

# EFFICIENT AND POSITIVE SEMIDEFINITE PRE-AVERAGING REALIZED COVARIANCE ESTIMATOR

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*Abstract:* We propose a realized-covariance estimator based on efficient multiple pre-averaging (EMP) for asynchronous and noisy high-frequency data. The EMP estimator is consistent, guaranteed to be positive-semidefinite, and achieves the optimal convergence rate at  $n^{-1/4}$ . It is constructed based on 1) an innovative synchronizing technique that uses all available price information, and 2) an eigenvalue correction method that ensures positive-semidefiniteness without sacrificing the optimal convergence rate. A simulation study demonstrates the good performance of the EMP estimator for finite samples in terms of accuracy, properties, and convergence rate. In a real-data analysis, the EMP covariance estimator delivers performance that is more stable than that of alternative estimators. The new estimator also outperforms alternative realized-covariance estimators in terms of portfolio selection.

*Key words and phrases:* Asynchronous and noisy high-frequency data, eigenvalue correction, synchronizing technique.

## 1. Introduction

Covariance plays an important role in portfolio allocation, derivative pricing, hedging, risk management, and many other modern financial applications. As a result, estimating the covariance has been of great interest to academics and industry practitioners alike. In particular, the realized covariance, a model-free estimator, has attracted attention owing to the availability of large-scale intradaily data sampled at second, millisecond, or even nanosecond frequency. A realized covariance is quantified as a quadratic variation of high-frequency data. It is theoretically consistent (Andersen and Bollerslev (1998); Barndorff-Nielsen and Shephard (2002a,b); Andersen et al. (2003)) and demonstrates good accuracy in numerous applications (French, Schwert and Stambaugh (1987); Andersen and Bollerslev (1998); Andersen et al. (2001)).

However, a direct calculation of the realized covariance from high-frequency

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raw data is inconsistent owing to the existence of asynchronous trading and microstructure noise. Thus, various synchronizing techniques are used to pre-process asynchronous raw data. The most common approaches are the previous tick technique (Wasserfallen and Zimmermann (1985); Dacorogna et al. (2001)) and the refresh time technique (Barndorff-Nielsen et al. (2008); Hautsch, Kyj and Oomen (2012); Aït-Sahalia, Fan and Xiu (2010)). However, the former may distort the dependence between multiple price processes in the raw data, and the latter may lead to low sample sizes if one or more assets are illiquid. Christensen, Podolskij and Vetter (2013) used the approach of Hayashi and Yoshida, which depends on selecting a smoothing parameter. Corsi, Peluso and Audrino (2015) and Shephard and Xiu (2017) proposed the Kalman filter technique, which assumes a Gaussian distribution. Note that no existing techniques consider intrinsic data features (e.g., negative serial correlation).

Microstructure noise hinders the synchronizing process. Bias correction thus becomes necessary, yet often at the cost of efficiency. Some important contributions to this problem include, but are not limited to, the multivariate scaled estimator (Zhang (2011); Wang and Zou (2010); Zhang, Mykland and Aït-Sahalia (2005)), multivariate realized kernel estimator (Barndorff-Nielsen et al. (2011, 2008); Zhou (1996); Hansen and Lunde (2006)), and quasi-maximum likelihood realized-covariance estimator (QMLE, Aït-Sahalia, Fan and Xiu (2010); Xiu (2010)). The multiple pre-averaging (MPA) estimator removes noise using a pre-averaging procedure; see Christensen, Kinnebrock and Podolskij (2010) and Jacod et al. (2009). While the QMLE and MPA estimators are  $n^{-1/4}$ -consistent, where  $n^{-1/4}$  is the optimal convergence rate, the other two are suboptimal, at  $\mathcal{O}_p(n^{-1/6})$  and  $\mathcal{O}_p(n^{-1/5})$ , respectively. Shephard and Xiu (2017) developed a multivariate realized quasi-maximum likelihood estimator based on synchronized observations that is positive-definite,  $n^{-1/4}$ -consistent, and asymptotically mixed-normal.

Bias correction approaches can introduce negative covariance estimators. The negative eigenvalues, though small in magnitude, may change the stochastic behavior of the covariance estimator, and in some cases, even its consistency. The MPA estimator, for instance, is not guaranteed to be positive-semidefinite. To enforce the right properties, the convergence rate becomes suboptimal. Several eigenvalue correction approaches have been proposed. One can replace negative eigenvalues with small positive values (McNeil, Frey and Embrechts (2005); Schaeffer (2014)) or zeros (Rebonato and Jäckel (2011)). Varneskov (2011) proposed an eigenvalue truncation procedure, showing that the correction was asymptotically negligible. Ikeda (2016) presented a Cholesky-type correction without altering the asymptotic distribution of the two-scale realized-kernel estimator.

In our study, we propose a realized-covariance estimator based on efficient multiple pre-averaging (EMP) that is consistent, positive-semidefinite, and simultaneously achieves the optimal  $n^{-1/4}$  convergence rate. The EMP estimator benefits from two innovative approaches. We develop a synchronizing technique called high-frequency filtering (HFF) to recover the “missing” records of high-frequency data by learning from the dependence of the same price processes that are synchronously sampled at a low frequency. Given a prior (realized) covariance estimator and the negative autocorrelation, the “unobserved” records in the asynchronous data are iteratively filtered. We also present an eigenvalue correction method for a consistent, yet negative realized covariance estimator. Here, negative eigenvalues with small magnitudes are replaced with their absolute values to enforce the positive-semidefiniteness of the estimator. We describe the convergence properties of the filtered high-frequency synchronous series. We show that the corrected realized-covariance estimator has the same limiting distribution as the consistent, but negative-semidefinite realized-covariance estimator with the optimal convergence rate. Both approaches are model-free in that they require neither distributional assumptions nor tuning parameters. The approaches are general, and can be used for any type of covariance and correlation estimator.

The remainder of this paper is organized as follows. Section 2 describes the model setting. Section 3 presents the EMP realized-covariance estimator. Here, we discuss the HFF technique and eigenvalue correction method and provide the asymptotic results. We demonstrate the finite-sample performance of the EMP estimator using an extensive simulation study in Section 4. An empirical data analysis is conducted in Section 5. Section 6 provides concluding remarks. All theoretical proofs are contained in the online Supplementary Material.

## 2. Model Setup

Consider  $p$  assets traded over a time interval  $t \in [0, 1]$ . The efficient log prices  $\mathbf{X}_t \in \mathbb{R}^p$  are assumed to follow the Brownian semimartingale model,

$$d\mathbf{X}_t = \boldsymbol{\mu}_t dt + \boldsymbol{\sigma}_t^\top d\mathbf{B}_t, \quad t \in [0, 1], \quad (2.1)$$

where  $\boldsymbol{\mu}_t = (\mu_{1t}, \dots, \mu_{pt})^\top$  is the drift vector of the multiple assets,  $\mathbf{B}_t = (B_{1t}, \dots, B_{pt})^\top$  is a standard  $p$ -dimensional Brownian motion,  $\boldsymbol{\sigma}_t$  is a  $p \times p$  matrix, and the symbol  $\top$  represents the Hermitian transpose. The quadratic variation of  $\mathbf{X}_t$  is given by:

$$[\mathbf{X}, \mathbf{X}]_t = \int_0^t \Sigma_u du = \int_0^t \boldsymbol{\sigma}_u^\top \boldsymbol{\sigma}_u du. \quad (2.2)$$

The integrated volatility matrix, denoted by  $\Sigma$ , is defined as

$$\Sigma \equiv \int_0^1 \Sigma_u du = \int_0^1 \boldsymbol{\sigma}_u^\top \boldsymbol{\sigma}_u du. \tag{2.3}$$

Our goal is to estimate the integrated volatility matrix  $\Sigma$ , given asynchronous and noisy data traded at high frequency.

The synchronous log prices  $Y_{t_j} \in \mathbb{R}^p$  at discrete and regular time points  $t_j = j/n$ , for  $j = 0, \dots, n$ , are assumed to follow the continuous diffusion model with additive noise,

$$\mathbf{Y}_{t_j} = \mathbf{X}_{t_j} + \boldsymbol{\epsilon}_{t_j}, \tag{2.4}$$

where  $\mathbf{X}_{t_j} = (X_{1,t_j}, \dots, X_{p,t_j})^\top$  denotes the efficient noise-free log prices, and  $\boldsymbol{\epsilon}_{t_j}$  is an independent and identically distributed (i.i.d.) microstructure noise with zero mean and finite variance  $E(\boldsymbol{\epsilon}_{t_j} \boldsymbol{\epsilon}_{t_j}^\top) = \text{diag}\{\eta_1^2, \dots, \eta_p^2\}$ . Furthermore,  $\mathbf{X}_{t_j}$  are assumed to be mutually independent with  $\boldsymbol{\epsilon}_{t_j}$ .

Given the return series  $R_{i,t_j} = Y_{i,t_j} - Y_{i,t_{j-1}}$ , it is easy to show that there is negative lag-1 autocorrelation

$$\begin{aligned} & \frac{\text{Cov}(R_{i,t_{j-1}}, R_{i,t_j})}{\sqrt{\text{Var}(R_{i,t_{j-1}})\text{Var}(R_{i,t_j})}} \\ &= \frac{-\eta_i^2}{\sqrt{\left((1/n)E \int_{t_{j-2}}^{t_{j-1}} \Sigma_{ii,u} du + 2\eta_i^2\right) \left((1/n)E \int_{t_{j-1}}^{t_j} \Sigma_{ii,u} du + 2\eta_i^2\right)}} \\ &\approx -0.5, \quad i = 1, \dots, p, \quad j = 2, \dots, n, \end{aligned} \tag{2.5}$$

where  $\Sigma_{ii,u}$  denotes the  $(i, i)$ -component of  $\Sigma_u$  in (2.2).

Given synchronous data, the MPA estimator (Christensen, Kinnebrock and Podolskij (2010)), denoted as  $S_1$ , is computed as follows:

$$S_1 = \frac{n}{n - k_n + 2} \frac{12}{k_n} \sum_{j=0}^{n-k_n+1} \bar{\mathbf{Y}}_{t_j}^n (\bar{\mathbf{Y}}_{t_j}^n)^\top - \frac{12}{2n\theta^2} \sum_{j=1}^n (\mathbf{Y}_{t_j} - \mathbf{Y}_{t_{j-1}})(\mathbf{Y}_{t_j} - \mathbf{Y}_{t_{j-1}})^\top, \tag{2.6}$$

where  $\bar{\mathbf{Y}}_{t_j}^n = (1/k_n) \left( \sum_{\ell=k_n/2}^{k_n-1} \mathbf{Y}_{t_{j+\ell}} - \sum_{\ell=0}^{k_n/2} \mathbf{Y}_{t_{j+\ell}} \right)$ ,  $k_n = \lfloor \theta \sqrt{n} \rfloor$  with a given constant  $\theta > 0$ , and the last term of (2.6) is a bias correction term. The MPA estimator is an unbiased estimator of  $\Sigma$  with convergence rate  $\mathcal{O}_p(n^{-1/4})$ , yet it is not guaranteed to be positive-semidefinite. By taking  $k_n = \lfloor \theta n^{0.6} \rfloor$ , the bias correction term can be ignored and the estimator becomes positive-semidefinite. In this case, the convergence rate reduces to  $\mathcal{O}_p(n^{-1/5})$ .

In practice, the observed log prices are irregularly spaced. We define an information set  $\mathcal{F}$  to record the time points with observed transactions:

$$\mathcal{F} = \{t_{ij} | Y_{i,t_{ij}} \text{ is available at } t_j, i = 1, \dots, p, j = 0, \dots, n\},$$

where  $t_{ij}$  represents the time point when the  $i$ th asset is traded at time  $t_j$ ; that is, the log price  $Y_{i,t_{ij}}$  is observable. If  $t_{ij} \notin \mathcal{F}$ , then there is no transaction of the  $i$ th asset at time  $t_j$ . In this case, the corresponding log price  $Y_{i,t_j}$  is considered a “missing” value.

### 3. Main Results

We now present the EMP realized-covariance estimator under two scenarios. For synchronous yet noisy data, we extend the Christensen, Kinnebrock and Podolskij (2010) MPA estimator by introducing a general eigenvalue correction method in Section 3.1. We show that the correction method ensures positive semidefiniteness without damaging the consistency or the asymptotic limiting distribution of the realized-covariance estimator. For asynchronous and noisy data, we show how to use the HFF technique to generate high-frequency synchronous data by retaining the original cross-dependence. The HFF synchronizing technique and its convergence are discussed in Section 3.2.

#### 3.1. The eigenvalue correction

Suppose an integrated covariance estimator, denoted as  $S_1$ , is available. Although  $\Sigma$  is a positive-semidefinite matrix with  $\Sigma \geq 0$  or a positive-definite matrix with  $\Sigma > 0$ , the estimator  $S_1$  may not satisfy  $S_1 \geq 0$  or  $S_1 > 0$  owing to, for example, a bias-correction approach. We propose a general approach to construct a nonnegative-definite estimator  $S$  that has the same convergence rate and limiting distribution as the preliminary estimator  $S_1$ .

Denote the spectral decompositions of  $S_1$  and  $\Sigma$  by

$$S_1 = U\hat{\Lambda}U^* = \sum_{i=1}^p \hat{\lambda}_i \mathbf{u}_i \mathbf{u}_i^*, \quad \Sigma = V\Lambda V^* = \sum_{i=1}^p \lambda_i \mathbf{v}_i \mathbf{v}_i^*, \tag{3.1}$$

where  $\hat{\lambda}$  and  $\lambda$  are the eigenvalues of  $S_1$  and  $\Sigma$ , respectively, and  $\mathbf{u}_i$  and  $\mathbf{v}_i$  are the orthonormal eigenvectors associated with  $\hat{\lambda}_i$  and  $\lambda_i$ , respectively, for all  $i$ . Set all eigenvalues  $\hat{\lambda}_i$  to  $|\hat{\lambda}_i|$ , for  $i = 1, \dots, p$ . The proposed eigenvalue correction, denoted by  $S$ , is performed as

$$S = U|\hat{\Lambda}|U^*, \tag{3.2}$$

where  $|\hat{\Lambda}| = \text{diag}(|\hat{\lambda}_1|, \dots, |\hat{\lambda}_p|)$ . Theorem 1 shows that the estimator  $S$  is consistent if the preliminary estimator  $S_1$  is consistent. The asymptotic distribution of  $S$  is derived in Theorem 2, which proves that the estimator has the same asymptotic limiting distribution as that of  $S_1$ .

**Theorem 1.** *Suppose  $\Sigma \geq 0$  and the maximum eigenvalue of  $\Sigma$ , denoted by  $\lambda_{max}$ , is bounded. Let  $S_1$  be a symmetric matrix satisfying*

$$S_1 - \Sigma \xrightarrow{P} 0. \quad (3.3)$$

*Then,  $S$  (cf. (3.2)) is a consistent estimator of  $\Sigma$ ; that is,*

$$S - \Sigma \xrightarrow{P} 0.$$

When reinforcing the condition on  $\Sigma$ , we conclude that  $S$  and  $S_1$  have the same limiting distribution, as shown in the following theorem.

**Theorem 2.** *Suppose  $\Sigma > 0$  and  $|\lambda_{max}|$  is bounded. Let  $S_1$  be a symmetric matrix satisfying*

$$\alpha_n(S_1 - \Sigma) \xrightarrow{d} Z, \quad (3.4)$$

*where  $\alpha_n \rightarrow \infty$  as  $n \rightarrow \infty$ . Then,*

$$\alpha_n(S - \Sigma) \xrightarrow{d} Z.$$

**Remark 1.** We choose the MPA as the preliminary estimator  $S_1$ . It has an optimal convergence rate  $\mathcal{O}_p(n^{-1/4})$ , but is not guaranteed to be positive semidefinite (see Christensen, Kinnebrock and Podolskij (2010)). After the eigenvalue correction procedure, the corrected estimator  $S$  has the same optimal convergence rate.

**Remark 2.** Rebonato and Jäckel (2011) suggested replacing the negative eigenvalues with zeros, whereas McNeil, Frey and Embrechts (2005) suggested replacing the negative eigenvalues with small positive numbers. We perform simulations to investigate the numerical performance of our alternative eigenvalue correction approach. We find that the proposed approach improves the relative accuracy of the smallest eigenvalues of the methods of Rebonato and Jäckel (2011) and McNeil, Frey and Embrechts (2005) by 43% and 67%, respectively; see Section S2.1 of the Supplementary Material.

### 3.2. Synchronization

For asynchronous data with noise, we employ the HFF synchronizing technique to preprocess the data. The role of HFF is to recover/estimate missing

observations in a sequence of synchronous filters obtained by eigendecomposing the covariance matrix of the lower-frequency sample.

Let  $S_0$  be a covariance estimator of the noisy data. Usually,  $S_0$  is a quadratic variation of the synchronized, yet low-frequency data. As a result of microstructure noise, the estimator is biased and eventually outputs the sum of the integrated covariance matrix  $\Sigma$  and the microstructure noise variance  $\Psi$ . Perform a spectral decomposition on  $S_0$ :

$$S_0 = \Gamma A \Gamma^\top = \sum_{i=1}^p a_i \gamma_i \gamma_i^\top, \tag{3.5}$$

where  $A$  is a diagonal matrix with eigenvalues  $a_i$  on the diagonal, and  $\Gamma$  is a matrix of orthonormal eigenvectors.

Assume there exists a linear filter  $\mathbf{Z}_{t_j}^{(0)} = (Z_{1t_j}^{(0)}, \dots, Z_{pt_j}^{(0)})^\top$  that is a projection of the unobserved synchronous log returns  $\mathbf{R}_{t_j} = \mathbf{Y}_{t_j} - \mathbf{Y}_{t_{j-1}}$ :

$$\mathbf{R}_{t_j} = \Gamma^\top \mathbf{Z}_{t_j}^{(0)}, \quad t_j = \frac{j}{n}, \quad j = 1, \dots, n. \tag{3.6}$$

The linear filter is synchronous and retains the dependence information in the return processes.

Without loss of generality, we assume that the initial value of each asset  $Y_{i,t_0}$  exists, for  $i = 1, \dots, p$ . Denote the synchronous, yet noisy log prices as  $\hat{\mathbf{Y}}_{t_j} = (\hat{Y}_{1t_j}, \dots, \hat{Y}_{pt_j})^\top$ , for  $j = 0, \dots, n$ . We set  $\hat{\mathbf{Y}}_{t_0} = \mathbf{Y}_{t_0}$ . Starting from time  $t_1$ , the HFF technique iteratively recovers the missing values by minimizing the squared prediction error. At any time  $t_j$ , when the previous log prices  $\hat{\mathbf{Y}}_{t_{j-1}}$  are known, we have the log returns  $\hat{R}_{i,t_{ij}} = Y_{i,t_{ij}} - \hat{Y}_{i,t_{j-1}}$ . For any  $t_{ij} \notin \mathcal{F}$ , we evaluate  $\hat{Z}_{t_j}$  using the minimizers

$$\begin{aligned} \hat{Z}_{t_j} = \operatorname{argmin}_{\mathbf{Z}_{t_j}} \sum_{i=1}^p \left[ \left( \hat{R}_{i,t_{ij}} - \hat{\gamma}_i^\top \mathbf{Z}_{t_j} \right)^2 I\{t_{ij} \in \mathcal{F}\} \right] \\ + \delta_n \left( \mathbf{Z}_{t_j} + 0.5 \hat{\mathbf{Z}}_{t_{j-1}} \right)^\top \hat{A}^{-1} \left( \mathbf{Z}_{t_j} + 0.5 \hat{\mathbf{Z}}_{t_{j-1}} \right), \end{aligned} \tag{3.7}$$

where the first part of (3.7) focuses on the projection errors. As such, the filtered series are disciplined by the eigendecomposition of  $S_0$ , and retain the stability of the cross-dependence structure. Owing to asynchrony, an optimization of the prediction error alone does not produce a unique solution. Thus, a smoothing penalty (i.e., the second part of (3.7)) is introduced that links the estimated filter with the previous (known) values. We standardize the filtered series using

its own variance, the eigenvalues of  $\hat{A}$ . This penalty selection not only ensures the continuity of the filtering procedure, but also incorporates the first-order autocorrelation in the noisy data. The tuning parameter  $\delta_n$  controls the level of smoothness of the filtered series. While large values of  $\delta_n$  lead to over-smoothing, small values may create an unnecessarily rough process. Cross-validation is used to select the optimal value of  $\delta_n$ . It turns out that its order is proportional to the inverse of the eigenvalues. Finally, the filtered log price is obtained using  $\hat{\mathbf{Y}}_{t_j} = \hat{\Gamma}^\top \hat{\mathbf{Z}}_{t_j} + \hat{\mathbf{Y}}_{t_{j-1}}$ , where  $\hat{\Gamma} = (\hat{\gamma}_1, \dots, \hat{\gamma}_p)$  and  $\hat{A} = \text{diag}\{\hat{a}_1, \dots, \hat{a}_p\}$  are the eigenvectors and eigenvalues, respectively, of the estimator  $S_0$ . If the assets are not all traded at time  $t_j$ , there is no benefit to using the dependence across assets rather than the previous tick technique. We set  $\hat{\mathbf{Y}}_{t_j} = \hat{\mathbf{Y}}_{t_{j-1}}$ .

The formal algorithm of the HFF technique is presented as follows: Set  $j = 1$ . Let  $\hat{\mathbf{Z}}_{t_0} = \mathbf{0}_p$ , and we have  $\hat{S} = \hat{\Gamma} \hat{A} \hat{\Gamma}^\top$ .

1. If  $t_{ij} \notin \mathcal{F}$ , for all  $i = 1, \dots, p$ , set  $\hat{\mathbf{Y}}_{t_j} = \hat{\mathbf{Y}}_{t_{j-1}}$  and jump to step 4.
2. If  $t_{ij} \in \mathcal{F}$ , with at least one  $i = 1, \dots, p$ , compute the log return  $\hat{R}_{i,t_{ij}} = Y_{i,t_{ij}} - \hat{Y}_{i,t_{j-1}}$ , for every  $i$  satisfying  $t_{ij} \in \mathcal{F}$ .
3. Obtain the linear filter  $\hat{\mathbf{Z}}_{t_j}$  that minimizes the objective function (3.7). We have  $\hat{\mathbf{Y}}_{t_j} = \hat{\Gamma}^\top \hat{\mathbf{Z}}_{t_j} + \hat{\mathbf{Y}}_{t_{j-1}}$ .
4. Stop when  $j = n$ ; otherwise, set  $j = j + 1$  and return to step 1.

Next, we investigate the convergence of the proposed filtering technique.

**Theorem 3.** *Assume that  $\hat{S} - S_0 = O_p(n^{-1/4})$ . Then, for all  $j = 1, 2, \dots, n$ , we have*

$$\|\hat{\mathbf{Z}}_{t_j} - \mathbf{Z}_{t_j}^{(0)}\| = O_p(n^{-1/4}) + O(\delta_n) + O(m_j), \tag{3.8}$$

where  $m_j$  represents the number of missing values of  $Y_{i,t_j}$  at time  $t_j$ . Moreover,

$$\frac{1}{n} \sum_{j=1}^n \|\hat{\mathbf{Z}}_{t_j} - \mathbf{Z}_{t_j}^{(0)}\| = O_p(n^{-1/4})$$

if  $\delta_n = O(n^{-1/4})$  and  $n^{-1} \sum_{j=1}^n m_j = O(n^{-1/4})$ .

### 3.3. The efficient and positive-semidefinite pre-averaging estimator

Given the synchronized high-frequency data  $\hat{\mathbf{Y}}_{t_j}$  from Section 3.2, the pre-averaging estimator is computed and denoted as  $S_1$ ; see Section 3.1:



$$S_1 = \frac{n}{n - k_n + 2} \frac{12}{k_n} \sum_{j=0}^{n-k_n+1} \bar{\mathbf{Y}}_{t_j}^n (\bar{\mathbf{Y}}_{t_j}^n)^\top - \frac{12}{2n\theta^2} \sum_{j=1}^n (\hat{\mathbf{Y}}_{t_j} - \hat{\mathbf{Y}}_{t_{j-1}})(\hat{\mathbf{Y}}_{t_j} - \hat{\mathbf{Y}}_{t_{j-1}})^\top, \tag{3.9}$$

where  $\bar{\mathbf{Y}}_{t_j}^n = (1/k_n) \left( \sum_{\ell=k_n/2}^{k_n-1} \hat{\mathbf{Y}}_{t_{j+\ell}} - \sum_{\ell=0}^{k_n/2} \hat{\mathbf{Y}}_{t_{j+\ell}} \right)$  and  $k_n = \lfloor \theta \sqrt{n} \rfloor$ , with a given constant  $\theta > 0$ . It is unbiased, but not guaranteed to be positive-semidefinite. Decompose  $S_1$  as in (3.1), and take the absolute value of the eigenvalues. We obtain the efficient and positive-semidefinite pre-averaging estimator  $S$  in (3.2), which we refer to as the efficient multiple pre-averaging (EMP) estimator. We show that the EMP estimator is consistent with the optimal convergence rate at  $\mathcal{O}_p(n^{-1/4})$  in Theorem 4 of the Appendix, with two additional assumptions.

#### 4. Simulation Study

In this section, we run a series of simulations to investigate the performance of the proposed EMP estimator. Then, we compare this performance with that of the following two popular alternative estimators:

- MPA: multiple pre-averaging estimator with the synchronizing technique of Hayashi and Yoshida, proposed by Christensen, Kinnebrock and Podolskij (2010) (cf. (2.6));
- MK: kernel estimator with the refresh time synchronization technique, proposed by Barndorff-Nielsen et al. (2011).

Moreover, given that the MPA showed the best performance in a previous analysis, we investigate the individual effects of the components of the EMP estimator in the MPA framework, namely the proposed eigenvalue correction approach (MPA-E), HFF technique (MPA-H), and negative first-order autocorrelation (MPA-N).

- MPA-E: MPA estimator with only the proposed eigenvalue correction;
- MPA-H: MPA estimator with only the HFF technique;
- MPA-N: MPA estimator with the proposed eigenvalue correction and HFF approach, but excluding the negative first-order autocorrelation.

In other words, MPA-N is the same as EMP, except that the high-frequency filtration is performed by minimizing the following function:

$$\hat{\mathbf{Z}}_{t_j} = \underset{\mathbf{Z}_{t_j}}{\operatorname{argmin}} \sum_{i=1}^p \left[ \left( \hat{R}_{i,t_{ij}} - \hat{\gamma}_i^\top \mathbf{Z}_{t_j} \right)^2 I\{t_{ij} \in \mathcal{F}\} \right] + \delta_n \mathbf{Z}_{t_j}^\top \hat{A}^{-1} \mathbf{Z}_{t_j}.$$

By comparing MPA-N and EMP, we can determine how the HFF technique improves the estimation of the covariance matrices by incorporating the empirical feature of the negative first-order autocorrelation.

We generate noisy and asynchronous processes under various scenarios with dimensions  $p = 5, 10, \text{ and } 15$ . The simulation contains three real data sets, oriented with parameters learned from Trade and Quote (TAQ) data in the finance, electronics, and food sectors. We also experiment on four extreme scenarios to investigate the performance of the EMP estimator.

#### 4.1. Setup

We first generate efficient and synchronous log prices  $\mathbf{X}_t$  of  $p$  assets, following the setup in Wang and Zou (2010):

$$d\mathbf{X}_t = \boldsymbol{\sigma}_t^\top d\mathbf{B}_t, \quad t \in [0, 1],$$

where  $\mathbf{B}_t = (B_{1t}, \dots, B_{pt})^\top$  is a standard  $p$ -dimensional Brownian motion, and  $\boldsymbol{\sigma}_t$  is a Cholesky decomposition of  $\Sigma_t = (\Sigma_{ij,t})_{1 \leq i, j \leq p}$ , which is defined below. Let the diagonal elements of  $\Sigma_t$  follow a Cox–Ingersoll–Ross (CIR) process,

$$d\Sigma_{ii,t} = \theta_i(\mu_i - \Sigma_{ii,t})dt + \omega_i\sqrt{\Sigma_{ii,t}}dW_{it},$$

where  $\mu_i$  denotes the long-term mean of the volatility, for  $i = 1, \dots, p$ , and  $W_{it}$  is a standard one-dimensional Brownian motion independent of  $\mathbf{B}_t$ . Define the off-diagonal elements by

$$\Sigma_{ij,t} = [\kappa(t)]^{|i-j|} \sqrt{\Sigma_{ii,t}\Sigma_{jj,t}}, \quad 1 \leq i \neq j \leq p,$$

where  $\kappa(t)$  is given by

$$\begin{aligned} \kappa(t) &= \frac{e^{2u(t)} - 1}{e^{2u(t)} + 1}, \quad du(t) = 0.3[0.64 - u(t)]dt + 0.118u(t)dW_{\kappa,t}, \\ W_{\kappa,t} &= \sqrt{0.96}W_{\kappa,t}^0 - 0.2 \sum_{i=1}^p \frac{B_{it}}{\sqrt{p}}, \end{aligned}$$

and  $W_{\kappa,t}^0$  is a standard one-dimensional Brownian motion independent of  $\mathbf{B}_t$  and  $W_{it}$ .

The synchronous, yet noisy log prices are generated with Gaussian noise:

$$\mathbf{Y}_{t_j} = \mathbf{X}_{t_j} + \boldsymbol{\epsilon}_{t_j},$$

where  $t_j = j/n$ , with  $j = 0, \dots, n$ , and  $\epsilon$  is an i.i.d. random vector with mean zero and variance  $\eta_i$ , for  $i = 1, \dots, p$ . Then, the asynchronous and noisy price processes are generated by sampling from Poisson processes with intensity  $\psi = (\psi_1, \dots, \psi_p)^\top$ . Note that the generated processes have on average,  $23,400/\psi_1$  to  $23,400/\psi_p$  observations.

For parameter settings, we consider three practically oriented experiments based on the TAQ data in the finance, electronics, and food sectors. For each sector, the variances of the microstructure noise ( $\eta_i$ ), long-term means of the volatility ( $\mu_i$ ), and intensities ( $\psi_i$ ) are estimated from five arbitrarily selected assets; see Table S4 in the Supplementary Material. For the extreme scenarios, we design four experiments, as follows:

- Noisy: a lower signal-to-noise ratio range from 0.017 to 0.034;
- Ex-Asy: dissimilar sampling frequencies, with  $\psi_i = 3 \sim 60$ ;
- Ex-HF: ultra-high sampling frequencies, with  $\psi_i = 3 \sim 5$ ;
- Negative: an artificial signal-to-noise ratio ranging from 0.00043 to 0.017 for estimating negative-definite covariance matrices.

The parameter settings of each scenario can be found in Table S4. In addition, the parameter settings of  $p = 10$  assets are combined with those of the finance and electronics sectors, and the parameter settings of  $p = 15$  assets are combined with those of the finance, electronics, and food sectors. In each sector, the sample size is  $n = 23,400$  with  $m = 1,000$  replications.

Following the initial screening, in 230 of the 1,000 replications, the MPA estimator is not positive semidefinite for the Negative scenario. In addition, the negative eigenvalues mostly occur for the fifth eigenvalue. For the cases of  $p = 10$  and  $p = 15$ , the frequencies at which the eigenvalues are negative for the 1,000 replications are plotted in Figure 1. Overall, the frequencies of nonpositive-semidefinite covariance estimators are 99% for both  $p = 10$  and  $p = 15$ .

For each scenario, the EMP estimator is obtained by

1. filtering the high-frequency synchronous data using the HFF technique, in which the tuning parameter  $\delta_n$  is chosen using cross-validation.
2. performing the proposed eigenvalue correction and obtaining the realized-covariance estimator.

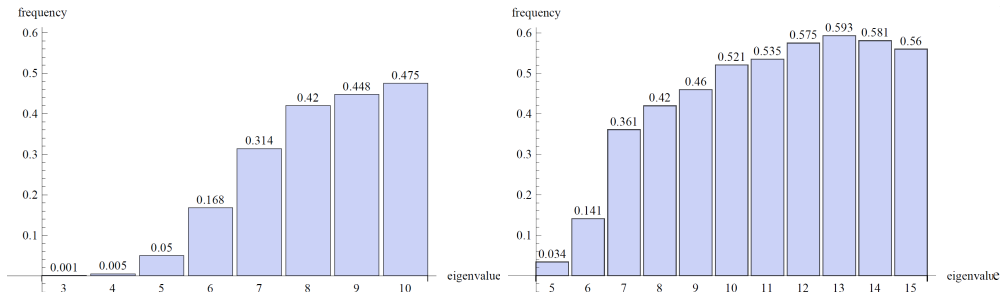


Figure 1. The occurrence frequencies of negative eigenvalues based on 1,000 replications for  $p = 10$  (left panel) and  $p = 15$  (right panel).

## 4.2. Evaluation and alternatives

We measure both the overall and the element-wise accuracy of the EMP estimator. The overall performance is evaluated using the relative error (RE) of each eigenvalue, defined as

$$RE_i = \frac{\sqrt{(1/m) \left[ \sum_{s=1}^m (\hat{\lambda}_i^{(s)} - \lambda_i)^2 \right]}}{\lambda_i}, \quad i = 1, \dots, p,$$

where  $\lambda_i/\hat{\lambda}_i^{(s)}$  denotes the  $i$ th true/estimated eigenvalue of the  $s$ th replication. The maximum norm (MN) evaluates the element-wise accuracy, measured by the largest absolute deviation of all elements:

$$MN = \frac{1}{m} \sum_{s=1}^m \left\{ \max_{i,j} |\hat{\Sigma}_{ij}^{(s)} - \Sigma_{ij}| \right\},$$

where  $\Sigma_{ij}$  is the  $(i, j)$ th element of the covariance, and  $\hat{\Sigma}_{ij}^{(s)}$  is the estimated  $(i, j)$ th element in the  $s$ th replication, for  $i, j = 1, \dots, p$ ,  $s = 1, \dots, m$ , with  $m = 1,000$ . The lower of these two measures represents the better accuracy of the estimated covariance matrix.

Table 1 reports the RE and MN of the EMP estimator. It shows that the EMP estimator provides accurate results with low estimation errors in the finance, electronics, food, Noisy, Ex-Asy, and Ex-HF sectors. The MPA and MK alternative estimators are compared with the EMP estimator by calculating the ratios of their errors to the corresponding EMP measurements. A ratio larger than one indicates poorer accuracy of the alternative. In the real-data-oriented scenarios (finance, electronics, and food), the EMP estimator, although far from optimal, still has lower relative errors than those of MPA and MK. More specif-

ically, the improvement in relative overall performance ranges from 1.7% ( $RE_4$  electronics) to 77% ( $RE_5$  finance), and the improvement in element-wise accuracy ranges from 60.8% (finance) to 66.2% (electronics), as compared with the MPA. Compared with MK, with the exception of the first eigenvalue in finance, the EMP estimator displays an increase in overall accuracy ranging from 8.4% ( $RE_3$  finance) to 198.1% ( $RE_1$  food), and an improvement of more than 246.2% (finance) in terms of MN. In the extreme scenarios (Noisy, Ex-Asy, and Ex-HF), the EMP estimator outperforms MK and MPA, without exception. The EMP estimator enhances the element-wise accuracy by between 69.5% (compared with MPA Noisy) and 311.7% (compared with MK Ex-HF).

Table 2 presents the REs of MPA, MPA-E, MPA-H, MPA-N, and EMP in the Negative scenario. The results confirm that the proposed eigenvalue correction approach efficiently improves the negative eigenvalue(s) by around 20.4%. Error correction contributes greatly in the cases with smaller eigenvalues, especially those close to zero or negative. For larger eigenvalues, there is little benefit to using the error correction approach. The HFF technique, conversely, leads to a big improvement in the larger eigenvalues by using the cross-dependence between the multiple assets. However, HFF does not provide significant benefits for smaller eigenvalues, which represent fewer features of the covariance matrix. The MPA-N results indicate the importance of incorporating the negative autocorrelation in the HFF technique. Without these empirical features, MPA-N produces a mixture of beneficial and detrimental contributions, but an overall decrease in accuracy. The EMP estimator nicely combines the two techniques and the empirical features. It benefits in the larger-eigenvalue cases from the richer information on the multiple assets, and in the smaller-eigenvalue cases from the correction of the negative values.

The results of  $p = 10$  and  $p = 15$  are similar and are discussed in Section S2.3 of the Supplementary Material.

In summary, the EMP estimator displays substantial improvements in relative performance and is stable in different scenarios, indicating that it estimates the true covariance matrix with reasonable accuracy.

## 5. Real-Data Analysis

In this section, we implement the synchronizing technique and eigenvalue correction approach to apply the EMP realized-covariance estimator to real-world tick-by-tick financial data. We also apply the proposed EMP estimator in portfolio selection to show its usefulness in financial applications, where covariance is

Table 1. Comparisons of EMP and alternative realized covariance estimators in terms of the RE of eigenvalues and maximum norms (MN).

	Food			Electronics			Finance		
	EMP	$\frac{MK}{EMP}$	$\frac{MPA}{EMP}$	EMP	$\frac{MK}{EMP}$	$\frac{MPA}{EMP}$	EMP	$\frac{MK}{EMP}$	$\frac{MPA}{EMP}$
$RE_1$	0.162	2.981	1.265	0.170	2.747	1.076	0.218	0.982	1.023
$RE_2$	0.142	2.951	1.577	0.145	2.725	1.539	0.159	1.390	1.226
$RE_3$	0.156	2.365	1.455	0.143	2.839	1.434	0.215	1.084	1.121
$RE_4$	0.183	2.891	1.426	0.230	1.913	1.017	0.200	1.740	1.165
$RE_5$	0.272	2.419	1.232	0.265	2.525	1.260	0.236	2.436	1.771
MNs	$6.98E - 5$	3.734	1.643	$6.72E - 5$	3.853	1.662	$7.02E - 5$	3.462	1.608
	Noisy			Ex-Asy			Ex-HF		
	EMP	$\frac{MK}{EMP}$	$\frac{MPA}{EMP}$	EMP	$\frac{MK}{EMP}$	$\frac{MPA}{EMP}$	EMP	$\frac{MK}{EMP}$	$\frac{MPA}{EMP}$
$RE_1$	0.176	2.892	1.250	0.209	2.909	1.038	0.138	2.928	1.326
$RE_2$	0.165	2.679	1.479	0.172	2.831	1.767	0.109	3.367	1.725
$RE_3$	0.341	1.067	0.633	0.217	2.037	1.258	0.256	1.457	0.738
$RE_4$	0.253	1.767	0.874	0.222	2.824	1.500	0.143	2.832	1.294
$RE_5$	0.303	2.205	1.218	0.339	2.469	2.555	0.168	3.595	1.595
MNs	$5.11E - 5$	3.560	1.695	$9.08E - 5$	3.992	1.800	$9.13E - 5$	4.117	1.780

Table 2. Comparison of MPA, MPA-E, MPA-H, MPA-N, and EMP in terms of REs.

	$RE_1$	$RE_2$	$RE_3$	$RE_4$	$RE_5$
MPA	0.4688	0.3702	0.5086	0.5799	0.8648
MPA-E	0.4688	0.3702	0.5086	0.5479	0.7182
MPA-H	0.2711	0.2607	0.2616	0.2258	1.4661
MPA-N	0.3003	0.8231	0.6509	0.5761	1.6064
EMP	0.2711	0.2607	0.2616	0.2258	0.7647

a key input factor.

We consider the TAQ data of seven assets listed on the New York Stock Exchange (NYSE) (i.e., AIG, GE, IBM, JPM, MRK, PFE, and T) over the period January 2, 2005, to December 31, 2005. The normal trading hours of the NYSE are from 9:30 to 16:00, or 6.5 hours (23,400 seconds). We remove the seven days from November 21, 2005, to November 30, 2005, owing to unavailable data for asset T. In total, there are 245 trading days. Figure 2 depicts the evolution of the daily adjusted closing prices of the PFE and MRK stocks in 2015. The two assets belong to the same industry, that is, pharmaceuticals, and hence are naturally positively correlated; the historical correlation estimator is 0.51.

The two alternative estimators MPA and MK are also computed based on the high-frequency data. Figure 3 depicts the time plot of the estimated daily correlations of PFE and MRK. Each of the realized-covariance estimators delivers

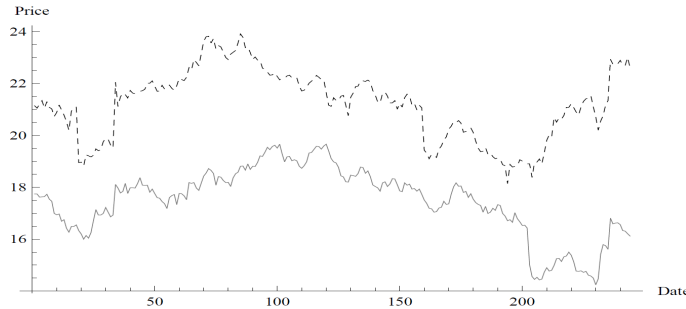


Figure 2. Time plot of daily closing prices of PFE (gray real line) and MRK (black dashed line) stocks for a total of 245 days.

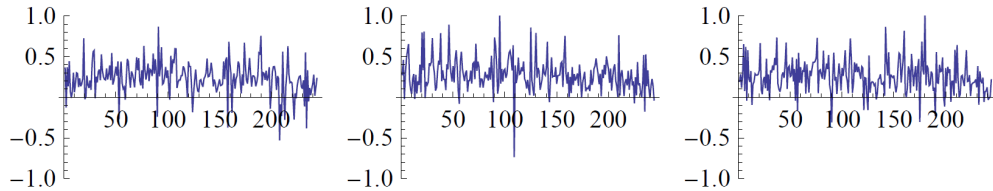


Figure 3. Time plots of the intra-daily correlation estimations between PFE and MRK stocks based on EMP (left panel), MPA (middle panel), and MK (right panel) for a total of 245 days.

positive correlations in most cases, with values varying in the range  $[-0.53, 0.87]$  for EMP, a larger range  $[-0.74, 0.98]$  for MPA, and the range  $[-0.31, 0.98]$  for MK. The correlation between PFE and MRK becomes negative after day 200. This is well represented by the EMP estimator, but not by the alternatives, an observation that supports the general accuracy of the EMP estimator. Furthermore, even with a large  $n = 12,552$ , there are 40 days when the MPA estimators are not positive semidefinite.

### 5.1. Application in portfolio allocation

Markowitz mean-variance portfolio selection has had a profound impact on financial economics. Suppose that  $\mathbf{w}$  represents the weights of a portfolio allocation, with the constraint that  $\mathbf{w}^* \mathbf{1} = 1$ . The Markowitz mean-variance optimization is equivalent to maximizing the following function:

$$M(\boldsymbol{\mu}, \Sigma) = \mathbf{w}^* \boldsymbol{\mu} - \lambda \mathbf{w}^* \Sigma \mathbf{w},$$

which is sensitive to estimation errors in the expected return and the covariance matrix, especially when the portfolio is large. Fan, Zhang and Yu (2012) showed

that the estimation errors can be bounded as

$$|M(\hat{\boldsymbol{\mu}}, \hat{\Sigma}) - M(\boldsymbol{\mu}, \Sigma)| \leq \|\hat{\boldsymbol{\mu}} - \boldsymbol{\mu}\|_{\infty} \|\mathbf{w}\|_1 + \lambda \|\hat{\Sigma} - \Sigma\|_{\infty} \|\mathbf{w}\|_1,$$

where  $\|\cdot\|_{\infty}$  refers to the maximum component-wise estimation errors. The problem disappears when the gross-exposure constraint  $\|\mathbf{w}\|_1 \leq c$  is imposed for a moderate  $c$ , where  $c$  is the total exposure allowed:

$$\min_{\mathbf{w}} \mathbf{w}^* \Sigma \mathbf{w} \quad s.t. \quad \|\mathbf{w}\|_1 \leq c \text{ and } \mathbf{w}^* \mathbf{1} = 1.$$

Letting  $R(\mathbf{w}, \Sigma) = \mathbf{w}^* \Sigma \mathbf{w}$ , Fan, Zhang and Yu (2012) showed that

$$|R(\mathbf{w}, \hat{\Sigma}) - R(\mathbf{w}, \Sigma)| \leq \|\hat{\Sigma} - \Sigma\|_{\infty} \|\mathbf{w}\|_1.$$

The above estimation errors do not accumulate in the risk. Fan, Li and Yu (2012) extended the work of Fan, Zhang and Yu (2012) to include high-frequency data by using the two-scale realized-covariance estimator combined with the all-refresh and pairwise-refresh synchronizing techniques.

Following Fan, Li and Yu (2012), we construct portfolios based on tick-by-tick records. The optimal weights are updated using the realized-covariance estimator from the previous day:

$$\min_{\mathbf{w}} \mathbf{w}^* \Sigma \mathbf{w} \quad s.t. \quad \|\mathbf{w}\|_1 \leq c \text{ and } \mathbf{w}^* \mathbf{1} = 1,$$

where we consider three cases,  $c = 1$ ,  $c = 2$ , and  $c = 3$ , using three alternative realized-covariance estimators, MPA, MK, and EMP.

Table 3 provides a statistical summary of the portfolios based on different realized-covariance estimators and  $c = 1, 2$ , and 3. Without exception, the EMP portfolios are better than the MPA and MK specifications. The EMP portfolio is the only portfolio with a positive mean, and it produces the smallest standard deviation. In most cases, the EMP portfolio outperforms the alternatives when extreme loss is considered and  $c = 2$  or 3. The other portfolios for extreme losses are also competitive with the best solutions. To visualize the differences between the estimators, we plot histograms of the daily log returns of the portfolios with different realized-covariance estimators in Figure 4. The EMP portfolio provides superior performance in terms of cumulative returns, as displayed in Figure 5, with  $c = 1$ ,  $c = 2$ , and  $c = 3$ . After  $t = 130$ , the EMP portfolio outperforms the alternatives and the equal-weighted portfolio. Figure 5 also depicts the daily portfolio volatility ( $\hat{\mathbf{w}}_{\text{opt}}^* \hat{\Sigma} \hat{\mathbf{w}}_{\text{opt}}$ ) using different realized-covariance estimators. The results, summarized in Table 4, indicate that the EMP portfolio has a greater



Table 3. The medians, means, standard deviations (Std.), and 1% and 5% quantiles of the log returns of portfolio prices based on three covariance matrix estimators.

	$c = 1$				
	Median	Mean	Std.	1% quantile	5% quantil
EMP	$1.40E - 4$	$4.67E - 5$	$6.87E - 3$	$-1.12E - 2$	$-1.57E - 2$
MK	$0.92E - 4$	$-1.93E - 5$	$7.42E - 3$	$-1.17E - 2$	$-1.65E - 2$
MPA	$-1.24E - 4$	$-1.46E - 4$	$6.94E - 3$	$-1.08E - 2$	$-1.53E - 2$
	$c = 2$				
	Median	Mean	Std.	1% quantile	5% quantile
EMP	$1.39E - 4$	$1.89E - 5$	$6.93E - 3$	$-1.12E - 2$	$-1.57E - 2$
MK	$-0.21E - 4$	$-8.09E - 5$	$8.85E - 3$	$-1.17E - 2$	$-2.08E - 2$
MPA	$-0.96E - 4$	$-9.72E - 5$	$7.21E - 3$	$-1.08E - 2$	$-1.59E - 2$
	$c = 3$				
	Median	Mean	Std.	1% quantile	5% quantile
EMP	$1.40E - 4$	$2.56E - 5$	$6.93E - 2$	$-1.12E - 2$	$-1.56E - 2$
MK	$-0.58E - 4$	$-1.21E - 4$	$9.37E - 2$	$-1.29E - 2$	$-2.05E - 2$
MPA	$-1.24E - 4$	$-9.84E - 5$	$7.38E - 2$	$-1.12E - 2$	$-1.96E - 2$

Table 4. Portions of the smallest portfolio volatility of different covariance estimators.

	$c = 1$	$c = 2$	$c = 3$
EMP	44.64%	50%	52.57%
MPA	30.90%	31.62%	31.62%
MK	24.46%	18.38%	15.81%

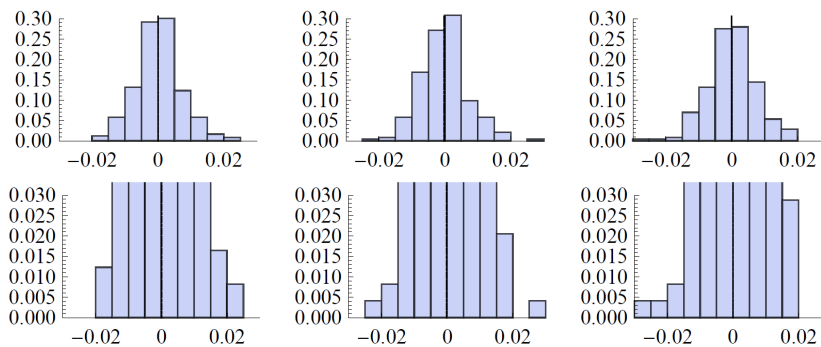


Figure 4. Histograms of the log returns of portfolio prices based on EMP (left panel), MPA (middle panel), and MK (right panel). The lower panel is zoomed in to show the tail sections.

chance of obtaining lower portfolio volatilities than do MPA and MK. To summarize, the EMP estimator is superior in the Markowitz mean-variance portfolio selection experiment.

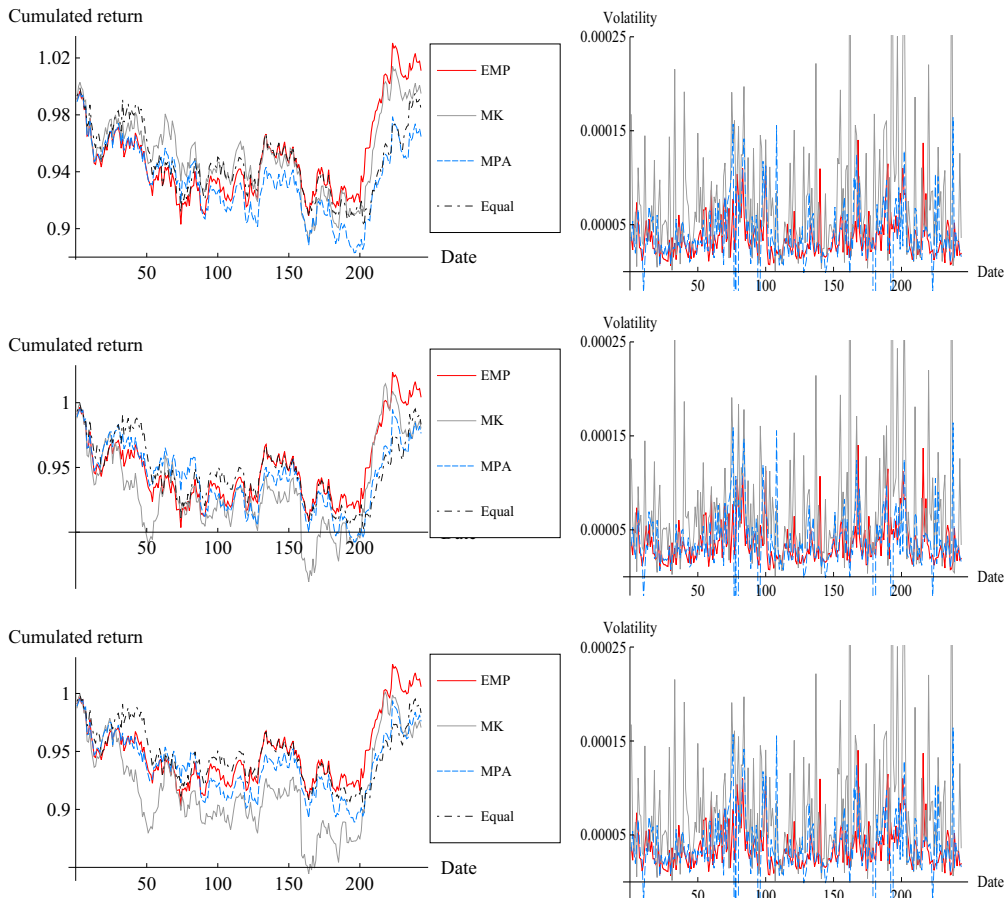


Figure 5. Cumulative portfolio returns (left panel) and portfolio volatilities (right panel) based on EMP (thick solid line), MK (solid line), MPA (dashed line), and equal weights (dot-dash line) for  $c = 1$  (upper panel),  $c = 2$  (middle panel), and  $c = 3$  (lower panel).

## 6. Conclusion

We have developed a new realized-covariance estimator that simultaneously ensures positive semidefiniteness and optimal efficiency. By drawing on the dependence information in the data, we were able to iteratively synchronize asynchronous high-frequency data. Together with a correction approach, the proposed estimator is positive semidefinite and efficient at the optimal convergence rate  $\mathcal{O}_p(n^{-1/4})$ . It is consistent and has the same limiting distribution as the efficient estimator. Real-data-oriented simulation experiments demonstrated the finite-sample performance of the estimator, showing that, compared with several alternatives, the proposed estimator provides the best accuracy. A real-data analysis

illustrated the superior performance of the proposed estimator in portfolio allocations. The proposed methods are general, and can be applied to other realized measures and to matrix corrections. In this study, we considered multidimensional covariance matrix estimators. Extensions to high- and large-dimensional covariance matrix estimators are of practical interest, and are left to future research. Some important works in this context include, but are not limited to, those of Ait-Sahalia and Xiu (2017), Dai, Lu and Xiu (2019), Fan, Furger and Xiu (2016), Kim et al. (2018), Kim, Wang and Zou (2016), Kong (2017), and Kong (2018).

**Supplementary Material**

All proofs and some simulations can be found in the online Supplementary Material.

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**Appendix**

**A. Appendix**

**Theorem 4.** *Let  $S_{true}$  be the multiple pre-averaging estimation based on efficient but unobservable log prices.*

$$S_{true} = \frac{n}{n - k_n + 2} \frac{12}{k_n} \sum_{j=0}^{n-k_n+1} \bar{\mathbf{Y}}_{t_j}^{n,(0)} (\bar{\mathbf{Y}}_{t_j}^{n,(0)})^\top - \frac{12}{2n\theta^2} \sum_{j=1}^n (\mathbf{Y}_{t_j} - \mathbf{Y}_{t_{j-1}})(\mathbf{Y}_{t_j} - \mathbf{Y}_{t_{j-1}})^\top,$$

where  $\bar{\mathbf{Y}}_{t_j}^{n,(0)} = (1/k_n) \left( \sum_{\ell=k_n/2}^{k_n-1} \mathbf{Y}_{t_{j+\ell}} - \sum_{\ell=0}^{k_n/2} \mathbf{Y}_{t_{j+\ell}} \right)$ . The asymptotic distribution of  $S_{true}$  is given in Christensen, Kinnebrock and Podolskij (2010) with convergence rate  $n^{1/4}$ . Let the assumptions of Theorem 2 and 3 hold, and further assume that

- (i)  $\hat{\mathbf{X}}_{t_j} - \mathbf{X}_{t_j}$  and  $\hat{\boldsymbol{\varepsilon}}_{t_j} - \boldsymbol{\varepsilon}_{t_j}$  share the same order with  $\hat{\mathbf{R}}_{t_j} - \mathbf{R}_{t_j}$ ;
- (ii)  $\hat{\boldsymbol{\varepsilon}}_{t_j}$  have lower dependency on each other,  $j = 1, \dots, n$ .

We have

$$\|n^{1/4}(S_1 - S_{true})\| = o_p(1),$$

which implies that  $S_1$  has the same limiting distribution as  $S_{true}$ .

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