January 27, 2012

Lack-of-fit testing of the conditional mean function in a class of Markov multiplicative error models[1]

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Running head: Lack-of-fit test for a multiplicative error model

Abstract

The family of multiplicative error models, introduced by Engle (2002), has attracted considerable attention in the recent literature for modeling positive random variables, such as the duration between trades at a stock exchange, volume transactions and squared log returns. Such models are also applicable to other positive variables like waiting time at a queue, daily/hourly rainfall, or demand for electricity. This paper develops a new method for testing the lack-of-fit of a given parametric multiplicative error model having a Markov structure. The test statistic is of Kolmogorov-Smirnov type based on a particular martingale transformation of a marked empirical process. The test is asymptotically distribution free, consistent against a large class of fixed alternatives and has non-trivial asymptotic power against a class of nonparametric local alternatives converging to the null hypothesis at the rate of $O(n^{-1/2})$. In a simulation study, the test performed better overall than the general purpose Ljung-Box Q-test, a Lagrange Multiplier type test and a Generalized Moment test. We illustrate the testing procedure by considering two data examples.

1 Introduction

Non-negative random variables are frequently encountered in economics and finance, as well as in other fields of social and natural sciences. Examples include, financial durations such as the duration between consecutive trades at a stock exchange, waiting time at a queue, daily/hourly rainfall, and demand for electricity. As a general framework for modeling such nonnegative processes, Engle (2002) introduced a family of multiplicative error models.

To introduce this family of models, let y_i, $i \in \mathbb{Z} := \{0, \pm 1, \pm 2, \cdots\}$, be a discrete time process defined on $[0, \infty)$, and let $\mathcal{H}_{i-1}$ denote the information available for forecasting y_i. A multiplicative error model takes the form

$$y_i = E[y_i \mid \mathcal{H}_{i-1}]\varepsilon_i, \quad \varepsilon_i \mid \mathcal{H}_{i-1} \sim D^+(1, \sigma^2), \tag{1}$$

where $D^+(1, \sigma^2)$ is a probability distribution on the positive real line with unit mean and a finite variance σ^2. The error sequence ε_i, $i \in \mathbb{Z}$, is often assumed to be independent and identically distributed.

This family of models has attracted considerable attention in the recent literature. Multiplicative error specifications have been adopted for modeling durations (Engle and Russell 1998), volume transactions (Manganelli 2005), high–low price range (Chou 2005), squared log returns (Engle and Gallo 2006), equity market volatilities (Engle, Gallo and Velucchi 2011), and realized volatility (Lanne 2006, and Engle and Gallo 2006), amongst many others.

The parametric form of $E[y_i \mid \mathcal{H}_{i-1}]$ is the main component of interest in a multiplicative error model (MEM), and hence, testing for the specification of this component has an important place in the process of model evaluation. However, a large proportion of MEMs have a complicated probabilistic structure (see Pacurar 2008 and Brownlees, Cipollini and Gallo 2011). Consequently, assessing the goodness-of-fit of such parametric specifications is a non-trivial task. A small number of general methods have been developed for testing the goodness-of-fit of a given parametric form for $E[y_i \mid \mathcal{H}_{i-1}]$. We will shortly describe some of these tests. One aspect of these general methods is that they are designed for models with more dynamic parametric forms. For example, they would typically allow $E[y_i \mid \mathcal{H}_{i-1}]$ to depend on the whole infinite past, $\{y_{t-1} : t \leq i\}$. However, in empirical studies, one would want to consider such elaborate models only if a simpler one does not fit. This paper develops a formal test for this purpose. More specifically, a method is developed for testing the lack-of-fit of a given MEM having the Markov specification

$$E[y_i \mid \mathcal{H}_{i-1}] = \tau(y_{i-1}), \tag{2}$$

where $\tau(\cdot)$ is a positive function defined on $\mathbb{R}^+ := [0, \infty)$. We shall call the model (1)–(2), a Markov MEM.

In what follows, we describe some of the existing methods of testing for multiplicative error models. A common practice for evaluating a MEM is to carry out simple diagnostic tests to examine the dynamical and distributional properties of the estimated residuals; for example, see Jasiak (1998), Giot (2000), Ghysels, Gouriéroux and Jasiak (2004), Bauwens and Veredas (2004), Luca and Gallo (2004) and Bauwens (2006). The Box-Pierce-Ljung type portmanteau test statistic applied to the estimated residuals or squared estimated residuals is among the most frequently used tests in the literature. This approach was employed for the class of multiplicative error models known as autoregressive conditional duration (ACD) by Engle and Russell (1998), and has frequently been employed in subsequent studies. Another method which was introduced by Engle and Russell (1998) is to test for no excess dispersion of the estimated residuals, paying particular attention for checking the first and second moments of the residuals when the error distribution is assumed to be either exponential or Weibull. These diagnostic tests may suggest that the MEM is misspecified as a result of a misspecification of the conditional mean and/or of the error distribution.

Several tests that exclusively test for misspecifications of the conditional mean function have also been proposed recently. Meitz and Teräsvirta (2006) developed Lagrange multiplier [LM] type tests, focusing on testing the specifications of the functional form of the conditional mean against various forms of parametric alternatives (e.g., tests against higher-order models, tests of linearity, and tests of parameter constancy). Hautsch (2006) also considered some Lagrange multiplier tests. One aspect of such LM-type tests is that they require the alternative hypothesis to specify a larger finite dimensional parametric model, so that the null hypothesis is obtained by setting some components of the model parameter equal to zero. Thus, LM type tests are targeted to detect departures in the direction of the particular finite dimensional parametric model in the alternative hypothesis.

Recently, Hong and Lee (2011) developed a class of tests using a generalized spectral derivative approach for testing the specification of the conditional mean, without assuming the knowledge of a parametric form under the alternative. These tests are based on kernel density estimators, and hence, their finite sample performances are subject to the choice of the kernal and the bandwidth. Chen and Hsieh (2010) proposed a set of generalized moment tests, unifying several existing parametric tests for the conditional mean. In addition, the general diagnostic test considered by Hong and Lee (2003) can also be used as a misspecification test for multiplicative error models (see Meitz and Teräsvirta 2006).

There are also methods available for testing the goodness-of-fit of a given parametric form for the distribution of the error term ε_i in (1) (for example see Fernandes and Grammig 2005, Chen and Hsieh 2010). However, these methods are not applicable for testing the adequacy of a given parametric form for the conditional mean function, which is the topic of this paper.

This paper develops a new test for the conditional mean specification of a Markov mul-

tiplicative error model. Most of the existing tests that we mentioned above are developed for general models that are not necessarily Markov. Thus, by design, they do not make use of the simple dynamic structure of the Markov model (2). By contrast, the test proposed in this paper is designed specifically to exploit the special structure of the model (2). Therefore, there is some ground to conjecture that, for the case of testing the lack-of-fit of a given Markov MEM, the test proposed in this paper would be more suitable than the existing ones. In a simulation study, when testing for the conditional mean specification of a Markov model, the new test performed significantly better than a LM test, a generalized moment test and a Box-Pierce-Ljung type portmanteau test. We expect that the new test complements these tests and spectral derivative based tests for multiplicative error models in a desirable fashion.

The test is introduced in section 2. It is based on a marked empirical process of residuals, analogous to the ones in Stute, Thies and Zhu (1998) and Koul and Stute (1999). The main result of section 2 says that the asymptotic null distribution of the test statistic is that of the supremum of the standard Brownian motion on $[0, 1]$. Therefore, the test is asymptotically distribution free, and a set of asymptotic critical values are available for general use. Consistency against a fixed alternative and the asymptotic power against a sequence of local nonparametric alternatives are discussed in section 3. Section 4 contains a simulation study. Two illustrative examples are discussed in section 5. Section 6 concludes the paper. The proofs are relegated to an Appendix.

2 The test statistic and its asymptotic null distribution

This section provides an informal motivation for the test, defines the test statistic and states its asymptotic null distribution. First, subsection 2.1 provides a motivation for the test and a brief indication of the approach adopted in constructing the test statistic. Then, subsection 2.2 introduces the regularity conditions, defines the test statistic and states the main result on its asymptotic null distribution.

To introduce the null and alternative hypotheses of our interest, let q be a known positive integer, $\Theta \subseteq \mathbb{R}^q$, and let $\mathcal{M} = \{\Psi(y, \theta) : y \geq 0, \theta \in \Theta\}$ be a parametric family of positive functions. We wish to test

$$H_0 : \tau(y) = \Psi(y, \theta), \text{ for some } \theta \in \Theta \text{ and } \forall\, y \geq 0, \quad \text{vs} \quad H_1 : \text{Not } H_0. \tag{3}$$

Let $\{Y_0, Y_1, \ldots, Y_n\}$ be observations of a positive, strictly stationary and ergodic process $\{Y_i\}$ that obeys the model (1)–(2). Let G denote the stationary distribution function of Y_0. Let τ, Ψ, σ^2 and the testing problem be as in (1)–(2) and (3). Let θ denote the true

parameter value under H_0 and ϑ denote an arbitrary point in Θ. Under H_0, G may depend on θ, but we do not exhibit this dependence.

2.1 Motivation for the test statistic

This subsection provides a motivation for the test and an overview of the general approach. The regularity conditions are not discussed here; they will be provided in the next subsection. Let $T(y, \vartheta) = \int_0^y [\{\tau(x)/\Psi(x; \vartheta)\} - 1] dG(x)$, and

$$\mathcal{U}_n(y, \vartheta) = n^{-1/2} \sum_{i=1}^n \left\{ \frac{Y_i}{\Psi(Y_{i-1}, \vartheta)} - 1 \right\} I(Y_{i-1} \leq y), \quad y \geq 0, \; \vartheta \in \Theta. \tag{4}$$

First, consider the special case when the true parameter value θ in H_0 is given. Arguing analogously as in Stute *et al.* (1998), because θ is known, the integral transform $T(\cdot, \theta)$ is uniquely determined by $\tau(\cdot)$, assuming G is known. Therefore, inference about the functional form of $\tau(\cdot)$ could be based on an estimator of $T(\cdot, \theta)$. From (2) it follows that under H_0, $T(y, \theta) = EI(Y_0 \leq y)[\{Y_1/\Psi(Y_0, \theta)\} - 1] = 0$, for all $y \geq 0$. Further, an unbiased estimator of $T(y, \theta)$ is given by $n^{-1/2} \mathcal{U}_n(y, \theta)$. It is shown later that, under H_0, $\mathcal{U}_n(y, \theta)$ converges weakly to $W \circ G$, where W is the standard Brownian motion. Therefore, a Kolmogorov-Smirnov type test could be based on $\sup_y |\mathcal{U}_n(y, \theta)|$, which converges weakly to $\sup_{0 \leq t \leq 1} |W(t)|$, under H_0.

Now, consider the testing problem (3), where H_0 specifies a parametric family $\Psi(\cdot, \theta)$ for $\tau(\cdot)$, for some unknown θ. Let $\widehat{\theta}$ be a $n^{1/2}$-consistent estimator of θ. Then, an estimator of $T(y, \theta)$ is $n^{-1/2} \mathcal{U}_n(y, \widehat{\theta})$. The limiting null distribution of $\mathcal{U}_n(y, \widehat{\theta})$ depends on $\widehat{\theta}$ and the unknown parameter θ in a complicated fashion. Therefore, the method outlined in the previous paragraph for known θ is no longer applicable, and it does not lead to an asymptotically distribution free test. Constructing such a test based on $\mathcal{U}_n(y, \widehat{\theta})$ is the focus of the next subsection.

The process $\mathcal{U}_n(y, \widehat{\theta})$ is an extension of the so called cumulative sum process for the one sample setting to the current set up. The use of cumulative sum process for testing the lack-of-fit of a given regression function goes back to von Neumann (1941), who proposed a test of constant regression based on an analog of this process. More recently, its analogs have been used by several authors to propose asymptotically distribution free (ADF) lack-of-fit tests in some other models.

Stute, Xu and Zhu (2008) and Escanciano (2010) proposed residual empirical processes marked by appropriately chosen weighting functions, for additive regression and certain time series models, respectively. The testing procedure proposed in Escanciano (2010) could also be viewed as a generalization of the method developed in Wooldridge (1990) for obtaining ADF tests. This approach is not directly applicable for testing H_0 in (3) using $\mathcal{U}_n(y, \widehat{\theta})$,

because $\mathcal{U}_n(y,\widehat{\theta})$ is a marked empirical process with the marks that are the centered residuals $(Y_i/\Psi(Y_{i-1},\widehat{\theta})$ - 1) and not functions of a conditioning set containing past observations as in Escanciano (2010).

Escanciano and Mayoral (2010) and Ling and Tong (2011) have also developed ADF tests based on marked empirical processes similar to $\mathcal{U}_n(y,\widehat{\theta})$. However, the hypotheses considered in these papers are different from (3), and hence, these tests are not applicable in the present context.

In this paper, we appeal to a particular martingale transformation method to construct an ADF test for H_0 in (3) based on $\mathcal{U}_n(y,\widehat{\theta})$. Such martingale transformation methods have been successfully applied to location, regression and certain autoregressive models. More specifically, tests have been developed when the null hypothesis specifies a parametric family for the mean function of a regression and/or an autoregressive model, and the conditional variance function in a regression model; see, for example, Stute *et al.* (1998), Koul and Stute (1999), Khmaladze and Koul (2004), Dette and Hetzler (2009), and Koul and Song (2010). A common feature of all these studies is that they are all for additive models. The Markov multiplicative time series models studied in this paper are structurally different (see Engle 2002, Brownlees *et al.* 2011).

2.2   The test and the main results

Let F denote the cumulative distribution function [*cdf*] of ε_1. In the sequel, $\|a\|$ denotes Euclidean norm of a vector $a \in \mathbb{R}^q$, and for a $q \times q$ real matrix D, $\|D\| := \sup\{\|a^T D\|;\ a \in \mathbb{R}^q,\ \|a\| = 1\}$. Now we shall introduce a set of regularity conditions.

(C1). The *cdf* G is continuous, $G(y) > 0$ for $y > 0$, and $EY_0^4 < \infty$. The sequence of random variables $\{\varepsilon_i\}$ is positive and independent and identically distributed (i.i.d.) with $E(\varepsilon_1) = 1$, $0 < \sigma^2 < \infty$ and ε_i is stochastically independent of $\{Y_{j-1},\ j \leq\ i\}$.

(C2). The *cdf* F of ε_1 has a bounded Lebesgue density f.

(C3). (a) $\Psi(y,\vartheta)$ is bounded away from zero, uniformly over $y \in \mathbb{R}^+$ and $\vartheta \in \Theta$.
(b) The true parameter value θ is in the interior of Θ, and $\int_0^\infty |\Psi(y,\theta)|^2\ dG(y) < \infty$. For all y, $\Psi(y,\vartheta)$ is continuously differentiable with respect to ϑ in the interior of Θ.

For $\vartheta \in \Theta$ and $y \geq 0$, let $\dot{\Psi}(y,\vartheta) = \left[(\partial/\partial\vartheta_1)\Psi(y,\vartheta), \cdots, (\partial/\partial\vartheta_q)\Psi(y,\vartheta)\right]^T$,

$$g(y,\vartheta) = \dot{\Psi}(y,\vartheta)/\Psi(y,\vartheta), \text{ and } \quad C(y,\vartheta) = \int_{z \geq y} g(z,\vartheta)g(z,\vartheta)^T\ dG(z).$$

(C4). For every $0 < K < \infty$,

$$\sup_{1 \leq i \leq n,\ \sqrt{n}\|\vartheta-\theta\| \leq K} \sqrt{n}|\Psi(Y_{i-1},\vartheta) - \Psi(Y_{i-1},\theta) - (\vartheta - \theta)'\dot{\Psi}(Y_{i-1},\theta)| = o_p(1).$$

(C5). There exists a $q \times q$ square matrix $\dot{g}(y, \theta)$ and a nonnegative function $h(y, \theta)$, both measurable in the y-coordinate, and satisfying the following: $\forall \delta > 0, \exists \eta > 0$ such that $\|\vartheta - \theta\| \leq \eta$ implies

$$\|g(y, \vartheta) - g(y, \theta) - \dot{g}(y, \theta)(\vartheta - \theta)\| \leq \delta h(y, \theta)\|\vartheta - \theta\|, \quad \forall y \geq 0,$$
$$Eh^2(Y_0, \theta) < \infty, \quad E\|\dot{g}(Y_0, \theta)\| \|g(Y_0, \theta)\|^j < \infty, \quad j = 0, 1.$$

(C6). $\int_0^\infty \|g(y, \theta)\|^2 \, dG(y) < \infty$.

(C7). $C(y, \theta)$ is a positive definite matrix for all $y \in [0, \infty)$.

(C8). $\|g^T(\cdot, \theta)C^{-1}(\cdot, \theta)\|$ is bounded on bounded intervals.

(C9). $\int \|g^T(y, \theta)C^{-1}(y, \theta)\| \, dG(y) < \infty$.

(C10). There exists an estimator $\widehat{\theta}_n$ of θ satisfying $n^{1/2}\|\widehat{\theta}_n - \theta\| = O_p(1)$.

An example of $\widehat{\theta}_n$ satisfying Condition (C10) is the quasi maximum likelihood (QML) estimator of θ given by

$$\widehat{\theta}_n = \arg\min_{\vartheta \in \Theta} Q_n(\vartheta), \quad \text{where } Q_n(\vartheta) = n^{-1} \sum_{i=1}^n \left\{ \frac{Y_i}{\Psi(Y_{i-1}, \vartheta)} + \ln \Psi(Y_{i-1}, \vartheta) \right\}. \tag{5}$$

Conditions (C2), (C8) and (C9) are needed to ensure tightness of some sequences of stochastic processes appearing in the proofs. Conditions (C3)−(C6) are concerned with the smoothness of the parametric model being fitted to the conditional mean function. Similar conditions have been assumed for regression and autoregressive models in Stute *et al.* (1998) and Koul and Stute (1999). It can be shown that, the conditions (C3)−(C9) are satisfied by linear Markov models of the form $\Psi(y, \vartheta) = \vartheta_1 + \vartheta_2 y, \; \vartheta_1, \vartheta_2 > 0$. The condition (C2) on the error distribution is satisfied by many distributions that are continuous and have positive supports, including exponential, Weibull, gamma, generalized-gamma, Burr and many others.

Now, let $\widehat{\mathcal{U}}_n(y) := \mathcal{U}_n(y, \widehat{\theta}_n)$, $\widehat{g}(y) := g(y, \widehat{\theta}_n)$, $G_n(y) := n^{-1}\sum_{i=1}^n I(Y_{i-1} \leq y)$, and $\widehat{C}_y := \int_{x \geq y} \widehat{g}(x)\widehat{g}(x)^T \, dG_n(x)$. The proposed test is to be based on the following transform of the $\widehat{\mathcal{U}}_n$:

$$\widehat{\mathcal{W}}_n(y) := \widehat{\mathcal{U}}_n(y) - \int_0^y [\widehat{g}(x)]^T \widehat{C}_x^{-1} \int_{z \geq x} \widehat{g}(z) d\widehat{\mathcal{U}}_n(z) \, dG_n(x). \tag{6}$$

This transformation is similar to the Stute-Thies-Zhu transform of Stute *et al.* (1998), which in turn has its roots in the work of Khmaladze (1981).

The next theorem provides the required weak convergence result. It implies that the transform (6) of $\mathcal{U}(\cdot, \widehat{\theta}_n)$, under H_0, is asymptotically nuisance parameter free. Recall that the weak convergence in $D[0, \infty)$ is the weak convergence in $D[0, y]$, for every $0 \leq y < \infty$ (see Stone 1963). Here, and in the sequel, the symbol "$\Longrightarrow$" denotes weak convergence and W is the standard Brownian motion.

Theorem 1. *Suppose that (1)–(2), (C1)−(C10) and H_0 hold. Further, suppose that, for some $\beta > 0$, $\gamma > 0$, we have that*

$$(a) \quad E\|g(Y_0, \theta)\|^4 < \infty, \qquad (b) \quad E\{\|g(Y_0, \theta)\|^4 |Y_0|^{1+\beta}\} < \infty,$$

$$(c) \quad E\{(\|g(Y_1, \theta)\|^2 \|g(Y_0, \theta)\|^2 |\varepsilon_1 - 1|^2 |Y_1|\}^{1+\gamma} < \infty. \tag{7}$$

Then, for any consistent estimator $\widehat{\sigma}$ of σ,

$$\widehat{\sigma}^{-1} \widehat{\mathcal{W}}_n(y) \Longrightarrow W \circ G(y), \ \ in \ D[0, \infty) \ and \ the \ uniform \ metric.$$

Let $0 < y_0 < \infty$. For the rest of this section, we assume that the conditions of Theorem 1 are satisfied, unless the contrary is clear. Then, it follows from the foregoing theorem that $\widehat{\sigma}^{-1} \widehat{\mathcal{W}}_n(y) \Longrightarrow W \circ G(y)$ on $D[0, y_0]$ with respect to the uniform metric. Therefore, $\widehat{\sigma}^{-1} \widehat{\mathcal{W}}_n(y)$ converges weakly to a centered Gaussian process. Further, as shown in the next section, $\widehat{\sigma}^{-1} \widehat{\mathcal{W}}_n(y)$ has a drift under H_1. This suggests that a test of H_0 vs H_1 could be based on a suitably chosen functional of $\widehat{\sigma}^{-1} \widehat{\mathcal{W}}_n(y)$. To this end, define

$$TKS = \{\widehat{\sigma} \sqrt{G_n(y_0)}\}^{-1} \sup_{0 \le y \le y_0} |\widehat{\mathcal{W}}_n(y)|. \tag{8}$$

Then, by arguments similar to those in Stute *et al.* (1998), it follows that $TKS \overset{d}{\to} \sup_{0 \le t \le 1} |W(t)|$. Therefore, an asymptotic level-α test rejects H_0 if $TKS > c_\alpha$ where $P(\sup_{0 \le t \le 1} |W(t)| > c_\alpha) = \alpha$. While the foregoing result holds for any fixed y_0, in practice, its choice would depend on the data. A practical choice of y_0 could be the 99-th percentile of $\{Y_0, \ldots, Y_n\}$ (see, Stute *et al.* 1998).

For computing $\widehat{\mathcal{W}}_n(y)$, the following equivalent expression may be used:

$$\widehat{\mathcal{W}}_n(y) = \frac{1}{\sqrt{n}} \sum_{i=1}^{n} r_i \left[I(Y_{i-1} \le y) - \frac{1}{n} \sum_{j=1}^{n} G_i I(Y_{j-1} \le Y_{i-1} \wedge y) \right], \tag{9}$$

where $r_i := \{Y_i / \Psi(Y_{i-1}, \widehat{\theta}_n) - 1\}$ and $G_i := \widehat{g}^T(Y_{j-1}) \widehat{C}_{Y_{j-1}}^{-1} \widehat{g}(Y_{i-1})$.

A candidate for $\widehat{\sigma}^2$ in the foregoing theorem is

$$\widehat{\sigma}^2 := n^{-1} \sum_{i=1}^{n} \left\{ \frac{Y_i}{\Psi(Y_{i-1}, \widehat{\theta}_n)} - 1 \right\}^2. \tag{10}$$

By (C3)(b), (C6) and (C10), the $\widehat{\sigma}^2$ in (10) converges in probability to σ^2, under H_0.

3 Asymptotic Power

In this section we show that the test introduced in the previous section is consistent against certain fixed alternatives, and that it has nontrivial asymptotic power against a class of local nonparametric alternatives converging to the null hypothesis at the rate of $O(n^{-1/2})$.

3.1 Consistency

Let $v \notin \mathcal{M}$ be a known positive measurable function defined on $\mathbb{R}^+$. The alternative we are interested in is

$$H_a : \tau(y) = v(y), \quad \forall y \geq 0. \tag{11}$$

Consider the following set of conditions.

(C11). (a) The estimator $\widehat{\theta}_n$ of θ, obtained under the assumption that H_0 holds, converges in probability to some point in Θ under H_a; we shall also denote this limit by θ. **(b)** $\inf_{y \in \mathbb{R}^+} v(y) > 0$.
(c) $E[v(Y_0)/\Psi(Y_0, \theta)] \neq 1$ and $Ev^2(Y_0) < \infty$ under H_a, where θ is as in part (a) of this condition, and conditions (C3)(b) and (C5)$-$(C7) are assumed to hold.
(d) There exists a $d > 0$ and a nonnegative function $t(y, \theta)$, measurable in the y-coordinate, such that, for $\dot{g}(y, \theta)$ as in (C5), $Et^2(Y_0, \theta) < \infty$, $E\|\dot{g}(Y_0, \theta)\|t(Y_0, \theta) < \infty$, and $\|\Psi(y, \vartheta) - \Psi(y, \theta)\| \leq t(y, \theta)\|\vartheta - \theta\|$ for $y \geq 0$ and $\|\vartheta - \theta\| \leq d$.
(e) There exists a $y > 0$, such that

$$E\left(\left[\frac{v(Y_0)}{\Psi(Y_0, \theta)} - 1\right]I(Y_0 \leq y)\right) - B(y, \theta) \neq 0, \tag{12}$$

where $D(x, \theta) := E\big([v(Y_0)/\Psi(Y_0, \theta) - 1]g(Y_0, \theta)I(Y_0 \geq x)\big)$, and

$$B(y, \theta) \quad := \quad \int_0^y g^T(x, \theta)C^{-1}(x, \theta)D(x, \theta)dG(x).$$

Now, the following theorem states the consistency of the proposed test.

Theorem 2. *Assume that (1)–(2), H_a, (C1), (C3)(a) and (C11) hold, and that the estimator $\widehat{\sigma}^2$ converges in probability to a constant $\sigma_a^2 > 0$. Then, $P(TKS > c_\alpha) \rightarrow 1$. That is, the test that rejects H_0 whenever $TKS > c_\alpha$, is consistent for H_a.*

Under H_a, by (C1), (C3)(a), (C11) and the Ergodic Theorem [ET], the $\widehat{\sigma}^2$ of (10) converges in probability to $\sigma_a^2 := \sigma^2 E\{v(Y_0)/\Psi(Y_0, \theta)\}^2 + E\{v(Y_0)/\Psi(Y_0, \theta) - 1\}^2 > 0$.

3.2 Local Power

Let $\gamma \notin \mathcal{M}$ be a positive measurable function on $\mathbb{R}^+$, θ be as in H_0, and consider the following sequence of alternatives

$$H_{n\gamma} : \tau(y) = \Psi(y, \theta) + n^{-1/2}\gamma(y), \quad y \geq 0. \tag{13}$$

Assume that $\widehat{\theta}_n$ continues to be $\sqrt{n}$-consistent under $H_{n\gamma}$. Let

$$\rho(y) := E\left[\frac{\gamma(Y_0)}{\Psi(Y_0, \theta)}g(Y_0)I(Y_0 \geq y)\right].$$

Then we have the following theorem.

Theorem 3. *Assume that (1)–(2), $H_{n\gamma}$, (7) and conditions (C1)–(C10) hold, and that the $\widehat{\sigma}$ in Theorem 1 continues to be a consistent estimator of σ. Also, assume that the function γ in (13) satisfies $E[\gamma^2(Y_0)] < \infty$. Then, for all $y_0 > 0$,*

$$\lim_{n\to\infty} P(TKS > c_\alpha) = P\Big(\sup_{0 \le y \le y_0} |W \circ G(y) + \sigma^{-2}M(y)| \ge c_\alpha\Big),$$

where $M(y) = E\Big[\{\gamma(Y_0)/\Psi(Y_0, \theta)\}I(Y_0 \ge y)\Big] - \int_{x \le y} g^T(x)C_x^{-1}\rho(x)\, dG(x)$. Consequently, the test based on TKS of (8) has nontrivial asymptotic power against $H_{n\gamma}$, for all γ for which $M \ne 0$.

A routine argument shows that the estimator $\widehat{\theta}_n$ defined in (5) continues to satisfy (C10), under $H_{n\gamma}$. In fact, one can verify that under $H_{n\gamma}$ and the assumed conditions, $n^{1/2}(\widehat{\theta}_n - \theta) \to_D \mathcal{N}\big(C^{-1}(0,\theta)E\{\gamma(Y_0)g(Y_0,\theta)/\Psi(Y_0,\theta)\}, \sigma^2 C^{-1}(0,\theta)\big)$.

Note also that the $\widehat{\sigma}^2$ in (10) continues to be a consistent estimator of σ^2 under $H_{n\gamma}$, because

$$
\begin{aligned}
\widehat{\sigma}^2 &= n^{-1}\sum_{i=1}^{n}\left\{\varepsilon_i \frac{\Psi(Y_{i-1},\theta)}{\Psi(Y_{i-1},\widehat{\theta}_n)} - 1\right\}^2 + n^{-2}\sum_{i=1}^{n}\left\{\varepsilon_i \frac{\gamma(Y_{i-1})}{\Psi(Y_{i-1},\widehat{\theta}_n)}\right\}^2 \\
&\quad + 2n^{-1}\sum_{i=1}^{n}\left\{n^{-1/2}\frac{\Psi(Y_{i-1},\theta)}{\Psi^2(Y_{i-1},\widehat{\theta}_n)}(\varepsilon_i - 1)\varepsilon_i\gamma(Y_{i-1})\right\} \\
&\quad + 2n^{-1}\sum_{i=1}^{n}\left\{n^{-1/2}\frac{[\Psi(Y_{i-1},\theta) - \Psi(Y_{i-1},\widehat{\theta}_n)]}{\Psi^2(Y_{i-1},\widehat{\theta}_n)}\varepsilon_i\gamma(Y_{i-1})\right\}.
\end{aligned}
$$

It follows from (C3)(b), (C6) and (C10) that, under $H_{n\gamma}$, $\max_{1 \le i \le n}|\Psi_i(Y_{i-1},\theta) - \Psi_i(Y_{i-1},\widehat{\theta}_n)| = o_p(1)$ [see (A.15) below in the Appendix]. Thus, the first term on the right of the last equality converges in probability to σ^2. Since $E[\gamma^2(Y_0)] < \infty$ and ε_1 is independent of Y_0, by Ergodic Theorem, the second term is $o_p(1)$. Since $n^{-1/2}\max_{1 \le i \le n}|\Psi(Y_{i-1},\theta)| = o_p(1)$ by (C3)(b), and $\max_{1 \le i \le n}|\Psi_i(Y_{i-1},\theta) - \Psi_i(Y_{i-1},\widehat{\theta}_n)| = o_p(1)$, the last two terms are also $o_p(1)$.

4   A simulation study

A simulation study was carried out to investigate the finite sample performance of the proposed test for checking the lack-of-fit of a given parametric form for the conditional mean $E[y_t \mid \mathcal{H}_{t-1}]$ of a Markov multiplicative error model. For comparison, the Ljung-Box Q test (Ljung and Box 1978), a Lagrange multiplier (LM) test (Meitz and Teräsvirta 2006), and a generalized moment test (Chen and Hsieh 2010) were also considered. The Ljung-Box Q test was first used for evaluating a multiplicative error model by Engle and Russell (1998). Since then, it has been used in a large proportion of the subsequent studies involving multiplicative error models. Ljung-Box Q statistic is given by $\mathrm{LBQ}(L) = T(T + 2)\sum_{k=1}^{L}(T - k)^{-1}\rho_k^2$,

where L is the number of autocorrelation lags included in the statistic, and ρ_k^2 is the squared sample autocorrelation at lag k of the residuals corresponding to the estimated model.

Design of the study:

To evaluate size performances of the tests, 6 data generating processes (DGPs) were considered for generating $Y_0, Y_1, \cdots, Y_n$. Five of them were based on the model,

$$\text{ACD}(1,0): \quad Y_i = \tau_i \varepsilon_i, \quad \tau_i = 0.2 + 0.1 Y_{i-1}, \tag{14}$$

where the error distributions were, respectively, the Exp(1) [E] and the following Weibull [W], Gamma [G], Generalized Gamma [GG] and Burr [B] distributions:

$$\text{W:} \quad f_W(x,a) = (a/b)(x/b)^{a-1} \exp\{-(x/b)^a\}, \quad a = 0.6$$

$$\text{G:} \quad f_G(x) = \{4/\Gamma(2)\} x \exp(-2x)$$

$$\text{GG:} \quad f_{GG}(x,a,c) = \{b^{ac}\Gamma(a)\}^{-1} c x^{ac-1} \exp\{-(x/b)^c\}, \quad a = 3, c = 0.3$$

$$\text{B:} \quad f_B(x,a,d) = (a/b)(x/b)^{a-1}\{1 + d(x/b)^a\}^{-(1+d^{-1})}, \quad a = 1.3, d = 0.4.$$

For each of these distributions, the scale parameter b was chosen so that $E(\varepsilon_1) = 1$. The sixth DGP for size was the following Squared-ARCH(1) model:

$$\text{Squared-ARCH}(1): \quad X_i = \sqrt{\tau_i}\epsilon_i, \quad \tau_i = 0.1 + 0.85 Y_{i-1}, \ Y_i = X_i^2, \tag{15}$$

where the errors $\{\epsilon_i\}$ are i.i.d. standard normal [N]. Here, $Y_i = X_i^2$ follows a Markov multiplicative error model of the form (1)–(2).

To evaluate the powers of the tests, 4 data generating processes were considered. First three of them were based on the following Markov multiplicative error model:

$$\mathcal{M}(\alpha, \beta, \gamma): \quad Y_i = \tau_i \varepsilon_i, \quad \tau_i = \alpha + \beta Y_{i-1} + \gamma \sqrt{Y_{i-1}}. \tag{16}$$

The data were generated from $\mathcal{M}(0.2, 0.1, 0.3)$, $\mathcal{M}(0.2, 0.1, 0.5)$ and $\mathcal{M}(0.2, 0.1, 0.7)$, keeping Exp(1) as the distribution of the error term ε_i. The fourth DGP to evaluate powers was the following Squared-ARCH(2) model:

$$\text{Squared-ARCH}(2): \quad X_i = \sqrt{\tau_i}\epsilon_i, \quad \tau_i = 0.2 + 0.1 Y_{i-1} + 0.05 Y_{i-2}, \ Y_i = X_i^2, \tag{17}$$

where $\{\epsilon_i\}$ are i.i.d. standard normal. The $Y_i = X_i^2$ in (17) follows a multiplicative error model, however, it is not Markov.

For each DGP, the null and alternative hypotheses were

$$H_0: \tau_i = \Psi(Y_{i-1}, \vartheta), \text{ where } \Psi(y, \vartheta) = \vartheta_1 + \vartheta_2 y, \quad \text{and} \quad H_1: \text{Not } H_0 \tag{18}$$

respectively, with $\vartheta = (\vartheta_1, \vartheta_2)' \in (\mathbb{R}^+)^2$, $Y_i = \tau_i \varepsilon_i$ and ε_i are i.i.d.. Thus, ACD(1,0) in (14) and Squared-ARCH(1) in (15) are models under H_0, whereas, $\mathcal{M}(\alpha, \beta, \gamma)$ and Squared-ARCH(2) in (16) and (17) are models under H_1.

To start the recursive data generating processes to generate $Y_0, Y_1, \cdots, Y_n$, the initial value of τ_i was set equal to the unconditional mean of Y for every DGP. To ensure that the effect of initialization is negligible, we generated $(n + \ell + 1)$ observations with $\ell = 300$, discarded the first ℓ observations and used the remaining $n + 1$ observations as $Y_0, Y_1, \cdots, Y_n$. All the simulation estimates are based on 1000 repetitions.

It follows from the null hypothesis in (18) that the parametric family to be fitted is $\mathcal{M} = \{\Psi(\cdot, \vartheta) : \Psi(y, \vartheta) = \vartheta_1 + \vartheta_2 y, \ \vartheta_1, \vartheta_2 > 0, \ y \geq 0\}$. Let $\widehat{\theta} = (\widehat{\theta}_1, \widehat{\theta}_2)'$ denote the quasi-maximum likelihood estimator (5) of θ and let $\widehat{\sigma}^2$ be given by (10). Then, we have that $\dot{\Psi}(y, \vartheta) = (1, \ y)'$, $g(y, \vartheta) = \dot{\Psi}(y, \vartheta)/\Psi(y, \vartheta)$,

$$\widehat{g}(y) = g(y, \widehat{\theta}_n) = [1, \ y]'/\{\widehat{\theta}_1 + \widehat{\theta}_2 y\}, \quad r_i = Y_i/\{\widehat{\theta}_1 + \widehat{\theta}_2 Y_{i-1}\} - 1 \quad \text{and}$$

$$\widehat{C}_y = n^{-1} \sum_{i=1}^n \widehat{g}(Y_{i-1})\widehat{g}(Y_{i-1})^T I(Y_{i-1} > y) = n^{-1} \sum_{i=1}^n V_{i-1}/\{\widehat{\theta}_1 + \widehat{\theta}_2 Y_{i-1}\}^2 I(Y_{i-1} > y),$$

where

$$V_{i-1} = \begin{bmatrix} 1 & Y_{i-1} \\ Y_{i-1} & Y_{i-1}^2 \end{bmatrix}.$$

Now, let $Y_{(1)}, Y_{(2)}, \cdots, Y_{(n)}$ be the ordered values of the sample $Y_1, Y_2, \cdots, Y_n$. Then, with the forgoing choices and with y_0 being the 99% quantile, we have that

$$\text{TKS} = \{\widehat{\sigma}\sqrt{0.99}\}^{-1} \sup_{0 \leq y \leq y_0} |\widehat{\mathcal{W}}_n(y)| = \{\widehat{\sigma}\sqrt{0.99}\}^{-1} \max_{1 \leq i \leq [n0.99]} |\widehat{\mathcal{W}}_n(Y_{(i-1)})|,$$

where $\widehat{\mathcal{W}}_n$ is as in (9).

The large sample level-α critical value c_α of TKS is equal to the $100(1 - \alpha)\%$ quantile of $\sup_{0 \leq t \leq 1} |W(t)|$. For $\alpha = 0.01, 0.05$ and 0.10, these critical values are 2.807034, 2.241403 and 1.959964, respectively. These values, prepared by Dr R. Brownrigg, are available at *http://homepages.mcs.vuw.ac.nz/~ray/Brownian*.

For the LM test, we used the form in Theorem 1 of Meitz and Teräsvirta (2006), with $\text{ACD}(2, 0)$ being the model under the maintained hypothesis. Because the null model is $\text{ACD}(1, 0)$, the asymptotic null distribution of LM is χ_1^2 (Meitz and Teräsvirta 2006). The generalized moment test is the M-test proposed in Chen and Hsieh (2010). Its test statistic M, was computed as on page 354 of Chen and Hsieh (2010), using $(\varepsilon_{i-1} - 1)$ as the "misspecification indicator" g_i. Under H_0, the statistic M converges in distribution to χ_1^2 (see page 353 in Chen and Hsieh 2010). As in Engle and Russell (1998), the critical values for the LBQ(L) were obtained from χ_L^2.

Results:

We evaluated the performance of the TKS test, with the LM, Ljung-Box Q (with lags 1, 5, 10 and 15) and M tests, for 1%, 5% and 10% levels, considering different data generating

processes and sample sizes. A summary of the main results are presented in Table 1. More detailed results are available from the authors on request.

Each entry in Table 1 is the percentage of times H_0 was rejected out of 1000 repetitions, at 5% level. For each such entry, say p, a corresponding standard error is $\{p(1-p)/1000\}^{1/2}$. It is evident from Table 1 that the TKS test proposed in this paper performed well in terms of size, although it was slightly undersized for $n = 200$. The M test exhibited serious size distortions for $n = 200$, but to a lesser extent for $n = 500$. Table 1 shows that, for $n = 200$, the type I error rate of the 5% level M test was at least 20%. However, this test performed well in terms of size when $n = 1000, 2000$, and 5000. The results for LBQ and LM were not particularly good. The LM test exhibited significant sensitivity to the form of the error distribution. For example, for the ACD(1,0) model, the type I error rate of the 5% level LM test ranged from 0.3% for gamma distribution to 22% for the Weibull distribution.

The estimated powers of the tests (in %) corresponding to 5% level are also presented in Table 1. The main observations may be summarized as follows.

(i) The test proposed in this paper, TKS, performed consistently well throughout. Its performance was either the best or close to the best. Specially, when the DGP was Markov, the power of the TKS test was substantially better than those for LBQ, LM and M tests.

(ii) The LM test implemented in this study was defined for testing against a Squared-ARCH(2) alternative. Consequently, as expected, the LM test performed the best when the DGP was Squared-ARCH(2) in (17). However, when the DGP was not Squared-ARCH(2), the LM test performed substantially worse than the TKS test.

(iii) The LBQ test appeared somewhat sensitive to the number of lags included in the statistic. In comparison, the performance of the M test was more consistent, throughout. However, its power was considerably lower than that of the TKS test, in all the simulations.

5   Empirical examples

In this section, we illustrate our testing procedure by considering two data examples. For comparison, the LBQ, LM and M tests considered in Section 4 are also employed.

Example 1:

We first apply the testing procedures to monthly squared log returns of Intel stocks. The data for this example were downloaded from the home page of Professor Ruey S. Tsay. The sample consists of monthly log stock returns of Intel Corporation from January 1973 to December 2008. Tsay (2010) studied this data set, and concluded that an ARCH(1) model

appears to fit well. This indicates that a multiplicative Markov model of the form (1)–(2) may be adequate for squared log returns. We employ the proposed testing procedure for checking the adequacy of the following Markov multiplicative error model:

$$Y_i = \Psi(Y_{i-1}, \vartheta)\varepsilon_i, \quad \Psi(y, \vartheta) = \vartheta_1 + \vartheta_2 y, \ \vartheta = (\vartheta_1, \vartheta_2)^T \in (\mathbb{R}^+)^2. \tag{19}$$

First, the model (19) is estimated by the QML estimator (5). The estimated model is, $\Psi(y, \widehat{\theta}) = 0.0115 + 0.3661y$, where the standard errors of the parameters are 0.0015, and 0.1226, respectively. Figure 1 provides a plot of $\{\widehat{\sigma}\sqrt{0.99}\}^{-1}|\widehat{\mathcal{W}}_n(y)|$ against y. From this graph, we obtain that TKS = 1.9192, which is the supremum of the graph. Hence, the TKS test does not reject the null model in (19) at 10% level. For other three tests, the observed test statistics are LBQ(1)=0.8001, LBQ(5)=6.7610, LBQ(10)=13.1506, LBQ(15)=30.5898, LM=0.8153 and $M = 3.5415$, with the corresponding p-values 0.3708, 0.2390, 0.2154, 0.010, 0.3666 and 0.06, respectively.

Thus, apart from LBQ(15), all other tests fail to reject the null model (19), at 5% level. In the simulations carried out in the last section, it was evident that the LBQ test was somewhat sensitive to the number of lags included in the statistic. Therefore, it is prudent not to rely on the conclusion of the LBQ(15) alone. The LM test too, in the simulations, was considerably sensitive to the distribution of the error term ε_i, which is unknown to us in this case. However, the TKS test, which displayed the best overall performance in the simulations, fails to reject the null model (19). The conclusions from the LBQ(L) (at $L = 1, 5, 10$) and M tests, are also similar. Therefore, the indications are that the model (19) provides a good fit for the data.

Example 2:

For the second example we consider the viscosity data (Series D) from Box and Jenkins (1976). This sample consists of 310 observations of hourly viscosity readings of a particular chemical process. Based on preliminary diagnostic tests, Datta and McCormick (1995) who studied this data set, concluded that a positive AR(1) model appears to fit well. This suggests that an additive Markov structure is adequate for the hourly viscosity readings of the process. In order to check whether a multiplicative Markov structure would also be adequate, we test the lack-of-fit of the Markov multiplicative error model in (19) for the data set.

We first estimate the model using QML estimator (5), and obtain that $\Psi(y, \widehat{\theta}) = 4.2814 + 0.5299y$, where the standard errors of the parameters are 0.3111, and 0.0342, respectively. A plot of $\{\widehat{\sigma}\sqrt{0.99}\}^{-1}|\widehat{\mathcal{W}}_n(y)|$ against y for this data set is given in Figure 2. As appears from this graph, we have that TKS = 10.9627. Therefore, our test would reject the null model (19) at any reasonable level of significance. This is also consistent with the conclusions of the M and LBQ tests. However, the LM test fails to reject the null model (19) even

when α is as high as 0.7. Specifically, we obtain that LBQ(1)=80.8609, LBQ(5)=229.3536, LBQ(10)=287.1413, LBQ(15)=306.0199, LM=0.133 and $M = 338.6616$, with the p-value of LM being 0.7154 and the p-values of M and LBQ(L), at all lags, being almost zero.

Therefore, as indicated by the TKS, M and LBQ tests, it does not appear that the multiplicative model (19) is a good fit for the data. The LM test performed poorly in the simulations carried out in the last section within the Markov setting. Therefore, the conclusion of the LM test may not be very reliable in this case.

6   Conclusion

The contribution of this paper has methodological and theoretical components. We developed a new test for the lack-of-fit of a given multiplicative error model having a Markov structure. The family of such Markov multiplicative error models is a simple subfamily of the general class of multiplicative models introduced by Engle (2002). In empirical studies, one would want to consider a general non-Markov model only if a simpler Markov model does not fit. The development of the test proposed in this paper, makes use of the Markov structure in the proposed model. Therefore, this test is fundamentally different from the more general ones such as the Lagrange Multiplier (LM) type tests (Meitz and Teräsvirta 2006, Hautsch 2006), spectral derivative based tests (Hong and Lee 2011) or generalized moment tests (Chen and Hsieh 2010), for multiplicative error models. Thus, it is reasonable to conjecture that these may also have properties that are complementary. In fact, in a simulation study, the new test performed better overall than the Ljung-Box Q-test, a LM test and a generalized moment test. Therefore, the indications are that the test proposed in this paper would be useful in empirical studies involving multiplicative error models. We illustrated the testing procedure by considering two data examples.

This paper also makes a theoretical contribution. The approach of constructing a process such as $\widehat{\mathcal{W}}_n(\cdot)$ through a particular martingale transformation of an empirical process marked by the residuals, and then using it to construct an asymptotically distribution free test, is fairly recent. At this stage, this method has been developed for location, regression and certain autoregressive models. This paper is the first to develop the method for multiplicative time series models.

The technical details of this method included in the Appendix to this paper, would provide valuable insight and facilitate extension to other models.

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APPENDIX: PROOFS

In this section we present the proofs of Theorem 1 and Theorem 2. We first obtain several needed preliminaries. The following lemma provides a general weak convergence result about the marked empirical process

$$\alpha_n(y) = n^{-1/2} \sum_{i=1}^{n} \ell(Y_{i-1})(\varepsilon_i - 1)I(Y_{i-1} \leq y),$$

where ℓ is a nonnegative measurable function on $\mathbb{R}^+$. This result will be used in the proofs of the other results in this section.

Lemma 1. *Assume that model (1)–(2), (C1) and (C2) hold, and that $\inf_{y \in \mathbb{R}^+} \tau(y) > 0$. Suppose, in addition, that for some $\beta > 0$, $\gamma > 0$,*

$$(a) \quad E\ell^4(Y_0) < \infty, \qquad (b) \quad E\{\ell^4(Y_0)|Y_0|^{1+\beta}\} < \infty,$$

$$(c) \quad E\{\ell^2(Y_0)\ell^2(Y_1)|\varepsilon_1 - 1|^2|Y_1|\}^{1+\gamma} < \infty. \tag{A.1}$$

Then, $\alpha_n \implies W \circ \rho$, in the space $D[0, \infty]$ with respect to uniform metric, where $\rho(y) := \sigma^2 E\ell^2(Y_0)I(Y_0 \leq y)$.

This lemma is similar to Lemma 3.1 of Koul and Stute (1999) but it does not directly follow from that lemma. The main reason is that the present model is multiplicative while the one considered in Koul and Stute (1999) is additive.

Proof of Lemma 1. The convergence of finite dimensional distributions of $\alpha_n(\cdot)$ follows by an application of the CLT for martingales [Hall and Heyde (1980), Corollary 3.1]. To show the tightness of $\alpha_n(\cdot)$ we now argue as in Koul and Stute (1999). First fix $0 \leq t_1 < t_2 < t_3 \leq \infty$. Then,

$$[\alpha_n(t_3) - \alpha_n(t_2)]^2[\alpha_n(t_2) - \alpha_n(t_1)]^2 = n^{-2} \sum_{i, j, k, l} U_i U_j V_k V_l,$$

where $U_i = \ell(Y_{i-1})(\varepsilon_i - 1)I(t_2 < Y_{i-1} \leq t_3)$ and $V_i = \ell(Y_{i-1})(\varepsilon_i - 1)I(t_1 < Y_{i-1} \leq t_2)$. Since ε_i is independent of $\{Y_{i-1}, Y_{i-2}, \cdots, Y_0\}$ and $E(\varepsilon_i) = 1$,

$$E\left\{n^{-2} \sum_{i, j, k, l} U_i U_j V_k V_l\right\} = n^{-2} \sum_{i, j<k} E\{V_i V_j U_k^2\} + n^{-2} \sum_{i, j<k} E\{U_i U_j V_k^2\}. \tag{A.2}$$

Note that by (A.1)(a) the above expectations exist.

We shall now find bounds for the two sums in the right hand side. We only consider the first sum. A bound for the second sum can be obtained similarly. First, let k be an arbitrary

integer in the range $2 \le k \le n$. Then, by the inequality $(a + b)^2 \le 2a^2 + 2b^2$, $a, b \in \mathbb{R}$, and the stationarity of $\{Y_i\}$,

$$\sum_{i,\ j<k} E\{V_i V_j U_k^2\} \ \le \ 2\sigma^2\Bigg[E\Big\{\Big(\sum_{i=1}^{k-2} V_i\Big)^2 \ell^2(Y_{k-1})I(t_2 < Y_{k-1} \le t_3)\Big\}$$

$$+ E\{V_1^2 \ell^2(Y_1)I(t_2 < Y_1 \le t_3)\}\Bigg]. \tag{A.3}$$

By conditioning on Y_{k-2} and using Fubini's theorem and the Cauchy - Schwarz inequality, the first expectation inside brackets is the same as

$$E\Big\{\Big(\sum_{i=1}^{k-2} V_i\Big)^2 \int_{t_2}^{t_3} \frac{\ell^2(y)}{\tau(Y_{k-2})} f\Big(\frac{y}{\tau(Y_{k-2})}\Big) \, dy\Big\}$$

$$\le \ \int_{t_2}^{t_3} \Big\{E\Big(\sum_{i=1}^{k-2} V_i\Big)^4\Big\}^{1/2} \Big\{\ell^4(y)E\Big[\frac{1}{\tau^2(Y_0)}f^2\Big(\frac{y}{\tau(Y_0)}\Big)\Big]\Big\}^{1/2} \, dy.$$

Since the V_i's form a centered martingale difference array, by the Burkholder's inequality [Chow and Teicher (1978), page 384] and the fact $(\sum_{i=1}^{k-2} V_i^2)^2 \le (k-2)(\sum_{i=1}^{k-2} V_i^4)$,

$$E\Big(\sum_{i=1}^{k-2} V_i\Big)^4 \le KE\Big(\sum_{i=1}^{k-2} V_i^2\Big)^2 \le K(k-2)^2 EV_1^4.$$

Here and in the rest of the proof, K is a generic constant that does not depend on n, k or the chosen t_1, t_2 and t_3 but may vary from expression to expression. Now, let

$$F_1(t) \ := \ E(\varepsilon_1 - 1)^4 E\big(\ell^4(Y_0)I(Y_0 \le t)\big), \qquad 0 \le t \le \infty,$$

$$F_2(t) \ := \ \int_0^t \Big\{\ell^4(y)E\Big[\frac{1}{\tau^2(Y_0)}f^2\Big(\frac{y}{\tau(Y_0)}\Big)\Big]\Big\}^{1/2} \, dy, \qquad 0 \le t \le \infty.$$

Then, we obtain, $EV_1^4 = E(\varepsilon_1 - 1)^4 E\big(\ell^4(Y_0)I(t_1 < Y_0 \le t_2)\big) = [F_1(t_2) - F_1(t_1)]$ and $\int_{t_2}^{t_3} \big\{\ell^4(y)E\big[f^2(y/\tau(Y_0))/\tau^2(Y_0)\big]\big\}^{1/2} \, dy = [F_2(t_3) - F_2(t_2)]$. Hence, the first expectation inside brackets in (A.3) is bounded from the above by

$$K(k-2)[F_1(t_2) - F_1(t_1)]^{1/2}[F_2(t_3) - F_2(t_2)]. \tag{A.4}$$

Since, $EY_1^4 < \infty$, we have that $E(\varepsilon_1 - 1)^4 < \infty$. Then, by assumption (A.1)(a), F_1 is a continuous nondecreasing bounded function on $\mathbb{R}^+$. Clearly, F_2 is also nondecreasing and continuous. We shall now show that $F_2(\infty)$ is finite.

To this end, let r be a strictly positive continuous Lebesgue density on $\mathbb{R}^+$ such that $r(y) \sim y^{-1-\beta}$ as $y \to \infty$, where β is as in (A.1)(b). Then, by the Cauchy – Schwarz

inequality, Fubini's theorem, and using the fact that f/τ is uniformly bounded,

$$
\begin{aligned}
F_2(\infty) &\leq \left[\int_0^\infty \ell^4(y) E\Big[\frac{1}{\tau^2(Y_0)} f^2\Big(\frac{y}{\tau(Y_0)} \Big) \Big] r^{-1}(y) \, dy \right]^{1/2} \\
&\leq K\left[E\Big\{ \int_0^\infty \ell^4(y) \frac{1}{\tau(Y_0)} f\Big(\frac{y}{\tau(Y_0)} \Big) r^{-1}(y) \, dy \Big\} \right]^{1/2} < \infty,
\end{aligned}
$$

where the finiteness of the last expectation follows from (A.1)(b).

By conditioning on Y_0, using Fubini's theorem, Hölder's inequality and the γ as in (A.1)(c), we obtain that the second expectation inside brackets in (A.3) is the same as

$$
\begin{aligned}
\int_{t_2}^{t_3} & E\Big\{ I(t_1 < Y_0 \leq t_2) \ell^2(Y_0) \ell^2(y) \Big(\frac{y}{\tau(Y_0)} - 1 \Big)^2 \frac{1}{\tau(Y_0)} f\Big(\frac{y}{\tau(Y_0)} \Big) \Big\} \, dy \\
&\leq \big\{ E I(t_1 < Y_0 \leq t_2) \big\}^{\gamma/(1+\gamma)} \\
&\quad \times \int_{t_2}^{t_3} \Big[E\Big\{ \ell^2(Y_0) \ell^2(y) \Big(\frac{y}{\tau(Y_0)} - 1 \Big)^2 \frac{1}{\tau(Y_0)} f\Big(\frac{y}{\tau(Y_0)} \Big) \Big\}^{1+\gamma} \Big]^{1/(1+\gamma)} \, dy.
\end{aligned}
$$

Thus,

$$
E\{ V_1^2 \ell^2(Y_1) I(t_2 < Y_1 \leq t_3) \} \leq [G(t_2) - G(t_1)]^{\gamma/(1+\gamma)} [F_3(t_3) - F_3(t_2)], \tag{A.5}
$$

where, for $t \in [0, \infty]$,

$$
F_3(t) := \int_0^t \Big[E\Big\{ \ell^2(Y_0) \ell^2(y) \Big(\frac{y}{\tau(Y_0)} - 1 \Big)^2 \frac{f\big(y/\tau(Y_0)\big)}{\tau(Y_0)} \Big\}^{1/(1+\gamma)} \Big]^{1+\gamma} \, dy.
$$

Clearly, F_3 is a nondecreasing and continuous function on $\mathbb{R}^+$. For the boundedness, we shall show that $F_3(\infty)$ is finite. Towards this end, let s be a strictly positive continuous Lebesgue density on $\mathbb{R}^+$ such that $s(y) \sim y^{-1-1/\gamma}$ as $y \to \infty$, where γ is as in (A.1)(c). Arguing as in the case of F_2, we obtain that $F_3(\infty)$ is less than or equal to

$$
\begin{aligned}
&\left[\int_0^\infty E\Big\{ \ell^2(Y_0) \ell^2(y) \Big(\frac{y}{\tau(Y_0)} - 1 \Big)^2 \frac{1}{\tau(Y_0)} f\Big(\frac{y}{\tau(Y_0)} \Big) \Big\}^{1+\gamma} s^{-\gamma}(y) \, dy \right]^{1/(1+\gamma)} \\
&\leq K\left[E\big\{ \ell^2(Y_0) \ell^2(Y_1) (\varepsilon_1 - 1)^2 s^{-\gamma/(1+\gamma)}(Y_1) \big\}^{1+\gamma} \right]^{1/(1+\gamma)} < \infty,
\end{aligned}
$$

This yields that F_3 is also a continuous nondecreasing and bounded function on $\mathbb{R}^+$. Now, by (A.3), (A.4) and (A.5) and summing from $k = 2$ to $k = n$ we obtain

$$
\begin{aligned}
n^{-2} \sum_{i,\, j < k} E\{ V_i V_j U_k^2 \} &\leq K\Big\{ [F_1(t_2) - F_1(t_1)]^{1/2} [F_2(t_3) - F_2(t_2)] \\
&\qquad + n^{-1} [G(t_2) - G(t_1)]^{\gamma/(1+\gamma)} [F_3(t_3) - F_3(t_2)] \Big\}.
\end{aligned}
$$

By similar arguments, the second sum in the right hand side of (A.2) also has a similar bound. Consequently, tightness of $\{\alpha_n\}$ follows from Theorem 15.6 in Billingsley (1968). This completes the proof of Lemma 1. ∎

For the proof of Theorem 1 we need some more additional results. Next lemma gives the needed weak convergence result for $\mathcal{U}_n(y, \theta)$.

Lemma 2. *Suppose (1)–(2), (C1), (C2), (C3)(a) and H_0 hold. Then, $\sigma^{-1}\mathcal{U}_n(y, \theta) \Longrightarrow W \circ G(y)$, in $D[0, \infty]$ and uniform metric.*

Proof. Under H_0 and (C3)(a), $\tau(y) = \Psi(y, \theta)$ is bounded away from zero uniformly in y. Since, by (C1), $EY_0^4 < \infty$ then condition (A.1) is satisfied for $\ell(y) \equiv 1$. Thus, an application of Lemma 1 completes the proof. ∎

For brevity, write $\mathcal{U}_n(y) = \mathcal{U}_n(y, \theta)$, $g(y) = g(y, \theta)$ and $C_y = C(y, \theta)$, and define

$$\mathcal{W}_n(y) := \mathcal{U}_n(y) - \int_0^y g^T(x)C_x^{-1}\left[\int_x^\infty g(z)\, d\mathcal{U}_n(z)\right] dG(x), \quad \mu_i(y) := I(Y_{i-1} \geq y).$$

The following lemma gives the weak convergence of $\mathcal{W}_n$.

Lemma 3. *Under (1)–(2), (C1)–(C9) and H_0, $\sigma^{-1}\mathcal{W}_n(y) \Longrightarrow W \circ G(y)$, in $D[0, \infty]$ and uniform metric.*

Proof. Arguing as in Stute *et al.* (1998) and using a conditioning argument, one can verify that $\text{Cov}\{\sigma^{-1}\mathcal{W}_n(r), \sigma^{-1}\mathcal{W}_n(s)\} = G(r \wedge s)$.

To establish the convergence of finite dimensional distributions, let $\mathcal{F}_i$ be the σ-algebra generated by $\{\varepsilon_i, \varepsilon_{i-1}, \cdots, Y_{i-1}, Y_{i-2}, \cdots\}, i \in \mathbb{Z}$ and

$$h_i(y) = \sigma^{-1}(\varepsilon_i - 1)\left\{I(Y_{i-1} \leq y) - \int_0^{y \wedge Y_{i-1}} g^T(x)C_x^{-1}g(Y_{i-1})\, dG(x)\right\}, \quad i = 1, \cdots, n.$$

Note that $E\big(h_i(y)|\mathcal{F}_{i-1}\big) = 0$, for all i and $\sigma^{-1}\mathcal{W}_n(y) = n^{-1/2}\sum_{i=1}^n h_i(y)$, for all y. Because $\text{Cov}\big(\sigma^{-1}\mathcal{W}_n(x), \sigma^{-1}\mathcal{W}_n(y)\big) = \text{Cov}\big(W \circ G(x), W \circ G(y)\big)$, by CLT for martingales, e.g., cf. Corollary 3.1 of Hall and Heyde (1980), all finite dimensional distributions of $\sigma^{-1}\mathcal{W}_n$ converge to those of $W \circ G$.

Lemma 2 implies the tightness of the process $\mathcal{U}_n(\cdot)$ in uniform metric. It remains to prove the tightness of the second term in $\mathcal{W}_n$. Denote it by $\mathcal{W}_{2n}$. Then,

$$\mathcal{W}_{2n}(y) = \frac{1}{\sqrt{n}}\sum_{i=1}^n (\varepsilon_i - 1)\int_0^y g^T(x)C_x^{-1}g(Y_{i-1})\mu_i(x)dG(x).$$

Proceeding as on page 231 of Koul and Stute (1999), let $A(y) := \int_0^y \|g^T(x)C_x^{-1}\|\, dG(x)$, $y \in [0, \infty]$. By condition (C9), $0 < A(\infty) < \infty$. Because G is continuous, the function $\mathcal{A}(y) := A(y)/A(\infty)$ is strictly increasing continuous distribution function on $[0, \infty]$. Moreover, using the fact $\|C_x\| \leq \int \|g\|^2 dG$, for all $0 \leq x \leq \infty$, and by the Fubini Theorem, for

$y_1 < y < y_2$,

$$E\big[\mathcal{W}_{2n}(y_1) - \mathcal{W}_{2n}(y_2)\big]^2 \;=\; \sigma^2 \int_{y_1}^{y_2}\int_{y_1}^{y_2} g^T(x_1) C_{x_1}^{-1} C_{x_1 \vee x_2} C_{x_2}^{-1} g(x_2) \; dG(x_1) \; dG(x_2)$$

$$\leq \;\; \sigma^2 \int \|g(y)\|^2 \; dG(y) [\mathcal{A}(y_2) - \mathcal{A}(y_1)]^2 A^2(\infty).$$

This bound, together with Theorem 12.3 of Billingsley (1968), imply that $\mathcal{W}_{2n}$ is tight. This completes the proof of Lemma 3. ∎

For the proof of Theorem 1 we also make use of Lemma 3.4 of Stute *et al.* (1998) which in turn is a generalization of Lemma 3.2 of Chang (1990). For the sake of completeness we reproduce it here.

Lemma 4. *Let V be a relatively compact subset of $D[0, y_0]$. Then with probability 1, for all $y_0 < \infty$, $\int_0^y v(x)[dG_n(x) - dG(x)] \longrightarrow 0$ as $n \to \infty$, uniformly in $0 \leq y \leq y_0$ and $v \in V$.*

Proof of Theorem 1. Fix a $y_0 > 0$. Recall that $\mathcal{U}_n(y) = \mathcal{U}_n(u, \theta)$ and $\widehat{\mathcal{U}}_n(y) = \mathcal{U}_n(y, \widehat{\theta}_n)$. Let

$$\widetilde{\mathcal{W}}_n(y) := \mathcal{U}_n(y) - \int_0^y \widehat{g}^T(x) \widehat{C}_x^{-1} \Big[\int_x^\infty \widehat{g}(z) \, d\mathcal{U}_n(z) \Big] \, dG_n(x).$$

We shall first show that $\sup_{0 \leq y \leq y_0} |\widehat{\mathcal{W}}_n(y) - \widetilde{\mathcal{W}}_n(y)| = o_p(1)$. Write

$$\widehat{\mathcal{W}}_n(y) - \widetilde{\mathcal{W}}_n(y) \;=\; \widehat{\mathcal{U}}_n(y) - \mathcal{U}_n(y) - \int_0^y \widehat{g}^T(x) \widehat{C}_x^{-1} J_n(x) \, dG_n(x), \tag{A.6}$$

where $J_n(y) := \int_y^\infty \widehat{g}(z) \, d\widehat{\mathcal{U}}_n(z) - \int_y^\infty \widehat{g}(z) \, d\mathcal{U}_n(z)$.

First, consider $\widehat{\mathcal{U}}_n(y) - \mathcal{U}_n(y)$. Let $\Delta_n := n^{1/2}(\widehat{\theta}_n - \theta)$. By the mean value theorem, there is a sequence of random vectors $\{\theta_n^*\}$ in Θ with $\|\theta_n^* - \theta\| \leq \|\widehat{\theta}_n - \theta\|$, and such that

$$\widehat{\mathcal{U}}_n(y) - \mathcal{U}_n(y) \;=\; -\Delta_n^T n^{-1} \sum_{i=1}^n \varepsilon_i g(Y_{i-1}) I(Y_{i-1} \leq y) \;+\; \Delta_n^T R_n(y), \tag{A.7}$$

where $\quad R_n(y) \;:=\; -n^{-1} \sum_{i=1}^n \Big(\frac{\Psi(Y_{i-1}, \theta)}{\Psi(Y_{i-1}, \theta_n^*)} g(Y_{i-1}, \theta_n^*) - g(Y_{i-1}) \Big) \varepsilon_i I(Y_{i-1} \leq y).$

Since, by (C3)(a), Ψ is bounded from below, $\kappa := 1/\inf_{y,\vartheta} \Psi(y, \vartheta) < \infty$. By the triangle inequality, $\sup_{y \geq 0} \|R_n(y)\|$ is bounded from the above by

$$n^{-1} \sum_{i=1}^n \Big\| \Big(\frac{\Psi(Y_{i-1}, \theta)}{\Psi(Y_{i-1}, \theta_n^*)} - 1 \Big) g(Y_{i-1}, \theta_n^*) \varepsilon_i + \big(g(Y_{i-1}, \theta_n^*) - g(Y_{i-1})\big) \varepsilon_i \Big\|$$

$$\leq \;\; \kappa \max_{1 \leq i \leq n} |\Psi(Y_{i-1}, \theta) - \Psi(Y_{i-1}, \theta_n^*)| \Big(n^{-1} \sum_{i=1}^n \|g(Y_{i-1}, \theta_n^*) \varepsilon_i\| \Big)$$

$$+ \; n^{-1} \sum_{i=1}^n \big\| \big(g(Y_{i-1}, \theta_n^*) - g(Y_{i-1})\big) \varepsilon_i \big\|. \tag{A.8}$$

By condition (C4),

$$\max_{1\leq i\leq n} |\Psi(Y_{i-1},\theta) - \Psi(Y_{i-1},\theta_n^*)| \leq \|\Delta_n\|n^{-1/2}\max_{1\leq i\leq n}\|\dot\Psi(Y_{i-1},\theta)\| + o_p(n^{-1/2}). \tag{A.9}$$

Since (C3)(b) gives $\int |\Psi(y,\theta)|^2\, dG(y) < \infty$, along with (C6), we obtain

$$\int \|\dot\Psi(y,\theta)\|^2\, dG(y) \leq \int \|g(y)\|^2\, dG(y)\int |\Psi(y,\theta)|^2\, dG(y) < \infty.$$

This in turn implies that

$$n^{-1/2}\max_{1\leq i\leq n}\|\dot\Psi(Y_{i-1},\theta)\| = o_p(1). \tag{A.10}$$

Thus, in view of (A.9) and (C10), $\max_{1\leq i\leq n}|\Psi(Y_{i-1},\theta)-\Psi(Y_{i-1},\theta_n^*)| = o_p(1)$. By the triangle inequality

$$n^{-1}\sum_{i=1}^n \|g(Y_{i-1},\theta_n^*)\varepsilon_i\| \leq n^{-1}\sum_{i=1}^n \|g(Y_{i-1})\|\varepsilon_i + n^{-1}\sum_{i=1}^n \|g(Y_{i-1},\theta_n^*) - g(Y_{i-1})\|\varepsilon_i.$$

Since $E(\varepsilon_1)=1$, and ε_1 is independent of Y_0, by the ET and (C6), the first term in the right hand side converges almost surely (a.s.) to $E\|g(Y_0)\| < \infty$. By (C5), the second term, on the set $\{\|\widehat\theta_n^* - \theta\|\leq\eta\}$, with η and h as in (C5), is less than or equal to $\{n^{-1}\sum_{i=1}^n \|\dot g(Y_{i-1})\|\varepsilon_i + n^{-1}\sum_{i=1}^n \delta h(Y_{i-1},\theta)\varepsilon_i\}\|\widehat\theta^* - \theta\|$. Then, (C5) and (C10) together with the ET imply

$$n^{-1}\sum_{i=1}^n \|g(Y_{i-1},\theta_n^*)\varepsilon_i\| = O_p(1). \tag{A.11}$$

From these derivations, we obtain that the first term in the upper bound (A.8) is $o_p(1)$. A similar argument together with condition (C5) shows that the second term in this bound tends to zero, in probability.

Thus, $\sup_{y\geq 0}\|R_n(y)\| = o_p(1)$, and uniformly over $0\leq y\leq\infty$,

$$\widehat{\mathcal{U}}_n(y) - \mathcal{U}_n(y) = -\Delta_n^T n^{-1}\sum_{i=1}^n \varepsilon_i g(Y_{i-1})I(Y_{i-1}\leq y) + o_p(1)$$
$$= -\Delta_n^T n^{-1}\sum_{i=1}^n g(Y_{i-1})I(Y_{i-1}\leq y) + o_p(1). \tag{A.12}$$

The last claim is proved as follows. Since ε_i is independent of $\{Y_{i-1},Y_{i-2},\cdots,Y_0\}$, $E(\varepsilon_1)=1$ and, by (C6), $E\|g(Y_0)\| < \infty$, ET implies the point wise convergence in (A.12). The uniformity is obtained by adapting a Glivenko-Cantelli type argument for the strictly stationary case as explained under (4.1) in Koul and Stute (1999).

Next, consider J_n in (A.6). For the sake of brevity, write $\widehat{g}_{i-1} = \widehat{g}(Y_{i-1})$ and $g_{i-1} = g(Y_{i-1})$. Because $\varepsilon_i = Y_i / \Psi(Y_{i-1}, \theta)$,

$$
\begin{aligned}
J_n(y) &= -n^{-1/2} \sum_{i=1}^{n} \widehat{g}_{i-1} \left(\frac{\Psi(Y_{i-1}, \widehat{\theta}) - \Psi(Y_{i-1}, \theta)}{\Psi(Y_{i-1}, \widehat{\theta})} \right) \varepsilon_i \mu_i(y) \\
&= J_{1n}(y)\Delta_n + J_{2n}(y)\Delta_n + J_{3n}(y)\Delta_n + J_{4n}(y) + J_{5n}(y)\Delta_n + J_{6n}(y)\Delta_n,
\end{aligned}
$$

where

$$
J_{1n}(y) = -\frac{1}{n} \sum_{i=1}^{n} \widehat{g}_{i-1}\widehat{g}_{i-1}^{T} \mu_i(y), \quad J_{2n}(y) = \frac{1}{n} \sum_{i=1}^{n} g_{i-1}g_{i-1}^{T}(1 - \varepsilon_i)\mu_i(y),
$$

$$
J_{3n}(y) = \frac{1}{n} \sum_{i=1}^{n} \left(\widehat{g}_{i-1}\widehat{g}_{i-1}^{T} - g_{i-1}g_{i-1}^{T} \right)(1 - \varepsilon_i)\mu_i(y),
$$

$$
J_{4n}(y) = \frac{-1}{\sqrt{n}} \sum_{i=1}^{n} \left[\Psi(Y_{i-1}, \widehat{\theta}) - \Psi(Y_{i-1}, \theta) - (\widehat{\theta} - \theta)^{T} \dot{\Psi}(Y_{i-1}, \theta) \right] \frac{\widehat{g}_{i-1}\varepsilon_i}{\Psi(Y_{i-1}, \widehat{\theta})} \mu_i(y),
$$

$$
J_{5n}(y) = \frac{1}{n} \sum_{i=1}^{n} \widehat{g}_{i-1} \left(\widehat{g}_{i-1} - g_{i-1} \right)^{T} \varepsilon_i \mu_i(y),
$$

$$
J_{6n}(y) = \frac{1}{n} \sum_{i=1}^{n} \widehat{g}_{i-1}g_{i-1}^{T} \left(\frac{\Psi(Y_{i-1}, \widehat{\theta}) - \Psi(Y_{i-1}, \theta)}{\Psi(Y_{i-1}, \widehat{\theta})} \right) \varepsilon_i \mu_i(y).
$$

By definition $J_{1n}(y) = -\widehat{C}_y$. We now show that

$$
\sup_{y \geq 0} \| J_{jn}(y) \| = o_p(1), \quad j = 2, \cdots, 6. \tag{A.13}
$$

Arguing as for (A.12) and (A.11), one obtains, respectively, $\sup_{y \geq 0} \| J_{2n}(y) \| = o_p(1)$, and $n^{-1} \sum_{i=1}^{n} \|\widehat{g}_{i-1}\| \varepsilon_i = O_p(1)$. Then, as Ψ is bounded below by $1/\kappa$, condition (C4) implies that, $\sup_{y \geq 0} \| J_{4n}(y) \| \leq \sqrt{n} \max_{1 \leq i \leq n} |\Psi(Y_{i-1}, \widehat{\theta}) - \Psi(Y_{i-1}, \theta) - (\widehat{\theta} - \theta)^{T} \dot{\Psi}(Y_{i-1}, \theta)| \kappa \, n^{-1} \sum_{i=1}^{n} \|\widehat{g}_{i-1}\| \varepsilon_i = o_p(1)$.

Next, consider $J_{3n}(y)$. Let $\dot{g}_{i-1} = \dot{g}(Y_{i-1}, \theta)$, $h_{i-1} = h(Y_{i-1}, \theta)$ where h is as in assumption (C5), $\gamma_n := \widehat{\theta}_n - \theta$ and $\eta_i = 1 - \varepsilon_i$. Then, (C5) and the triangle inequality implies that, on the set $\{\|\gamma_n\| \leq \eta\}$, where η is as in (C5),

$$
\begin{aligned}
\sup_{y \geq 0} \| J_{3n}(y) \| &\leq \frac{1}{n} \sum_{i=1}^{n} \left[\|\widehat{g}_{i-1} - g_{i-1}\|^2 + 2\|g_{i-1}\| \left(\|\widehat{g}_{i-1} - g_{i-1}\| \right) \right] |\eta_i| \\
&\leq \frac{1}{n} \sum_{i=1}^{n} \left[\left(\delta h_{i-1} + \|\dot{g}_{i-1}\| \right)^2 \|\gamma_n\|^2 + 2\|g_{i-1}\| \left(\delta h_{i-1} + \|\dot{g}_{i-1}\| \right) \|\gamma_n\| \right] |\eta_i|.
\end{aligned}
$$

Then by (C5), ET and (C10), $\sup_{y \geq 0} \| J_{3n}(y) \| = o_p(1)$. A similar argument proves (A.13) for $j = 5$. For the case of $j = 6$, note that $\sup_{y \geq 0} \| J_{6n}(y) \|$ is bounded above by

$$
\kappa \left(\max_{1 \leq i \leq n} |\Psi(Y_{i-1}, \widehat{\theta}) - \Psi(Y_{i-1}, \theta)| \right) \left\| \frac{1}{n} \sum_{i=1}^{n} \widehat{g}_{i-1}g_{i-1}^{T} \varepsilon_i \right\|, \tag{A.14}
$$

where $1/\kappa$ is the lower bound on Ψ. By (A.10), (C4) and (C10),

$$\max_{1\leq i\leq n} |\Psi(Y_{i-1},\widehat{\theta}) - \Psi(Y_{i-1},\theta)| = o_p(1). \tag{A.15}$$

By (C5), (C10) and the ET, on the set $\{\|\gamma_n\| \leq \eta\}$, where η is as in (C5),

$$
\begin{aligned}
\left\|\frac{1}{n}\sum_{i=1}^n \widehat{g}_{i-1}g_{i-1}^T\varepsilon_i\right\| &\leq \frac{1}{n}\sum_{i=1}^n (\|\dot{g}_{i-1}\|\|\gamma_n\| + \delta h_{i-1}\|\gamma_n\| + \|g_{i-1}\|)\|g_{i-1}\|\varepsilon_i \\
&= \|\gamma_n\|\Big(E\|\dot{g}_0\|\|g_0\| + \delta E(h_0\|g_0\|) + o_p(1)\Big) + E\|g_0\|^2 + o_p(1) \\
&= E\|g_0\|^2 + o_p(1) = O_p(1).
\end{aligned}
$$

Hence, the upper bound (A.14) is $o_p(1)$. We have thus proved that

$$\sup_{y\geq 0} \|J_n(y) + \widehat{C}_y\Delta_n\| = o_p(1). \tag{A.16}$$

Next, observe $\sup_{y\geq 0}\|\widehat{C}_y - C_y\| \leq \sup_{y\geq 0}\big\|n^{-1}\sum_{i=1}^n (\widehat{g}_{i-1}\widehat{g}_{i-1}^T - g_{i-1}g_{i-1}^T)\mu_i(y)\big\| + \sup_{y\geq 0}\big\|n^{-1}\sum_{i=1}^n g_{i-1}g$ $C_y\big\|$. The first term in the right hand side is $o_p(1)$ by arguing as for (A.13), $j = 3$. A Glivenko-Cantelli type argument and ET imply that the second term is also $o_p(1)$. Thus, $\sup_{y\geq 0}\|\widehat{C}_y - C_y\| = o_p(1)$. Consequently, the positive definiteness of C_y for all $y \in [0,\infty)$ implies that

$$\sup_{0\leq y\leq y_0} \big\|\widehat{C}_y^{-1} - C_y^{-1}\big\| = o_p(1). \tag{A.17}$$

Condition (C5) and ET imply $n^{-1}\sum_{i=1}^n \|\widehat{g}_{i-1} - g_{i-1}\| = o_p(1)$. Hence, (A.17), (C9) and a routine argument yield $n^{-1}\sum_{i=1}^n \widehat{g}_{i-1}^T\widehat{C}_{Y_{i-1}}^{-1}I(Y_{i-1} \leq y) = O_p(1)$, uniformly over $0 \leq y \leq y_0$. Upon combining these facts with (A.6), (A.12) and (A.16), we obtain

$$\sup_{0\leq y\leq y_0} |\widehat{\mathcal{W}}_n(y) - \widetilde{\mathcal{W}}_n(y)| = o_p(1). \tag{A.18}$$

Next, we shall show

$$\sup_{0\leq y\leq y_0} |\widetilde{\mathcal{W}}_n(y) - \mathcal{W}_n(y)| = o_p(1). \tag{A.19}$$

First observe that, $\mathcal{W}_n(y) - \widetilde{\mathcal{W}}_n(y) = D_{1n}(y) + D_{2n}(y) + D_{3n}(y) + D_{4n}(y)$, where

$$
\begin{aligned}
D_{1n}(y) &= \int_0^y g^T(x)C_x^{-1}\Big\{\int_x^\infty g(z)\,d\mathcal{U}_n(z)\Big\}[dG_n(x) - dG(x)], \\
D_{2n}(y) &= \int_0^y \Big[\widehat{g}^T(x)\big(\widehat{C}_x^{-1} - C_x^{-1}\big)\Big\{\int_x^\infty \widehat{g}(z)\,d\mathcal{U}_n(z)\Big\}\Big]dG_n(x), \\
D_{3n}(y) &= \int_0^y \Big[\widehat{g}^T(x)C_x^{-1}\Big\{\int_x^\infty (\widehat{g}(z) - g(z))\,d\mathcal{U}_n(z)\Big\}\Big]dG_n(x), \\
D_{4n}(y) &= \int_0^y \Big[(\widehat{g}^T(x) - g^T(x))C_x^{-1}\Big\{\int_x^\infty g(z)\,d\mathcal{U}_n(z)\Big\}\Big]dG_n(x).
\end{aligned}
$$

Note that because g_0 and $\varepsilon_1 - 1$ are square integrable, uniformly in $y \geq 0$,

$$
\int_y^\infty g(z) d\mathcal{U}_n(z) = \frac{1}{\sqrt{n}} \sum_{i=1}^n g_{i-1}(\varepsilon_i - 1) I(Y_{i-1} \geq y)
$$

$$
= \frac{1}{\sqrt{n}} \sum_{i=1}^n g_{i-1}(\varepsilon_i - 1) - \frac{1}{\sqrt{n}} \sum_{i=1}^n g_{i-1}(\varepsilon_i - 1) I(Y_{i-1} \leq y) + o_p(1).
$$

By the martingale CLT, the first term is bounded in probability. Lemma 1 together with (C1), (C2), (C3)(a), (7) and the continuous mapping theorem, imply that the second term is $O_p(1)$, uniformly over $y \geq 0$. Hence,

$$
\sup_{y \geq 0} \| \int_y^\infty g d\mathcal{U}_n \| = O_p(1). \tag{A.20}
$$

By (C8) and (C7), $\sup_{0 \leq y \leq y_0} \| g(y)^T C_y^{-1} \| < \infty$. These facts together with Lemma 4 yield $\sup_{0 \leq y \leq y_0} \| D_{1n}(y) \| = o_p(1)$.

We shall next prove that $\sup_{0 \leq y \leq y_0} |D_{jn}(y)| = o_p(1)$ for $j = 2, 3, 4$. Towards this end we make use of the following fact.

$$
\sup_{y \geq 0} \left\| n^{-1/2} \sum_{i=1}^n (\widehat{g}_{i-1} - g_{i-1})(\varepsilon_i - 1)\mu_i(y) \right\| = o_p(1). \tag{A.21}
$$

The proofs of this fact will be given shortly.

Arguing as in the proof of (A.11), by (C5), (C10) and ET, we obtain that $n^{-1} \sum_{i=1}^n$ $\| \widehat{g}_{i-1} - g_{i-1} \| = o_p(1)$ and $n^{-1} \sum_{i=1}^n \| g_{i-1} \| = O_p(1)$. Since, for each $0 \leq y \leq y_0$, $C_y - C_{y_0}$ is positive semi-definite, we also have $\sup_{0 \leq y \leq y_0} \| C_y^{-1} \| < \infty$. Hence, (A.17), (A.20), (A.21) and a routine argument yield $\sup_{y \in [0, y_0]} |D_{2n}(y)| = o_p(1)$. Similarly, by (A.21), it follows that $\sup_{y \in [0, y_0]} |D_{3n}(y)| = o_p(1)$, and by (A.20), it yields $\sup_{y \in [0, y_0]} |D_{4n}(y)| = o_p(1)$. This completes the proof of $\sup_{0 \leq y \leq y_0} |D_{jn}(y)| = o_p(1)$ for $j = 2, 3, 4$, and hence of (A.19).

Consequently, in view of (A.18), we obtain

$$
\sup_{0 \leq y \leq y_0} |\widehat{\mathcal{W}}_n(y) - \mathcal{W}_n(y)| = o_p(1). \tag{A.22}
$$

This fact, together with consistency of $\widehat{\sigma}$ for $\sigma > 0$ and Lemma 3 completes the proof of Theorem 1.

We shall now prove (A.21). Again, for the sake of brevity, write $\xi_{i-1} = (\widehat{g}_{i-1} - g_{i-1} - \dot{g}_{i-1}(\widehat{\theta}_n - \theta))$. Observe that the left hand side of (A.21) is bounded above by

$$
\sup_{y \geq 0} \left\| n^{-1/2} \sum_{i=1}^n \xi_{i-1}(\varepsilon_i - 1)\mu_i(y) \right\| + \sup_{y \geq 0} \left\| n^{-1} \sum_{i=1}^n \dot{g}_{i-1}(\varepsilon_i - 1)\mu_i(y) \right\| \|\Delta_n\|. \tag{A.23}
$$

The following argument is similar to that in the proof of (4.19) of Koul and Stute (1999). Condition (C5) implies that, on the set $\{\|\widehat{\theta}_n - \theta\| \leq \eta\}$, where η is as in (C5),

$$\sup_{y \geq 0} \left\| n^{-1/2} \sum_{i=1}^n \xi_{i-1}(\varepsilon_i - 1)\mu_i(y) \right\| \leq \delta \Delta_n n^{-1} \sum_{i=1}^n h(Y_{i-1})|\varepsilon_i - 1| = O_p(\delta).$$

Since $\delta > 0$ is arbitrarily chosen, this implies that the first term in (A.23) is $o_p(1)$. On the other hand, as ε_i is independent of $\{Y_{i-1}, Y_{i-2}, \cdots, Y_0\}$, $E(\varepsilon_1) = 1$ and $E\|\dot{g}_0\| < \infty$, we have $E\dot{g}_0(\varepsilon_1 - 1)\mu_0(y) = 0$. Hence, by (C10), a Glivenko-Cantelli type argument and ET, the second term in the bound (A.23) is $o_p(1)$. ∎

Proof of Theorem 2. It suffices to show that $n^{-1/2}|\widehat{\mathcal{W}}_n(y)| = O_p(1)$, for some $0 < y < \infty$ satisfying (12). Fix such a y. Under H_a, $\varepsilon_i = Y_i/v(Y_{i-1})$. Write $v_i := v(Y_i)$, $\Psi_i := \Psi(Y_i, \theta)$, and $\widehat{\Psi}_i := \Psi(Y_i, \widehat{\theta}_n)$. Then, with θ as in (C11),

$$n^{-1/2}\widehat{\mathcal{U}}_n(y) = n^{-1} \sum_{i=1}^n \varepsilon_i v_{i-1} \left[\widehat{\Psi}_{i-1}^{-1} - \Psi_{i-1}^{-1} \right] I(Y_{i-1} \leq y)$$

$$+ n^{-1} \sum_{i=1}^n \left\{ \varepsilon_i (v_{i-1}/\Psi_{i-1}) - 1 \right\} I(Y_{i-1} \leq y). \qquad (A.24)$$

By (C11)(d), for d and $t(\cdot, \theta)$ as in (C11), on the set $\|\widehat{\theta}_n - \theta\| \leq d$, the first term on the right hand side of (A.24) is bounded from the above by $\kappa^2 n^{-1} \sum_{i=1}^n \varepsilon_i v_{i-1} t(Y_{i-1}, \theta) \|\widehat{\theta}_n - \theta\| = o_p(1)$, by ET, and because $\widehat{\theta}_n \to_p \theta$. Hence, by an extended Glivenko-Cantelli type argument,

$$n^{-1/2}\widehat{\mathcal{U}}_n(y) = E\big([v(Y_0)/\Psi(Y_0, \theta) - 1]I(Y_0 \leq y)\big) + o_p(1), \quad \text{under } H_a. \qquad (A.25)$$

Recall under (C11), $E(v(Y_0)/\Psi(Y_0, \theta)) \neq 1$.

Next, let $\widehat{\mathcal{L}}_n(y)$ denote the second term in $\widehat{\mathcal{W}}_n(y)$ and

$$\widehat{K}_n(x) := n^{-1/2} \int_{z \geq x} \widehat{g}(z) d\widehat{\mathcal{U}}_n(z), \quad K_n(x) := n^{-1/2} \int_{z \geq x} g(z) d\mathcal{U}_n(z).$$

Recall $\widehat{g}(z) = g(z, \widehat{\theta})$, $g(z) = g(z, \theta)$ and $\mu_i(x) = I(Y_{i-1} \geq x)$. Also, observe that $K_n(x) = n^{-1} \sum_{i=1}^n [\varepsilon_i(v_{i-1}/\Psi_{i-1}) - 1]g_{i-1}\mu_i(x)$, and $EK_n(x) = E\big([v(Y_0)/\Psi(Y_0, \theta) - 1]g(Y_0, \theta)I(Y_0 \geq x)\big) = D(x, \theta)$. Hence, an adaptation of the Glivenko-Cantelli argument yields

$$\sup_x \|K_n(x) - D(x, \theta)\| = o_p(1). \qquad (A.26)$$

Moreover,

$$\widehat{K}_n(x) - K_n(x) = n^{-1} \sum_{i=1}^n \varepsilon_i v_{i-1} \left[\frac{1}{\widehat{\Psi}_{i-1}} - \frac{1}{\Psi_{i-1}} \right] [\widehat{g}_{i-1} - g_{i-1}]\mu_i(x)$$

$$+ n^{-1} \sum_{i=1}^n \varepsilon_i v_{i-1} \left[\frac{1}{\widehat{\Psi}_{i-1}} - \frac{1}{\Psi_{i-1}} \right] g_{i-1}\mu_i(x) + n^{-1} \sum_{i=1}^n \varepsilon_i \frac{v_{i-1}}{\Psi_{i-1}} [\widehat{g}_{i-1} - g_{i-1}]\mu_i(x).$$

Then using arguments as above we see that under the assumed conditions,

$$\sup_{x\in[0,\infty]} \|\widehat{K}_n(x) - K_n(x)\| = o_p(1), \qquad \text{under } H_a. \tag{A.27}$$

Now,

$$
\begin{aligned}
n^{-1/2}\widehat{\mathcal{L}}_n(y) &= \int_0^y \widehat{g}^T(x)\big(\widehat{C}_x^{-1} - C_x^{-1}\big)\widehat{K}_n(x) \ dG_n(x)\\
&+ \int_0^y \widehat{g}^T(x)C_x^{-1}\big(\widehat{K}_n(x) - K_n(x)\big)dG_n(x) + \int_0^y \widehat{g}^T(x)C_x^{-1}K_n(x)dG_n(x)\\
&= S_1(y) + S_2(y) + S_3(y), \quad \text{say.}
\end{aligned}
$$

Let $H_n(z) := \int_0^z \|\widehat{g}(x)\|dG_n(x)$. Arguing as above, we see that uniformly in $z \in [0, \infty]$, $H_n(z) = E\|g(Y_0)\|I(Y_0 \le z) + o_p(1)$. Hence, by (A.17), (A.27) and (A.26), it follows that $|S_1(y)| \le \sup_{x\le y} \|\widehat{C}_x^{-1} - C_x^{-1}\| \sup_x \|\widehat{K}_n(x)\|H_n(y) = o_p(1)$. Similarly, $|S_2(y)| = o_p(1)$, while $S_3(y) = B(y) + o_p(1)$. These facts combined with (A.25) yield

$$
\begin{aligned}
n^{-1/2}\widehat{\mathcal{W}}_n(y) &= n^{-1/2}\widehat{\mathcal{U}}_n(y) - n^{-1/2}\widehat{\mathcal{L}}_n(y)\\
&= E\big([\frac{v(Y_0)}{\Psi(Y_0, \theta)} - 1]I(Y_0 \le y)\big) - B(y, \theta) + o_p(1), \quad \text{under } H_a.
\end{aligned}
$$

In view of (12), this completes the proof of Theorem 2. ∎

Proof of Theorem 3. Many details of the proof are similar to that of Theorem 1, so we shall be brief at times. Fix a $y_0 > 0$. We shall shortly show that under the assumptions of Theorem 3, (A.22) continues to hold. Consequently, by the consistency of $\hat{\sigma}$ for $\sigma > 0$ under $H_{n\gamma}$, the weak limit of $\widehat{\sigma}^{-1}\widehat{\mathcal{W}}_n(y)$ is as same as that of $\sigma^{-1}\mathcal{W}_n(y)$. Let $\overline{U}_n(y) := n^{-1/2}\sum_{i=1}^n (\varepsilon_i - 1)I(Y_{i-1} \le y)$ and

$$\overline{\mathcal{W}}_n(y) := \overline{U}_n(y) - \int_0^y g^T(x)C^{-1}(x)\Big[\int_x^\infty g(z) \ d\overline{U}_n(y)\Big] \ dG(x), \quad y \ge 0.$$

Then $\mathcal{W}_n(y) = \overline{\mathcal{W}}_n(y) + M_n(y), \ y \ge 0$, where

$$
\begin{aligned}
M_n(y) &:= n^{-1}\sum_{i=1}^n \frac{\gamma(Y_{i-1})}{\Psi(Y_{i-1}, \theta)}\varepsilon_i\mu_i(y)\\
&- \int_0^y g^T(x)C^{-1}(x)\Big[n^{-1}\sum_{i=1}^n \frac{g_{i-1}\gamma(Y_{i-1})}{\Psi(Y_{i-1}, \theta)}\varepsilon_i\mu_i(x)\Big] \ dG(x).
\end{aligned}
$$

Proceeding as in the proof of Lemma 3 we obtain that, $\sigma^{-1}\overline{\mathcal{W}}_n(y) \implies W \circ G(y)$ in $D[0, \infty)$ and uniform metric. By ET and an extended Glivenko-Cantelli type argument, $\sup_{y\ge 0}|M_n(y) - M(y)| = o_p(1)$, where M is as in Theorem 3. Now, these facts, together

with consistency of $\widehat{\sigma}$ for $\sigma > 0$, Slutsky's theorem and the continuous mapping theorem completes the proof of Theorem 3.

We shall now prove (A.22) holds under the conditions of Theorem 3. For brevity, write $\Psi_{i-1}^* := \Psi(Y_{i-1}, \theta_n^*)$, $\dot{\Psi}_{i-1}^* := \dot{\Psi}(Y_{i-1}, \theta_n^*)$, and $g_{i-1}^* := g(Y_{i-1}, \theta_n^*)$. Arguing as for (A.7), we obtain

$$\widehat{\mathcal{U}}_n(y) - \mathcal{U}_n(y) = -\Delta_n^T n^{-1} \sum_{i=1}^n \varepsilon_i \{\Psi_{i-1} \dot{\Psi}_{i-1}^*/\Psi_{i-1}^{*2}\} I(Y_{i-1} \leq y) + \Delta_n^T \widetilde{R}_n(y),$$

where $\{\theta_n^*\} \in \Theta$ satisfies $\|\theta_n^* - \theta\| \leq \|\widehat{\theta}_n - \theta\|$, and

$$\widetilde{R}_n(y) := -n^{-1} \sum_{i=1}^n \varepsilon_i n^{-1/2} \{\gamma(Y_{i-1}) \dot{\Psi}_{i-1}^*/\Psi_{i-1}^{*2}\} I(Y_{i-1} \leq y).$$

By the triangle inequality, $n^{-1} \sum_{i=1}^n \varepsilon_i \|\dot{\Psi}_{i-1}^*/\Psi_{i-1}^{*2}\| \leq S_n + n^{-1} \sum_{i=1}^n \varepsilon_i \|g_{i-1}/\Psi_{i-1}\|$, where $S_n := n^{-1} \sum_{i=1}^n \varepsilon_i \|\{g_{i-1}^*/\Psi_{i-1}^*\} - \{g_{i-1}/\Psi_{i-1}\}\| \leq \max_{1 \leq i \leq n} \|\Psi_{i-1} - \Psi_{i-1}^*\| \kappa^2 \big(n^{-1} \sum_{i=1}^n \|g_{i-1}^*\| \varepsilon_i\big) + \kappa\big(n^{-1} \sum_{i=1}^n \|g_{i-1}^* - g_{i-1}\| \varepsilon_i\big)$. Proceeding as in the proof of Theorem 1, one can obtain that $\max_{1 \leq i \leq n} \|\Psi_{i-1} - \Psi_{i-1}^*\| (n^{-1} \sum_{i=1}^n \|g_{i-1}^*\| \varepsilon_i) = o_p(1)$ and that $(n^{-1} \sum_{i=1}^n \|g_{i-1}^* - g_{i-1}\| \varepsilon_i) = o_p(1)$, under $H_{n\gamma}$. Hence, $S_n = o_p(1)$. Also note that, $n^{-1/2} \max_{1 \leq i \leq n} |\gamma(Y_{i-1})| = o_p(1)$, and clearly $n^{-1} \sum_{i=1}^n \varepsilon_i \|g_{i-1}/\Psi_{i-1}\| = O_p(1)$. Thus, $\sup_{y \geq 0} \|\widetilde{R}_n(y)\| \leq n^{-1/2} \max_{1 \leq i \leq n} |\gamma(Y_{i-1})| \big(S_n + n^{-1} \sum_{i=1}^n \varepsilon_i \|g_{i-1}/\Psi_{i-1}\|\big) = o_p(1)$. Consequently, under $H_{n\gamma}$, uniformly in $y \in [0, \infty]$,

$$\widehat{\mathcal{U}}_n(y) - \mathcal{U}_n(y) = -\Delta_n^T n^{-1} \sum_{i=1}^n \varepsilon_i \frac{\Psi_{i-1} \dot{\Psi}_{i-1}^*}{\Psi_{i-1}^{*2}} I(Y_{i-1} \leq y) + o_p(1).$$

Thus, by proceeding as for the proof of (A.12) we obtain that, under $H_{n\gamma}$, uniformly in $y \in [0, \infty]$, $\widehat{\mathcal{U}}_n(y) - \mathcal{U}_n(y) = -\Delta_n^T n^{-1} \sum_{i=1}^n g_{i-1} I(Y_{i-1} \leq y) + o_p(1)$. Then, in view of (A.6), under $H_{n\gamma}$, uniformly in $0 \leq y \leq y_0$,

$$\widehat{\mathcal{W}}_n(y) - \widetilde{\mathcal{W}}_n(y)$$
$$= -\Delta_n^T \frac{1}{n} \sum_{i=1}^n g_{i-1} I(Y_{i-1} \leq y) - \int_0^y \widehat{g}^T(x) \widehat{C}_x^{-1} \widetilde{J}_n(x) \, dG_n(x) + o_p(1),$$

$$\widetilde{J}_n(y) := \frac{1}{\sqrt{n}} \sum_{i=1}^n \widehat{g}_{i-1} \Big(\frac{Y_i}{\widehat{\Psi}_{i-1}} - 1\Big) \mu_i(y) - \frac{1}{\sqrt{n}} \sum_{i=1}^n \widehat{g}_{i-1} \Big(\frac{Y_i}{\Psi_{i-1}} - 1\Big) \mu_i(y)$$

$$= \Big[-\frac{1}{\sqrt{n}} \sum_{i=1}^n \widehat{g}_{i-1} \Big(\frac{\widehat{\Psi}_{i-1} - \Psi_{i-1}}{\widehat{\Psi}_{i-1}}\Big) \varepsilon_i \mu_i(y)\Big] + \widetilde{S}_n(y),$$

and $\widetilde{S}_n(y) := -n^{-1} \sum_{i=1}^n \{\widehat{g}_{i-1} \gamma(Y_{i-1})(\widehat{\Psi}_{i-1} \Psi_{i-1})^{-1}(\widehat{\Psi}_{i-1} - \Psi_{i-1}) \varepsilon_i \mu_i(y)\}$. Since we assume $E\gamma^2(Y_{i-1}) < \infty$, by (C5), ET and a routine argument, $n^{-1} \sum_{i=1}^n \|\widehat{g}_{i-1}\| \gamma(Y_{i-1}) \varepsilon_i = O_p(1)$. One can verify, under the assumptions of Theorem 3, that (A.15) continues to hold true.

Since Ψ is bounded below by κ^{-1}, then it follows that $\sup_{y\geq 0}\|\widetilde{S}_n(y)\| \leq \kappa^2 \max_{1\leq i\leq n}|\widehat{\Psi}_{i-1} - \Psi_{i-1}|\big[n^{-1}\sum_{i=1}^{n}\|\widehat{g}_{i-1}\|\gamma(Y_{i-1})\varepsilon_i\big] = o_p(1)$. Consequently, uniformly in $y \geq 0$, $\widetilde{J}_n(y) = -n^{-1/2}\sum_{i=1}^{n}\widehat{g}_{i-1}\big((\widehat{\Psi}_{i-1} - \Psi_{i-1})/\widehat{\Psi}_{i-1}\big)\varepsilon_i\mu_i(y) + o_p(1)$. Thus, proceeding as in the proof of Theorem 1, we obtain that $\sup_{y\geq 0}\|\widetilde{J}_n(y) + \widehat{C}_y\Delta_n\| = o_p(1)$. This fact and a routine argument yield (A.18) continues to hold under the assumptions of Theorem 3.

Next we shall show that (A.19) also holds under the assumptions of Theorem 3. First observe that

$$\mathcal{U}_n(y) = \overline{U}_n(y) + n^{-1}\sum_{i=1}^{n}\left\{\frac{\gamma(Y_{i-1})}{\Psi_{i-1}}\varepsilon_i I(Y_{i-1} \leq y)\right\}, \ y \geq 0.$$

Let $\quad e_n(y) := n^{-1}\sum_{i=1}^{n}g_{i-1}\frac{\gamma(Y_{i-1})}{\Psi_{i-1}}\varepsilon_i\mu_i(y)\ , \quad \widetilde{e}_n(y) := n^{-1}\sum_{i=1}^{n}\widehat{g}_{i-1}\frac{\gamma(Y_{i-1})}{\Psi_{i-1}}\varepsilon_i\mu_i(y).$

Then, under $H_{n\gamma}$, $\mathcal{W}_n(y) - \widetilde{\mathcal{W}}_n(y) = L_n(y) + \ell_{1n}(y) + \ell_{2n}(y) + \ell_{3n}(y) + \ell_{4n}(y)$, where

$$\begin{aligned}
L_n(y) &= \int_0^y \widehat{g}^T(x)\widehat{C}_x^{-1}\Big[\int_x^\infty \widehat{g}(z)\,d\overline{U}_n(z)\Big]\,dG_n(x) \\
&\quad - \int_0^y g^T(x)C_x^{-1}\Big[\int_x^\infty g(z)\,d\overline{U}_n(z)\Big]\,dG(x), \\
\ell_{1n}(y) &= \int_0^y g^T(x)C_x^{-1}e_n(x)\,[dG_n(x) - dG(x)], \\
\ell_{2n}(y) &= \int_0^y \Big[\widehat{g}^T(x)\big(\widehat{C}_x^{-1} - C_x^{-1}\big)\widetilde{e}_n(x)\Big]\,dG_n(x), \\
\ell_{3n}(y) &= \int_0^y \Big[\widehat{g}^T(x)C_x^{-1}\big(\widetilde{e}_n(x) - e_n(x)\big)\Big]\,dG_n(x), \\
\ell_{4n}(y) &= \int_0^y \Big[\big(\widehat{g}^T(x) - g^T(x)\big)C_x^{-1}e_n(x)\Big]\,dG_n(x).
\end{aligned}$$

Proceeding as in the proof of Theorem 1, one can show that under $H_{n\gamma}$ and the assumed conditions on $\mathcal{M}$ and γ, $\sup_{0\leq y\leq y_0}|L_n(y)| = o_p(1) = \sup_{0\leq y\leq y_0}|\ell_{jn}(y)|$, $j = 1, 2, 3, 4$. $\blacksquare$

Table 1: Percentage of times the null hypothesis was rejected by 5% level tests for different data generating processes.

DGP	F	TKS	Q_5	Q_{15}	LM	M	TKS	Q_5	Q_{15}	LM	M
				n=200					n=500		
S1	E	2.5	1.4	4.1	2.4	21.8	4.9	2.9	2.9	5.1	8.2
	W	3.0	2.8	3.7	22.0	22.8	4.4	4.1	4.3	21.9	9.6
	G	3.6	2.0	3.2	0.4	22.1	4.5	2.3	3.7	0.3	10.9
	GG	2.9	2.8	3.3	7.7	22.1	3.7	2.6	3.7	8.6	9.9
	B	2.6	2.5	3.8	6.1	19.9	3.9	2.6	3.5	7.4	9.4
				n=500					n=1000		
S2	N	5.7	2.8	4.2	14.0	4.4	5.2	3.9	4.8	11.4	5.4
P1	E	15.5	3.4	5.0	0.0	4.4	28.2	3.1	4.4	0.1	8.8
P2	E	26.7	3.3	4.8	0.1	7.6	55.1	5.4	6.2	0.1	8.2
P3	E	40.4	4.6	5.7	0.2	7.5	76.5	7.6	6.3	0.3	8.9
P4	N	16.3	9.4	7.6	35.2	10.5	17.4	14.7	11.6	50.6	10.8

Notes: The DGPs under the null hypothesis are S1 and S2, where S1 is ACD(1,0) in (14) and S2 is Squared-ARCH(1) in (15). The error distributions are Exponential [E], Weibull [W], Gamma [G], Generalized Gamma [GG], Burr [B] and Normal [N].

The DGPs P1–P4, are under the alternative hypothesis. Specifically, P1 is $\mathcal{M}(0.1, 0.2, 0.3)$, P2 is $\mathcal{M}(0.1, 0.2, 0.5)$ and P3 is $\mathcal{M}(0.1, 0.2, 0.7)$, where $\mathcal{M}(\alpha, \beta, \gamma)$ is the model in (16), and P4 is Squared-ARCH(2) in (17).

The test proposed in this paper is TKS. The other tests are Ljung-Box Q test with lag length L (Q_L), the Lagrange Multiplier test (LM) and M test (M).

Figure 1: Plot of $\{\widehat{\sigma}\sqrt{0.99}\}^{-1}|\widehat{\mathcal{W}}_n(y)|$ against y for squared log returns of Intel stocks. The horizontal dashed-line corresponds to the 10% level critical value of the TKS test. The observed test statistic TKS = 1.9192 is the supremum of the curve.
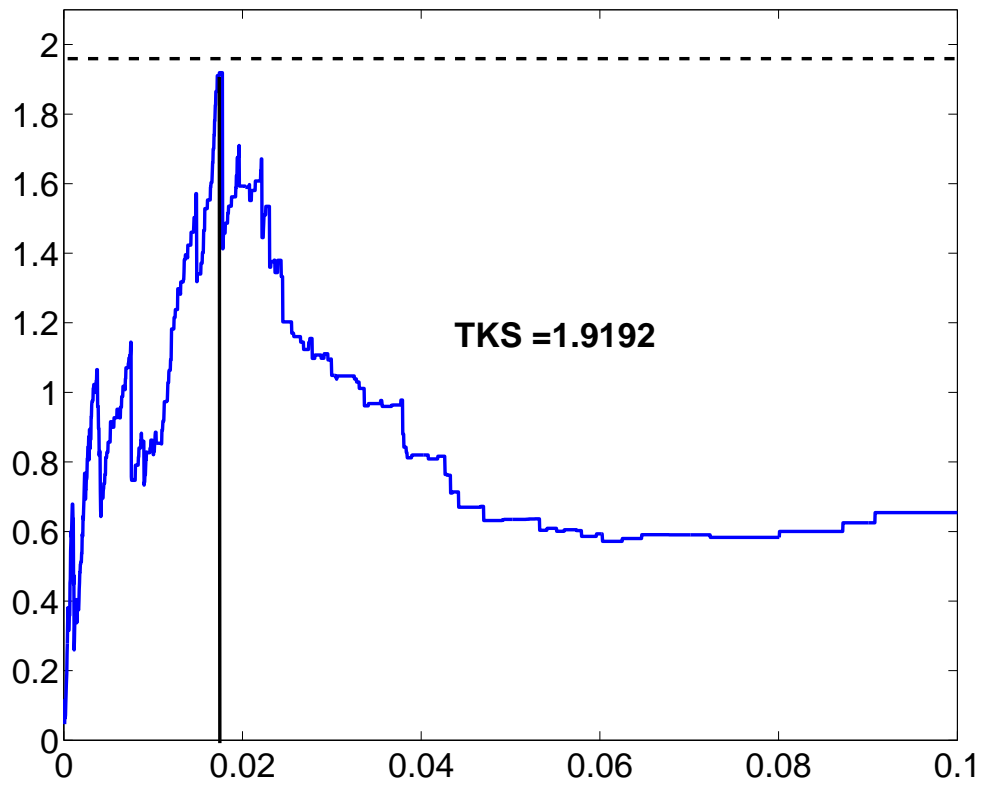

TKS =1.9192

Figure 2: Plot of $\{\widehat{\sigma}\sqrt{0.99}\}^{-1}|\widehat{\mathcal{W}}_n(y)|$ against y for the viscosity data (Series D in Box and Jenkins 1976). The horizontal dashed-line corresponds to the 10% level critical value of the TKS test.

TKS =10.9627