Jumps and betas: A new framework for disentangling and estimating systematic risks

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\begin{abstract}
We provide a new theoretical framework for disentangling and estimating the sensitivity towards systematic diffusive and jump risks in the context of factor models. Our estimates of the sensitivities towards systematic risks, or betas, are based on the notion of increasingly finer sampled returns over fixed time intervals. We show consistency and derive the asymptotic distributions of our estimators. In an empirical application of the new procedures involving high-frequency data for forty individual stocks, we find that the estimated monthly diffusive and jump betas with respect to an aggregate market portfolio differ substantially for some of the stocks in the sample.
\end{abstract}

\section{Introduction}
Linear discrete-time factor models permeate academic asset pricing finance and also form the basis for a wide range of practical portfolio and risk management decisions. Importantly, within this modeling framework equilibrium considerations imply that only non-diversifiable risk, as measured by the factor loading(s) or the sensitivity to the systematic risk factor(s), should be priced, or carry a risk premium. Conversely, so-called neutral strategies that immunize the impact of the systematic risk factor(s) should earn the risk free rate.

Specifically, consider the one-factor representation,

\begin{equation}
    r_i = \alpha_i + \beta_i r_0 + \epsilon_i, \quad i = 1, \ldots, N,
\end{equation}

where \(r_i\) and \(r_0\) denote the returns on the \(i\)th asset and the systematic risk factor, respectively, and the idiosyncratic risk, \(\epsilon_i\), is assumed to be uncorrelated with \(r_0\). Then, provided sufficiently weak cross-asset dependencies in the idiosyncratic risks (see Ross (1976) and Chamberlain and Rothschild (1983)), the absence of arbitrage implies that \(E(r_i) = r_f + \lambda_0 \beta_i\), where \(r_f\) and \(\lambda_0\) denote the risk free rate and the premium for bearing systematic factor risk, respectively, so that the differences in expected returns across assets are solely determined by the cross-sectional variation in the betas. This generic one-factor setup obviously encompasses the popular market model and CAPM implications in which the betas are proportional to the covariation of the assets with respect to the aggregate market portfolio. However, the use of other benchmark portfolios in place of \(r_0\), or more general dynamic multi-factor representations (see, e.g., the discussion in Sentana and Fiorentini (2001) and Fiorentini et al. (2004)), attach the same key import to the corresponding betas.

The beta(s) of an asset is(are), of course, not directly observable. The traditional way of circumventing this problem and estimating betas rely on rolling linear regression, typically based on five years of monthly data, see, e.g., Fama and MacBeth (1973) and Fama and French (1992). Meanwhile, the recent advent of readily-available high-frequency financial
prices have spurred a renewed interest into alternative ways for more accurately estimating betas. In particular, Andersen et al. (2005), Andersen et al. (2006), Bollerslev and Zang (2003), and Barndorff-Nielsen and Shephard (2004a) among others, have all explored new procedures for measuring and forecasting period-by-period betas based on so-called realized variation measures constructed from the summation of squares and cross-products of higher frequency within period returns. These studies generally confirm that the use of high-frequency data results in statistically far superior beta estimates relative to the traditional regression based procedures.

Meanwhile, another strand of the burgeoning recent empirical literature concerned with the analysis of high-frequency intraday financial data has argued that it is important to allow for the possibility of price discontinuities, or jumps, in satisfactorily describing financial asset prices; see, e.g., Andersen et al. (2007), Barndorff-Nielsen and Shephard (2004b, 2006), Huang and Tauchen (2005), Mancini (2001, 2008), Lee and Mykland (2008) and Ait-Sahalia and Jacod (2009b). Related to this, there is mounting empirical evidence from derivatives markets that options traders price the expected variation in equity returns associated with sharp price discontinuities, or jumps, differently from the expected variation associated with more smooth, or continuous, price moves; see, e.g., Bates (2000), Eraker (2004), Pan (2002) and Todorov (forthcoming). In other words, it appears as if the market rewards erratic price moves differently from more orderly or smooth price variation, and implicitly treating the risk premia for two different types of price variation to be the same, as it is commonly done in most existing pricing models, is too simplistic.

Combining these recent ideas and empirical observations naturally suggests decomposing the return on the benchmark portfolio(s) within the linear factor model framework into the returns associated with continuous and discontinuous price moves ($r_0^c$ and $r_0^d$, respectively). In particular, for the one-factor model in Eq. (1),

$$ r_i = \alpha_i + \beta_i^c r_0^c + \beta_i^d r_0^d + \epsilon_i, \quad i = 1, \ldots, N, $$

where by definition $r_0 = r_0^c + r_0^d$, and the two separate betas represent the systematic risks attributable to each of the two return components. Of course, for $\beta_i^c = \beta_i^d$ the model trivially reduces to the standard one-factor model in Eq. (1). However, there is no a priori theoretical reason to restrict, let alone expect, the two betas to be the same. Indeed, the classical paper by Merton (1976) hypothesized that in the context of the market model, jump risks for individual stocks are likely to be non-systematic, so that effectively $\beta_i^d = 0$. On the other hand, the evidence for larger cross-asset correlations for extreme returns documented in Ang and Chen (2002) among others, indirectly suggests non-zero jump sensitivities, or $\beta_i^d > 0$. Despite the potential importance of such a decomposition, both from a theoretical asset pricing as well as a practical portfolio management perspective, direct empirical assessment has hitherto been hampered by the lack of formal statistical procedures for actually estimating different types of beta. The present paper fills this void by developing a general theoretical framework for disentangling and separately estimating the sensitivity towards systematic continuous and systematic jump risks. For simplicity and ease of notation, we will focus on the one-factor representation in Eq. (2), but the same ideas and estimation procedures extend to more general multi-factor representations.

The asymptotic theory underlying our results rely on the notion of increasingly finer sampled returns over a fixed time-interval.

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1 A very different economically motivated decomposition of the beta within the context of the one factor model market into so-called cash-flow and discount rate betas has recently been proposed by Campbell and Vuolteenaho (2004). Our estimation and inference procedures thus extend the results in Barndorff-Nielsen and Shephard (2004a) on realized covariation measures for continuous sample path diffusions. The derivation of our results directly builds on and extends the work of Jacod (2008) on power variation for general semimartingales (containing jumps) as well as the recent work of Ait-Sahalia and Jacod (2009b) and Jacod and Todorov (2009) on testing for jumps in discretely sampled univariate and multivariate processes. Related ideas have also recently been explored by Mancini (2008) and Göbbi and Mancini (2008). Additionally, we also utilize the procedures of Barndorff-Nielsen and Shephard (2004b) and Barndorff-Nielsen et al. (2005) for measuring the continuous sample path variation in the construction of feasible estimates for the asymptotic variances of the betas.

To illustrate the practical usefulness of the new procedures, we estimate separate continuous and jump betas with respect to an aggregate market portfolio for a sample of forty individual stocks, focussing on the monthly horizon. Consistent with the aforementioned studies on high-frequency based beta estimates, which implicitly restrict the two kinds of beta to be the same, we find overwhelming empirical evidence that both kinds of beta vary non-trivially over time. Our findings of systematically positive jump betas for all of the stocks directly contradict the notion that jump risk is diversifiable. Our results also show that for some of the stocks the two types of beta can be quite different, with the estimated jump betas typically being larger and less persistent than their continuous counterparts.

The calendar time span of high-frequency data available for the empirical analysis is too short to allow for the construction of meaningful statistical tests for whether the separate betas truly reflect differences in priced systematic risks. However, the differences in the magnitudes of the estimates for some of the companies are such that the new betas developed here could make a material difference in terms of pricing and similarly allow for more informed portfolio and risk management decisions.

The rest of the paper proceeds as follows. Section 2 details our theoretical setup and assumptions, along with the intuition for how to calculate continuous and jump betas in the unrealistic situation when continuous price records are available. Our new procedures for actually estimating separate betas based on discretely sampled high-frequency observations and the corresponding asymptotic distributions allowing for formal statistical inference are presented in Section 3. Our empirical application entail- ing estimates of the betas for the extended market model for the forty individual stocks is discussed in Section 3. Section 4 concludes. All of the proofs are relegated to a technical Appendix.

2. The continuous record case and assumptions

Discrete-time models and procedures along the lines of the simple one-factor model in Eq. (1) are commonly used in finance for describing returns over annual, quarterly, monthly or even daily horizons. Our goal here is to make inference for the separate betas in the extended one-factor model in (2) under minimal assumptions about the processes that govern the returns within the discrete time intervals.

To this end, assume that within some fixed time-interval $[0, T]$ the log-price $p_t$ is generated by the following general process (defined on some filtered probability space $(\Omega, \mathcal{F}, (\mathcal{F}_t)_{t \geq 0}, \mathbb{P})$),

$$ dp_t = \alpha_t dt + \beta_t^c \sigma_t^c dW_{c,t} + \sigma_t^d dW_{d,t} + \int_{E_t} \kappa_t^c(\delta(t, x)) \mu_t^c d\mathbf{x} + \int_{E_t} \kappa_t^d(\delta(t, x)) \mu_t^d d\mathbf{x} + \int_{E_t} \kappa_t^e(\delta(t, x)) \mu_t^e d\mathbf{x}, \quad i = 1, \ldots, N, $$

where $\alpha_t, \beta_t^c, \beta_t^d, \sigma_t^c, \sigma_t^d, \mu_t^c, \mu_t^d, \mu_t^e$ are measurable functions of time and $\mathbf{x}$ is a vector of jump variables. The jumps are assumed to be independent of the continuous part of the process and to be distributed according to a mixture of Poisson distributions with intensity measures $\mu_t^c, \mu_t^d, \mu_t^e$ and jump sizes $\kappa_t^c, \kappa_t^d, \kappa_t^e$. This allows for a wide range of jump processes, including Poisson, compound Poisson, and Poisson with superposition. The process $(\mathcal{F}_t)_{t \geq 0}$ is assumed to be a filtration generated by a collection of continuous and jump processes.

The measure $\mathbb{P}$ is equivalent to the physical measure $\mathbb{P}$, which is the probability measure under which all the continuous and jump processes are martingales. This assumption is necessary for the derivation of the asymptotic results. The filtration $(\mathcal{F}_t)_{t \geq 0}$ is assumed to be right-continuous and complete, which is standard in the literature on high-frequency data analysis.
where \((W_0, W_1, \ldots, W_N)\) denotes a \((N+1) \times 1\) standard Brownian motion with independent elements; \(\mu_0\) is a Poisson random measure on \([0, \infty) \times E_0\) with \((E_0, \xi_0)\) an auxiliary measurable space, with the compensator of \(\nu_0\) denoted \(v_0(\xi, \xi_0) = ds \otimes \lambda_0(\xi)\) for some \(\sigma\)-finite measure \(\lambda_0\) on \((E_0, \xi_0)\); \(\mu_i\) is a Poisson random measure on \([0, \infty) \times E_i\) with \((E_i, \xi_i)\) an auxiliary measurable space, with the compensator of \(\mu_i\) denoted \(v_i(\xi, \xi_i) = ds \otimes \lambda_i(\xi)\) for some \(\sigma\)-finite measure \(\lambda_i\) on \((E_i, \xi_i)\); the measures \(\mu_i\) are mutually independent for \(i = 0, 1, \ldots, N\); \(\tilde{\mu}_i := \mu_i - v_i\) is the compensated jump measure for \(i = 0, 1, \ldots, N\); \(\kappa(x)\) is a continuous function on \(\mathbb{R}\) into itself with compact support such that \(\kappa(x) \equiv 0\) around \(0\) and \(\kappa(x) = x\) for \(x > 0\). \(^2\)

This very general theoretical framework essentially encompasses all discrete-time one-factor models described by the benchmark representation in Eq. (1). The systematic diffusion risk is captured by \(\sigma \partial_t W_\alpha\), explicitly allowing for time-varying stochastic volatility. The systematic jump risk is determined by the Poisson measure \(\mu_0\) and the jump size function \(\delta_0(\cdot, \cdot)\), which allows for both time-varying jump intensities and jump sizes. Consistent with the extended discrete-time model in (2), the continuous-time representation in (3) also explicitly allows for different (but constant over \([0, T]\)) sensitivities to the systematic diffusive and jump risks, captured by \(\beta_i^\ell\) and \(\beta_i^d\), respectively.

Now, suppose that continuous records over the \([0, T]\) time-interval were available for all the price processes. Is it possible to separately infer the \(\beta_i^\ell\) and \(\beta_i^d\), \(i = 1, \ldots, N\) coefficients, without making any additional parametric assumptions about the underlying process? The answer to this question is a qualified ‘yes’.

In particular, it follows by standard parametric arguments that, for \(i \neq j\),

\[
[p_i, p_j]_{[0, T]} = \beta_i^\ell \beta_j^\ell \int_0^T \sigma_0^2 ds \quad \text{and} \quad \sum_{k \leq T} \left| \Delta p_k \right|^\gamma |\Delta p_{k_j}|^\gamma = |\beta_i^\ell \beta_j^\ell| \int_0^T \left| \delta_0(t, x) \right|^\gamma \mu_0(dt, dx),
\]

where \([p_i, p_j]_{[0, T]}\) is the quadratic covariation between the continuous parts of \(p_i\) and \(p_j\) over \([0, T]\); for arbitrary asset \(i\) and time \(t\), \(\Delta p_t = p_t - p_{t^-}\) with \(p_{t^-}\) denoting the limit from the left (the processes are càdlàg); \(\gamma\) is some positive number such that \(\int_0^T \int_0^T |\delta_0(t, x)|^\gamma \mu_0(dt, dx) < \infty\) almost surely, i.e. \(2 \gamma > 0\) is above the generalized Blumenthal–Getoor index of Alt-Sahalia and Jacod (2009a) of the process \(p_0\) on \([0, T]\). The most natural choice of \(\gamma\) in the continuous record case is \(\gamma = 1\) in which case \(\sum_{k \leq T} \left| \Delta p_k \right|^\gamma |\Delta p_{k_j}|^\gamma = \sum_{k \leq T} \left| [p_i, p_j]_{[0, T]} \right|^\gamma\) is (the absolute value of) the discontinuous quadratic variation. However, the estimation of the latter quantity in the case of discrete sampling is harder and higher values of \(\gamma\) are typically preferred.

We discuss this further in Section 3. From (4), ratios of the separate betas are readily obtained as,

\[
\beta_i^\ell = \frac{[p_i, p_i]_{[0, T]}}{[p_i, p_0]_{[0, T]}}, \quad \text{and} \quad \beta_i^d = \frac{\sum_{k \leq T} \text{sign}(\Delta p_k \Delta p_{k_j}) |\Delta p_k \Delta p_{k_j}|^\gamma}{\sum_{k \leq T} |\Delta p_k |^{2\gamma}},
\]

so that the actual values of the betas, and not just their ratios, may be uncovered from the continuous price records. Even if the one-factor structure in Eq. (3) does not hold exactly, the \(\beta_i^\ell\) and \(\beta_i^d\) in Eqs. (8) and (9), respectively, still provide meaningful measures of the (average over \([0, T]\)) sensitivity of asset \(i\) to the diffusive and jump moves in the reference asset 0.

The expressions for the betas given above form the basis for all of our estimators and inference procedures discussed below. However, for the results reported on below, we need the following, mostly, technical conditions on the underlying process in (3).

**Assumption A1.** (a) The processes \(\alpha(t, \omega), \sigma_0(t, \omega), \text{and } \sigma_\phi(t, \omega)\) are càdlàg and \(\delta_0(t, x, \omega)\) and \(\delta_i(t, x, \omega)\) are predictable functions of \(t\) for all \(i = 1, \ldots, N\).

(b) \(\left| \delta_0(t, x, \omega) \right| \leq \gamma(x)\) for \(t \leq T_\omega(x)\), where \(\gamma(x)\) is a deterministic function such that \(\int_0^T (\gamma(x))^2 \lambda_0(dx) < \infty\), and \(T_\omega\) is a sequence of stopping times increasing to \(+\infty\). A similar condition holds for \(\delta_i(t, x, \omega)\) for all \(i = 1, \ldots, N\).

\(^3\) An alternative estimator for the ratio of the jump betas that does not involve a reference asset \(k\) may be constructed as

\[
\frac{\beta_i^d}{\beta_i^\ell} = \left( \frac{\sum_{k \leq T} |\Delta p_k |^{2\gamma} |\Delta p_k |^\gamma}{\sum_{k \leq T} |\Delta p_i |^{2\gamma} |\Delta p_i |^\gamma} \right)^{1/\alpha}, \quad \alpha > 0.
\]
The constants $\phi$ correspond to a vector of discrete price increments, and separating those from the diffusive risks. The current paper's goal is estimating systematic jump risks in the prices. In the case of time-homogeneous jumps, Assumption A2 will be negligible (asymptotically) only for powers greater than 2. Intuitively, higher powers (higher than two) serve to "compress" the contribution from the continuous price moves, while at the same time inflating the contribution coming from jumps, in effect making the jumps "visible".\footnote{4}

We consider also an alternative estimator to (14), which uses only the "big" increments,

$$\frac{\hat{\beta}^d_i}{\hat{\beta}^d_i} = \frac{\text{sign}(V_i(p_k, \alpha, \omega)) V_i(p_k, \alpha, \omega)}{\left| \frac{V_i(f_0(p_k, \alpha, \omega))}{|1|} \right|^\frac{1}{\gamma}}. \quad (15)$$

As shown below, this estimator is asymptotically equivalent to $\frac{\hat{\alpha}_i}{\hat{\alpha}_i}$.\footnote{5}

In order to characterize the distribution of the estimators, we will consider an auxiliary space $(\Omega', F', \mathbb{P})$, which is an extension of the original space $(\Omega, F, \mathbb{P})$ and supports two sequences $(U_q)$ and $(U'_q)$ for $q = 0, 1, \ldots$, which is strictly different from 0, 1, \ldots, N + 1-dimensional standard normals, as well as a sequence $(\xi_k)$ of uniform random variables on $[0, 1]$, all of which are mutually independent. We further denote by $(S_q)_{q \geq 1}$ the sequence of stopping times that exhausts the "jumps" in the measures $f_0$ and $\mu_1$, $i = 1, \ldots, N$; i.e., for each $\omega$ we have $S_0(\omega) \neq S_q(\omega)$ if $p \neq q$, where $\mu_0(\omega, \{t \times E_0\}) = 1$ or $\mu_1(\omega, \{t \times E\}) = 0$ and if only if $t \equiv S_q(\omega)$ for some $q$. Finally, following \textit{Jacod and Todorov} (2009) we define the following subsets of $\Omega$.

$$\Omega_i^{(i)} = \{\omega : \text{on } [0, T] \text{ the process } \Delta p_i \text{ is not identically 0}\}, \quad (16)$$

\textit{Inference about $\beta_i^d$}

Our estimator for the sensitivity towards systematic jump risk is constructed by consistently estimating the numerator and denominator in the infeasible ratio in Eq. (6). In so doing, we build on some of the results in \textit{Jacod and Todorov} (2009). The latter paper derives tests for deciding the common arrival of jumps, while the current paper's goal is estimating systematic jump risks in individual prices (and separating those from the diffusive risks). The two problems are related but obviously different.

To this end, let $p = (p_0, p_1, \ldots, p_n)$, and denote the corresponding vector of discrete price increments,

$$\Delta^d p = p_{\Delta t} - p_0. \quad (10)$$

With any measurable function $\phi$ we associate the process

$$V_n(\phi) = \sum_{i=1}^{\lfloor t/\Delta t \rfloor} \phi(\Delta^d p), \quad 0 \leq t \leq T, \quad (11)$$

and an analogous one based on the "big increments"

$$V'_n(\phi, \alpha, \omega) = \sum_{i=1}^{\lfloor t/\Delta t \rfloor} \phi(\Delta^d p)^{1 \left| \lfloor \alpha \Delta p \rfloor \leq \lfloor \alpha \Delta^d p \rfloor \leq \lfloor \alpha \Delta^d p \rfloor + 1 \right|} \times 0 \leq t \leq T, \quad \alpha \geq 0, \quad (12)$$

The constants $\alpha$ and $\omega$ in the truncation of the individual components in (12) were chosen the same for the ease of exposition only. They can, and later in the empirical section will, be taken differently. In the estimation we make use of the $\mathbb{R}^{N+1} \times \mathbb{R}^{N+1}$ measurable function $f$, given by $f = (f_i)_{i,j=0,1,\ldots,N}$ for

$$f_i(p, \tau) = \text{sign}(p_i p_j) p_j \tau, \quad \tau > 0, \quad (13)$$

where $i, j = 0, 1, \ldots, N$. For ease of notation, we use $f_i(p)$ to denote $f_i(p, \tau)$, as $\tau$ will be kept constant in the estimation.

Our estimator for the ratio of the jump betas between assets $i$ and $j$ may then be compactly expressed as

$$\frac{\hat{\beta}^d_i}{\hat{\beta}^d_j} = \frac{\text{sign}(V_i(f_0)) V_i(f_1)}{\left| \frac{V_i(f_0)}{|1|} \right|^\frac{1}{\gamma}}. \quad (14)$$

for some $k = 0, 1, \ldots, N$. To avoid trivial (and uninteresting) cases we further restrict $i \neq j, j \neq k$, and $j = k$ if and only if $j = k = 0$. Note that for $k = j = 0$, the ratio provides a direct estimate of $\beta_i^d$. The feasible estimator in Eq. (14) directly mirrors the expression in (6) based on continuously recorded prices. In order to be consistent for the ratio of jump betas, however, we need to restrict $\tau \geq 2$, as the contribution from the continuous part of the prices in $f_i(\Delta^d p)$ will be negligible (asymptotically) only for powers greater than or equal to 2. Intuitively, higher powers (higher than two) serve to "compress" the contribution from the continuous price moves, while at the same time inflating the contribution coming from jumps, in effect making the jumps "visible".\footnote{4}

We consider also an alternative estimator to (14), which uses only the "big" increments,

$$\frac{\hat{\beta}^d_i}{\hat{\beta}^d_j} = \frac{\text{sign}(V_i(f_0)) V_i(f_1)}{\left| \frac{V_i(f_0)}{|1|} \right|^\frac{1}{\gamma}}. \quad (15)$$

As shown below, this estimator is asymptotically equivalent to $\frac{\hat{\alpha}_i}{\hat{\alpha}_i}$.\footnote{5}

In order to characterize the distribution of the estimators, we will consider an auxiliary space $(\Omega', F', \mathbb{P})$, which is an extension of the original space $(\Omega, F, \mathbb{P})$ and supports two sequences $(U_q)$ and $(U'_q)$ for $q = 0, 1, \ldots, N + 1$-dimensional standard normals, as well as a sequence $(\xi_k)$ of uniform random variables on $[0, 1]$, all of which are mutually independent. We further denote by $(S_q)_{q \geq 1}$ the sequence of stopping times that exhausts the "jumps" in the measures $f_0$ and $\mu_1$, $i = 1, \ldots, N$; i.e., for each $\omega$ we have $S_0(\omega) \neq S_q(\omega)$ if $p \neq q$, where $\mu_0(\omega, \{t \times E_0\}) = 1$ or $\mu_1(\omega, \{t \times E\}) = 0$ and if only if $t \equiv S_q(\omega)$ for some $q$. Finally, following \textit{Jacod and Todorov} (2009) we define the following subsets of $\Omega$.

$$\Omega_i^{(i)} = \{\omega : \text{on } [0, T] \text{ the process } \Delta p_i \text{ is not identically 0}\}, \quad (16)$$
for $i, j = 1, \ldots, N$ and $i \neq j$. The set $\Omega_{ij}^{(0)}$ represents the events for which there is at least one common jump in $p_i$ and $p_j$ over the $[0, T]$ time-interval. Because of the assumed one-factor structure, these sets are equivalent to the set $\Omega_{T}^{(0)}$ with at least one systematic jump on $[0, T]$. Note that even if the model allows for systematic jump risk in the assets, it still might be the case that the observed realization of the prices is not in the set $\Omega_{ij}^{(0)}$. This can happen with a positive probability for example if the systematic jumps are compound Poisson. The following theorem provides the distribution of our estimators on all non-empty sets, $\Omega_{ij}^{(0)}$.

**Theorem 1.** Assume that $p_i$ and $p_0$ are governed by Eqs. (3) and (7), respectively, and that $\beta_{ij} \neq 0$ for all $i = 1, \ldots, N$. Further assume that Assumption A1 holds. Then for $\Delta_n \to 0$, $\tau \geq 2$ and $i \neq 0^6$:

(a)  
\[
\frac{\hat{\beta}_{ij}^d}{\hat{\beta}_{ij}^d} \overset{p}{\to} \frac{\beta_{ij}^d}{\beta_{ij}^d} \text{ on } \Omega_{ij}^{(0)},
\]

(b)  
\[
\frac{1}{\sqrt{\Delta_n}} \left( \frac{\hat{\beta}_{ij}^d}{\beta_{ij}^d}, \frac{\hat{\beta}_{ij}^d}{\beta_{ij}^d} \right) \xrightarrow{d} t_{ij}^d \text{ on } \Omega_{ij}^{(0)},
\]

(c)  
\[
R_i^1 = \frac{1}{\beta_j^d} \sigma_{i-k_j}^{d} U_{ij}^i - 1_{[\beta_j \neq 0]} \frac{1}{\beta_j^d} \sigma_{i-k_j}^{d} U_{ij}^j \text{ and } R_i^2 = \frac{1}{\beta_j^d} \sigma_{i-k_j}^{d} U_{ij}^i - 1_{[\beta_j \neq 0]} \frac{1}{\beta_j^d} \sigma_{i-k_j}^{d} U_{ij}^j.
\]

(d)  
Conditional on $F_t$, $t_{ij}^d$ has mean 0 and variance, $V_{ij}$, given in Box I.

\[
\text{If in addition } \Delta_{\text{POS}} \Delta_{\text{Sj}} = 0 \text{ for all } S_j \leq T, \text{ then conditional on } F_t, t_{ij}^d \text{ is normal.}
\]

Proof. See Appendix. □

Part (a) of the theorem shows that the proposed estimator does indeed converge to the ratio of the sensitivities toward systematic jump risk. Importantly, this convergence is restricted to the set $\Omega_{ij}^{(0)}$.\footnote{The notation $\overset{d}{\to}$ refers to convergence stable in law. This convergence is stronger than the usual convergence in law, and implies joint convergence in law of the converging sequence with any random variable defined on the original probability space; see, e.g., Jacob and Shiryaev (2003) for further discussion concerning this mode of convergence on filtered probability spaces.} This is, of course, quite natural as it is not possible to infer any quantities/parameters related to co-jumping in the absence of common jump arrivals. As such, the estimator in Eq. (14) should only be used in situations when systematic jumps are actually present. Note also that the convergence in probability and the Central Limit Theorem stated in part (a) and part (b) of the theorem hold under very general conditions and in particular no restriction on the jump activity: finite or infinite activity, finite or infinite variation jumps are all allowed.

\[ \text{7 For the events in } \Omega_T^{(0)}, \text{ corresponding to only idiosyncratic jumps in } i, j \text{ or } k, \text{ the limiting value of the estimator in (14) is a random quantity conditional on the observed prices. When neither systematic nor idiosyncratic jumps are present on } [0, T], \text{ the limit equals the expression given in Box III which for } j = k = 0 \text{ is strictly greater than the sensitivity towards the diffusive systematic risk.} \]
Several observations regarding the asymptotic limit in (19) are in order. First, the larger the systematic jumps, the lower the asymptotic variance and the more accurate the estimates for the sensitivities to systematic jump risk. Intuitively, smaller common jumps are generally harder to separate from continuous co-movements, and in turn result in less precise estimates of $\beta_i^s$. Second, the longer the $[0,T]$ time-interval, the more realizations of systematic jumps on average, and hence the more accurate the estimates. Of course, this assumes that the same one-factor structure with identical jump sensitivities in (3) hold true over the entire time-interval. We will return to this issue in the empirical section below. Third, the less the idiosyncratic risks, the more precise the estimates. In particular, if observations on the common (systematic) factor $p_0$ are available, the use of these will result in the most precise estimates.

As noted in part (b) of the theorem, the absence of any common jumps between the price levels and the stochastic volatility for the continuous price process implies that the distribution of $L^c_{ij}$ will be mixed normal. In the empirical results reported on below we simply proceed under this maintained assumption. The results reported in Jacob and Todorov (2009) suggest that even if this assumption is violated, the use of the right approximating limit for $L^c_{ij}$, obtained by substituting the jumps in $L^c_{ij}$ with the price increments and the stochastic volatilities with the square root of the $\zeta$’s, would not give rise to materially different distributions and test statistics.

Part (c) of the theorem formally shows that the asymptotic results in parts (a) and (b) remain true if we drop the terms in $V^s_{n}(f_{0i})_{T}$ for which both price increments are smaller than some pre-specified threshold level. Intuitively, these terms will capture continuous moves and their impact will therefore be negligible asymptotically. In finite samples, however, it might be desirable to use the truncated estimator in Eq. (15) as it is based on the “big” increments. Of course, for very high values of $\sigma$ the two estimators will be numerically the same. We will discuss reasonable choices for $\sigma$ and $\sigma$ in the empirical section below.

The final part (d) of the theorem provides a consistent estimator for $V_{T}$ in the case of $j = k = 0$. This is the estimator that we will actually rely on in the empirical section.6 In addition to the previous Assumption A1, the $V_{T}$ estimator requires that Assumption A2 holds for some $s < 2$. This is a very weak regularity type assumption. Jumps for which $s = 2$ are extremely active and for practical purposes impossible to separate from the continuous price movements. Otherwise the estimator for $V_{T}$ is essentially based on a portfolio consisting of assets $p_i$ and $p_0$, which eliminates the systematic diffusive risk, along with an estimate of the local stochastic variance of the continuous part of this portfolio, $\zeta(n, \pm)$. The truncation employed in the estimator is asymptotically immaterial. Just like the truncated estimator itself defined in part (c), the price increments only enter the variance estimator in powers higher than two so that the contribution from the continuous part is asymptotically negligible.

3.2. Inference about $\beta_i^c$

Analogous to the estimator for the sensitivity towards jump risk discussed above, our estimator for the sensitivity towards continuous systematic risk is based on the first infeasible ratio in Eq. (5), replacing the numerator and denominator by feasible estimates.

To this end, we need some additional notation. In particular, let $X$ denote a generic $N$-dimensional semimartingale. The following multidimensional realized truncated variation

$$V_{n}^{c}(X, \alpha, \sigma)_t = \left( \begin{array}{c} v_{1}^{c}(X, \alpha, \sigma)_t \\ \vdots \\ v_{n}^{c}(X, \alpha, \sigma)_t \end{array} \right),$$

is defined on an extension of the original probability space and is independent of the filtration $\mathcal{F}$, and

$$K_T = \sqrt{\int_{0}^{\Delta T} \left( \sum_{i=1}^{n} \beta_i^c \sigma_{i,0} \right)^2 \sigma_{i,0}^2 \frac{dU}{\sigma_{i,0}^2 du}},$$

where $U \sim N(0,1)$ is defined on an extension of the original probability space and is independent of the filtration $\mathcal{F}$, and

$$K_T = \sqrt{\int_{0}^{\Delta T} \left( \sum_{i=1}^{n} \beta_i^c \sigma_{i,0} \right)^2 \sigma_{i,0}^2 \frac{dU}{\sigma_{i,0}^2 du}}.$$

(c) The variance $K_T$ may be consistently estimated by

$$\hat{K}_T = \sqrt{\frac{\sum_{i=1}^{n} \beta_i^c \sigma_{i,0} \frac{dU}{\sigma_{i,0}^2 du}}{K_T^2}},$$

for $i = 1, \ldots, N$ and $j, k = 0, 1, \ldots, N$.

Our estimator for the ratio of the continuous betas is then defined as,

$$\frac{\hat{\beta}_i^c}{\hat{\beta}_j^c} = \frac{V_{n}^{c}(X_{i}^{0}, \alpha, \sigma)_T - V_{n}^{c}(X_{j}^{0}, \alpha, \sigma)_T}{V_{n}^{c}(X_{i}^{0}, \alpha, \sigma)_T - V_{n}^{c}(X_{j}^{0}, \alpha, \sigma)_T}.$$

The following theorem characterizes the behavior of the estimator. As in the previous subsection, to avoid uninteresting cases we restrict $i \neq j, i \neq k$, and $j = k$ if and only if $j = k = 0$.

Theorem 2. Assume that $p_i$ and $p_0$ are governed by Eq. (3) and (7), respectively with $\beta_i^c \neq 0$ for $i = 1, \ldots, N$. Further assume that Assumption A1 holds, and let $\alpha > 0$ and $\sigma \in (0, \frac{1}{\alpha})$. Then for $\Delta_n \rightarrow 0$:

(a) \begin{align*}
\left( \begin{array}{c} \hat{\beta}_i^c \\ \hat{\beta}_j^c \\ \hat{\beta}_k^c \end{array} \right) & \xrightarrow{p} \left( \begin{array}{c} \beta_i^c \\ \beta_j^c \\ \beta_k^c \end{array} \right),
\end{align*}

(b) If in addition Assumption A2 holds for some $s \leq \frac{4\sigma - 1}{2\alpha}$,

$$\frac{1}{\sqrt{\Delta n}} \left( \begin{array}{c} \hat{\beta}_i^c \\ \hat{\beta}_j^c \\ \hat{\beta}_k^c \end{array} \right) \xrightarrow{(d)} L^c_T := K_T \times U,$$

where $U \sim N(0,1)$ is defined on an extension of the original probability space and is independent of the filtration $\mathcal{F}$, and

(c) The variance $K_T$ may be consistently estimated by

$$\hat{K}_T = \frac{\sum_{i=1}^{n} \beta_i^c \sigma_{i,0} \frac{dU}{\sigma_{i,0}^2 du}}{K_T^2},$$
where,
\[
\hat{K}_t^\tau = \frac{\pi^2}{4A_\tau} \sum_{i=1}^{[T/\Delta_\tau]-3} |\Delta_t^n p_i \Delta_t^{\tau+1} \tilde{p}_i^n \Delta_t^{\tau+2} p_i |, \\
\hat{K}_t^\pi = \frac{\pi}{8} \sum_{i=1}^{[T/\Delta_\tau]-1} |\Delta_t^n (p_i + p_k) \Delta_t^{\pi+1} (p_j + p_k) | \\
- |\Delta_t^n (p_j - p_k) \Delta_t^{\pi+1} (p_i - p_k) |,
\]
and \( \tilde{p}_i^n := p_i - \left( \frac{\hat{p}_i}{\hat{p}_j} \right) p_j \).

**Proof.** See Appendix. \[\Box\]

Part (a) of the theorem shows that the use of the truncated variation measures affords a consistent estimator for the quantity of interest. This consistency holds true for any values of \( \alpha > 0 \) and \( \sigma \in (0, \frac{1}{2}) \). Of course, as discussed further in the empirical section below, the actual numerical value of the estimator for a given \( \Delta_\tau \) will depend upon the specific choice of these tuning parameters. Assumption A1, part (c) guarantees non-vanishing systematic diffusive risk, so that in contrast to the estimator for the sensitivity towards systematic jump risk in Theorem 1, which only converges on \( \Omega(T) \), the estimator for the sensitivity to systematic diffusive risk converges on the whole set \( \Omega \).

Unlike the CLT for the jump beta in Theorem 1, which holds quite generally, the CLT for the continuous beta in part (b) of Theorem 2 involves a non-trivial restriction related to the activity of the jumps. In practical applications it is natural to choose \( \sigma \) to be close to 0.5, so that in the case of time-homogeneous jumps the restriction in part (b) essentially excludes jumps of infinite variation. Importantly, the limiting distribution of \( L_t^\tau \) is always normal. In parallel with the estimates for the jump beta, the expression for the asymptotic variance of \( L_t^\pi \) indicates that the precision of the continuous beta estimates increases with the use of longer \([0, T]\) time-periods and assets with less idiosyncratic risk.

The consistent estimator for the asymptotic variance of \( L_t^\pi \) in part (c) is based on multipower variation measures, see Barndorff-Nielsen and Shephard (2004b) and Barndorff-Nielsen et al. (2005). Analogous to the construction in part (d) in Theorem 1, the estimate \( \hat{K}_t^\pi \) involves a linear combination, \( \tilde{p}_i^n \), of assets \( i \) and \( j \) that eliminates the systematic diffusive risk. The particular ordering of \( p_i \) and \( \tilde{p}_j \) used in defining \( \hat{K}_t^\pi \) is, of course, arbitrary.9

Before we turn to the practical empirical illustration of the new estimators and distributional results derived in Theorems 1 and 2, we finish this section with a few more specific remarks related to the statistical properties of the estimators.

**Remark 3.1.** Based on our continuous beta estimate, a natural alternative estimator for the discontinuous beta is given by Eq. (15) with \( \tau = 1 \) and \( \sigma \in (0, 0.5) \). Indeed, the proof of Theorem 2 already establishes the limit and asymptotic distribution of such an estimator. However, while an assumption of the type in Assumption A2 used in Theorem 2 is unavoidable for the estimation of the continuous beta, we prefer not to impose it for the estimation of the discontinuous beta. Consequently, we need the power \( \tau \geq 2 \) in Eqs. (14) and (15).

**Remark 3.2.** The continuous beta estimate in (25) has been proposed independently in concurrent work by Gobbi and Mancini (2008) (they also propose a cojump measure parallel with the one discussed in Remark 3.1). However, their derivation of the asymptotic distribution of the estimator is based on the more restrictive assumption of finite activity jumps only.

**Remark 3.3.** Eq. (3) imposes that the sensitivities toward systematic diffusive and jump risks be constant over the \([0, T]\) time-interval. In the empirical section we will discuss ways in which to assess that assumption in practice. Meanwhile, even if the betas vary over the estimation interval \([0, T]\), our estimators still provide meaningful estimates of the sensitivities towards systematic diffusive and jump risks. The only conceptual difference is that in this case the limiting quantities of our estimators will be random variables, as opposed to constants. Of course, when the jump beta is time-varying our estimate thereof will invariably depend on the value of \( \tau \) that is used in the estimation.

**Remark 3.4.** The estimators of the discontinuous and continuous betas in Eq. (15) (with \( k = j = 0 \)) and (25), respectively, are naturally interpreted as regression coefficients. Indeed, it is possible to view the two estimates as (powers of) slope coefficients in a regression of the high-frequency “big”, respectively “small”, individual price increments (or their powers) on the corresponding high-frequency “big”, respectively “small”, systematic factor increments (or their powers) over the \([0, T]\) time-interval.

4. **Empirical illustration**

Our empirical illustration is based on high-frequency transaction prices for forty large capitalization stocks over the January 1, 2001 to December 31, 2005 sample period, for a total of 1241 active trading days. The data were obtained from the Trade and Quote Database (TAQ). The name and ticker symbols for each of the individual stocks are given in the tables below. The same data has previously been analyzed by Bollerslev et al. (2008) from a very different perspective, and we refer to the discussion therein for further details concerning the methods and filters employed in cleaning the raw price data.

The theoretical results derived in the preceding section is based on the notion of increasingly finer sample prices, or \( \Delta_n \to 0 \). Meanwhile, a host of practical market microstructure complications, including bid-ask spreads, price discreteness and non-synchronous trading effects, prevent us from sampling too frequently, while maintaining the fundamental semimartingale assumption underlying our results. Ways in which to best deal with the market microstructure “noise” in the implementation of univariate realized variation measures is currently a very active area of research; see, e.g., Zhang et al. (2005); Hansen and Lunde (2006); Barndorff-Nielsen et al. (2008a), and the references therein. These procedures do not easily generalize to a multivariate context, where the issues are further confounded by non-synchronous recording of prices across assets. Important recent work along these lines include the refresh time sampling and multivariate kernels of Barndorff-Nielsen et al. (2008b), the pre-averaging procedure of Christensen et al. (2009), and the non-synchronous two-scale approach of Zhang (forthcoming). Instead of attempting to adopt any of these procedures to the present context, here we simply follow most of the literature in the use of an intermediate sampling frequency as a way to strike a reasonable balance between the desire for as finely sampled prices as possible on the one hand and the desire not to overwhelm the measures by market microstructure effects on the other. While the magnitude and the impact of the “noise” obviously differs across stocks and across time, the analysis in Bollerslev et al. (2008) suggests that a conservative sampling frequency of 22.5 min strikes such a balance and effectively mitigates the impact of the “noise” for all of the forty stocks in the sample.10

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9 An alternative, and somewhat more complicated, estimator for \( K_\tau \) could be constructed from appropriately defined truncated power variation measures.

10 For simplicity we decided to maintain the identical sampling frequency for all of the stocks throughout the sample. However, we also experimented with the use of other sampling frequencies, resulting in the same basic findings as the ones reported below.
The one-factor market model most often employed in practice identifies the systematic risk factor with the return on the aggregate market portfolio. Thus, rather than estimating the relative factor sensitivities across the forty stocks, we treat the market as asset 0 and focus on the sensitivities with respect to that benchmark as defined in Eqs. (8) and (9). These direct beta estimates are obviously also somewhat easier to interpret than the more generally valid sensitivity ratios.\footnote{As noted above, the distributional results in Theorems 1 and 2 also imply that the use of the “right” benchmark asset will give rise to the most accurate sensitivity estimates.} We use the S&P500 index as our measure for the aggregate market, with the corresponding high-frequency returns constructed from the prices for the SPY Exchange Traded Fund (ETF).

Our model-free approach only permits the estimation of discontinuous betas over periods in which there were actually jumps in the reference asset 0, as formally defined by the set $\Omega_0$. We therefore begin our empirical analysis with testing for systematic jumps in the SPY contract. Consistent with previous studies on similar data, here we use the non-parametric test in Barndorff-Nielsen and Shephard (2006) and Huang and Tauchen (2005) based on the difference in the logarithmic daily realized variance and bi-power variation measures. Since the SPY is less susceptible to market microstructure “noise” than many of the forty stocks in the sample, we rely on a finer 5 min sampling frequency in the implementation of the tests. To avoid falsely classifying no-jump days as jump days, we use a fairly conservative critical value of 3.09 for the normally distributed test statistic, corresponding to a 0.2% significance level. The resulting tests indicate that the market jumped on 106 of the 1241 days in sample. At the monthly level 50 out of the 60 months in the sample contained at least one significant jump day, while all of the 20 quarters contained significant jumps. In the following we restrict our calculation of jump betas to only those significant time periods; i.e., 106 days, 50 months, and 20 quarters.

In calculating the betas, we rely on the estimators defined in Eqs. (15) and (25) with $j = k = 0$ and $\tau = 2$. Both estimators involve a truncation of the price increments, necessitating a choice of $\alpha$ and $\varpi$. As previously noted, choosing $\varpi = 0.49 < 0.5$ essentially excludes jumps of infinite variation (recall the condition on the jump activity $s$ in part (b) of Theorem 2), which are (perhaps) hard to differentiate from continuous price moves with discretely sample observations. For $\hat{\beta}_T^2\alpha$, we set $\alpha = 2\sqrt{BV(0, T)}$, where $BV(0, T)$ denotes the bi-power variation of the relevant price process, which provides a measure of the continuous price variation over the period.\footnote{The asymptotic theory in the previous section is derived for a threshold that does not depend on the data within the interval $[0, T]$. Thus a theoretically correct way of incorporating the time-varying volatility of the continuous price in constructing the threshold would be to use the previous period bi-power variation. In practice this makes very little difference because the volatility is a persistent process.} Intuitively, over short time-periods the continuous part of the price process is approximately normal, so that our choice of $\alpha$ used in estimating the jump betas discards only those price increments which are within two standard deviations of 0, and thus most likely to be associated with continuous price movements. On the other hand, for $\hat{\beta}_T^2\varpi$ we set $\alpha = 3\sqrt{BV(0, T)}$, discarding only those price increments which are more than three standard deviations away from 0, and thus unlikely to be associated with continuous price moves. These two different values of $\alpha$ arguably reflect a conservative choice in classifying (and consequently discarding) a price increment as being either continuous or one that contains jump(s). Of course, asymptotically the values of $\alpha$ and $\varpi$ do not matter.\footnote{We also experimented with other values for these tuning parameters, resulting in very similar beta estimates to the ones reported below. Further details concerning these results are available upon request.}

Turning to the actual empirical results, Figs. 1–4 plot the time series of quarterly, monthly and daily continuous and jump beta estimates for two representative firms, IBM and Genentech. The daily beta estimates are obviously somewhat noisy and difficult to interpret. Meanwhile, the estimates for the monthly betas appear much more stable, while still showing interesting and clearly discernible patterns over time. Even though the same longer run dynamic dependencies are visible in the quarterly betas, some of the more subtle variations appear to have been lost at the quarterly horizon. In the following we will therefore concentrate our discussion and analysis on the monthly beta estimates.\footnote{This also mirrors the ubiquitous monthly return regressions in the empirical finance literature.}

In order to more directly compare the monthly beta estimates, Fig. 5 combines the separate betas for each of the two representative stocks in the same graph. The plot in the top panel shows that the betas for IBM tend to be close. However, the plot for Genentech in the bottom panel reveals some rather marked differences
in the estimates. In particular, for the months in which there were systematic jumps, $\hat{\beta}_d^i$ is almost always greater than $\hat{\beta}_c^i$, and sometimes by a considerable amount. Before starting to speculate on the economic significance and importance of these findings, it is naturally to ask whether these apparent differences in the betas are actually statistically significant.

The asymptotic distributional results in Theorems 1 and 2 afford a direct way of assessing the accuracy of the beta estimates, and in turn allow for the calculation of period-by-period confidence intervals. Looking at the corresponding 95% confidence intervals in Figs. 6 and 7, it is clear that the intervals for the monthly Genentech betas often do not have any points in common, indicating that the betas are indeed different. Meanwhile, the intervals for IBM generally involve some overlap making it impossible to statistically tell the two betas apart. Note that the width of the confidence intervals for the jump betas vary much more than the width of the intervals for the continuous betas. As discussed in connection with Theorem 1 above, this is to be expected. Intuitively, it is much easier to estimate the sensitivity to systematic jump risk in months where the market experienced a few large jumps than it is in months involving more moderate sized jumps.

To illustrate the results on a broader basis, we report in Table 1 the average monthly continuous and jump beta estimates for each of the forty stocks in the sample. We also include (in square brackets) the corresponding 95% confidence intervals for the averages, constructed from the asymptotic variances in Theorems 1 and 2. Consistent with the visual impression from the figures, the average betas for IBM are very close, 0.981 versus 0.984,
with overlapping confidence intervals, while those for Genentech are very different, 0.992 versus 1.287, with non-overlapping confidence intervals. Looking across all of the forty stocks, for only five of the stocks do the confidence intervals for the average betas overlap, thus indicating that on average most of the stocks do indeed respond differently to continuous and discontinuous market moves. Moreover, with a few exceptions the average jump betas are greater than the continuous betas, suggesting that for the large capitalization stocks analyzed here, larger (jump) market moves tend to be associated with proportionally larger systematic price reactions than smaller more common (continuous) market moves. Also, while Genentech exhibits the largest numerical difference of 0.295, the differences in the average betas for many of the other stocks are non-trivial and economically important.\footnote{We also calculated the proportion of the total diffusive and jump variation for each of the stocks due to idiosyncratic variation,}

In addition to allowing for the estimation of separate betas, one of the main attractive features of the high-frequency based estimation approach developed here is the ability to reliably estimate the betas and any temporal variation therein over relatively short time spans, such as a month.\footnote{As noted above in connection with our discussion of the representative time series plots for IBM and Genentech, the monthly beta estimates for both of the stocks do indeed seem to vary in an orderly and reliable fashion from one month to the next.} The monthly averages reported in Table 1, of course, obscures any variation in the betas over time. Thus, to complement these results and more directly highlight this important feature of our new procedures, we present a series of tests for constancy of the betas.

In particular, let $\hat{\beta}_{ \mathbf{m} }^c$ denote the estimate for $\beta_{ \mathbf{m} }^c$ for month $ \mathbf{m} = 1, \ldots, 60$ in the sample. The following three test statistics,

$$T_{\mathbf{m}} = \sum_{\mathbf{t}=1}^{60} \frac{ (\hat{\beta}_{\mathbf{t}, 2\mathbf{m}}^c - \hat{\beta}_{\mathbf{t}, 2\mathbf{m}-1}^c )^2 }{ \text{Avar}(\hat{\beta}_{\mathbf{t}, 2\mathbf{m}}^c) + \text{Avar}(\hat{\beta}_{\mathbf{t}, 2\mathbf{m}-1}^c) } \sim \chi^2_{10} \quad (28)$$

The average values of the two measures averaged across the forty stocks and sixty (resp. fifty) months in the sample were close and equal to 0.688 and 0.696, respectively. The averages generally also differed very little for each of the individual stocks, with a maximum difference of only 0.071 for Texas Instruments. Further details of these results are available upon request.
Meanwhile, for a few of the stocks we are not able to strongly reject that the monthly and quarterly jumps have a limiting distribution under the null hypothesis of no jump, respectively. The actual results of the tests reported in Table 2 strongly reject that the monthly and quarterly jumps have a limiting distribution under the null hypothesis of no jump.

bets stayed the same over the sample. This is true for both types of betas. 17 Meanwhile, for a few of the stocks we are not able to reject the hypothesis that the annual averages are constant.

In a sum, the empirical results show that not only do the monthly continuous and jump betas differ significantly for most of the stocks in the sample, the betas also changed significantly through time. As such the results clearly highlight the benefits and insights afforded by our new estimation and inference procedures vis-à-vis the more traditional regressions-based approaches for estimating betas, restricting the continuous and jump betas to be the same and implicitly treating the betas to be constant over long multi-year periods.

5. Conclusion

Discrete-time factor models are used extensively in asset pricing finance. We provide a new theoretical framework for separately identifying and estimating sensitivities towards continuous and discontinuous systematic risks, or betas, within this popular framework.

17 These results also indirectly suggest that temporal variation in the betas might be predictable. We will not pursue the issue of modeling and forecasting the betas here, instead referring to Andersen et al. (2006) where reduced-form time series models for simpler realized monthly betas based on standard realized variation measures are presented.
model setup. Our estimates and distributional results are based on the idea of increasingly finer sampled returns over fixed time-intervals. Using high-frequency data for a large cross-section of individual stocks and a benchmark portfolio mimicking the aggregate market, we find that allowing for separate continuous and jump betas can result in materially different estimates from the ones restricting the two betas to be the same. These results raise a number of new interesting questions.

As discussed in the introduction, several recent studies have argued that the risk premia associated with discontinuous, or jump, risks often appear to be quite different from the premia associated with continuous risks. The relatively limited time-span of high-frequency data available for the empirical analysis here invariably limits the scope of such investigations. Nonetheless, it would be interesting to somehow test whether the two types of betas carry separate risk premia. Along these lines, our findings of different sensitivities to systematic jump risks also has important implications for practical portfolio and risk management. In particular, our results suggest that portfolios designed to hedge the largest market moves, or systematic price jumps, might have to be constructed differently from portfolios intended to neutralize, or immunize, the more common systematic day-to-day market movements. At a more fundamental level, the ability to accurately estimate separate betas over relatively short calendar time-spans also raise the possibility of empirically investigating the economic determinants behind the different types of risk and any temporal variation therein. In spite of the continued dominance of the market model in practical applications, more complicated multifactor representations have often been shown to provide more accurate descriptions of the cross-sectional variation in expected returns. It would be interesting to formally extend the theoretical results for the one-factor model presented here to a multifactor setting allowing for the estimation of different continuous and jump betas with respect to specific factor representing portfolios, including the popular Fama-French book-to-market and size sorted portfolios as well as momentum based portfolios. We leave further investigations of all of these issues for future research.

Appendix A. Proof of Theorem 1

Part (a). Part (a) of the Theorem follows directly from Lemma 8.3 in Jacod and Todorov (2009).

Part (b). To prove part (b) we first introduce some additional notation. We define \( \sigma_t \), a random \((N + 1) \times (N + 1)\) matrix as follows

\[
\sigma_t = \begin{pmatrix}
\sigma_{0t} & 0 & \cdots & 0 \\
\beta_1 \sigma_{0t} & \sigma_{1t} & 0 & \cdots & 0 \\
\vdots & 0 & \ddots & \cdots & 0 \\
\beta_N \sigma_{0t} & \cdots & 0 & \cdots & 0 \\
\end{pmatrix},
\]

(A.1)

Note that \( \bar{\sigma} \sigma_t = c_t \), where \( c_t = \int_0^t c_s ds \) is the second characteristic of the Itô semimartingale \( p \) (see Jacod and Shiryaev (2003) for a definition of the characteristics of semimartingales). Using \( \bar{\sigma} \), we define the \( N + 1 \)-dimensional variable

\[
R_t = \sqrt{k_T S_{0t}} - U_q + \sqrt{1 - k_T S_{0t}} U_q',
\]

(A.2)

and we denote with \( R_{0i}^{(n)} \) the \( i \)th element of \( R_n \) for \( i = 1, \ldots, N + 1 \). The proof of Theorem 1, part (b) is based on the following Lemma.

Lemma 1. For the Itô semimartingale \( p \) satisfying the conditions in Theorem 1 and the functions \( f_i(\cdot) \) defined in (13) we have

\[
\frac{1}{\sqrt{\Delta t}} \begin{pmatrix}
V_n(f_0)_T - \sum_{t \leq T} f_0(\Delta p_{0i}) \\
V_n(f_1)_T - \sum_{t \leq T} f_1(\Delta p_{1i}) \\
\vdots \\
V_n(f_N)_T - \sum_{t \leq T} f_N(\Delta p_{Ni})
\end{pmatrix} \overset{L(\cdot)}{\rightarrow} \begin{pmatrix}
Z_t^{01} \\
Z_t^{11} \\
\vdots \\
Z_t^{N1}
\end{pmatrix},
\]

(A.3)

where for arbitrary \( i \) we define

\[
Z_t^{ki} = \sum_{q \leq s \leq t} (\tau \text{sign}[\Delta p_{0i}] | \Delta p_{0i} |^{-1} | \Delta p_{1i} |^{-1}| R_{q}^{0i} + \tau \text{sign}[\Delta p_{0i}] | \Delta p_{0i} |^{-1} | \Delta p_{1i} |^{-1}| R_{q}^{1i} ) .
\]

Proof of Lemma 1. First note that the elements \( Z_{t}^{ki} \) are well defined using Lemma 8.1 in Jacod and Todorov (2009). The proof of the stable convergence result in (A.3) follows from Theorem 8.4 in Jacod and Todorov (2009).

On \( \Theta_T^{(0)} \sum_{t \leq T} f_0(\Delta p_{0i}) \) for \( i = 0, \ldots, N \) are all away from 0. Therefore on a set approaching \( \Theta_T^{(0)} \), \( \left( \frac{\sigma_t^i}{\rho_t^i} \right) \) is a differentiable function of the vector \( (V_n(f_0)_T, \ldots, V_n(f_N)_T)' \). Hence, we can use the CLT result in Eq. (A.3) and apply a delta method on this set, to derive that \( \frac{1}{\sqrt{\Delta t}} \left( \frac{\sigma_t^i}{\rho_t^i} - \frac{\rho_t^i}{\rho_t^j} \right) \) converges stably in law on \( \Theta_T^{(0)} \) to the random variable

\[
\frac{1}{\tau} \text{sign}[\Delta p_{0i}] \frac{\left( \sum_{t \leq T} | \Delta p_{0i} \Delta p_{1i} |^r \right)^{1/r}}{\left( \sum_{t \leq T} | \Delta p_{0i} \Delta p_{1i} |^r \right)} Z_t^{ki},
\]

(A.4)

where \( s \) denotes an arbitrary jump time in the process \( p_0 \). Using Eqs. (3) and (7) we have

\[
\text{sign}[\Delta p_{0i} \Delta p_{1i}] \left( \sum_{t \leq T} | \Delta p_{0i} \Delta p_{1i} |^r \right)^{1/r} = \left( \sum_{t \leq T} | \Delta p_{0i} \Delta p_{1i} |^r \right)^{1/r} \left( \sum_{t \leq T} | \Delta p_{0i} \Delta p_{1i} |^r \right)^{-1/r} Z_t^{ki},
\]

(A.5)
\[ \text{for arbitrary } i. \text{ Plugging the last three expressions into Eq. (A.4) we get (19). To show (21) we use (A.1) and the definition of } R^0_q \text{ to write}
\]
\[ R^0_q = \sqrt{\mathbb{K} \sigma_{0,0} - U_q^0 + \sqrt{1 - \kappa_q \sigma_{0,0} U_q^0}}, \]
\[ R^i_q = \beta^0 R^0_q + \sqrt{\mathbb{K} \sigma_{0,0} - U_q^i + \sqrt{1 - \kappa_q \sigma_{0,0} U_q^i}}. \]  

(A.8)  

For the stopped processes, using the Burkholder-Davis-Gundy inequality (see e.g. Prokhorov (2004), Theorem IV.48), we have
\[ E_{n}^{\mathbb{F}_{\delta(\cdot)}} \left[ |\Delta^X_{\tau}X^C_{\tau} + \Delta^X_{\tau}X^{\bar{C}}_{\tau}|^p \right] \leq K \Delta_n^{p/2}, \quad p \geq 2, \quad i = 1, 2, \]
\[ E_{n}^{\mathbb{F}_{\delta(\cdot)}} \left[ |\Delta^X_{\tau}X^C_{\tau} + \Delta^X_{\tau}X^{\bar{C}}_{\tau}| \right] \leq K \Delta_n^{1+(p-2)/m}, \quad \forall q > 0, \quad i = 1, 2, \]
\[ E_{n}^{\mathbb{F}_{\delta(\cdot)}} \left[ |\Delta^X_{\tau}X^C_{\tau} + \Delta^X_{\tau}X^{\bar{C}}_{\tau}| \right] \leq K \Delta_n^{1+(2r-2-m)/m}, \quad \forall q > 0, \quad i = 1, 2. \]  

(A.15)  

and since \( \sigma > \frac{1}{K} \), the bounds in (A.15) above follow trivially.  

(A.16)  

where \( K \) is some positive constant and we have used the abbreviation \( E_{n}^{\mathbb{F}_{\delta(\cdot)}} = \mathbb{E}(\mathbb{F}_{\delta(\cdot)}) \). Then applying (A.13), Cauchy-Schwarz inequalities and the bounds in (A.15) above, we get
\[ E_{n}^{\mathbb{F}_{\delta(\cdot)}} \left[ |g_n(\Delta^X_{\tau}X^C_{\tau} + \Delta^X_{\tau}X^{\bar{C}}_{\tau}) - g_n(\Delta^X_{\tau}X^C_{\tau}, \Delta^X_{\tau}X^{\bar{C}}_{\tau})| \right] \leq K \Delta_n^{1+(2r-2-m)/m}, \quad \forall q > 0, \quad i = 1, 2. \]  

(A.12)  

and since \( \tilde{\sigma} = \frac{1}{K} \), the bounds in (A.13) also follow. This completes the proof of part (c).  

Part (d). We are left with showing part (d) of the Theorem. To do so we will make use of the following generic one-dimensional Itô semimartingale:
\[ X_t = X_0 + \int_0^t b_s \, ds + \int_0^t \sigma_s \, dW_s + \int_0^t \int E \left( \delta(t, x) \right) \mu(du, dx), \]
\[ + \int_0^t \int E \left( \delta(t, x) \right) \mu(du, dx), \]
\[ \text{where } W \text{ is a Brownian motion and } \mu \text{ is a Poisson measure with compensator } ds \otimes \lambda(du) \text{ and all other quantities associated with the process are defined similar to the corresponding price process in (3). For the proof of part (d) we first state and prove a result of independent interest.} \]

\[ \text{Lemma 2. For the process } X \text{ in (A.17) assume that Assumption A1 and Assumption A2 for some } s < 2 \text{ are both satisfied. Then for some } l > 2 \text{ we have}
\]
\[ \sum_{i=0}^{l-2} |\Delta^X_{n}X^C_{n} - \bar{c}(n, +, )| \]
\[ \to \sum_{q \in \mathbb{F}_{\delta(\cdot)}} |\Delta^X_{n}X^C_{n}| \left( \sigma_{q}^2 + \sigma_{q}^2 \right), \]
\[ \text{where}
\]
\[ \bar{c}(n, \pm) = \frac{1}{K_0 \Delta_n} \sum_{i=1}^{n} \left[ |\Delta^X_{n}X^C_{n}| \right|^{\pm}X^C_{n}, \]
\[ \text{and } k_0, k_1 \text{ are defined in Theorem 1.} \]

\[ \text{Proof of Lemma 2. The proof parallels the proof of Theorem 4, part (b) in Ait-Sahalia and Jacod (2009b), and we follow the main steps therein (Ait-Sahalia and Jacod (2009b)) use a different } \mathcal{C}(n, \pm) \text{ than ours. In parallel with that proof, we will prove Lemma 2 under the stronger condition that the drift, the stochastic volatility (and its coefficients) in the Itô semimartingale decomposition) and the jumps of the process } X \text{ are bounded. The result after this can be extended to the general case using a localization procedure as in Jacod (2008). Our proof consists of two steps.} \]
Step 1. We denote $\delta^n = \sigma_{(t-1)\Delta_n} \Delta^n W$. Then in this first step we show that Lemma 2 will follow if we have proved the following

$$\frac{1}{k_n \Delta_n} \sum_{i=1}^{I_n} \sum_{j=t(i)+1}^{t(i+1)} |\Delta^n_i X|^p \left| \left| \delta^{n}_{i,j} \right| \right|_{L^p} \leq K \Delta_n^q / \Delta_n.$$  \hspace{1cm} (A.19)

where $I_n(t) = I_{(t-1)\Delta_n} (t)$. We note that this is somewhat similar to the result in Barndorff-Nielsen et al. (2006) regarding the robustness of realized multipower variation estimators with respect to Lévy-type jumps. To establish Step 1 we first prove some preliminary results. Recall from the proof of part (c) the abbreviation $E^n_{t-1} = E \left( | \mathcal{F}_{t-1} \right)$. Using the boundedness of $b_n$, $\sigma_n$ and $\mu(x, u)$, the following three inequalities are straightforward,

$$E^n_{t-1} \left( |b_n u| \right) \leq K \Delta_n,$$  \hspace{1cm} (A.20)

$$(\sigma_n - (t-1)\Delta_n) dW_n $$ \hspace{1cm} (A.21)

$$E^n_{t-1} \left( \int_{t-1}^{t} \int_{t-1}^{t} \int_{E} \int_{E} \kappa'(\delta(u, x)) \mu(dx, du) \right) \leq K \Delta_n,$$  \hspace{1cm} (A.22)

We proceed with bounding the conditional expectation of the increment of $X$ due to the jump martingale. First if $s < 1$, the jump martingale can be split into two integrals (one with respect to $\mu$ and the other one with respect to $\nu$) and we can then bound the conditional expectation of the jump martingale as in the above case. Thus, assume that $s \geq 1$ and choose an arbitrary $\alpha$ such that $s < \alpha < 2$. Then, using Jensen’s inequality and the Burkholder-Davis-Gundy inequality we have

$$E^n_{t-1} \left( \int_{t-1}^{t} \int_{t-1}^{t} \int_{E} \int_{E} \kappa'(\delta(u, x)) \mu(dx, du) \right) \leq K \Delta_n^{\alpha/2},$$  \hspace{1cm} (A.23)

where for the last inequality we used the fact that since $s < \alpha < 2$ we have the following inequality holding pathwise $(\sum_{0<\alpha<T} \kappa'(\Delta X_t))^p \leq \sum_{0<\alpha<T} |\kappa'(\Delta X_t)|^p$ for an arbitrary $\alpha$. Now using the fact that $\sigma_n$ is an Itô semimartingale (Assumption A1(d)) and an application of the same type inequalities as in (A.20)–(A.23) yields

$$E^n_{t-1} \left( \int_{t-1}^{t} \int_{t-1}^{t} \int_{E} \int_{E} |\kappa'(\delta(u, x))| \mu(dx, du) \right) \leq K \Delta_n^{\alpha/2},$$  \hspace{1cm} (A.24)

In fact (A.24) is much stronger than what we really need (i.e. a bound of $K \Delta_n^{1+\epsilon}$ for $\epsilon > 0$ suffices for what follows). Further (see e.g. Jacod (2008) for a proof),

$$E^n_{t-1} \left( | \Delta^n_i X|^p \right) \leq K \Delta_n^{q/2 + 1/2}, \quad q \geq 1.$$  \hspace{1cm} (A.25)

Finally, we also have the following basic algebraic inequality

$$|\Delta^n_i X||\Delta^n_{i-1} X| - |\delta^n_{i,j}|^{1/2} \leq |\Delta^n_i X - \delta^n_{i,j}| |\Delta^n_{i-1} X - \delta^n_{i,j}| + |\delta^n_{i,j}||\Delta^n_{i-1} X - \delta^n_{i,j}| + |\Delta^n_i X - \delta^n_{i,j}| |\delta^n_{i,j}| - \delta^n_{i,j}. $$  \hspace{1cm} (A.26)

Then the absolute value of the difference between the left-hand-sides of (A.18) and (A.19) can be bounded by a sum of terms of the following form

$$K \frac{1}{k_n \Delta_n} |\Delta^n_{i-1} X|^1 ||\Delta^n_{i} X - \delta^n_{i,j}| \leq K \Delta_n^{q/2 + 1/2}, \quad q \geq 1.$$  \hspace{1cm} (A.27)

where $\tau_1$, $\tau_2$ and $\tau_3$ are three integers different from each other and $K$ is some constant. Then upon taking successive conditional expectations and using the bounds of the moments in (A.20)–(A.26) we have that the products in (A.27) are bounded by $K \Delta_n^{1/2 + 1/2}/k_n$ for some constant $K$ and where $\alpha$ is the constant in (A.23). Then a simple count of the number of terms of the type in (A.27) that bounds the difference between the left-hand-sides of (A.18) and (A.19) shows that the latter difference is asymptotically negligible and this proves Step 1.

Step 2. In the second step we verify that

$$\frac{\pi}{2} \frac{1}{k_n \Delta_n} \sum_{j \in \mathcal{I}_q} |\delta^n_{j-1,j}| \sigma^n_{j-1,j} \to \sigma^2_{\mathcal{I}_q},$$  \hspace{1cm} (A.28)

where as in Ait-Sahalia and Jacod (2009b) we set $i(n, q) = \inf \left\{ t : t \Delta_n \geq S_q \right\}$, $I_{n,i} = \{ j : j \neq (n, q), \left| t - i(n, q) \right| \leq k_n, j < t(n, q) \}$, $L_{n,i} = \{ j : j \neq (n, q), \left| t - i(n, q) \right| \leq k_n, j > t(n, q) \}$ and recall that $S_q$ is any sequence of stopping times exhausting the jump times of $X$. Then similar to Ait-Sahalia and Jacod (2009b), we also define

$$U^n_q = \frac{\pi}{2} \frac{1}{k_n \Delta_n} \sum_{j \in \mathcal{I}_q} |\Delta^n_{j-1,j} W||\Delta^n_{j,j} W|$$  \hspace{1cm} (A.29)

Then by a standard Law of Large Numbers, we have that $U^n_q \to_{a.s.} 1$, $T^n_q \to_{a.s.} \frac{s^2}{\mathcal{I}_q^2}$ and $T^n_q \to_{a.s.} \frac{s^2}{\mathcal{I}_q^2}$. Hence the first part of (A.28) follows. The second part of (A.28) is proved analogously. This establishes Step 2.

Combining Step 1 and Step 2 along with the proof of Theorem 4, part (b) in Ait-Sahalia and Jacod (2009b) (where loosely speaking it is shown that substitution of $|\Delta^n_i X|$ with the jumps $|\Delta X_i|$ does not change the estimator) the claim in Lemma 2 follows.

Using Lemma 2 trivially establishes part (d) of Theorem 1. The difference between $V_T$ and the same estimator with $\beta^n_i$ substituted by $\beta^n_i$ can be bounded with a sum of functions of the type $|\beta^n_i - \beta^n_i|^p K_n$, where $K_n \to K$ for some processes $K_n$ and $K$ (this follows from using inequalities analogous to the one in (A.26)). Therefore part (d) follows from the consistency of $\beta^n_i$ for $\beta^n_i$. (Note that the indicator function in the denominator of $V_T$ does not matter asymptotically). □
Appendix B. Proof of Theorem 2

Part (a). Part (a) follows trivially from the following results, see e.g. Jacod (2008), Theorem 2.4. (dimension plays no role here of course), taking into account the restrictions on \(i, j \) and \(k \) in defining \(X_{ij}^k \) in (24)

\[
V_n^{-1}(X_{ij}^k, \alpha, \sigma) = \left( \frac{1}{\sqrt{d_n}} \right) \left( \V_n(X_{ij}^k, \alpha, \sigma) \right) = \frac{1}{\sqrt{d_n}} \left( \V_n^{-1}(X_{ij}^k, \alpha, \sigma) \right)
\]

Then a Delta method and the above Lemma imply that

\[
\frac{1}{\sqrt{d_n}} \left( \frac{\beta_i}{\beta_j} \right) - \frac{\beta_i}{\beta_j} = \frac{1}{4\beta_i^2 \beta_j^2} \int_0^T \sigma_\alpha^2 \int_0^T \sigma_\alpha^2 dt + \frac{1}{\beta_i^2} \int_0^T \frac{1}{\beta_j^2} \sigma_\alpha^2 dt + \frac{1}{\beta_j^2} \int_0^T \frac{1}{\beta_i^2} \sigma_\alpha^2 dt.
\]

Part (b). We make use of the following Lemma.

**Lemma 3.** Let \( X \) be a \( N \)-dimensional Itô semimartingale, satisfying the same conditions as price process \( p \) in Theorem 2.2 defined on the probability space \((\Omega, F, P)\). Let \( C_1 = \int_0^T c_0 du \) to be the second characteristic of the semimartingale \( X \). We have

\[
\frac{1}{\sqrt{d_n}} \left( \int_0^T c_1 du \right) \xrightarrow{L^1} \sqrt{2} A_d dW_n.
\]

where \( W_n \) is a \( N \)-dimensional Brownian motion defined on an extension of the original probability space, independent from the filtration \( F \). \( A_d \) is a \( N \times N \) matrix with entries \( a_{ij} \) satisfying \( (c_{ij})^2 = \sum_{i=1}^N a_{ij}^2 d_n \).

**Proof of Lemma 3.** Follows from an application of Theorem 2.12 in Jacod (2008), which is multidimensional. □

Using this Lemma the proof of part (b) is easy. Set

\[
\overline{V}_n^{-1}(X_{ij}^k, \alpha, \sigma) = \frac{1}{\sqrt{d_n}} \left( \V_n^{-1}(X_{ij}^k, \alpha, \sigma) \right)
\]

\[
- \int_0^T (\beta_i - \beta_j)^2 \sigma_\alpha^2 du + \sigma^2_\alpha + 1_{\{k \neq \alpha\}} \sigma_{2, j}^2 du.
\]

\[
\overline{V}_n^{-2}(X_{ij}^k, \alpha, \sigma) = \frac{1}{\sqrt{d_n}} \left( \V_n^{-2}(X_{ij}^k, \alpha, \sigma) \right)
\]

\[
- \int_0^T (\beta_i - \beta_j)^2 \sigma_\alpha^2 du + \sigma^2_\alpha + 1_{\{k \neq \alpha\}} \sigma_{2, j}^2 du.
\]

\[
\overline{V}_n^{-3}(X_{ij}^k, \alpha, \sigma) = \frac{1}{\sqrt{d_n}} \left( \V_n^{-3}(X_{ij}^k, \alpha, \sigma) \right)
\]

\[
- \int_0^T (\beta_i + \beta_j)^2 \sigma_\alpha^2 du + 1_{\{j \neq \alpha\}} \sigma_{2, j}^2 du + 1_{\{k \neq \alpha\}} \sigma_{2, k}^2 du.
\]

Combining everything yields the result in (27).

\[
\overline{V}_n^{-4}(X_{ij}^k, \alpha, \sigma) = \frac{1}{\sqrt{d_n}} \left( \V_n^{-4}(X_{ij}^k, \alpha, \sigma) \right)
\]

\[
- \int_0^T (\beta_i - \beta_j)^2 \sigma_\alpha^2 du + 1_{\{k \neq \alpha\}} \sigma_{2, j}^2 du + 1_{\{k \neq \alpha\}} \sigma_{2, k}^2 du.
\]
Part (c). For the case when \( \hat{\beta}^c \) is replaced with \( \hat{\beta}^c \) in \( \hat{K}^c \), part (c) of the Theorem follows from general results about realized multipower variation in Barndorff-Nielsen et al. (2005) (the presence of jumps does not affect the limit). As shown exactly in the proof of Theorem 1, part (d), the substitution of a consistent estimator for \( \hat{\beta}^c \) does not alter the results. □

References


