where  $|\Gamma|$  is the size of the set  $\Gamma$ . The critical values of the test can be tabulated by rather complicated simulations. For this reason, we leave further details for future study.

**Proposition 2** *With Assumptions 1, 3, and 4, as  $K \rightarrow \infty$  the second case of Theorem 3 is*

$$T^{3/2}(\hat{\varphi} - \gamma(T)) \xrightarrow{P} 0.$$

*For the third case we have*

$$T(\hat{\varphi} - 1) \xrightarrow{P} -\frac{3\sigma_\tau^2(\infty)}{2\lambda_\tau(\infty)} \leq 0, \quad (16)$$

where  $\sigma_\tau^2(\infty)$  and  $\lambda_\tau(\infty)$  are defined in Assumption 1.

**Proof.** See the Appendix for proof. ■

The first result is straightforward. Equation (16) confirms the results of Leybourne



at el. (1998) in the presence of multiple breaks. If there are structural breaks in mean in unit root process, rejections of the unit root do not necessarily imply that the true process is stationary. The negative bias is a function of noncentral variance and skewness of the duration variable  $\tau_k$ .

Equation (16) suggests that break size becomes less important as  $K$  increases. This point can be seen clearly when the break durations are presumably the same.

**Remark 1** *If  $\tau_k = \frac{1}{K} \forall k$  such that  $\sigma_\tau^2(K) = \frac{1}{K^2}$  and  $\lambda_\tau(K) = \frac{1}{K^3}$ , then*

$$\hat{\phi} - 1 \xrightarrow{P} -\frac{3}{2}p,$$

where  $p$  is the probability of breaks.

The result indicates that the asymptotic behaviour of  $\hat{\phi}$  does not depend on break sizes but on break probability. As the number of breaks increases with the number of observations, break size and the order of breaks do not appear in the asymptotic properties.

### 3 Simulations

The asymptotic results in theorems and propositions are not easy to interpret even with this simple AR(1) process. We need to better understand how fast the asymptotic conditional distributions could be achieved, and how the sample least squares (LS) estimates behave for different values of  $\phi$ , different break sizes, and different numbers of breaks. To answer these questions we simulate the asymptotic conditional distributions and compare the results with the sample LS estimates we obtain by estimating (5).

AR(1) series are generated for the sample sizes of  $T=100, 200, 500, 1000,$  and  $3000$ . For the numbers of breaks, we set  $K-1=4, 9, 49,$  and  $99$  where  $K$  is the number of sub-processes. The error term in the AR process follows standard normal,  $\xi_t \sim N(0, 1)$ , while the sizes of structural breaks are drawn from three different normal distributions, i.e.,

$\epsilon_t \sim N(0, 0.1^2)$ ,  $N(0, 1)$ , and  $N(0, 10^2)$ , which have average break sizes ( $=\sigma_\epsilon/\sigma = \sqrt{V}$ ) of 0.1, 1, and 10, relative to the AR error term. For the values of  $\phi$ , we take 1, 0.9, 0.5, 0, and -0.5. Our main concern is AR processes with positive values of  $\phi$ , but we also include -0.5 to see the effects of SBMs for negative values of  $\phi$ . For the asymptotic conditional distributions we generate Brownian motions ( $W_k(1)$ ) with 10000 i.i.d. standard normal variates. We repeat the procedure 10000 times to obtain the sample LS estimates and asymptotic conditional distributions.

Table 1 reports the results of  $\hat{\varphi} - \phi$  at various percentage points for various numbers of breaks, and break sizes, when the AR parameter is 0.5. When the numbers of breaks are small and break sizes are small, i.e.,  $K = 4$  and  $\sigma_\epsilon/\sigma = 1$  or 0.1, our asymptotic conditional distribution does not explain the sample distributions well. However except these few cases the asymptotic conditional distributions in Theorems 1 and 2 explain the sample distributions well. As expected as break size increases, the positive bias increases. Sample distributions do not seem to approach the limiting distributions quickly. In some cases 500 to 1000 observations are required to approximate the limiting distributions.

Panel A also shows the distributions of  $\hat{\varphi} - \phi$  as  $K$  increases. As mentioned in Assumption 3, we do not expect  $K$  is infinite in reality. The panel shows that  $\hat{\varphi} - \phi$  approaches  $\frac{V}{1-\phi + 1+\phi}$  slowly as  $K$  increases from 4 to 99. In Panel B the effects of SBMs for different values of  $\phi$  are reported;  $\hat{\varphi} - \phi$  is negatively related with the values of  $\phi$ . As  $\phi$  increases  $\hat{\varphi} - \phi$  decreases, which confirms Proposition 1. The case of  $\phi = -0.5$  at the bottom of Panel B shows that our analytical results also work well for negative  $\phi$ .

Figure 1 reports the Gaussian kernel densities of  $\hat{\varphi} - \phi$  for various numbers of samples and break sizes in the presence of SBMs when  $\phi=0.5$  and  $K=9$ . For a large value of  $\sigma_\epsilon/\sigma$  the mass of the densities move towards 0.5 with a larger negative skewness. As  $T$  increases the negative skewness decreases and thus the sample densities approach the limiting distributions at the bottom of Figure 1.

We repeat a similar procedure for the unit root case in Theorem 3. Figure 2 shows that the sample LS estimates of  $\hat{\varphi}$  are always negatively biased and thus the null unit root

hypothesis will be rejected, which is consistent with the limiting conditional distribution of case 3 of Theorem 3. We find that  $T^{3/2}(\hat{\varphi} - 1)$  in case 2 is symmetric around zero and is not different from zero.<sup>3</sup> Although the limiting conditional distribution may show non-trivial non-zero values of  $T^{3/2}(\hat{\varphi} - \gamma(T))$  for smaller values of  $\sigma_\epsilon/\sigma$ , it approaches zero as  $K$  increase as in Proposition 2. In addition, the limiting conditional distribution in case 3 shows that  $T(\hat{\varphi} - 1)$  is not trivial but  $\hat{\varphi} - 1$  approaches a small negative number as  $T$  increases. Thus though we have three different limiting distributions in the presence of SBMs when the true process is unit root, the simulation results suggest that it is case 3 that dominates the other two.

## 4 Conclusion

These results suggest several conclusions. First, by some asymptotic arguments and the proposed conditional DGP approach we show that the LSE of the AR parameter has an asymmetric limiting distribution when there are structural breaks in the mean of a zero mean stationary  $AR(1)$  process. Structural breaks in mean lead to an increase in persistence level that further depends on break sizes and break durations. On the other hand, when the DGP follows a unit root with structural breaks in the mean, three different limiting cases emerge. Monte Carlo simulations support our theoretical findings.

Second, our results suggest that when there are SBMs, the conventional statistics we use for inferences may not be appropriate. Because of slow convergence rates and biases in the persistence level, the conventional Gaussian  $t$  test and the DF test do not have power for these processes. The analysis of time series such as forward discounts, equity premium, or volatility becomes more difficult; and the differentiation between stationarity and nonstationarity is ambiguous in the presence of structural breaks. Therefore, we propose a new unit root test as a remedy to the problem of spurious rejection of unit root by the DF test in the presence of SBMs as found in Leybourne et al. (1998).

## Notes

<sup>1</sup>Besides the relationship between structural breaks and persistence, a significant number of studies focus on cointegration and long memory in the presence of structural breaks. Some recent studies on these topics are Campos et al. (1996), Lobato and Savin (1998), Diebold and Inoue (2001) and Granger and Hyung (2004). A vast literature has also developed around forecasting in the presence of structural breaks. See the prominent work of Clements and Hendry (1996), and Pesaran and Timmermann (2005) for a recent development in this area.

<sup>2</sup>Since we have assumed that the sample paths of the mean process with zero expectation vary around zero,  $c_k = 0 \forall k$  when there is no structural breaks in the mean.

<sup>3</sup>In the simulations we set  $\gamma(T)$  equal to 1.

## Appendix

Liptser and Shirayev (1989, page 582) show that if  $\xi^{(T)} = (\xi_{T,t}, \mathcal{F}_t^{(T)})$  is a martingale difference array, and the following conditions

$$\sum_{t=1}^{[T\tau]} E[\xi_{T,t}^2 | \mathcal{F}_{t-1}^{(T)}] \xrightarrow{P} C_\tau,$$

$$\sum_{t=1}^{[T\tau]} E \left[ |\xi_{T,t}| \mathbf{1}_{(|\xi_{T,t}| > a)} | \mathcal{F}_{t-1}^{(T)} \right] \xrightarrow{P} 0 \text{ for } a \in (0, 1] \text{ and } \tau \in (0, 1]$$

are satisfied, then

$$\sum_{k=1}^{[T\tau]} \xi_{T,t} \xrightarrow{W} W(C_\tau). \quad (17)$$

Using the above result, we derive the following lemma and corollary to prove theorems and propositions in our study.

**Lemma 1** *Let  $\xi_t$  be a sequence of martingale differences with  $E[\xi_t | \mathcal{F}_{t-1}] = 0$  and  $E[\xi_t^2 | \mathcal{F}_{t-1}] = \sigma^2$ . Let  $S_{[T\tau]} = \sum_{t=1}^{[T\tau]} \phi_t \xi_t, \forall \tau \in (0, 1]$ . If*

$$\lim_{T \rightarrow \infty} \sum_{t=1}^{[T\tau]} \phi_t^2 = C \cdot g(\tau), \quad (18)$$

where  $C$  is a positive constant and  $g(\tau)$  is a positive finite function of  $\tau$ , then

$$\lim_{T \rightarrow \infty} \frac{S_{[T\tau]}}{\sigma \sqrt{C}} \xrightarrow{W} W(g(\tau)), \quad (19)$$

where  $W(g(\tau))$  is a Brownian motion with variance  $g(\tau)$ .

**Proof.** The proof follows by verifying the conditions of Liptser and Shiriyayev's result above:

$$\begin{aligned} \lim_{T \rightarrow \infty} \sum_{t=1}^{[T\tau]} \phi_t^2 E[\xi_t^2 | \mathcal{F}_{t-1}] &= \sigma^2 \lim_{T \rightarrow \infty} \sum_{t=1}^{[T\tau]} \phi_t^2 = C.g(\tau) \\ \lim_{T \rightarrow \infty} \sum_{t=1}^{[T\tau]} \phi_t^2 E \left[ |\xi_t| \mathbf{1}_{(|\xi_t| > \phi_t^{-1}a)} | \mathcal{F}_{t-1} \right] &\leq \lim_{T \rightarrow \infty} \max_{0 < t \leq T} \phi_t^2 \sum_{t=1}^{[T\tau]} E \left[ |\xi_t| \mathbf{1}_{(|\xi_t| > \frac{a}{\max_{0 < t \leq T} \phi_t})} | \mathcal{F}_{t-1} \right] = 0 \end{aligned}$$

in view of equation (3). ■

The following corollary is a special case of Lemma 1.

**Corollary 1** *If  $\phi_t = \phi^t$  and  $|\phi| < 1$  then*

$$\lim_{T \rightarrow \infty} \frac{S_{[T\tau]}}{\sigma \sqrt{\frac{\phi^2}{1-\phi^2}}} \xrightarrow{W} W(1) \quad (20)$$

**Proof.** The result follows since  $\lim_{T \rightarrow \infty} \sum_{t=1}^{[T\tau]} \phi^{2t} = \frac{\phi^2}{1-\phi^2}$ . ■

## Proof of Theorem 1

Since

$$\begin{aligned} \frac{1}{T} \sum_{t=1}^T z_t &= \frac{1}{T} \sum_{k=1}^K \sum_{t_k=T(k-1)+1}^{T(k)} z_{t_k} \\ &= \sum_{k=1}^K \frac{T(k) - T(k-1)}{T} \frac{1}{T(k) - T(k-1)} \sum_{t_k=T(k-1)+1}^{T(k)} z_{t_k} \\ &\xrightarrow{m.s.} \sum_{k=1}^K \tau_k \frac{c_k}{1-\phi} \xrightarrow{a.s.} 0 \end{aligned}$$

by the weak law of large number for covariance-stationary processes, the sample mean of  $z_t$  is asymptotically zero. Therefore the LSE of  $\varphi$  is

$$\hat{\varphi} = \frac{\sum_{t=1}^T z_t z_{t-1}}{\sum_{t=1}^T z_{t-1}^2}. \quad (21)$$

Note

$$\sum_{t=1}^T z_t z_{t-1} = \sum_{t=1}^{T(1)} z_t z_{t-1} + \dots + \sum_{t=T(k)+1}^{T(k)} z_t z_{t-1} + \dots + \sum_{t=T(K)+1}^{T(K)} z_t z_{t-1},$$

and

$$\sum_{t=1}^T z_{t-1}^2 = \sum_{t=1}^{T(1)} z_{t-1}^2 + \dots + \sum_{t=T(k)+1}^{T(k)} z_{t-1}^2 + \dots + \sum_{t=T(K)+1}^{T(K)} z_{t-1}^2,$$

where  $T(k) = \sum_{i=1}^k [T\tau_i]$  with  $T(0) = 0$ . We then obtain

$$\begin{aligned} \hat{\varphi} &= \frac{\sum_{k=1}^K \sum_{t_k=T(k-1)+1}^{T(k)} z_{t_k} z_{t_k-1}}{\sum_{k=1}^K \sum_{t_k=T(k-1)+1}^{T(k)} z_{t_k-1}^2} \quad (22) \\ &= \frac{\sum_{k=1}^K \sum_{t_k=T(k-1)+1}^{T(k)} (c_k + \phi z_{t_k-1} + \xi_{t_k}) z_{t_k-1}}{\sum_{k=1}^K \sum_{t_k=T(k-1)+1}^{T(k)} z_{t_k-1}^2} \\ &= \frac{\sum_{k=1}^K \sum_{t_k=T(k-1)+1}^{T(k)} c_k z_{t_k-1} + \sum_{k=1}^K \sum_{t_k=T(k-1)+1}^{T(k)} \phi z_{t_k-1}^2 + \sum_{k=1}^K \sum_{t_k=T(k-1)+1}^{T(k)} \xi_{t_k} z_{t_k-1}}{\sum_{k=1}^K \sum_{t_k=T(k-1)+1}^{T(k)} z_{t_k-1}^2} \\ &= \phi + \frac{\sum_{k=1}^K c_k \sum_{t_k=T(k-1)+2}^{T(k)} z_{t_k-1} + \sum_{k=1}^K c_k z_{T(k-1)} + \sum_{k=1}^K \sum_{t_k=T(k-1)+2}^{T(k)} \xi_{t_k} z_{t_k-1} + \sum_{k=1}^K \xi_{T(k-1)+1} z_{T(k-1)}}{\sum_{k=1}^K \sum_{t_k=T(k-1)+2}^{T(k)} z_{t_k-1}^2 + \sum_{k=1}^K z_{T(k-1)}^2} \end{aligned}$$

with  $\xi_0 = 0$  and  $z_0 = 0$ . Note that  $z_{t_k-1}$  can be rewritten as

$$z_{t_k-1} = \frac{c_k}{1-\phi} + \phi^{-T(k-1)-1} \left( \phi^{t_k-1} \tilde{z}_{T(k-1)+1} + \sum_{j=T(k-1)+1}^{t_k-2} \phi^j \xi_{t_k-j+T(k-1)} \right), \quad (23)$$

where  $\tilde{z}_{T(k-1)+1} = z_{T(k-1)+1} - \frac{c_k}{1-\phi}$  and  $\sum_{j=T(k-1)-1}^{T(k-1)} \phi^j \xi_{t_k-j+T(k-1)} = 0$ . We now derive asymptotic properties of each individual elements in equation (22).

1. Let  $A_1^*$  defined as follows;

$$\begin{aligned} A_1^* &\equiv \sum_{t_k=T(k-1)+2}^{T(k)} \xi_{t_k} z_{t_k-1} \\ &= \sum_{t_k=T(k-1)+2}^{T(k)} \xi_{t_k} \left\{ \frac{c_k}{1-\phi} + \phi^{-T(k-1)-1} \left( \phi^{t_k-1} z_{T(k-1)+1} + \sum_{j=T(k-1)+1}^{t_k-2} \phi^j \xi_{t_k-j+T(k-1)} \right) \right\}. \end{aligned}$$

- The first component of  $A_1^*$ : Note that since  $\xi_{t_k}$  is an ergodic MDS we have

$$\begin{aligned} T^{-1/2} \sum_{t_k=T(k-1)+2}^{T(k)} \xi_{t_k} &= T^{-1/2} \sum_{t_k=1}^{T(k)-T(k-1)-1} \xi_{t_k+T(k-1)+1} \quad (24) \\ &\stackrel{d}{=} T^{-1/2} \sum_{t_k=1}^{T(k)-T(k-1)-1} \xi_{t_k} \\ &= T^{-1/2} \sum_{t_k=1}^{[T\tau_k]-1} \Delta S_{2t_k}, \end{aligned}$$

where  $S_{2t_k} = \sum_{j=1}^{t_k} \xi_j$  and  $\Delta$  is the difference operator. Since

$$T^{-1/2} S_{2[T\tau_k]} \xrightarrow{W} \sigma W_{2k}(\tau_k) \quad (25)$$

by Donsker's IP (see Theorem 14.1 of Billingsley (1999)), we have the following limit

$$T^{-1/2} \frac{c_k}{1-\phi} \sum_{t_k=T(k-1)+2}^{T(k)} \xi_{t_k} \xrightarrow{W} \frac{c_k \sigma}{1-\phi} W_{2k}(\tau_k), \quad (26)$$

where  $\tau_k = \lim_{T \rightarrow \infty} \frac{[T\tau_k]-1}{T}$  and  $W_{2k}$  is a Brownian motion.



- The second component of  $A_1^*$ : With a similar argument above we have

$$\begin{aligned}
\phi^{-T(k-1)} \sum_{t_k=T(k-1)+2}^{T(k)} \xi_{t_k} \phi^{t_k-1} &= \sum_{t_k=1}^{T(k)-T(k-1)-1} \phi^{t_k} \xi_{t_k+T(k-1)+1} \\
&\stackrel{d}{=} \sum_{t_k=1}^{T(k)-T(k-1)-1} \phi^{t_k} \xi_{t_k} \\
&= \sum_{t_k=1}^{[T\tau_k]-1} \phi^{t_k} \xi_{t_k} \\
&= S_{1[T\tau_k]-1},
\end{aligned}$$

where  $S_{1[T\tau_k]-1} = \sum_{t_k=1}^{[T\tau_k]-1} \phi^{t_k} \xi_{t_k}$ . Using Corollary 1 we have

$$S_{1[Ts]-1} \xrightarrow{W} \sigma \sqrt{C} W_{1k}(1), \quad (27)$$

where  $C = \frac{\phi^2}{1-\phi^2}$  and  $W_{1k}$  is the Brownian motion. Therefore we obtain

$$z_{T(k-1)+1} \phi^{-T(k-1)} \sum_{T(k-1)+2}^{T(k)} \xi_{t_k} \phi^{t_k-1} \xrightarrow{W} z_\infty \sigma \sqrt{C} W_{1k}(1), \quad (28)$$

where  $z_\infty$  denote the initial changing point of the process  $z_t$  by Assumption 4.

- The third component of  $A_1^*$ : We have

$$\begin{aligned}
& T^{-1/2} \phi^{-T(k-1)} \sum_{t_k=T(k-1)+2}^{T(k)} \xi_{t_k} \sum_{j=T(k-1)+1}^{t_k-2} \phi^j \xi_{t_k-j+T(k-1)} \\
&= T^{-1/2} \sum_{t_k=1}^{T(k)-T(k-1)-1} \xi_{t_k+T(k-1)+1} \sum_{j=1}^{t_k-1} \phi^j \xi_{t_k-j} \quad (29) \\
&\stackrel{d}{=} T^{-1/2} \sum_{t_k=1}^{T(k)-T(k-1)-1} \xi_{t_k} \sum_{j=1}^{t_k-1} \phi^j \xi_{t_k-j} \\
&= T^{-1/2} \sum_{t_k=1}^{T(k)-T(k-1)-1} \Delta S_{2t_k} S_{1t_k-1} \\
&= \sum_{t_k=1}^{[T\tau_k]-1} \int_{\frac{t_k}{T}}^{\frac{t_k+1}{T}} \frac{\Delta S_{2[Ts]}}{\sqrt{T}} S_{1[Ts]-1}.
\end{aligned}$$

Since  $S_{1t_k}$  and  $S_{2t_k}$  are independent, an application of equation (27) and the continuous mapping theorem yields the following limit:

$$T^{-1/2} \phi^{-T(k-1)-1} \sum_{t_k=T(k-1)+2}^{T(k)} \xi_{t_k} \sum_{j=T(k-1)+1}^{t_k-2} \phi^j \xi_{t_k-j+T(k-1)} \xrightarrow{W} \frac{\sigma^2 \sqrt{C}}{\phi} W_{1k}(1) W_{2k}(\tau_k).$$

- Therefore the asymptotic property of  $A_1$  is

$$\begin{aligned}
T^{-1/2} A_1 &= T^{-1/2} \sum_{k=1}^K \sum_{t_k=T(k-1)+2}^{T(k)} \xi_{t_k} z_{t_k-1} \\
&\xrightarrow{W} \sum_{k=1}^K \frac{c_k \sigma}{1-\phi} W_{2k}(\tau_k) + \sum_{k=1}^K \frac{\sigma^2 \sqrt{C}}{\phi} W_{1k}(1) W_{2k}(\tau_k) + o_p(1) \quad (30)
\end{aligned}$$

2. Using Equation (23), we have

$$\begin{aligned} \sum_{t_k=T(k-1)+2}^{T(k)} z_{t_k-1} &= \frac{c_k}{1-\phi} ([T\tau_k] - 1) + \phi^{-T(k-1)-1} \tilde{z}_{T(k-1)+1} \sum_{T(k-1)+2}^{T(k)} \phi^{t_k-1} \\ &\quad + \phi^{-T(k-1)-1} \sum_{t_k=T(k-1)+2}^{T(k)} \sum_{j=T(k-1)+1}^{t_k-2} \phi^j \xi_{t_k-j+T(k-1)}. \end{aligned}$$

Note that

$$T^{-1} \phi^{-T(k-1)-1} \tilde{z}_{T(k-1)+1} \sum_{T(k-1)+2}^{T(k)} \phi^{t_k-1} \implies T^{-1} \sum_{t_k=1}^{[T\tau_k]-1} \phi^{t_k} = o_p(1).$$

In addition

$$\begin{aligned} T^{-1} \phi^{-T(k-1)-1} \sum_{t_k=T(k-1)+2}^{T(k)} \sum_{j=T(k-1)+1}^{t_k-2} \phi^j \xi_{t_k-j+T(k-1)} &= T^{-1} \phi^{-1} \sum_{t_k=1}^{T(k)-T(k-1)-1} \sum_{j=1}^{t_k-1} \phi^j \xi_{t_k-j} \\ &\stackrel{d}{=} T^{-1} \phi^{-1} \sum_{t_k=1}^{[T\tau_k]-1} S_{1t_k-1} \\ &= \phi^{-1} \sum_{t_k=1}^{[T\tau_k]-1} \int_{\frac{t_k}{T}}^{\frac{t_k+1}{T}} S_{1[Ts]-1} ds \\ &\xrightarrow{W} \frac{\sigma \sqrt{C} \tau_k W_{1k}(1)}{\phi} \end{aligned}$$

in view of Corollary 1. Therefore we obtain

$$T^{-1} \sum_{t_k=T(k-1)+2}^{T(k)} z_{t_k-1} \xrightarrow{W} \tau_k \frac{c_k}{1-\phi} + \frac{\tau_k \sigma \sqrt{C}}{\phi} W_{1k}(1) + o_p(1), \quad (31)$$

and

$$\begin{aligned}
T^{-1}A_2 &= T^{-1} \sum_{k=1}^K c_k \sum_{t_k=T(k-1)+2}^{T(k)} z_{t_k-1} \\
&\xrightarrow{W} \sum_{k=1}^K \frac{\tau_k c_k^2}{1-\phi} + \sum_{k=1}^K \frac{\tau_k c_k \sigma \sqrt{C}}{\phi} W_{1k}(1) + o_p(1).
\end{aligned}$$

3. Since

$$z_{T(k-1)} = \frac{c_{k-1}}{1-\phi} + \phi^{-T(k-2)-1} \left( \phi^{T(k-1)} \tilde{z}_{T(k-2)+1} + \sum_{j=T(k-2)+1}^{T(k-1)-1} \phi^j \xi_{T(k-1)+T(k-2)-j+1} \right), \quad (32)$$

we have

$$\begin{aligned}
T^{-1/2}A_3 &\equiv T^{-1/2} \sum_{k=1}^K \xi_{T(k-1)+1} z_{T(k-1)} \\
&= T^{-1/2} \sum_{k=1}^K \xi_{T(k-1)+1} \left( \frac{c_{k-1}}{1-\phi} + \phi^{T(k-1)-T(k-2)-1} \tilde{z}_{T(k-2)+1} \right) \\
&\quad + T^{-1/2} \phi^{-T(k-2)-1} \sum_{k=1}^K \xi_{T(k-1)+1} \sum_{j=T(k-2)+1}^{T(k-1)-1} \phi^j \xi_{T(k-1)+T(k-2)-j+1} \\
&\implies o_p(1), \quad (33)
\end{aligned}$$

using equation (28) and similar arguments above.

4. From equation (32), we have

$$\begin{aligned}
\phi^{-T(k-2)-1} \sum_{j=T(k-2)+1}^{T(k-1)-1} \phi^j \xi_{T(k-1)+T(k-2)-j+1} &= \phi^{-1} \sum_{j=1}^{T(k-1)-T(k-2)-1} \phi^j \xi_{T(k-1)-j+1} \\
&\stackrel{d}{=} \phi^{-1} \sum_{j=1}^{T(k-1)-T(k-2)-1} \phi^j \xi_j \\
&\xrightarrow{W} \frac{\sigma \sqrt{C} W_{1k-1}(1)}{\phi}
\end{aligned}$$

in view of Corollary 1. In addition the limit of the second component in (32) is

$$\frac{c_{k-1}}{1-\phi} + \phi^{T(k-1)-T(k-2)-1} z_{T(k-2)+1} \implies \frac{c_{k-1}}{1-\phi} + o_p(1).$$

Therefore we have

$$\begin{aligned} A_4 &\equiv \sum_{k=1}^K c_k z_{T(k-1)} \\ &\xrightarrow{W} \frac{c_{k-1}}{1-\phi} + \sum_{k=1}^K \frac{c_k \sigma \sqrt{C} W_{1k-1}(1)}{\phi} + o_p(1). \end{aligned}$$

5. Let  $A_5 = \sum_{k=1}^K \sum_{t_k=T(k-1)+2}^{T(k)} z_{t_k-1}^2$ . Using similar asymptotic arguments, we also obtain

$$\begin{aligned} T^{-1} A_5 &= T^{-1} \sum_{k=1}^K \sum_{T(k-1)+2}^{T(k)} z_{t_k-1}^2 \\ &\xrightarrow{W} \sum_{k=1}^K \tau_k \left( \frac{c_k}{1-\phi} \right)^2 + 2 \sum_{k=1}^K \frac{c_k \sigma \tau_k \sqrt{C}}{\phi(1-\phi)} W_{1k}(1) + \sum_{k=1}^K \frac{\sigma^2 \tau_k C}{\phi^2} W_{1k}^2(1) + o_p(1) \end{aligned} \quad (34)$$

6. Finally we have

$$\begin{aligned} A_6 &\equiv \sum_{k=1}^K z_{T(k-1)}^2 \tag{35} \\ &\xrightarrow{W} \sum_1^K \frac{c_{k-1}^2}{(1-\phi)^2} + 2 \frac{c_{k-1} \sigma \sqrt{C}}{\phi(1-\phi)} \sum_1^K W_k(1) + \frac{\sigma^2 C}{\phi^2} \sum_1^K W_k^2(1) + o_p(1) \tag{36} \end{aligned}$$

Therefore, we arrive at the following expression:

$$\varphi - \phi \xrightarrow{W} \frac{O_p(T^{-1/2}) + \sum_{k=1}^K \frac{\tau_k c_k^2}{1-\phi} + \sum_{k=1}^K \frac{c_k \tau_k \sigma \sqrt{C}}{\phi} W_k(1)}{O_p(T^{-1}) + \sum_{k=1}^K \frac{\tau_k c_k^2}{(1-\phi)^2} + 2 \sum_{k=1}^K \frac{c_k \tau_k \sigma}{(1-\phi) \sqrt{1-\phi^2}} W_k(1) + \sum_{k=1}^K \frac{\tau_k \sigma^2}{1-\phi^2} W_k^2(1)}. \tag{37}$$

## Proof of Proposition 1

From equation (7) and Assumption 3, an application of Loeve's SLLN yields

$$\sum_{k=1}^K \tau_k c_k W_k(1) = \sum_{k=1}^K \tau_k W(\sqrt{c_k}) \xrightarrow{a.s.} 0, \quad (38)$$

since  $\sum_{k=1}^K \tau_k = 1$  where  $\tau_k \in (0, 1)$  and  $\tau_k$  and  $c_k$  are independent. Therefore

$$\begin{aligned} \sum_{k=1}^K \frac{c_k \tau_k \sigma \sqrt{C}}{\phi} W_k(1) &\xrightarrow{a.s.} 0, \text{ and} \\ \frac{2}{(1-\phi)\sqrt{1-\phi^2}} \sum_{k=1}^K c_k \tau_k \sigma W_k(1) &\xrightarrow{a.s.} 0. \end{aligned}$$

In addition, applying Etemadi's SLLN for non-negative random variables we have

$$\begin{aligned} \sum_{k=1}^K \frac{\tau_k \sigma^2}{1-\phi^2} W_k^2(1) &= \frac{\sigma^2}{1-\phi^2} \sum_{k=1}^K W_k^2(\sqrt{\tau_k}) \\ &\xrightarrow{a.s.} \frac{\sigma^2}{1-\phi^2}, \end{aligned} \quad (39)$$

since

$$\sum_{k=1}^K W_k^2(\sqrt{\tau_k}) \xrightarrow{a.s.} \sum_{k=1}^K \tau_k = 1.$$

Furthermore,

$$\lim_{K \rightarrow \infty} \sum_{k=1}^K \tau_k c_k^2 = \lim_{K \rightarrow \infty} \sum_{k=1}^K \tau_k \epsilon_k^2 \xrightarrow{a.s.} \sigma_\epsilon^2, \quad (40)$$

since the random component  $\epsilon_t$  moves around zero with volatility  $\sigma_\epsilon^2$ . Therefore equations (38), (39), (40), and (7) together with Assumptions 3 give

$$\begin{aligned}
\lim_{T \rightarrow \infty, K \rightarrow \infty} \frac{A}{B} &= \frac{\lim_{T \rightarrow \infty, K \rightarrow \infty} \sum_{k=1}^K \left\{ \frac{\tau_k c_k^2}{1-\phi} + \frac{c_k \tau_k \sigma \sqrt{C}}{\phi} W_k(1) \right\}}{\lim_{T \rightarrow \infty, K \rightarrow \infty} \sum_{k=1}^K \left\{ \frac{\tau_k c_k^2}{(1-\phi)^2} + 2 \frac{c_k \tau_k \sigma}{(1-\phi) \sqrt{1-\phi^2}} W_k(1) + \frac{\tau_k \sigma^2}{1-\phi^2} W_k^2(1) \right\}} \\
&= \frac{V}{\frac{V}{1-\phi} + \frac{1}{1+\phi}} \\
&\equiv \frac{A_\infty}{B_\infty} \geq 0,
\end{aligned} \tag{41}$$

where  $V = \sigma_\epsilon^2 / \sigma^2$ , and  $A_\infty$  and  $B_\infty$  are obviously defined. It is straight forward to show that  $\frac{\partial}{\partial V} \left( \frac{A_\infty}{B_\infty} \right) = \frac{1}{1+\phi} \left( \frac{V}{1-\phi} + \frac{1}{1+\phi} \right)^{-2} > 0$  and  $\frac{\partial}{\partial \phi} \left( \frac{A_\infty}{B_\infty} \right) = -V \left( \frac{V}{1-\phi} + \frac{1}{1+\phi} \right)^{-2} \left( \frac{V}{(1-\phi)^2} - \frac{1}{(1+\phi)^2} \right)$ . The second case shows that we have  $\frac{\partial}{\partial \phi} \left( \frac{A_\infty}{B_\infty} \right) < 0$  when  $V > \frac{(1-\phi)^2}{(1+\phi)^2}$ .

## Proof of Theorem 2

Note that

$$\begin{aligned}
\widehat{\varphi} &= \frac{\sum_{k=1}^K \sum_{t_k=T(k-1)+1}^{T(k)} z_{t_k} z_{t_k-1}}{\sum_{k=1}^K \sum_{t_k=T(k-1)+1}^{T(k)} z_{t_k-1}^2} \\
&= \frac{\sum_{k=1}^K \sum_{t_k=T(k-1)+1}^{T(k)} (c_{t_k} + \xi_{t_k})(c_{t_k-1} + \xi_{t_k-1})}{\sum_{k=1}^K \sum_{t_k=T(k-1)+1}^{T(k)} (c_{t_k-1} + \xi_{t_k-1})^2} \\
&= \frac{\sum_{k=1}^K (c_k c_{k-1} + c_k^2 ([T\tau_k] - 1)) + \sum_{k=1}^K c_k \sum_{t_k=T(k-1)+1}^{T(k)} \xi_{t_k-1}}{\sum_{k=1}^K (c_{k-1}^2 + c_k^2 ([T\tau_k] - 1)) + \sum_{k=1}^K \sum_{t_k=T(k-1)+1}^{T(k)} \xi_{t_k-1}^2} \\
&= \frac{+ \sum_{k=1}^K (c_{k-1} \xi_{T(k-1)} + c_k \sum_{t_k=T(k-1)+2}^{T(k)} \xi_{t_k}) + \sum_{k=1}^K \sum_{t_k=T(k-1)+1}^{T(k)} \xi_{t_k} \xi_{t_k-1}}{+ 2 \sum_{k=1}^K (c_{k-1} \xi_{T(k-1)} + c_k \sum_{t_k=T(k-1)+2}^{T(k)} \xi_{t_k-1})} \tag{42}
\end{aligned}$$

We have

$$\begin{aligned} \sum_{T(k-1)+1}^{T(k)} \xi_{t_k} \xi_{t_k-1} &= \sum_{t_k=1}^{T(k)-T(k-1)} \xi_{t_k+T(k-1)} \xi_{t_k+T(k-1)-1} \\ &\stackrel{d}{=} \sum_{t_k=1}^{T(k)-T(k-1)} \xi_{t_k} \xi_{t_k-1}. \end{aligned}$$

Since  $E(\xi_t \xi_{t-1} | \mathcal{F}_{t-1}) = \xi_{t-1} E(\xi_t | \mathcal{F}_{t-1}) = 0$  thus  $\xi_t \xi_{t-1}$  is a sequence of martingale differences. An application of SLLN for martingale difference sequences (White, 1984) yields

$$\frac{1}{[T\tau_k]} \sum_{t=1}^{[T\tau_k]} \xi_t \xi_{t-1} \xrightarrow{a.s.} 0, \text{ thus} \quad (43)$$

$$\frac{1}{\max\{[T\tau_k]\}_{k=1}^K} \sum_{t=1}^{[T\tau_k]} \xi_t \xi_{t-1} \xrightarrow{a.s.} 0. \quad (44)$$

- Since  $\xi_t$  is an ergodic MDS, we have  $\sum_{t_k=T(k-1)+1}^{T(k)} \xi_{t_k} \stackrel{d}{=} \sum_{t_k=1}^{[T\tau_k]} \xi_{t_k}$ . We apply SLLN for MDS to obtain

$$\begin{aligned} \frac{1}{[T\tau_k]} \sum_{t_k=1}^{[T\tau_k]} \xi_{t_k} &\xrightarrow{a.s.} 0, \text{ thus,} \\ \frac{1}{\max\{[T\tau_k]\}_{k=1}^K} \sum_{t_k=1}^{[T\tau_k]} \xi_{t_k} &\xrightarrow{a.s.} 0. \end{aligned}$$

- Since  $\xi_t$  is an ergodic MDS, we obtain  $\sum_{T(k-1)+1}^{T(k)} \xi_{t_k-1}^2 \stackrel{d}{=} \sum_{t_k=1}^{[T\tau_k]} \xi_{t_k}^2$ . By applying Etemadi's SLLN for non-negative  $\mathcal{L}_2$  random variables we get

$$\frac{1}{\max\{[T\tau_k]\}_{k=1}^K} \sum_{t_k=1}^{[T\tau_k]} \xi_{t_k}^2 \xrightarrow{a.s.} \frac{\sigma^2 \tau_k}{\max\{\tau_k\}_{k=1}^K}. \quad (45)$$

By dividing both the numerator and denominator of equation (42) by  $\max\{\tau_k\}_{k=1}^K$



together with equations (43) to (45) we have

$$\widehat{\varphi} \xrightarrow{a.s.} \frac{\sum_{k=1}^K \tau_k c_k^2}{\sum_{k=1}^K \tau_k c_k^2 + \sigma^2} \quad (46)$$

Since  $c_k$  is a sample path of the occasionally changing process  $c_t$  generated by  $\epsilon_t$ , an application of SLLN for MDS yields

$$\sum_{k=1}^K \tau_k c_k^2 \xrightarrow{a.s.} \sigma_\epsilon^2, \text{ as } K \rightarrow \infty. \quad (47)$$

Therefore, we obtain

$$\widehat{\varphi} \xrightarrow{a.s.} \frac{\sigma_\epsilon^2}{\sigma_\epsilon^2 + \sigma^2} = \frac{V}{V+1}. \quad (48)$$

### Proof of Theorem 3

The LSE of  $\varphi$  is given by

$$\widehat{\varphi} = \frac{\sum_{k=1}^K z_{T(k-1)+1} z_{T(k-1)} + \sum_{k=1}^K \sum_{t_k=T(k-1)+2}^{T(k)} z_{t_k} z_{t_k-1}}{\sum_{k=1}^K z_{T(k-1)}^2 + \sum_{k=1}^K \sum_{t_k=T(k-1)+2}^{T(k)} z_{t_k-1}^2}. \quad (49)$$

Since

$$\sum_{t_k=T(k-1)+2}^{T(k)} z_{t_k} z_{t_k-1} = c_k \sum_{t_k=T(k-1)+2}^{T(k)} z_{t_k-1} + \sum_{t_k=T(k-1)+2}^{T(k)} z_{t_k-1}^2 + \sum_{t_k=T(k-1)+2}^{T(k)} \xi_{t_k} z_{t_k-1},$$

we obtain

$$\widehat{\varphi} - 1 = \frac{\sum_{k=1}^K z_{T(k-1)+1} z_{T(k-1)} + \sum_{k=1}^K c_k \sum_{t_k=T(k-1)+2}^{T(k)} z_{t_k-1} + \sum_{k=1}^K \sum_{t_k=T(k-1)+2}^{T(k)} \xi_{t_k} z_{t_k-1} - \sum_{k=1}^K z_{T(k-1)}^2}{\sum_{k=1}^K z_{T(k-1)}^2 + \sum_{k=1}^K \sum_{t_k=T(k-1)+2}^{T(k)} z_{t_k-1}^2}, \quad (50)$$

or

$$\hat{\varphi} = \frac{\sum_{k=1}^K \left\{ \sum_{T(k-1)+2}^{T(k)} z_{t_k-1}^2 + c_k \sum_{T(k-1)+2}^{T(k)} z_{t_k-1} \right\}}{\sum_{k=1}^K \left\{ z_{T(k-1)}^2 + \sum_{T(k-1)+2}^{T(k)} z_{t_k-1}^2 \right\}} = \frac{\sum_{k=1}^K \left\{ z_{T(k-1)+1} z_{T(k-1)} + \sum_{T(k-1)+2}^{T(k)} \xi_{t_k} z_{t_k-1} \right\}}{\sum_{k=1}^K \left\{ z_{T(k-1)}^2 + \sum_{T(k-1)+2}^{T(k)} z_{t_k-1}^2 \right\}} \quad (51)$$

Let's derive the limiting distributions of the terms in equation (50).

1. Using

$$z_{t_k-1} = z_{T(k-1)+1} + (t_k - T(k-1) - 2)c_k + \sum_{j=T(k-1)+2}^{t_k-1} \xi_j,$$

we define  $B_1$  as follows

$$\begin{aligned} B_1 &\equiv \sum_{T(k-1)+2}^{T(k)} z_{t_k-1}^2 \\ &= \sum_{t_k=T(k-1)+2}^{T(k)} \left\{ \begin{aligned} &z_{T(k-1)+1}^2 + c_k^2 (t_k - T(k-1) - 2)^2 + \left( \sum_{j=T(k-1)+2}^{t_k-1} \xi_j \right)^2 \\ &+ 2c_k z_{T(k-1)+1} (t_k - T(k-1) - 2) + 2z_{T(k-1)+1} \sum_{j=T(k-1)+2}^{t_k-1} \xi_j \\ &+ 2c_k (t_k - T(k-1) - 2) \sum_{j=T(k-1)+2}^{t_k-1} \xi_j \end{aligned} \right\} \quad (52) \end{aligned}$$

• First we have

$$T^{-1} \sum_{t_k=T(k-1)+2}^{T(k)} z_{T(k-1)+1}^2 = z_{T(k-1)+1}^2 T^{-1} (T(k) - T(k-1) - 1) \implies z_{\infty} \tau_k, \quad (53)$$

• and

$$\begin{aligned} T^{-3} \sum_{t_k=T(k-1)+2}^{T(k)} (t_k - T(k-1) - 2)^2 &= T^{-3} \sum_{t_k=0}^{T(k)-T(k-1)-2} t_k^2 \\ &\implies \frac{(\tau_k)^3}{3}. \end{aligned} \quad (54)$$

- The third component becomes

$$\begin{aligned}
T^{-2} \sum_{t_k=T(k-1)+2}^{T(k)} \left( \sum_{j=T(k-1)+2}^{t_k-1} \xi_j \right)^2 &= T^{-2} \sum_{t_k=1}^{T(k)-T(k-1)-1} \left( \sum_{j=1}^{t_k-1} \xi_{j+T(k-1)+1} \right)^2 \\
&= \sum_{t_k=1}^{[T\tau_k]-1} \int_{\frac{t_k}{T}}^{\frac{t_k+1}{T}} \frac{(S_{2[Ts]-1})^2}{T} \frac{1}{T} \\
&\xrightarrow{W} \sigma^2 \int_0^{\tau_k} W_k^2(s) ds, \tag{55}
\end{aligned}$$

using Donsker's IP and the fact that  $\xi_t$  is an ergodic MDS.

- Using a similar method as in equation (54), we also have

$$\begin{aligned}
c_k z_{T(k-1)+1} T^{-2} \sum_{t_k=T(k-1)+2}^{T(k)} (t_k - T(k-1) - 2) &= c_k z_{T(k-1)+1} T^{-2} \sum_{t_k=0}^{T(k)-T(k-1)-2} t_k \\
&\implies c_k z_\infty \frac{(\tau_k)^2}{2}, \tag{56}
\end{aligned}$$

by the same argument as (54) and

$$\begin{aligned}
T^{-3/2} z_{T(k-1)+1} \sum_{t_k=T(k-1)+2}^{T(k)} \sum_{j=T(k-1)+2}^{t_k-1} \xi_j &\stackrel{d}{=} z_{T(k-1)+1} T^{-3/2} \sum_{t_k=1}^{T(k)-T(k-1)-1} \sum_{j=1}^{t_k-1} \xi_j \\
&= z_{T(k-1)+1} \sum_{t_k=1}^{[T\tau_k]-1} \int_{\frac{t_k}{T}}^{\frac{t_k+1}{T}} \frac{S_{2t_k-1}}{\sqrt{T}} \frac{1}{T} \\
&\xrightarrow{W} z_\infty \sigma \int_0^{\tau_k} W_k(s) ds, \tag{57}
\end{aligned}$$

by the same argument as (55).

- Finally

$$\begin{aligned}
T^{-5/2} \sum_{t_k=T(k-1)+2}^{T(k)} (t_k - T(k-1) - 2) \sum_{j=T(k-1)+2}^{t_k-1} \xi_j &\stackrel{d}{=} T^{-5/2} \sum_{t_k=1}^{T(k)-T(k-1)-1} t_k \sum_{j=1}^{t_k-1} \xi_j \\
&= \sum_{t_k=1}^{[T\tau_k]-1} \int_{\frac{t_k}{T}}^{\frac{t_k+1}{T}} \frac{[Ts]}{T} \frac{S_{2[Ts]-1}}{\sqrt{T}} \frac{1}{T} \\
&\stackrel{W}{\Longrightarrow} \sigma \int_0^{\tau_k} s W_{2k}(s) ds,
\end{aligned}$$

by the same argument as (55)

- Therefore the asymptotic property of  $B_1$  is

$$T^{-3} B_1 \stackrel{W}{\Longrightarrow} \frac{c_k^2(\tau_k)^3}{3} + O_p(T^{-1/2}) \quad (58)$$

2. We next define  $B_2$  and investigate the asymptotic property of  $B_2$ .

$$\begin{aligned}
B_2 &\equiv \sum_{t_k=T(k-1)+2}^{T(k)} \xi_{t_k} z_{t_k-1} \\
&= \sum_{t_k=T(k-1)+2}^{T(k)} \xi_{t_k} \left[ z_{T(k-1)+1} + c_k(t_k - T(k-1) - 2) + \sum_{j=T(k-1)+2}^{t_k-1} \xi_j \right] \quad (59)
\end{aligned}$$

where

$$\begin{aligned}
T^{-1} \sum_{t_k=T(k-1)+2}^{T(k)} \xi_{t_k} \sum_{j=T(k-1)+2}^{t_k-1} \xi_j &= T^{-1} \sum_{t_k=1}^{T(k)-T(k-1)-1} \xi_{t_k+T(k-1)+2} \sum_{j=1}^{t_k-1} \xi_{j+T(k-1)+1} \\
&\stackrel{d}{=} T^{-1} \sum_{t_k=1}^{T(k)-T(k-1)-1} \xi_{t_k} \sum_{j=1}^{t_k-1} \xi_j \\
&= T^{-1} \sum_{t_k=1}^{T(k)-T(k-1)-1} \Delta S_{2t_k} S_{2t_k-1} \\
&= \sum_{t_k=1}^{T(k)-T(k-1)-1} \int_{\frac{t_k}{T}}^{\frac{t_k+1}{T}} \frac{S_{2[Ts]}}{\sqrt{T}} \Delta \frac{S_{2[Ts]}}{\sqrt{T}} \\
&\stackrel{W}{\Longrightarrow} \sigma^2 \int_0^{\tau_k} W_{2k}(s) dW_{2k}(s). \tag{60}
\end{aligned}$$

Similarly,

$$\begin{aligned}
T^{-3/2} c_k \sum_{t_k=T(k-1)+2}^{T(k)} \xi_{t_k} (t_k - T(k-1) - 2) &\stackrel{d}{=} T^{-3/2} c_k \sum_{t_k=1}^{T(k)-T(k-1)-1} t_k \xi_{t_k} \\
&= c_k \sum_{t_k=1}^{T(k)-T(k-1)-1} \int_{\frac{t_k}{T}}^{\frac{t_k+1}{T}} \frac{[Ts]}{T} \frac{\Delta S_{2[Ts]+1}}{\sqrt{T}} \\
&\stackrel{W}{\Longrightarrow} \sigma c_k \int_0^{\tau_k} s dW_{2k}(s). \tag{61}
\end{aligned}$$

Finally

$$\begin{aligned}
T^{-1/2} \sum_{t_k=T(k-1)+2}^{T(k)} \xi_{t_k} z_{T(k-1)+1} &= z_{T(k-1)+1} T^{-1/2} \sum_{t_k=1}^{[T\tau_k]-1} \xi_{t_k} \\
&\stackrel{W}{\Longrightarrow} z_\infty \sigma W_{2k}(\tau_k). \tag{62}
\end{aligned}$$

Thus,

$$T^{-3/2} B_2 \stackrel{W}{\Longrightarrow} \sigma c_k \int_0^{\tau_k} s dW_{2k}(s) + O_p(T^{-1/2}). \tag{63}$$

3. Let us define

$$\begin{aligned}
B_3 &\equiv z_{T(k-1)}^2 \\
&= z_{T(k-2)+1}^2 + ([T\tau_{k-1}] - 1)^2 c_{k-1}^2 + \left( \sum_{j=T(k-2)+2}^{T(k-1)} \xi_j \right)^2 + 2z_{T(k-2)+1} c_{k-1} ([T\tau_{k-1}] - 1) \\
&\quad + 2z_{T(k-2)+1} \sum_{j=T(k-2)+2}^{T(k-1)} \xi_j + 2c_{k-1} ([T\tau_{k-1}] - 1) \sum_{j=T(k-2)+2}^{T(k-1)} \xi_j,
\end{aligned}$$

where

$$\begin{aligned}
T^{-2} c_{k-1}^2 ([T\tau_{k-1}] - 1)^2 &\implies c_{k-1}^2 (\tau_{k-1})^2, \\
T^{-1} \left( \sum_{j=T(k-2)+2}^{T(k-1)} \xi_j \right)^2 &\xrightarrow{W} \sigma^2 W_{2k-1}^2 (\tau_{k-1}), \\
T^{-1} z_{T(k-2)+1} c_{k-1} ([T\tau_{k-1}] - 1) &\implies z_\infty c_{k-1} \tau_{k-1}, \\
T^{-1/2} z_{T(k-2)+1} \sum_{j=T(k-2)+2}^{T(k-1)} \xi_j &\xrightarrow{W} z_\infty \sigma W_{k-1} (\tau_{k-1}), \\
T^{-3/2} c_{k-1} ([T\tau_{k-1}] - 1) \sum_{j=T(k-2)+2}^{T(k-1)} \xi_j &\xrightarrow{W} \tau_{k-1} c_{k-1} \sigma W_{k-1} (\tau_{k-1}).
\end{aligned}$$

Thus

$$T^{-2} B_3 = T^{-2} z_{T(k-1)}^2 \xrightarrow{W} c_{k-1}^2 (\tau_{k-1})^2 + O_p(T^{-1/2}). \quad (64)$$

4. Let

$$\begin{aligned}
B_4 &= \sum_{t_k=T(k-1)+2}^{T(k)} z_{t_k-1} = \sum_{t_k=T(k-1)+2}^{T(k)} z_{T(k-1)+1} + \sum_{t_k=T(k-1)+2}^{T(k)} (t_k - T(k-1) - 2) c_k \\
&\quad + \sum_{t_k=T(k-1)+2}^{T(k)} \sum_{j=T(k-1)+2}^{t_k-1} \xi_j \\
&\stackrel{d}{=} z_{T(k-1)+1} ([T\tau_{k-1}] - 1) + c_k \sum_{t_k=0}^{T(k)-T(k-1)-2} t_k + \sum_{t_k=1}^{T(k)-T(k-1)-1} \sum_{j=1}^{t_k-1} \xi_j,
\end{aligned}$$

since  $\xi_t$  is an ergodic MDS. We have

$$\begin{aligned}
T^{-1}z_{T(k-1)+1}([T\tau_{k-1}] - 1) &\implies z_\infty\tau_k, \\
T^{-2}c_k \sum_{t_k=0}^{T(k)-T(k-1)-2} t_k &\implies \frac{c_k(\tau_k)^2}{2} \text{ in view of equation (56),} \\
T^{-3/2} \sum_{t_k=1}^{T(k)-T(k-1)-1} \sum_{j=1}^{t_k-1} \xi_j &\xrightarrow{W} \sigma_k \int_0^{\tau_k} W_k(s)ds \text{ in view of equation (57).}
\end{aligned}$$

Therefore, we obtain

$$T^{-2}c_k B_4 = T^{-2}c_k \sum_{t_k=T(k-1)+2}^{T(k)} z_{t_k-1} \implies \frac{c_k^2 \tau_k^2}{2} + O_p(T^{-1/2}).$$

5. Finally since  $z_{T(k-1)} = z_{T(k-2)+1} + (T(k-1) - T(k-2) - 1)c_{k-1} + \sum_{j=T(k-2)+2}^{T(k-1)} \xi_j$ , we have

$$\begin{aligned}
B_5 &\equiv z_{T(k-1)+1}z_{T(k-1)} \\
&= z_{T(k-1)+1} \left[ z_{T(k-2)+1} + c_{k-1}(T(k-1) - T(k-2) - 1) + \sum_{j=T(k-2)+2}^{T(k-1)} \xi_j \right],
\end{aligned}$$

where

$$\begin{aligned}
z_{T(k-1)+1}z_{T(k-2)+1} &\implies (z_\infty)^2, \\
T^{-1}z_{T(k-1)+1}c_{k-1}(T(k-1) - T(k-2) - 1) &\implies z_\infty c_{k-1}\tau_{k-1}, \\
T^{-1/2}z_{T(k-1)+1} \sum_{j=T(k-2)+2}^{T(k-1)} \xi_j &\stackrel{d}{=} T^{-1/2}z_{T(k-1)+1} \sum_{j=1}^{T(k-1)-T(k-2)-1} \xi_j \xrightarrow{W} z_\infty \sigma W_k(\tau_{k-1}).
\end{aligned}$$

Therefore

$$T^{-1}B_5 = T^{-1}z_{T(k-1)+1}z_{T(k-1)} \implies z_\infty c_{k-1}\tau_{k-1} + O_p(T^{-1/2}). \quad (65)$$

Summarising, we have

$$T^{-3}B_1 \implies \frac{c_k^2(\tau_k)^3}{3} + O_p(T^{-1/2}) \quad (66)$$

$$T^{-3/2}B_2 \xrightarrow{W} \sigma c_k \int_0^{\tau_k} sdW_{2k}(s) + O_p(T^{-1/2}). \quad (67)$$

$$T^{-2}B_3 \xrightarrow{W} c_{k-1}^2(\tau_{k-1})^2 + O_p(T^{-1/2}). \quad (68)$$

$$T^{-2}c_k B_4 \implies \frac{c_k^2(\tau_k)^2}{2} + O_p(T^{-1/2}). \quad (69)$$

$$T^{-1}B_5 \xrightarrow{W} c_{k-1}z_\infty^* \tau_{k-1} + O_p(T^{-1/2}) \quad (70)$$

Equations (66) to (70) yield the following asymptotic properties of  $\hat{\varphi}$ :

- From Equation 49 we have:

$$\hat{\varphi} - 1 = o_p(1)$$

- On the other hand from equation (51) we have:

$$T^{3/2}(\hat{\varphi} - 1) \xrightarrow{W} \frac{\sigma \sum_{k=1}^K c_k \int_0^{\tau_k} sdW_{2k}(s) + O_p(T^{-1})}{\frac{\sum_{k=1}^K c_k^2(\tau_k)^3}{3} + O_p(T^{-1/2})},$$

in view of

$$\lim_{T \rightarrow \infty} \frac{\sum_{k=1}^K \left\{ \sum_{T(k-1)+2}^{T(k)} z_{t_{k-1}}^2 + c_k \sum_{T(k-1)+2}^{T(k)} z_{t_{k-1}} \right\}}{\sum_{k=1}^K \left\{ z_{T(k-1)}^2 + \sum_{T(k-1)+2}^{T(k)} z_{t_{k-1}}^2 \right\}} = \lim_{T \rightarrow \infty} \gamma(T) \left( = \frac{\frac{c_k^2(\tau_k)^3}{3}}{\frac{c_k^2(\tau_k)^3}{3}} = 1 \right).$$

- Finally from equation (50) we have :

$$T(\hat{\varphi} - 1) \xrightarrow{W} \frac{\sum_1^K \frac{c_k^2(\tau_k)^2}{2} - \sum_1^K c_{k-1}^2(\tau_{k-1})^2 + O_p(T^{-1/2})}{\sum_1^K \frac{c_k^2(\tau_k)^3}{3} + O_p(T^{-1})}.$$



## Proof of Proposition 2

Assumptions 1 and 3 and an application of SLLN for ergodic MDS give:

$$\begin{aligned}\lim_{K \rightarrow \infty} \frac{1}{K} \sum_{k=1}^K c_k^2(\tau_k)^2 &= \lim_{K \rightarrow \infty} \frac{1}{K} \sum_{k=1}^K c_{k-1}^2(\tau_{k-1})^2 = E[\epsilon_k^2 \tilde{\tau}_k^2] = \sigma_\epsilon^2 \sigma_\tau^2(\infty), \\ \lim_{K \rightarrow \infty} \frac{1}{K} \sum_{k=1}^K c_k^2(\tau_k)^3 &= E[\epsilon_k^2 \tilde{\tau}_k^3] = \sigma_\epsilon^2 \lambda_\tau(\infty).\end{aligned}$$

Proposition 2 follows.

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**Table 1 Percentage Points of the Distributions of  $\varphi-\hat{\varphi}$  for Various Number of Breaks, Break Sizes, and AR Parameters In the Presence of Structural Breaks in Mean**

AR(1) series are generated for the sample sizes of T=100, 200, 500, 1000, and 3000. For the numbers of breaks, we use 4, 9, 49, and 99. The error term in the AR process follows standard normal, N(0,1), while the sizes of structural breaks are drawn from three different normal distributions, i.e., N(0,0.1<sup>2</sup>), N(0,1), and N(0,10<sup>2</sup>), which have average break sizes of 0.1, 1, and 10, relative to the AR error term. For the values of  $\phi$ , we take 1, 0.9, 0.5, 0, and -0.5. For the asymptotic distributions we generate Brownian motions with 10000 i.i.d. standard normal variates. We repeat the procedure 10000 times to obtain the sample LS estimates and asymptotic distributions.

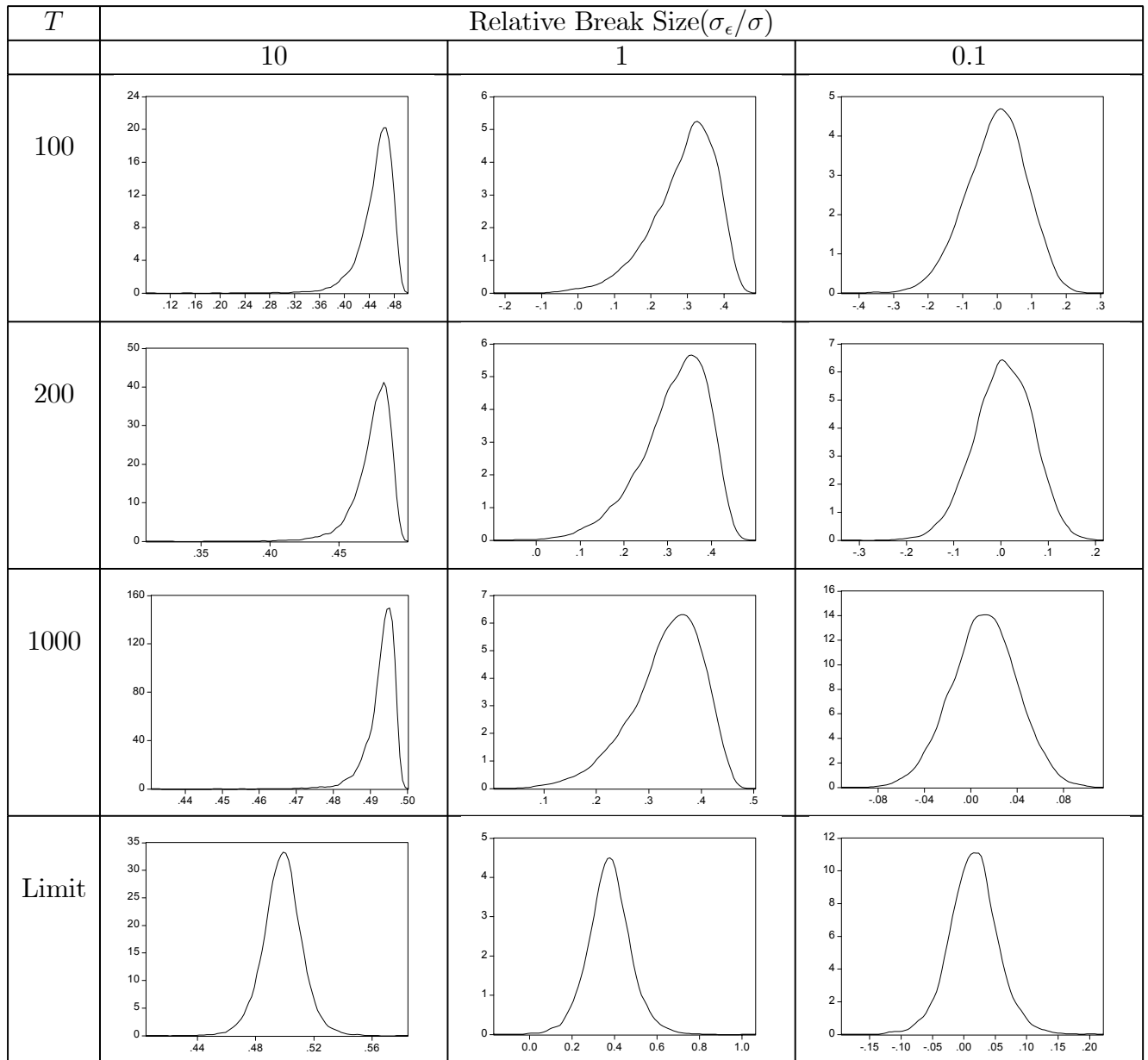
**A. The Effects of Structural Breaks in Mean for Various Number of Breaks, Break Sizes, and Number of Observations**

AR Parameter	Number of Breaks	Break Size	Total Number of Observations	Percentage Points of the Distributions								
				1%	2.50%	5%	10%	50%	90%	95%	97.50%	99%
0.5	4	10	100	0.321	0.374	0.407	0.434	0.473	0.488	0.491	0.492	0.494
			200	0.403	0.432	0.449	0.463	0.485	0.493	0.495	0.496	0.496
			500	0.434	0.456	0.468	0.479	0.492	0.496	0.497	0.498	0.498
			1000	0.443	0.464	0.475	0.484	0.495	0.498	0.498	0.498	0.499
			Limit	0.439	0.455	0.465	0.474	0.498	0.522	0.532	0.542	0.556
		1	100	-0.055	-0.002	0.043	0.099	0.292	0.404	0.422	0.435	0.447
			200	-0.014	0.028	0.075	0.128	0.309	0.413	0.429	0.441	0.452
			500	0.028	0.061	0.095	0.140	0.313	0.416	0.433	0.445	0.456
			1000	0.033	0.064	0.099	0.147	0.314	0.416	0.434	0.445	0.456
			Limit	-0.057	0.063	0.131	0.195	0.374	0.556	0.625	0.702	0.819
		0.1	100	-0.224	-0.184	-0.155	-0.121	-0.001	0.104	0.131	0.152	0.177
			200	-0.151	-0.123	-0.104	-0.079	0.004	0.081	0.101	0.118	0.135
			500	-0.090	-0.073	-0.059	-0.043	0.009	0.059	0.073	0.085	0.098
			1000	-0.058	-0.048	-0.038	-0.028	0.010	0.048	0.059	0.068	0.077
			Limit	-0.153	-0.111	-0.082	-0.055	0.015	0.085	0.111	0.142	0.184
0.5	49	10	100	0.135	0.164	0.186	0.211	0.290	0.351	0.366	0.377	0.389
			200	0.333	0.347	0.357	0.368	0.404	0.430	0.437	0.442	0.448
			500	0.435	0.441	0.445	0.449	0.462	0.472	0.475	0.477	0.479
			1000	0.467	0.470	0.472	0.474	0.481	0.486	0.487	0.488	0.489
			Limit	0.485	0.487	0.489	0.491	0.498	0.506	0.508	0.509	0.511
		1	100	-0.025	0.011	0.041	0.073	0.175	0.257	0.277	0.294	0.311
			200	0.137	0.164	0.183	0.206	0.273	0.327	0.340	0.351	0.363
			500	0.233	0.252	0.266	0.281	0.331	0.371	0.380	0.388	0.396
			1000	0.268	0.282	0.294	0.307	0.351	0.386	0.395	0.402	0.409
			Limit	0.268	0.288	0.304	0.320	0.375	0.429	0.446	0.459	0.477
		0.1	100	-0.229	-0.190	-0.158	-0.121	-0.005	0.099	0.124	0.145	0.169
			200	-0.151	-0.125	-0.103	-0.078	0.002	0.078	0.099	0.115	0.132
			500	-0.084	-0.069	-0.056	-0.042	0.010	0.058	0.070	0.082	0.096
			1000	-0.055	-0.045	-0.035	-0.024	0.012	0.047	0.056	0.064	0.074
			Limit	-0.026	-0.019	-0.013	-0.006	0.015	0.036	0.042	0.048	0.055
0.5	99	10	200	0.191	0.210	0.225	0.241	0.294	0.339	0.350	0.359	0.370
			500	0.389	0.396	0.401	0.407	0.425	0.441	0.445	0.448	0.452
			1000	0.445	0.448	0.451	0.454	0.463	0.471	0.472	0.474	0.475
			Limit	0.489	0.490	0.492	0.493	0.498	0.504	0.505	0.506	0.508
		1	200	0.049	0.072	0.091	0.113	0.182	0.241	0.256	0.270	0.283
			500	0.215	0.230	0.242	0.255	0.296	0.332	0.341	0.349	0.358
			1000	0.269	0.280	0.290	0.301	0.335	0.363	0.370	0.376	0.383
			Limit	0.304	0.316	0.324	0.336	0.375	0.414	0.425	0.434	0.446
		0.1	200	-0.155	-0.127	-0.107	-0.081	0.001	0.073	0.091	0.109	0.130
			500	-0.090	-0.074	-0.058	-0.043	0.008	0.055	0.067	0.079	0.091
			1000	-0.055	-0.044	-0.034	-0.025	0.011	0.044	0.054	0.062	0.071
			Limit	-0.013	-0.009	-0.005	0.000	0.014	0.030	0.034	0.039	0.043

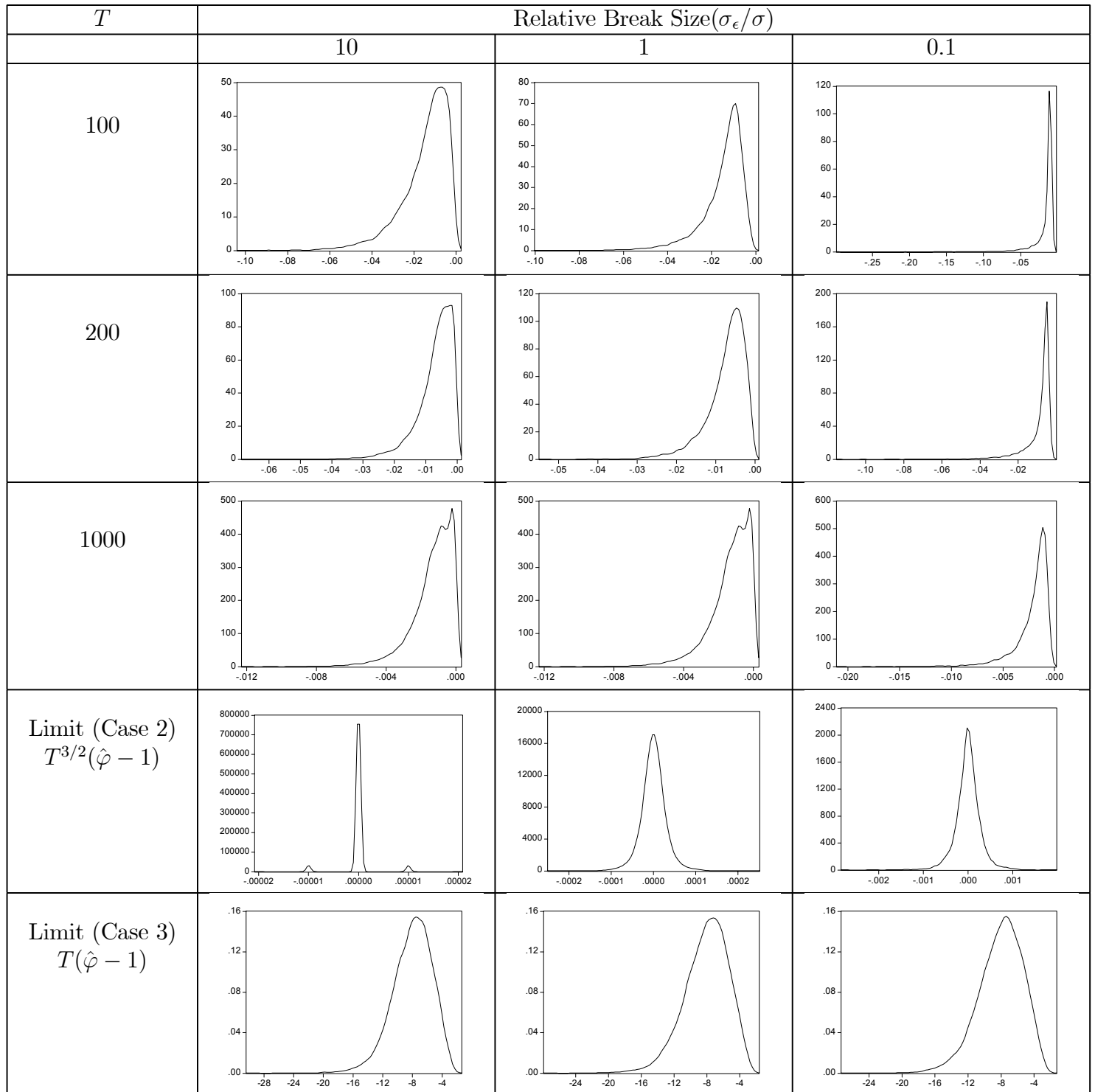
**B. The Effects of Structural Breaks in Mean for Different AR Parameters**

AR Parameter	Number of Breaks	Break Size	Total Number of Observations	Percentage Points of the Distributions									
				1%	2.50%	5%	10%	50%	90%	95%	97.50%	99%	
0.9	9	10	100	0.035	0.050	0.061	0.069	0.088	0.095	0.096	0.097	0.098	
			200	0.070	0.076	0.082	0.086	0.094	0.098	0.098	0.099	0.099	
			1000	0.094	0.096	0.097	0.097	0.099	0.100	0.100	0.100	0.100	
			Limit	0.097	0.098	0.098	0.099	0.100	0.101	0.102	0.102	0.103	
		1	100	-0.013	0.008	0.024	0.039	0.073	0.088	0.091	0.092	0.092	0.094
			200	0.033	0.047	0.056	0.065	0.083	0.092	0.094	0.094	0.095	0.096
			1000	0.065	0.073	0.078	0.082	0.092	0.096	0.097	0.097	0.097	0.098
			Limit	0.069	0.074	0.078	0.082	0.095	0.107	0.111	0.115	0.121	
		0.1	100	-0.175	-0.138	-0.112	-0.085	-0.011	0.035	0.045	0.052	0.059	
			200	-0.095	-0.077	-0.062	-0.046	0.001	0.034	0.042	0.047	0.053	
			1000	-0.028	-0.022	-0.016	-0.009	0.011	0.029	0.034	0.038	0.042	
			Limit	-0.028	-0.020	-0.012	-0.005	0.016	0.037	0.043	0.051	0.061	
0.5	9	10	100	0.355	0.383	0.400	0.418	0.457	0.478	0.482	0.485	0.488	
			200	0.425	0.439	0.449	0.458	0.478	0.488	0.490	0.492	0.493	
			1000	0.478	0.483	0.486	0.488	0.494	0.497	0.497	0.497	0.498	
			Limit	0.464	0.471	0.476	0.482	0.498	0.514	0.520	0.525	0.533	
		1	100	0.023	0.080	0.122	0.169	0.306	0.389	0.405	0.417	0.429	
			200	0.090	0.129	0.165	0.206	0.327	0.402	0.417	0.428	0.440	
			1000	0.134	0.171	0.203	0.238	0.343	0.412	0.427	0.438	0.448	
			Limit	0.119	0.174	0.211	0.252	0.375	0.497	0.543	0.584	0.638	
		0.1	100	-0.223	-0.186	-0.155	-0.119	0.002	0.106	0.132	0.154	0.177	
			200	-0.147	-0.123	-0.100	-0.076	0.006	0.082	0.102	0.119	0.139	
			1000	-0.056	-0.045	-0.036	-0.025	0.012	0.048	0.058	0.066	0.076	
			Limit	-0.081	-0.064	-0.048	-0.032	0.015	0.063	0.079	0.096	0.115	
0	9	10	100	0.641	0.702	0.751	0.791	0.884	0.937	0.948	0.955	0.965	
			200	0.786	0.828	0.854	0.879	0.935	0.964	0.970	0.974	0.978	
			1000	0.910	0.928	0.942	0.953	0.976	0.987	0.989	0.990	0.992	
			Limit	0.876	0.900	0.916	0.935	0.990	1.045	1.062	1.079	1.102	
		1	100	0.004	0.059	0.111	0.174	0.397	0.592	0.639	0.682	0.721	
			200	0.057	0.108	0.156	0.209	0.412	0.607	0.657	0.695	0.735	
			1000	0.104	0.143	0.181	0.230	0.429	0.619	0.662	0.702	0.743	
			Limit	-0.098	0.013	0.118	0.214	0.499	0.782	0.878	0.979	1.100	
		0.1	100	-0.218	-0.185	-0.156	-0.122	0.009	0.136	0.172	0.205	0.237	
			200	-0.156	-0.130	-0.107	-0.082	0.008	0.100	0.125	0.148	0.179	
			1000	-0.065	-0.054	-0.043	-0.031	0.009	0.050	0.061	0.072	0.085	
			Limit	-0.111	-0.088	-0.068	-0.047	0.010	0.066	0.085	0.102	0.128	
-0.5	9	10	100	0.685	0.798	0.885	0.976	1.189	1.323	1.350	1.372	1.394	
			200	0.936	1.035	1.101	1.160	1.308	1.392	1.408	1.420	1.432	
			1000	1.188	1.246	1.290	1.328	1.413	1.453	1.460	1.465	1.471	
			Limit	1.156	1.214	1.264	1.312	1.458	1.597	1.643	1.691	1.753	
		1	100	-0.036	0.004	0.042	0.091	0.297	0.548	0.626	0.692	0.759	
			200	0.013	0.044	0.077	0.117	0.304	0.536	0.613	0.668	0.752	
			1000	0.055	0.083	0.107	0.140	0.303	0.528	0.602	0.661	0.748	
			Limit	-0.390	-0.248	-0.128	0.003	0.371	0.735	0.858	0.971	1.114	
		0.1	100	-0.163	-0.136	-0.116	-0.089	0.015	0.135	0.171	0.203	0.241	
			200	-0.123	-0.104	-0.086	-0.066	0.009	0.093	0.117	0.141	0.169	
			1000	-0.055	-0.047	-0.039	-0.029	0.005	0.042	0.053	0.064	0.074	
			Limit	-0.098	-0.076	-0.060	-0.043	0.006	0.055	0.072	0.087	0.108	

**Figure 1 Kernel Densities of  $\hat{\varphi} - \phi$  for Various Number of Samples and Break Sizes In the Presence of Structural Breaks in Mean When  $\phi = 0.5$  and  $K - 1 = 9$**



**Figure 2 Kernel Densities of  $\hat{\varphi}-1$  for Various Number of Samples and Break Sizes In the Presence of Structural Breaks in Mean When  $K - 1 = 9$**



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**2005**

1. Shaun Bond and Soosung Hwang, Smoothing, Nonsynchronous Appraisal and Cross-Sectional Aggregation in Real Estate Price Indices, WP05-17



2. Mark Salmon, Gordon Gemmill and Soosung Hwang, Performance Measurement with Loss Aversion, WP05-16
3. Philippe Curty and Matteo Marsili, Phase coexistence in a forecasting game, WP05-15
4. Matthew Hurd, Mark Salmon and Christoph Schleicher, Using Copulas to Construct Bivariate Foreign Exchange Distributions with an Application to the Sterling Exchange Rate Index (Revised), WP05-14
5. Lucio Sarno, Daniel Thornton and Giorgio Valente, The Empirical Failure of the Expectations Hypothesis of the Term Structure of Bond Yields, WP05-13
6. Lucio Sarno, Ashoka Mody and Mark Taylor, A Cross-Country Financial Accelerator: Evidence from North America and Europe, WP05-12
7. Lucio Sarno, Towards a Solution to the Puzzles in Exchange Rate Economics: Where Do We Stand?, WP05-11
8. James Hodder and Jens Carsten Jackwerth, Incentive Contracts and Hedge Fund Management, WP05-10
9. James Hodder and Jens Carsten Jackwerth, Employee Stock Options: Much More Valuable Than You Thought, WP05-09
10. Gordon Gemmill, Soosung Hwang and Mark Salmon, Performance Measurement with Loss Aversion, WP05-08
11. George Constantinides, Jens Carsten Jackwerth and Stylianos Perrakis, Mispricing of S&P 500 Index Options, WP05-07
12. Elisa Luciano and Wim Schoutens, A Multivariate Jump-Driven Financial Asset Model, WP05-06
13. Cees Diks and Florian Wagener, Equivalence and bifurcations of finite order stochastic processes, WP05-05
14. Devraj Basu and Alexander Stremme, CAY Revisited: Can Optimal Scaling Resurrect the (C)CAPM?, WP05-04
15. Ginwestra Bianconi and Matteo Marsili, Emergence of large cliques in random scale-free networks, WP05-03
16. Simone Alfarano, Thomas Lux and Friedrich Wagner, Time-Variation of Higher Moments in a Financial Market with Heterogeneous Agents: An Analytical Approach, WP05-02
17. Abhay Abhayankar, Devraj Basu and Alexander Stremme, Portfolio Efficiency and Discount Factor Bounds with Conditioning Information: A Unified Approach, WP05-01

## **2004**

1. Xiaohong Chen, Yanqin Fan and Andrew Patton, Simple Tests for Models of Dependence Between Multiple Financial Time Series, with Applications to U.S. Equity Returns and Exchange Rates, WP04-19
2. Valentina Corradi and Walter Distaso, Testing for One-Factor Models versus Stochastic Volatility Models, WP04-18
3. Valentina Corradi and Walter Distaso, Estimating and Testing Stochastic Volatility Models using Realized Measures, WP04-17
4. Valentina Corradi and Norman Swanson, Predictive Density Accuracy Tests, WP04-16
5. Roel Oomen, Properties of Bias Corrected Realized Variance Under Alternative Sampling Schemes, WP04-15
6. Roel Oomen, Properties of Realized Variance for a Pure Jump Process: Calendar Time Sampling versus Business Time Sampling, WP04-14
7. Richard Clarida, Lucio Sarno, Mark Taylor and Giorgio Valente, The Role of Asymmetries and Regime Shifts in the Term Structure of Interest Rates, WP04-13
8. Lucio Sarno, Daniel Thornton and Giorgio Valente, Federal Funds Rate Prediction, WP04-12
9. Lucio Sarno and Giorgio Valente, Modeling and Forecasting Stock Returns: Exploiting the Futures Market, Regime Shifts and International Spillovers, WP04-11
10. Lucio Sarno and Giorgio Valente, Empirical Exchange Rate Models and Currency Risk: Some Evidence from Density Forecasts, WP04-10
11. Ilias Tsiakas, Periodic Stochastic Volatility and Fat Tails, WP04-09
12. Ilias Tsiakas, Is Seasonal Heteroscedasticity Real? An International Perspective, WP04-08
13. Damin Challet, Andrea De Martino, Matteo Marsili and Isaac Castillo, Minority games with finite score memory, WP04-07
14. Basel Awartani, Valentina Corradi and Walter Distaso, Testing and Modelling Market Microstructure Effects with an Application to the Dow Jones Industrial Average, WP04-06

15. Andrew Patton and Allan Timmermann, Properties of Optimal Forecasts under Asymmetric Loss and Nonlinearity, WP04-05
16. Andrew Patton, Modelling Asymmetric Exchange Rate Dependence, WP04-04
17. Alessio Sancetta, Decoupling and Convergence to Independence with Applications to Functional Limit Theorems, WP04-03
18. Alessio Sancetta, Copula Based Monte Carlo Integration in Financial Problems, WP04-02
19. Abhay Abhayankar, Lucio Sarno and Giorgio Valente, Exchange Rates and Fundamentals: Evidence on the Economic Value of Predictability, WP04-01

## **2002**

1. Paolo Zaffaroni, Gaussian inference on Certain Long-Range Dependent Volatility Models, WP02-12
2. Paolo Zaffaroni, Aggregation and Memory of Models of Changing Volatility, WP02-11
3. Jerry Coakley, Ana-Maria Fuertes and Andrew Wood, Reinterpreting the Real Exchange Rate - Yield Differential Nexus, WP02-10
4. Gordon Gemmill and Dylan Thomas, Noise Training, Costly Arbitrage and Asset Prices: evidence from closed-end funds, WP02-09
5. Gordon Gemmill, Testing Merton's Model for Credit Spreads on Zero-Coupon Bonds, WP02-08
6. George Christodoulakis and Steve Satchell, On the Evolution of Global Style Factors in the MSCI Universe of Assets, WP02-07
7. George Christodoulakis, Sharp Style Analysis in the MSCI Sector Portfolios: A Monte Carlo Integration Approach, WP02-06
8. George Christodoulakis, Generating Composite Volatility Forecasts with Random Factor Betas, WP02-05
9. Claudia Riveiro and Nick Webber, Valuing Path Dependent Options in the Variance-Gamma Model by Monte Carlo with a Gamma Bridge, WP02-04
10. Christian Pedersen and Soosung Hwang, On Empirical Risk Measurement with Asymmetric Returns Data, WP02-03
11. Roy Batchelor and Ismail Orgakcioglu, Event-related GARCH: the impact of stock dividends in Turkey, WP02-02
12. George Albanis and Roy Batchelor, Combining Heterogeneous Classifiers for Stock Selection, WP02-01

## **2001**

1. Soosung Hwang and Steve Satchell, GARCH Model with Cross-sectional Volatility; GARCHX Models, WP01-16
2. Soosung Hwang and Steve Satchell, Tracking Error: Ex-Ante versus Ex-Post Measures, WP01-15
3. Soosung Hwang and Steve Satchell, The Asset Allocation Decision in a Loss Aversion World, WP01-14
4. Soosung Hwang and Mark Salmon, An Analysis of Performance Measures Using Copulae, WP01-13
5. Soosung Hwang and Mark Salmon, A New Measure of Herding and Empirical Evidence, WP01-12
6. Richard Lewin and Steve Satchell, The Derivation of New Model of Equity Duration, WP01-11
7. Massimiliano Marcellino and Mark Salmon, Robust Decision Theory and the Lucas Critique, WP01-10
8. Jerry Coakley, Ana-Maria Fuertes and Maria-Teresa Perez, Numerical Issues in Threshold Autoregressive Modelling of Time Series, WP01-09
9. Jerry Coakley, Ana-Maria Fuertes and Ron Smith, Small Sample Properties of Panel Time-series Estimators with I(1) Errors, WP01-08
10. Jerry Coakley and Ana-Maria Fuertes, The Felsdtein-Horioka Puzzle is Not as Bad as You Think, WP01-07
11. Jerry Coakley and Ana-Maria Fuertes, Rethinking the Forward Premium Puzzle in a Non-linear Framework, WP01-06
12. George Christodoulakis, Co-Volatility and Correlation Clustering: A Multivariate Correlated ARCH Framework, WP01-05

13. Frank Critchley, Paul Marriott and Mark Salmon, On Preferred Point Geometry in Statistics, WP01-04
14. Eric Bouyé and Nicolas Gaussel and Mark Salmon, Investigating Dynamic Dependence Using Copulae, WP01-03
15. Eric Bouyé, Multivariate Extremes at Work for Portfolio Risk Measurement, WP01-02
16. Erick Bouyé, Vado Durrleman, Ashkan Nikeghbali, Gael Riboulet and Thierry Roncalli, Copulas: an Open Field for Risk Management, WP01-01

## **2000**

1. Soosung Hwang and Steve Satchell, Valuing Information Using Utility Functions, WP00-06
2. Soosung Hwang, Properties of Cross-sectional Volatility, WP00-05
3. Soosung Hwang and Steve Satchell, Calculating the Miss-specification in Beta from Using a Proxy for the Market Portfolio, WP00-04
4. Laun Middleton and Stephen Satchell, Deriving the APT when the Number of Factors is Unknown, WP00-03
5. George A. Christodoulakis and Steve Satchell, Evolving Systems of Financial Returns: Auto-Regressive Conditional Beta, WP00-02
6. Christian S. Pedersen and Stephen Satchell, Evaluating the Performance of Nearest Neighbour Algorithms when Forecasting US Industry Returns, WP00-01

## **1999**

1. Yin-Wong Cheung, Menzie Chinn and Ian Marsh, How do UK-Based Foreign Exchange Dealers Think Their Market Operates?, WP99-21
2. Soosung Hwang, John Knight and Stephen Satchell, Forecasting Volatility using LINEX Loss Functions, WP99-20
3. Soosung Hwang and Steve Satchell, Improved Testing for the Efficiency of Asset Pricing Theories in Linear Factor Models, WP99-19
4. Soosung Hwang and Stephen Satchell, The Disappearance of Style in the US Equity Market, WP99-18
5. Soosung Hwang and Stephen Satchell, Modelling Emerging Market Risk Premia Using Higher Moments, WP99-17
6. Soosung Hwang and Stephen Satchell, Market Risk and the Concept of Fundamental Volatility: Measuring Volatility Across Asset and Derivative Markets and Testing for the Impact of Derivatives Markets on Financial Markets, WP99-16
7. Soosung Hwang, The Effects of Systematic Sampling and Temporal Aggregation on Discrete Time Long Memory Processes and their Finite Sample Properties, WP99-15
8. Ronald MacDonald and Ian Marsh, Currency Spillovers and Tri-Polarity: a Simultaneous Model of the US Dollar, German Mark and Japanese Yen, WP99-14
9. Robert Hillman, Forecasting Inflation with a Non-linear Output Gap Model, WP99-13
10. Robert Hillman and Mark Salmon, From Market Micro-structure to Macro Fundamentals: is there Predictability in the Dollar-Deutsche Mark Exchange Rate?, WP99-12
11. Renzo Avesani, Giampiero Gallo and Mark Salmon, On the Evolution of Credibility and Flexible Exchange Rate Target Zones, WP99-11
12. Paul Marriott and Mark Salmon, An Introduction to Differential Geometry in Econometrics, WP99-10
13. Mark Dixon, Anthony Ledford and Paul Marriott, Finite Sample Inference for Extreme Value Distributions, WP99-09
14. Ian Marsh and David Power, A Panel-Based Investigation into the Relationship Between Stock Prices and Dividends, WP99-08
15. Ian Marsh, An Analysis of the Performance of European Foreign Exchange Forecasters, WP99-07
16. Frank Critchley, Paul Marriott and Mark Salmon, An Elementary Account of Amari's Expected Geometry, WP99-06
17. Demos Tambakis and Anne-Sophie Van Royen, Bootstrap Predictability of Daily Exchange Rates in ARMA Models, WP99-05
18. Christopher Neely and Paul Weller, Technical Analysis and Central Bank Intervention, WP99-04
19. Christopher Neely and Paul Weller, Predictability in International Asset Returns: A Re-examination, WP99-03

20. Christopher Neely and Paul Weller, Intraday Technical Trading in the Foreign Exchange Market, WP99-02
21. Anthony Hall, Soosung Hwang and Stephen Satchell, Using Bayesian Variable Selection Methods to Choose Style Factors in Global Stock Return Models, WP99-01

**1998**

1. Soosung Hwang and Stephen Satchell, Implied Volatility Forecasting: A Comparison of Different Procedures Including Fractionally Integrated Models with Applications to UK Equity Options, WP98-05
2. Roy Batchelor and David Peel, Rationality Testing under Asymmetric Loss, WP98-04
3. Roy Batchelor, Forecasting T-Bill Yields: Accuracy versus Profitability, WP98-03
4. Adam Kurpiel and Thierry Roncalli, Option Hedging with Stochastic Volatility, WP98-02
5. Adam Kurpiel and Thierry Roncalli, Hopscotch Methods for Two State Financial Models, WP98-01