Extreme returns and intensity of trading

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Summary
Asymmetric information models of market microstructure claim that variables such as trading intensity are proxies for latent information on the value of financial assets. We consider the interval-valued time series (ITS) of low/high returns and explore the relationship between these extreme returns and the intensity of trading. We assume that the returns (or prices) are generated by a latent process with some unknown conditional density. At each period of time, from this density, we have some random draws (trades) and the lowest and highest returns are the realized extreme observations of the latent process over the sample of draws. In this context, we propose a semiparametric model of extreme returns that exploits the results provided by extreme value theory. If properly centered and standardized extremes have well-defined limiting distributions, the conditional mean of extreme returns is a nonlinear function of the conditional moments of the latent process and of the conditional intensity of the process that governs the number of draws. We implement a two-step estimation procedure. First, we estimate parametrically the regressors that will enter into the nonlinear function, and in a second step we estimate nonparametrically the conditional mean of extreme returns as a function of the generated regressors. Unlike current models for ITS, the proposed semiparametric model is robust to misspecification of the conditional density of the latent process. We fit several nonlinear and linear models to the 5-minute and 1-minute low/high returns to seven major banks and technology stocks, and find that the nonlinear specification is superior to the current linear models and that the conditional volatility of the latent process and the conditional intensity of the trading process are major drivers of the dynamics of extreme returns.

1 | INTRODUCTION

Most of the financial literature has focused on the dynamics of average returns and other moments of the return distribution. We have numerous empirical studies of volatility dynamics as well as information models of market microstructure that claim that variables such as trading volume (or trading intensity) are proxies for latent information on the value of financial assets (see; Easley & O’Hara, 1992). Much less attention has been paid to the dynamics of extreme returns and to the links between information, proxied by trading intensity, and extreme returns.

We explore the modeling of interval-valued time series (ITS) of extreme returns, which is defined as the collection of the intervals formed by the highest and the lowest returns in a given period of time. We propose a new semiparametric model that explains the generation of extreme returns as a function of volatility and trading intensity. Unlike current models for ITS discussed in subsequent paragraphs, the main advantage of this approach is that it does not rely on the assumption...
of normality and, thus, it is robust to distributional assumptions. Additionally, asymptotic results of extreme value theory dictate nonlinear functional forms for extreme values as a function of the moments of the underlying process. The nonlinearity is also different for different distributional assumption of the process. Thus, on proposing a semiparametric approach, we robustify the modeling of extreme returns not only against the misspecification of the conditional density of the return process but also against unknown nonlinear functions between extreme returns and volatility and trades.

Though a link between trading volume and volatility has already been established, the link between trading volume and extreme returns has not been analyzed in much detail. A sample of most representative results on volume and volatility follows in historical order. Lamoureux and Lastrapes (1990) find that identical latent factors drive trade volume and return volatility. Andersen (1996) proposes a model in which informational asymmetries and liquidity needs motivate trading, which in turn drives the dynamics of a stochastic volatility model. Engle (2000) analyzes an autoregressive conditional duration model and a generalized autoregressive conditional heteroskedasticity (GARCH) model to conclude that the absence of trading means either bad news or no news and translates into low-volatility regimes. With high-frequency data (5-minute intraday data), Darrat, Rahman, and Zhong (2003) find evidence of significant lead–lag relations between volume and volatility in agreement with the sequential information arrival hypothesis. Fleming and Kirby (2011) analyze the joint dynamics of trading volume and realized volatility and find that there is strong correlation between the innovations to volume and volatility. Sita and Westerholm (2011) find that trade durations (inversely related to trade volume in equity markets) have forecasting power for returns but only within the trading day. One can argue that the range of the interval of extreme returns is a very good volatility estimator (Parkinson, 1980) and, in this sense, the result of the aforementioned studies may apply. However, the dynamics of the low/high interval are richer than those of the range itself because the modeling of the interval captures not only variability but also the dynamics of the bounds themselves. For instance, Ning and Wirjanto (2009) find that there is a significant and asymmetric return–volume dependence at the extremes. The largest returns tend to be associated with extremely large trading volumes but the lowest returns tend not to be related to either large or small volumes. In this context, our work offers a joint modeling of volatility, trading intensity and extreme returns with high-frequency data that combines parametric and nonparametric specifications. We proceed by building on the statistical framework that we proposed in our previous work.

The intervals formed by extreme returns have statistical properties that can be exploited. This is in contrast to the modeling of a classical time series of returns, for which it is very difficult to find any time dependence in the average return. For instance, in González-Rivera and Lin (2013), the authors estimate a constrained bivariate linear system for the daily lowest/highest returns of the S&P 500 index and find that there is statistically significant dependence with adjusted R-squared (in-sample) of about 50%. Although this work generalizes specifications of previous regression models on lower/upper bounds or center/radius of intervals (see the references herein), it relies on the assumption of bivariate normality. In a subsequent analysis, unlike the regression-type models just mentioned, Lin and González-Rivera (2016) propose an alternative modeling approach by pondering how interval-valued data are generated. They consider the lower and upper bounds of the interval as the realizations of minimal and maximal order statistics coming from a sample of \( N_t \) random draws from the conditional density (at time \( t \)) of a latent random process \( \{Y_t\} \). Through the statistical implementation of this approach to prices of agricultural commodities, they also find that their models provide a very good fit for extreme returns with average coverage rates (percentage overlap of the actual low/high interval with the fitted interval) of 83%. However, there are also some disadvantages to this approach. First, the joint probability density function (PDF) of minimal and maximal order statistics degenerates as the number of random draws goes to infinity. Second, the normality assumption on the latent random process \( \{Y_t\} \) may be too restrictive.

To overcome these drawbacks and, in particular, the restrictions imposed by the distributional assumptions, we propose a new two-step semiparametric model that exploits the extreme property of the lower and upper bounds of the interval. We maintain the general setup of Lin and González-Rivera (2016) by assuming that there is a latent process \( \{Y_t\} \) with conditional density \( f_{Y_t}(.) \), from which, at every moment of time, there are \( N_t \) random draws and the lower and upper bounds of the interval are the \textit{realized extreme} observations of \( Y_t \) over the sample of draws. However, we will not assume any particular functional form of \( f_{Y_t} \), so that the estimation procedure is robust to density misspecification of the underlying stochastic process. We will only need conditional moments of the latent process and we will rely on limiting results provided by \textit{extreme value theory} to estimate the conditional mean of the lower and upper bounds of the interval. The proposed estimation procedure consists of two steps. First, we obtain parametric estimates of the conditional mean and conditional variance of the latent process \( \{Y_t\} \) and estimates of the conditional trading intensity of the process \( \{N_t\} \). Second, with the generated conditional moments of the first step as the regressors, we specify a nonparametric model for the conditional means of the lower and upper bounds. We propose a nonparametric function because, according to extreme
value theory, the conditional mean of an extreme value is often a nonlinear function that is difficult to estimate parametrically. Thus this semiparametric approach is a natural vehicle to analyze the role of trading intensity jointly with the statistical properties of the latent return process on the generation of extreme returns.

We fit the proposed semiparametric model to the time series of intervals of low/high returns at the 5-minute and 1-minute frequencies in the trading days of June 2017 for seven very liquid stocks: three major banks—Wells Fargo, Bank of America, and JP Morgan—and four giant technology stocks—Amazon, Apple, Google, and Intel. We find that the proposed semiparametric model is superior to the current linear specifications and that there is a nonlinear relationship between extreme returns and intensity of trading with a somehow more intense response from the low returns.

The organization of this paper is as follows. In Section 2, we provide the basic assumptions for estimation of the model. In Section 3, we present the two-step estimation procedure and establish the asymptotic properties of the second-step nonparametric regression with generated regressors. In Section 4, we analyze several models to explain the relationship between extreme returns and intensity of trading with a somehow more intense response from the low returns. Finally, we conclude in Section 5. In the Appendix, we discuss relaxing the i.i.d. assumption maintained in the data-generating process (DGP). Owing to space limitations, detailed regularity conditions and the proof of Theorem 1, TAQ data cleaning procedure, some intermediate empirical results, and additional tables and figures are relegated to the online Supporting Information.

2 | BASIC ASSUMPTIONS

We describe the DGP of the interval-valued time series. We need several assumptions that are not too restrictive, and they accommodate many of the processes frequently encountered in financial data.

Assumption 1 (DGP). Let $\{Y_t : t = 1, \ldots, T\}$ be an underlying stationary stochastic process. The continuous random variable $Y_t$ at time $t$ has conditional density $f(y_t | F_{t-1})$, where $F_{t-1}$ is the information set available at time $t$. At each time $t$, there are $N_t$ independent draws from $f(y_t | F_{t-1})$ collected in a set $S_t \equiv \{y_{it} : i = 1, \ldots, N_t\}$ with random sample size $N_t$, which is assumed to follow a conditional distribution $H(n_t | F_{t-1})$.

Let $y_{lt}$ and $y_{ut}$ denote the smallest and largest values in the sample $S_t$ at time $t$:

$$y_{lt} \equiv \min_i S_t = \min_{1 \leq i \leq N_t} \{y_{it}\},$$

$$y_{ut} \equiv \max_i S_t = \max_{1 \leq i \leq N_t} \{y_{it}\}.$$

Then, $\{(y_{lt}, y_{ut}) : t = 1, \ldots, T\}$ is the observed interval time series (ITS) of lower and upper bounds.

The intuition behind Assumption 1 is straightforward. For instance, suppose that we have financial data and we choose a frequency, say, every 5 minutes. During these 5 minutes trading takes place and, for every transaction, we observe a return (price). Then, in each block of 5 minutes, we will observe the lowest return, the highest return, and the number of trades. Our assumption means that the conditional density of returns $f(y_t | F_{t-1})$ is updated every 5 minutes according to some dynamic specification. The number of trades during the 5-minute time interval represents the number of random draws $n_t$ from the conditional distribution of returns. Then, the lowest and the highest returns ($y_{lt}$ and $y_{ut}$) are the two extremal (minimal and maximal) observations in the sample $S_t$ of size $n_t$.

Given this data-generating mechanism, our analysis of ITS data proceeds with the analysis of extremal observations $\{(y_{lt}, y_{ut})\}$ based on the results of the extreme value theory. The asymptotic theory for maxima (and minima) is very different from the theory applied to averages. Once the average is properly centered around its mean and standardized by its standard deviation, central limit theorems provide a normal limiting distribution. In contrast, the centering and standardizing terms in the limit theorems for maxima (minima) are more difficult to derive because they depend on the tail characteristics of the assumed underlying density. The key result in extreme value theory is the Fisher–Tippett theorem (Fisher & Tippett, 1928; Gnedenko, 1943), which provides the limiting distributions of properly centered and standardized maxima (minima). The three limiting distributions are Frechet, Weibull, and Gumbel, which can be nested into a one-parameter generalized extreme value (GEV) distribution $H_\xi$, defined as

$$H_\xi(x) = \begin{cases} 
\exp\left[-(1 + \xi x)^{-1/\xi}\right] & \text{if } \xi \neq 0, \\
\exp[-\exp(-x)] & \text{if } \xi = 0.
\end{cases}$$

1We only consider continuous random variables; therefore the existence of a nondegenerate limiting distribution should always hold.
in which \( \xi \) is a shape parameter and \( 1 + \xi x > 0 \). Then, (i) \( \xi = \alpha^{-1} > 0 \) corresponds to the Fréchet distribution, (ii) \( \xi = 0 \) corresponds to the Gumbel distribution, and (iii) \( \xi = -\alpha^{-1} < 0 \) corresponds to the Weibull distribution. For more detail, see theorem 1.1.3 and its discussion in de Haan and Ferreira (2000).

It is said that the random variable \( Y_t \) belongs to the maximum domain of attraction (MDA) of the extreme value distribution \( H_\xi [Y_t \in \text{MDA}(H_\xi)] \) if the limiting distribution of standardized extremes—that is, \( c_{ut}^{-1}(Y_t - d_{ut}) \)—is the extreme value distribution \( H_\xi \). The standardizing and centering terms, \( c_{ut} \) and \( d_{ut} \), depend on \( t \) through the conditional distribution of \( Y_t \) and the number of random draws \( N_t \). Explicitly, we write \( c_{ut} \equiv c_u[N_t, f(y_t|F_{t-1})] \) and \( d_{ut} \equiv d_u[N_t, f(y_t|F_{t-1})] \). Based on Assumption 1 (DGP), the limiting distribution of maxima \( Y_{ut} \) conditioning on \( F_{t-1} \) is

\[
c_{ut}^{-1}(Y_{ut} - d_{ut})|F_{t-1} \overset{d}{=} H_{\xi_u}, \quad \text{for each } t = 1, \ldots, T, \tag{1}
\]
as the number of random draws \( N_t \) goes to infinity in probability, which follows directly from the Fisher–Tippett theorem and lemma 2.5.6 in Embrechts, Klüppelberg, and Mikosch (1997). The same argument holds for the minima process \( \{Y_{lt}\} \), so that

\[
c_{lt}^{-1}(Y_{lt} - d_{lt})|F_{t-1} \overset{d}{=} H_{\xi_l}, \quad \text{for each } t = 1, \ldots, T, \tag{2}
\]
as the number of random draws \( N_t \) goes to infinity in probability.

A key requirement to invoke the Fisher-Tippett theorem is that the maxima \( \tilde{Y}_{ut} \) are i.i.d. random sample \( S_t \) as stated in Assumption 1. However, under certain regularity conditions, the i.i.d. assumption can be substantially relaxed to strict stationarity, which allows the \( y_{it} \) sequence in \( S_t \) to be weakly dependent without essentially affecting our model specification. We further discuss the regularity conditions in the Appendix.

Since we would like to build conditional mean models for the extremes, the above convergence in distribution (Equations (1) and 2) is too weak. We need to impose restrictions on the first moments of \( Y_{ut} \) and \( Y_{lt} \) to achieve stronger convergence. To simplify notation, let \( \tilde{Y}_{ut}(N_t) \equiv c_{ut}^{-1}(Y_{ut} - d_{ut}) \) and \( \tilde{Y}_{lt}(N_t) \equiv c_{lt}^{-1}(Y_{lt} - d_{lt}) \) be the appropriately standardized maxima and minima, whose dependence on the number of random draws \( N_t \) is explicitly expressed.

**Assumption 2.** For all \( t \), there exists \( \delta > 0 \), such that

\[
\sup_n E \left[ \tilde{Y}_{ut}(n)^{1+\delta} | F_{t-1} \right] = M_t < \infty, \quad \sup_n E \left[ \tilde{Y}_{lt}(n)^{1+\delta} | F_{t-1} \right] = M_t < \infty.
\]

Given Assumption 2, and according to theorem 4.5.2 in Chung (2001), we have that for each \( t = 1, \ldots, T, \)

\[
E[\tilde{Y}_{ut}(N_t)|F_{t-1}] \overset{p}{\rightarrow} E(Y_{\xi_u}), \quad E[\tilde{Y}_{lt}(N_t)|F_{t-1}] \overset{p}{\rightarrow} E(Y_{\xi_l}).
\]
as \( N_t \) goes to infinity in probability. Since the conditional expectation of the GEV random variable \( Y_{\xi_u} \) is \( E(Y_{\xi_u}) = [\Gamma(1 - \xi_u) - 1]/\xi_u \), where \( \Gamma(\cdot) \) is the Gamma function, the conditional expectations of the extrema are

\[
E(Y_{ut}|N_t; F_{t-1}) = d_u[N_t, f(y_t|F_{t-1})] + c_u[N_t, f(y_t|F_{t-1})] \frac{\Gamma(1 - \xi_u) - 1}{\xi_u} + o(c_u),
\]

\[
E(Y_{lt}|N_t; F_{t-1}) = d_l[N_t, f(y_t|F_{t-1})] + c_l[N_t, f(y_t|F_{t-1})] \frac{\Gamma(1 - \xi_l) - 1}{\xi_l} + o(c_l).
\]

The conditional mean functions of the upper and lower bounds depend on the centering and standardizing terms associated with the assumed conditional density \( f(y_t|F_{t-1}) \). Even for some common densities like normal or Student’s \( t \), these terms are nonlinear on the moments of interest. Therefore, we propose to estimate the conditional mean functions non-parametrically so that they are robust to density misspecification of the underlying stochastic processes. In doing so, we also avoid the difficult task of calculating the associated standardizing and centering terms. Then, we write

\[\text{if } y_t \text{ is normally distributed } N(\mu_t, \sigma_t^2), \text{ we have}
\]

\[c_u(n_t, \mu_t, \sigma_t) = \frac{1}{\sigma_t \sqrt{2 \ln n_t}}, \quad d_u(n_t, \mu_t, \sigma_t) = \mu_t + \sigma_t \sqrt{2 \ln n_t} - \sigma_t \ln(4 \pi) + \ln \ln n_t
\]

\[\frac{1}{2(2 \ln n_t)^{1/2}}.
\]
where \( m_l(\cdot) \) and \( m_u(\cdot) \) are the conditional mean functions depending on the conditional density of the underlying process \( f(y_t|F_{t-1}) \), the number of random draws \( N_t \), and the shape parameters of the limiting GEV distribution \( \xi_l \) and \( \xi_u \). Note that \( \xi_l \) and \( \xi_u \) are constant, and therefore can be innocuously excluded from the functions.

We also assume that the conditional density \( f(y_t|F_{t-1}) \) is indexed by a finite-dimensional parameter. We will include the first two moments of the underlying random process \( Y_t \) in a parameter vector \( \theta_t \)—that is, \( \theta_t = (\mu_t, \sigma_t) \)—to capture the location and the scale of the conditional distribution of \( Y_t \) at time \( t \). Similarly, for the number of random draws \( N_t \), we assume that the conditional distribution \( H(n_t|F_{t-1}) \) is indexed by the first moment of \( N_t \), denoted by \( \lambda_t \). Formally:

**Assumption 3.**

(i) For any time period \( t \), the conditional density \( f(y_t|F_{t-1}) \) is indexed by the first- and second-order conditional moments \( \theta_t \equiv (F_{t-1}) \in \Theta \subset \mathbb{R}^2 \), where \( \Theta \) is a compact subset of the Euclidean space; that is, \( f(y_t|F_{t-1}) = f(y_t; \theta_t) \) for all \( t \).

(ii) For any time period \( t \), the conditional distribution \( H(n_t|F_{t-1}) \) is indexed by the first-order conditional moment \( \lambda_t \equiv \lambda(F_{t-1}) \in \Theta \subset \mathbb{R} \), where \( \Theta \) is a compact subset of the Euclidean space; that is, \( H(n_t|F_{t-1}) = H(n_t; \lambda_t) \) for all \( t \).

(iii) Let \( \Psi_1 \) and \( \Psi_2 \) be compact subsets on some finite \( k \)-dimensional Euclidean space \( \mathbb{R}^k \). The expectational models \( M_1(\Psi_1) \) and \( M_2(\Psi_2) \) are correctly specified for \( \theta_t \equiv (\mu_t, \sigma_t) \) and \( \lambda_t \), respectively; that is,

\[
\mu_t \equiv E(Y_t|F_{t-1}) = \mu(F_{t-1}, \psi_t^1),
\sigma_t^2 \equiv E[(Y_t - \mu_t)^2|F_{t-1}] = \sigma^2(F_{t-1}, \psi_t^2),
\lambda_t \equiv E(n_t|F_{t-1}) = \lambda(F_{t-1}, \psi_t^2),
\]

almost surely for each time \( t \) with some \( \psi_t^1 \in \Psi_1 \) and \( \psi_t^2 \in \Psi_2 \). In addition, the point-valued time series \( \{y_t\}_{t=1}^T \) (e.g., returns based on closing prices), and \( \{n_t\}_{t=1}^T \), used to estimate the parameters in the specifications \( M_1 \) and \( M_2 \), satisfy regularity conditions such that the estimates \( \hat{\psi}_1 \) and \( \hat{\psi}_2 \) are \( \sqrt{T} \)-consistent.

Given Assumption 3(i), the conditional expectations of maxima and minima in Equations (3) and (4) can be further simplified to

\[
E(Y_u|N_t, F_{t-1}) = m_u(N_t, \theta_t), \quad E(Y_u|N_t, F_{t-1}) = m_u(N_t, \theta_t).
\]

(5)

For these conditional expectations, observe that the conditioning information set includes not only past information \( F_{t-1} \) but also the number of random draws \( N_t \) in the current period. Since \( N_t \) is not observable until time period \( t \) ends, econometric models directly built upon Equation (5) cannot be used to forecast future extreme returns in practice. To overcome this drawback, we integrate out the random variable \( N_t \) in Equation (5) so that the conditioning information set only contains \( F_{t-1} \), which is available at the beginning of time \( t \). With assumption 3(ii), we can calculate the marginal expectations of the extremes as

\[
E(Y_u|F_{t-1}) = M_l(\theta_t, \lambda_t) \equiv \int m_l(s, \theta_t) dH(s; \lambda_t),
\]

(6)

\[
E(Y_u|F_{t-1}) = M_u(\theta_t, \lambda_t) \equiv \int m_u(s, \theta_t) dH(s; \lambda_t).
\]

(7)

If \( y_t \) has \( t \)-distribution with mean \( \mu_t \) and degrees of freedom \( \nu_t \), we have \( d_u(n_t, \mu_t, \sigma_t) = 0 \) and \( c_u(n_t, \mu_t, \nu_t) \) is the solution to the following reduced-form model:

\[
\frac{1}{n_t} = \frac{1}{2} (c - \mu_t) I\left( \frac{\nu_t}{2} + \frac{1}{2} \right) \cdot \frac{\sqrt{\nu_t}}{2} \cdot \frac{\gamma_1}{\sqrt{\nu_t}} \left( \frac{1}{2} \right).
\]

where \( _2F_1 \) is the hypergeometric function.
Assumption 3(iii) is a high-level assumption. In the framework of QMLE, it requires that the quasi log-likelihood function obeys the strong uniform law of large numbers (SULLN). Primitive conditions are available in the literature; see Domowitz and White (1982), among others.

3 | ESTIMATION

We propose to estimate Equations (6) and (7) in two steps. First, we will generate the regressors $\theta_t$ and $\lambda_t$, and secondly we will estimate nonparametrically the conditional mean functions.

If the parameter $\lambda_t$ and $\theta_t$ were known, we could directly use nonparametric methods to estimate the following two conditional mean models:

$$Y_{lt} = M_l(\theta_t, \lambda_t) + \varepsilon_{lt},$$

(8)

and

$$Y_{ut} = M_u(\theta_t, \lambda_t) + \varepsilon_{ut}.$$  

(9)

However, in most situations the regressors $\lambda_t$ and $\theta_t$ are unknown. We will estimate them by proposing some parametric models that, according to Assumption 3(iii), must be well specified. Consequently, our objective is the estimation of nonparametric conditional mean functions of generated regressors:

$$Y_{lt} = M_l(\hat{\theta}, \hat{\lambda}) + v_{lt},$$

(10)

and

$$Y_{ut} = M_u(\hat{\theta}, \hat{\lambda}) + v_{ut}.$$  

(11)

To estimate $\theta_t \equiv (\mu, \sigma^2)$, we work with a point-valued time series. If we are modeling returns, we can follow the standard practice of choosing the series of returns calculated at the end of each time period. Alternatively, we could also choose the series of the centers of the intervals as a realized sample path of the underlying process $\{Y_t\}$ and specify the dynamics of the conditional mean of the centers. The specification of the dynamics of the variance could be based on the time series of ranges of the intervals. Similarly, we work with the realized sample path $\{n_t\}$, specify and estimate the dynamics of the conditional intensity $\lambda_t = E(N_t|F_{t-1}).$

It is possible to avoid these generated regressors by directly inserting into the nonparametric functions those observed regressors in the information set $F_{t-1}$ that drive the conditional moments $\mu_t, \sigma^2_t$ and $\lambda_t$. The drawback of this approach is that the number of regressors could be very large, so we face the curse of dimensionality of nonparametric models. The generated regressor approach offers a more parsimonious model, though we need to take into account the extra uncertainty generated by the estimation of the regressors.

There are two important differences with the approach in Lin and González-Rivera (2016). There, the estimation methodology is maximum likelihood and the log-likelihood function is based on the joint density of the lowest and the highest rank-order statistics of the random sample $S_t \equiv \{y_{lt} : i = 1, \ldots, N_t\}$. Although we assume conditional normality for the underlying process $\{Y_t\}$, a QML estimator may not exist because, as we discussed there, the joint density of the ordinal statistics does not belong to the quadratic exponential family and the consistency of the QML estimator cannot be guaranteed. The approach that we propose here is robust to distributional assumptions:

(i) With the realized sample paths of point-valued time series—that is, $\{y_{lt}\}$ and $\{n_t\}$, associated with the underlying stochastic processes $\{Y_t\}$ and $\{N_t\}$—we estimate consistently the conditional moments $(\theta_t, \lambda_t)$.

(ii) With the maxima and minima of the interval-valued time series $(\{y_{lt}\}, \{y_{ut}\})$ and the parametrically generated covariates $(\hat{\theta}, \hat{\lambda})$, we estimate nonparametrically the two conditional mean functions (Equations (10) and (11)).

The second difference is related to the feasibility of the order statistics approach when the number of draws $N_t$ is very large. A quick look at the log-likelihood function based on the joint density of the ordinal statistics reveals that, for a large number of trades, the function will explode, and the optimization exercise will not have a solution. Hence the extreme value approach proposed here is general enough to provide both time feasibility and robustness.

Under Assumption 3(iii) and within a QMLE framework, the first-step estimators $(\hat{\theta}, \hat{\lambda})$ enjoy standard asymptotic properties. Now, we focus on the asymptotics of the second-step nonparametric estimator. In this respect, we follow Conrad and Mammen (2008), who estimate a semiparametric GARCH-in-mean model in which the dynamics of the conditional variance are parametrically specified, and the dependence of the return on its conditional variance is estimated by nonparametric kernel smoothing methods. Our two-step estimator is similar to their iterated estimator but much simpler.
First, the latent regressors in our model are generated parametrically, while their first-step estimators have both parametric and nonparametric components. Second, because the conditional variance enters the nonparametric conditional mean function and depends on past error terms, the estimator in Conrad and Mammen needs an iterative estimation procedure. In contrast, our first-step estimates are obtained from parametric models based on realized sample paths of the underlying process. Hence an iterative estimation procedure is not needed for our two-step estimator. The only difficulty is that our nonparametric conditional mean functions involve multiple generated covariates as opposed to a single covariate in Conrad and Mammen. Therefore, we need an adaptation of their theorems to show that the oracle property of a kernel-based nonparametric estimator also applies to our two-step estimator.

Before stating Theorem 1, we first introduce some terms to simplify notation. Let \( h_t \equiv h_t(\psi_0) = (\theta_t(\psi_0), \lambda_t(\psi_0)) \) be the finite \( q \)-dimensional random process of true moments and \( \hat{h}_t \equiv h_t(\hat{\psi}) \) be their estimates obtained in the first-step estimation. Let \( \sigma^2_j(x) = \mathbb{E}(\epsilon^2_j | h_t = x) \) be the conditional variance of the error terms \( \epsilon_{jt} (j = l \) and \( u) \) in Equations (8) and 9. \( f_\theta(x) \) the \( q \)-dimensional unconditional PDF of \( h_t \), and \( I \) the codomain of \( h_t = (\theta_t, \lambda_t) \).

**Theorem 1** (Asymptotic properties of the two-step local linear estimator). For \( j = l \) and \( u \), assume that \( M_j(x), f_\theta(x) \) and \( \sigma^2_j(x) \) are twice differentiable and that the codomain of \( h_t \), denoted by \( I \), is compact. \( K(v) = \prod_{r=1}^s k(v_{rs}) \) is a bounded second-order kernel, \( \kappa_{rs} = \int k(v)^r v^s dv \) for nonnegative integers \( r \) and \( s \), the vector \( b = (b_1, \ldots, b_q) \) are the bandwidths for the \( q \) variables in \( h_t \), with \( Tb_1 \ldots b_q \rightarrow \infty \). Given Assumptions 1–3 and the regularity conditions stated in Supporting Information Section S.1, we have

(i) (Asymptotic equivalence) For \( j = l \) and \( u \), the two-step local linear estimators \( M^LL_j(x) \) and \( \nabla M^LL_j(x) \) with generated covariates \( \hat{h}_t \) is asymptotic equivalent to the infeasible estimators \( M^{\ast LL}_j(x) \) and \( \nabla M^{\ast LL}_j(x) \) in the sense that

\[
\sup_{x \in I} \left\| \frac{M^LL_j(x)}{D_b \nabla M^LL_j(x)} - \left( \frac{M^{\ast LL}_j(x)}{D_b \nabla M^{\ast LL}_j(x)} \right) \right\| = o_P(T^{\eta_{-1}/2} + T_m^{-2q}),
\]

where \( D_b \) is a \( q \times q \) diagonal matrix with the \( s \)th diagonal element given by \( b_s, \eta_s = \sum_{r=1}^q \eta_{rs}, T_m^{-2q} = \sum_{r=1}^q T_r^{-2q}, \) and the two terms \( T^{\eta_{-1}/2} \) and \( T_m^{-2q} \) are the orders of the leading variance and bias terms for the infeasible estimator \( M^{\ast LL}_j(x) \) respectively.

(ii) (Asymptotic normality) For \( j = l \) and \( u \), we further assume that \( E(Y_{jt}^{2+\nu}) < \infty \) for some \( \nu > 0 \). Then the limiting distribution of the feasible two-step local linear estimator is the same as that of the infeasible estimator; that is,

\[
D(T) \begin{pmatrix} M^LL_j(x) \\ \nabla M^LL_j(x) \end{pmatrix} - \begin{pmatrix} M_j(x) \\ \nabla M_j(x) \end{pmatrix} - \left( \frac{\kappa_{12}}{2} \sum_{r=1}^q b_r^2 M^{(2)}_r(x) \right) \xrightarrow{d} N(0, \Sigma),
\]

where

\[
D(T) = \begin{pmatrix} \sqrt{Tb_1} \cdots b_q & 0 \\ 0 & \sqrt{Tb_1} \cdots b_q D_b \end{pmatrix}, \quad \Sigma = \begin{pmatrix} \frac{\kappa_{2} \sigma^2_j(x)}{f_\theta(x)} & 0 \\ \frac{\kappa_{21} \sigma_1^2(x)}{f_\theta(x)} & \frac{\kappa_{22} \sigma_1^2(x)}{f_\theta(x)} I_q \end{pmatrix},
\]

and \( I_q \) is an identity matrix of dimension \( q \).

We provide a proof of Theorem 1 in Supporting Information Section S.2. Essentially, the regularity conditions require that (a) the process from which the true moments \( h_t \) will be estimated be stationary and \( \beta \)-mixing; (b) the estimates \( \hat{h}_t \), converge to their true values at the \( \sqrt{T} \)-rate, which is fast enough; (c) the dynamic specifications in Assumption 3(iii) can be well approximated by linear functions of parameters \( \psi \) in a neighborhood of their true values \( \psi^\ast \); (d) the error terms \( \epsilon_{lt} \) and \( \epsilon_{ut} \) have conditional subexponential tails; and (e) some other regularity conditions on the kernel functions controlling the bias terms of the local linear smoothing.

## 4 | Extreme Returns and Intensity of Trading

We model the interval-valued time series of the low/high returns to seven stocks in the US financial and technology sectors. The financial stocks correspond to three banks: Wells Fargo Corporation (WFC), Bank of America (BAC), and JP
Morgan Chase (JPM), which are traded in the New York Stock Exchange. The technology stocks correspond to the four tech giants Apple (AAPL), Amazon (AMZN), Google (GOOG), and Intel (INTC), which are traded in the Nasdaq Stock Market. All these stocks are very liquid as their trading volumes are very high. We analyze the time series at the 5-minute and 1-minute frequencies from June 1 to June 30, 2017, for a total of 22 trading days. The data are retrieved from the NYSE Trade and Quote (TAQ) database that provide all trades and quotes occurring on the trading days of June 2017 for all those stocks. We record the stock price of every trade and split the trading day into 5-minute and 1-minute periods so that for each stock we have two time series to model. We compute the log-returns with respect to the last price of the previous period and report the returns in basis points (1 basis point is defined as 1 per ten thousand that is, 1 basis point = 1%).

\[
y_{ut} \equiv \log(P_{\text{high},t}/P_{\text{close},t-1}) \times 10,000\%
\]

where \(P_{\text{high},t}\) and \(P_{\text{low},t}\) are the highest and lowest price in the period \(t\), and \(P_{\text{close},t-1}\) is the last price in the previous period \((t-1)\). Given the interval-valued return \([y_{lt}, y_{ut}]\), the center \(c_t\) and range \(r_t\) are defined as

\[
c_t \equiv \frac{y_{lt} + y_{ut}}{2} = \log(\sqrt{P_{\text{high},t}P_{\text{low},t}}/P_{\text{close},t-1}) \times 10,000\%
\]

\[
r_t \equiv y_{ut} - y_{lt} = \log(P_{\text{high},t}/P_{\text{low},t}) \times 10,000%.
\]

The total number of observations is 1,716 (22 days \(\times\) 78 observations per day) at the 5-minute frequency, and 8,580 (22 days \(\times\) 390 observations per day) at the 1-minute frequency.

The complexity of the estimation generates a sheer number of models and, due to space constraints, we will only report a subset of results. We showcase our modeling strategy for one bank stock (BAC) and for one technology stock (AMZN) and provide additional online Supporting Information on the description and estimation results of the five remaining stocks.

Prior to the analysis, we analyze the outliers in the samples. We implement a modified version of Tukey's fences (Tukey, 1977) for identification and removal of outliers that is more conservative than that provided by Brownless and Gallo (2006) and Barndorff-Nielsen, Hansen, Lunde, and Shephard (2009). The detailed procedure is explained in Supporting Information Section S.3.

In Table 1, we start by reporting descriptive statistics for BAC and AMZN lowest and highest returns as well as the close-to-close returns and the time series of the number of trades, at both 5-minute and 1-minute frequencies. We also report the characteristics of the time series of the center and range of the low/high interval of returns. These series are also plotted in Figure S2.

As expected, the highest returns are positively skewed and the lowest returns negatively skewed, both with large kurtosis. There is a mild positive correlation or no correlation between the highest and the lowest returns, and a mild negative correlation between the center and range series. The number of trades series exhibit overdispersion with a variance much larger than the mean, favoring a negative binomial distribution. The 1-minute time series are much less volatile than the 5-minute series, which is expected. On average, the number of trades at the 5-minute frequency is about five times the number of trades at the 1-minute frequency. For BAC, the close-to-close returns and the center series are very similar, and they seem to be symmetric around a median (or mean) of zero with no much skewness and mild kurtosis. The range series is positively skewed with large kurtosis. These features hold at both frequencies and are also present in the JPM and WFC series (see Supporting Information Tables S3 and S4). For AMZN, we observe similar features to those in BAC but more pronounced; there is more volatility, more skewness, and more kurtosis in the AMZN and other tech return series than those in the banking time series. A distinctive feature for AMZN and the rest of the technology stock returns is that the lowest returns tend to be more volatile and more skewed than the highest returns. Even after removing outliers, the lowest returns tend to be much larger in magnitude than the highest returns (see Supporting Information Tables S5, S6, and S7).

---

3The first-step estimation involves searching for the best models for the conditional mean and the conditional variance of the latent process, and for the conditional intensity of the number of trades. With seven stocks and two frequencies, we end up with 42 final models \((7 \times 2 \times 3)\). In the second-step estimation, we search for the best nonparametric specification for low and high returns. We entertain six nonparametric models and two linear models. With seven stocks and two frequencies, we end up with 112 final models \((7 \times 2 \times 8)\).
### TABLE 1 Descriptive statistics for Bank of America Corp. and Amazon.com Inc

<table>
<thead>
<tr>
<th>Statistics</th>
<th>Returns in Bank of America Corp. (BAC) at 5-minute frequency</th>
<th>Returns in Bank of America Corp. (BAC) at 1-minute frequency</th>
<th># of trades</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>-89.65</td>
<td>-59.23</td>
<td>298.00</td>
</tr>
<tr>
<td>High</td>
<td>-6.63</td>
<td>-8.43</td>
<td>-55.38</td>
</tr>
<tr>
<td>Close</td>
<td>-78.61</td>
<td>-3.85</td>
<td>-2.14</td>
</tr>
<tr>
<td>Center</td>
<td>-40.58</td>
<td>0.04</td>
<td>8.42</td>
</tr>
<tr>
<td>Range</td>
<td>298.00</td>
<td>0.04</td>
<td>8.42</td>
</tr>
<tr>
<td># of trades</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minimum</td>
<td>-13.09</td>
<td>-6.39</td>
<td>1,049.50</td>
</tr>
<tr>
<td>1st quartile</td>
<td>4.13</td>
<td>2.09</td>
<td>-3.85</td>
</tr>
<tr>
<td>Median</td>
<td>-6.86</td>
<td>-3.85</td>
<td>-2.14</td>
</tr>
<tr>
<td>3rd quartile</td>
<td>-4.34</td>
<td>0.00</td>
<td>8.42</td>
</tr>
<tr>
<td>Maximum</td>
<td>12.67</td>
<td>4.18</td>
<td>279.00</td>
</tr>
<tr>
<td>Mean</td>
<td>1,438.50</td>
<td>0.00</td>
<td>11.00</td>
</tr>
<tr>
<td>Variance</td>
<td>0.04</td>
<td>0.04</td>
<td></td>
</tr>
<tr>
<td>Correlation</td>
<td>0.28</td>
<td>0.25</td>
<td></td>
</tr>
<tr>
<td>Skewness</td>
<td>-13.09</td>
<td>-6.39</td>
<td>-3.85</td>
</tr>
<tr>
<td>Kurtosis</td>
<td>4.13</td>
<td>2.09</td>
<td>-3.85</td>
</tr>
</tbody>
</table>

**Note.** The sample period is 22 trading days in June 2017. Returns are in the unit of 1 basis point, and the sample size is 1,716 and 8,580 at 5-minute and 1-minute frequency, respectively. For BAC, the raw data set contains 3,085,563 trades in total. After removal of outliers, the total number of trades is 3,074,919 for the sample at 5-minute frequency, and 3,050,589 at 1-minute frequency. For AMZN, the raw data set contains 1,441,127 trades in total. After removal of outliers, the total number of trades is 1,440,561 for the sample at 5-minute frequency, and 1,436,377 at 1-minute frequency.
4.1 | Conditional moments of the latent process

We proceed to model the conditional moments of the underlying latent process $Y_t$. We implement two different approaches to model the dynamics of $Y_t$. First, we consider the center and range of the low/high intervals as good proxies for the location and scale of the conditional PDF of $Y_t$. We will call this approach the “interval value approach for $Y_t$.” Second, we simply use the close-to-close returns series $\{y_{rt}\}$ as a realized sample path of the underlying latent processes $Y_t$ and model its conditional moments. We will call this approach the “point value approach for $Y_t$.”

Owing to space constraints, we report the estimation results for the interval value approach here and those for the point value approach in the Supporting Information (see Section S.4).

We model the dynamics of the center and range series separately. In all our specification searches, we select the best model—that is, optimal number of lags—by minimizing the Akaike information criterion (AIC). This criterion is rather conservative as it tends to choose models with a large number of lags. In our modeling strategy, we prefer to be conservative in the first-step estimation to guard against potential misspecification. As we have described in the previous sections, the estimated conditional moments of the latent process are inputs into the final nonparametric models of the low/high returns and they need to be correctly specified for the results of Theorem 1 to go through. Thus we prefer less parsimonious models, even at the cost of carrying some noise into the second-step estimation. In addition, each specification needs to pass standard diagnosis tests; that is, the residuals must be white noise and the pseudo Pearson residuals must have zero mean and unit standard deviation.

For the center series $\{c_t\}$, we fit simple autoregressive moving average (ARMA) models. The preferred specifications for the center series of BAC are ARMA(3, 1) (5-minute frequency) and MA(2) (1-minute frequency). For AMZN, AR(1) (5-minute frequency) and ARMA(1, 2) (1-minute frequency). In the top panel of Table 2, we report the estimations results of the ARMA models for the center series of BAC and AMZN at 5-minute frequency (see Supporting Information Table S9 for results at the 1-minute frequency). In Figure 1 and Supporting Information Figure S3, we plot the fitted time series versus the actual series at the 5-minute and 1-minute frequency respectively.

As expected, the time dependence in the conditional mean is very weak in both stocks and it only reflects some microstructure noise. In the case of BAC, the mean is zero and in the case of AMZN the mean is negative. In comparison with the actual values of the center time series, the conditional means are practically zero. This is evident in the time series plots of the center series in Figure 1. We will call $\hat{c}_t$ the fitted value for the center that proxies the estimated conditional mean of the latent process.

For the range series $\{r_t\}$, we specify a conditional autoregressive range model with Burr distribution (CARR-Burr). Since the original range series $\{r_t\}$ exhibit strong diurnal patterns, we first remove the intraday seasonality for each weekday separately by cubic B-spline smoothing; that is,

$$r_{t(d)}^* = \frac{r_{t(d)}}{f_d(i_{t(d)})}, \quad f_d(i_{t(d)}) = \exp \left( b_0 + \sum_{j_d=1}^{L_d} b_{j_d} B_{j_d}(i_{t(d)}) \right), \quad (12)$$

where $\{B_{j_d}(\cdot) : j_d = 1, \ldots, L_d\}$ are B-spline basis functions, $t(d)$ selects those observations on weekday $d \in \{\text{Monday, Tuesday, Wednesday, Thursday, Friday}\}$, and $i_{t(d)}$ is the fraction of time in the trading day for the $t$th observation, such that

$$i_{t(d)} = \begin{cases} 1, & \text{if } t(d) \text{ mod } D = 0 \\ t(d)/D - \lfloor t(d)/D \rfloor, & \text{otherwise}, \end{cases}$$

where $D$ is the total number of observations in each day. We have $D = 78$ for the series in 5-minute frequency and $D = 390$ for the series in 1-minute frequency. After taking natural logarithm on both sides of Equation (12), we obtain the coefficient estimates $\hat{b}_j$ and $\hat{f}_d(i_{t(d)})$ by ordinary least squares and the number of splines $L_d$ is selected by generalized cross-validation (reported in Supporting Information Table S8); and the estimated intraday seasonality for each time period $t$ is $\hat{f}(t) = \hat{f}_d(i_{t(d)})$ if the time period $t$ is in weekday $d$. 

Then, we specify the conditional autoregressive range model with Burr distribution, CARR\((p, s)\)-Burr, for the adjusted range \(r_t^*\):

\[
\begin{align*}
    r_t^* &= \psi_t \epsilon_t, \\
    \psi_t &= \omega + \sum_{i=1}^p \alpha_i r_{t-i}^* + \sum_{j=1}^s \beta_j \psi_{t-j}, \\
    \epsilon_t | F_{t-1} &\sim g_{\text{Burr}}(\cdot; \theta),
\end{align*}
\]

where \(\psi_t\) is the conditional mean of the adjusted range based on the information set available at time \(t\). The normalized adjusted range \(\epsilon_t = r_t^*/\psi_t\) is assumed to be standardized in the Burr distributed density function \(g_{\text{Burr}}(\cdot; \theta)\) with unit mean and shape parameters \(\theta \equiv (\kappa, \sigma^2)\). We impose the restriction \(\sum_{i=1}^p \alpha_i + \sum_{j=1}^s \beta_j < 1\) to ensure that the series \(r_t^*\) is stationary. As with the center series, the optimal lags \(p\) and \(s\) in CARR\((p, s)\)-Burr are selected by AIC and the adequacy of the models is assessed with standard diagnostics. The selected model for the range series of BAC is CARR\((3, 4)\) (5-minute frequency) and CARR\((5, 6)\) (1-minute frequency). For AMZN, CARR\((6, 5)\) (5-minute frequency) and CARR\((9, 10)\) (1-minute frequency).

We denote \(\hat{r}_t^*\) as the fitted range with diurnal pattern adjustment and \(\hat{r}_t = \hat{r}_t^* \hat{f}(i_t)\) the fitted range for the original range. In the bottom panel of Table 2, we report the estimation results of the CARR-Burr models for the range series of BAC and AMZN at 5-minute frequency (see Supporting Information Table S8 for results at the 1-minute frequency). Both series have large persistence: For BAC the persistence is about 0.82 (obtained by \(\sum \alpha_i + \sum \beta_j\)), while that of AMZN is 0.95.

### TABLE 2 Models for center and range series of low/high return interval for BAC and AMZN at 5-minute frequency

<table>
<thead>
<tr>
<th></th>
<th>BAC</th>
<th>AMZN</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Center series: ARMA models</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Intercept</td>
<td>-0.9051 (0.2248)</td>
<td>-0.0579 (0.0241)</td>
</tr>
<tr>
<td>AR(1)</td>
<td>-0.6943 (0.2164)</td>
<td>0.0579 (0.0241)</td>
</tr>
<tr>
<td>AR(2)</td>
<td>0.0098 (0.0299)</td>
<td>0.0106 (0.0252)</td>
</tr>
<tr>
<td>AR(3)</td>
<td>0.7194 (0.2150)</td>
<td>0.7194 (0.2150)</td>
</tr>
<tr>
<td>MA(1)</td>
<td>69.84</td>
<td>77.1</td>
</tr>
<tr>
<td>Log-like.</td>
<td>−6,076.12</td>
<td>−6,161.97</td>
</tr>
<tr>
<td>AIC</td>
<td>12,162.24</td>
<td>12,329.93</td>
</tr>
</tbody>
</table>

|                |     |      |
| **Range series: CARR models** |     |      |
| \(\omega\)     | 0.1918 (0.0499) | 0.0567 (0.0157) |
| \(\alpha_1\)   | 0.1615 (0.0219) | 0.2650 (0.0228) |
| \(\alpha_2\)   | 0.2486 (0.0384) | 0.1337 (0.0322) |
| \(\alpha_3\)   | 0.1512 (0.0251) | -0.1163 (0.0304) |
| \(\alpha_4\)   | 0.1705 (0.0365) | 0.1705 (0.0365) |
| \(\alpha_5\)   | 0.1776 (0.0308) | 0.1776 (0.0308) |
| \(\alpha_6\)   | -0.0592 (0.0308) | -0.0592 (0.0308) |
| \(\beta_1\)    | -1.1157 (0.1684) | 0.0085 (0.0509) |
| \(\beta_2\)    | 0.2269 (0.1411) | 0.8488 (0.0293) |
| \(\beta_3\)    | 0.9194 (0.1005) | -0.8550 (0.0655) |
| \(\beta_4\)    | 0.2320 (0.1418) | -0.3783 (0.0254) |
| \(\beta_5\)    | 0.2320 (0.1418) | 0.7572 (0.0401) |
| \(\kappa\)     | 3.7189 (0.1295) | 5.6709 (0.2478) |
| \(\sigma^2\)   | 0.4743 (0.0643) | 1.3530 (0.1251) |
| Log-like.       | -833.01 | -635.71 |
| AIC            | 1,686.02 | 1,299.41 |

**Ljung–Box test on standardized residuals**

<table>
<thead>
<tr>
<th>Statistic</th>
<th>1131</th>
<th>1131</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q(50)</td>
<td>38.0931</td>
<td>41.4138</td>
</tr>
<tr>
<td>Q(100)</td>
<td>89.5671</td>
<td>78.8183</td>
</tr>
<tr>
<td>Q(200)</td>
<td>151.2688</td>
<td>170.3999</td>
</tr>
</tbody>
</table>

\(^a\)If the two null hypotheses for distributional parameters \(\kappa = 1\) and \(\sigma^2 = 0\) are true, the Burr distribution reduces to the exponential distribution. \(^b\)For the pseudo-Pearson residuals, the mean and standard deviation are 0.001 and 0.9835 for BAC respectively, and −0.0090 and 0.9322 for AMZN respectively.
The shape parameters $\kappa$ and $\sigma^2$ are significantly different from 1 and 0 respectively for both stocks, so that the empirical conditional standardized probability density is far from exponential. Standard diagnostic tests indicate that the fitting is adequate. The standardized residuals have zero mean and unit standard deviation. The Q-statistics of the standardized residuals show no residual dependence left in the data. We plot the fitted range series in Figure 1. For the remaining five stocks, the preferred specifications for the center and range series are in Supporting Information Table S11.

4.2 | Conditional trading intensity

We specify autoregressive dynamics in the conditional trading intensity to account for the temporal dependence in the number of trades series $\{n_t\}$. As in the range series $\{r_t\}$, the number of trades series exhibits a clear diurnal pattern. We remove the intraday seasonality for each weekday separately by spline smoothing on the original series; that is,

$$n_t^* = n_t / f_d(i_t(d)),$$  

(13)

where the intraday seasonality $f_d(i_t(d))$ is defined and obtained as in the case of the range series explained in Section 4.1. Then, for the adjusted numbers of trades $n_t^*$, we specify the model

$$\psi_t = \omega + \sum_{i=1}^{p} \alpha_i n_{t-i}^* + \sum_{j=1}^{s} \beta_j \psi_{t-j}.$$

(14)

Combining Equations (13) and (14), we propose the autoregressive conditional intensity (ACI) model:

$$\lambda_t = f_i(t) \psi_t \quad \text{and} \quad n_t \sim \text{gNB}(; \lambda_t, d).$$

(15)
where \( \lambda_t \) is the conditional trading intensity based on the information set available at time \( t \). The number of trades \( N_t \) is assumed to be negative binomial distributed with density function \( g_{NB}(\cdot; \lambda_t, d) \) with mean \( \lambda_t \) and dispersion parameter \( d \). We restrict \( \sum_{i=1}^p a_i + \sum_{j=1}^n \beta_j < 1 \) to ensure that the series \( \{n_t\} \) is stationary. We select the optimal number of lags \( p \) and \( s \) by AIC and test the specification of the model with standard diagnostic statistics. The estimated conditional trading intensity is denoted by \( \hat{\lambda}_t \).

For the BAC series, the preferred models are ACI(12,13) (5-minute frequency) and ACI(12,12) (1-minute frequency). For the AMZN series, they are ACI(10,10) (5-minute and 1-minute frequencies). We report the estimation results of the ACI models for the number of trades series of BAC and AMZN at 5-minute frequency in Table 3 (see Supporting Information Table S10 for the results at the 1-minute frequency) and we plot the estimated conditional intensity against the ACI models for the number of trades series of BAC and AMZN at 5-minute frequency in Table 3 (see Supporting Information Table S10 for the results at the 1-minute frequency) and we plot the estimated conditional intensity against the 5-minute and 1-minute frequencies. We report the estimation results of the ACI models for the number of trades series of BAC and AMZN at 5-minute frequency in Table 3 (see Supporting Information Table S10 for the results at the 1-minute frequency) and we plot the estimated conditional intensity against the actual number of trades in Figure 1. Both series have a strong persistence, being 0.75 for BAC and 0.81 for AMZN. The pseudo-Pearson residuals have mean zero and variance one and their Q-statistics do not show any dependence, indicating that these specifications are adequate. For the remaining five stocks, the preferred specifications for the number of trades series are displayed in Supporting Information Table S11.

### 4.3 | Nonparametric conditional mean for lower and upper bounds

From the modeling of the latent process \( Y_t \), we gather the estimated regressors—that is, conditional mean, range, and intensity—that will be fed into a nonparametric regression to obtain the conditional means of the lower and upper bounds—that is, \( y_{lt} \) and \( y_{ut} \)—of the return interval. We propose and evaluate the following nonparametric regressions.

The first model has as regressors the estimated conditional centers \( \hat{c}_t \) (ARMA models), conditional mean ranges \( \hat{r}_t \) (CARR-Burr models), and conditional intensity \( \hat{\lambda}_t \) (ACI-NB models). It is the most general and parsimonious model:

**Model 1**: \( y_{jt} = M_j(\hat{c}_t, \hat{r}_t, \hat{\lambda}_t) + v_{jt}, \quad \text{for } j = l, u. \)

If the models for centers, ranges, and intensity have short dynamics, we could avoid the first estimation step and directly include original regressors such as \( c_{t-1}, r_{t-1}, n_{t-1} \), etc. in the nonparametric regressions. The drawback of this approach is that, if the number of lags is very large, we run into the curse of dimensionality. With the current data, we experiment with the following model:

### Table 3  Models for series of the number of trades for BAC and AMZN at 5-minute frequency

<table>
<thead>
<tr>
<th></th>
<th>BAC Coeff.</th>
<th>SE</th>
<th>AMZN Coeff.</th>
<th>SE</th>
<th>Coeff.</th>
<th>SE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Series of number of trades: autoregressive conditional intensity models</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>( a_1 )</td>
<td>0.30</td>
<td>0.03</td>
<td>( a_1 )</td>
<td>0.50</td>
<td>0.02</td>
<td>-1.52</td>
</tr>
<tr>
<td>( a_2 )</td>
<td>0.13</td>
<td>0.01</td>
<td>( a_2 )</td>
<td>0.84</td>
<td>0.05</td>
<td>-1.30</td>
</tr>
<tr>
<td>( a_3 )</td>
<td>0.12</td>
<td>0.01</td>
<td>( a_3 )</td>
<td>0.88</td>
<td>0.04</td>
<td>-1.16</td>
</tr>
<tr>
<td>( a_4 )</td>
<td>0.12</td>
<td>0.01</td>
<td>( a_4 )</td>
<td>0.92</td>
<td>0.03</td>
<td>-0.93</td>
</tr>
<tr>
<td>( a_5 )</td>
<td>0.11</td>
<td>0.01</td>
<td>( a_5 )</td>
<td>0.80</td>
<td>0.02</td>
<td>-0.10</td>
</tr>
<tr>
<td>( a_6 )</td>
<td>0.11</td>
<td>0.01</td>
<td>( a_6 )</td>
<td>0.40</td>
<td>0.02</td>
<td>0.10</td>
</tr>
<tr>
<td>( a_7 )</td>
<td>0.11</td>
<td>0.01</td>
<td>( a_7 )</td>
<td>0.17</td>
<td>0.03</td>
<td>0.70</td>
</tr>
<tr>
<td>( a_8 )</td>
<td>0.15</td>
<td>0.01</td>
<td>( a_8 )</td>
<td>-0.16</td>
<td>0.04</td>
<td>0.95</td>
</tr>
<tr>
<td>( a_9 )</td>
<td>0.10</td>
<td>0.01</td>
<td>( a_9 )</td>
<td>-0.30</td>
<td>0.05</td>
<td>0.30</td>
</tr>
<tr>
<td>( a_{10} )</td>
<td>0.22</td>
<td>0.01</td>
<td>( a_{10} )</td>
<td>-0.13</td>
<td>0.04</td>
<td>-0.15</td>
</tr>
<tr>
<td>( a_{11} )</td>
<td>0.25</td>
<td>0.01</td>
<td>( a_{11} )</td>
<td>0.56</td>
<td>0.01</td>
<td></td>
</tr>
<tr>
<td>( a_{12} )</td>
<td>-0.02</td>
<td>0.03</td>
<td>( a_{12} )</td>
<td>0.15</td>
<td>0.01</td>
<td></td>
</tr>
<tr>
<td>( \omega )</td>
<td>0.07</td>
<td>0.00</td>
<td>( \omega )</td>
<td>0.16</td>
<td>0.01</td>
<td>1/d</td>
</tr>
</tbody>
</table>

| AIC       | 25,578.22 |     | 22,772.22 |

**Ljung–Box test on standardized residuals**

| Q(50)    | 38.0931 | 0.8912 | 41.4138 | 0.801 |
| Q(100)   | 89.5671 | 0.7635 | 78.8183 | 0.9419 |
| Q(200)   | 151.2688| 0.9958 | 170.3999| 0.9365 |

*For the pseudo-Pearson residuals, the mean and standard deviation are 0.0054 and 1.0433 for BAC respectively, and 0.0017 and 1.1379 for AMZN respectively.*
a. **Model 2:** \( y_{jt} = M_j(c_{t-1}, r_{t-1}, n_{t-1}) + v_{jt}, \) for \( j = l, u. \)

The next model considers regressors when the modeling of \( Y_t \) follows the “point value approach.” We estimate the conditional standard deviation \( \hat{\sigma}_t \) (GARCH-GED models) (see Supporting Information Tables S1 and S2) in addition to the conditional intensity \( \hat{\lambda}_t \) (ACI models), \( \hat{\lambda}_t \); that is,

**Model 3:** \( y_{jt} = M_j(\hat{\sigma}_t, \hat{\lambda}_t) + v_{jt}, \) for \( j = l, u. \)

We propose the next two nonparametric models to assess the importance of the intensity of trading in the modeling of the conditional mean of the upper and lower bounds:

**Model 4:** \( y_{jt} = M_j(\hat{\sigma}_t, \hat{r}_t) + v_{jt}, \) for \( j = l, u. \)

**Model 5:** \( y_{jt} = M_j(c_{t-1}, r_{t-1}) + v_{jt}, \) for \( j = l, u. \)

Finally, we also propose Model 6 to assess whether the conditional trading intensity \( \hat{\lambda}_t \) could be sufficient to predict the expected lower and upper bounds without information about the latent process \( Y_t \):

**Model 6:** \( y_{jt} = M_j(\hat{\lambda}_t) + v_{jt}, \) for \( j = l, u. \)

### 4.4 In-sample model evaluation

We evaluate the performance of the proposed models by comparing several measures of fit for interval-valued data. In addition to the six specifications of the previous section, we include two additional models proposed in González-Rivera and Lin (2013), which are constrained VAR-type specifications satisfying the inequality \( y_{lt} \leq y_{ut} \) for all \( t \). These are interval autoregressive two-step (IAR-TS) and interval autoregressive modified two-step (IAR-MTS). These models have been proven to be superior to the existing interval-valued regression approaches (see; González-Rivera & Lin, 2013; Lin & González-Rivera, 2016).

For a sample of size \( T \), let \( \{\hat{y}_l, \hat{y}_u\} \) be the fitted values of the corresponding interval \( y_t = [y_{lt}, y_{ut}] \) provided by each model. We consider the following criteria:

(i) **Mean squared error (MSE)** for upper and lower bounds separately:

\[
\text{MSE}_{\text{lower}} = \frac{1}{T} \sum_{t=1}^{T} (\hat{y}_{lt} - y_{lt})^2 / T, \quad \text{MSE}_{\text{upper}} = \frac{1}{T} \sum_{t=1}^{T} (\hat{y}_{ut} - y_{ut})^2 / T.
\]

(ii) **Multivariate loss functions (MLF)** for the vector of lower and upper bounds (Komunjer & Owyang, 2012):

\[
L_p(\tau, e) = \left( \| e \|_p + \| \tau \|^{p-1} \right) \| e \|_p^{p-1} \quad \text{where} \quad \| \cdot \|_p \text{ is the} \ l_p \text{-norm,} \ \tau \text{ is a two-dimensional parameter vector that determines the asymmetry of the loss function (if} \ \tau = 0 \text{, the bivariate loss is symmetric,} \text{ and} \ e = (e_l, e_u) \text{ is the bivariate residual interval} \ (\hat{y}_{lt} - y_{lt}, \hat{y}_{ut} - y_{ut}). \ \text{We consider two norms,} \ p = 1 \text{ and} \ p = 2, \text{ and their corresponding} \ \tau \text{ parameter vectors within the unit balls} \ B_{\infty} \equiv \{(r_1, r_2) \in \mathbb{R}^2 : |r_1| \leq 1 \text{ and} |r_2| \leq 1 \} \text{ and} \ B_2 \equiv \{(r_1, r_2) \in \mathbb{R}^2 : r_1^2 + r_2^2 \leq 1 \}, \text{ respectively.}
\]

The MLF are then defined by their sample averages:

\[
\text{MLF}_1 = \frac{1}{T} \sum_{t=1}^{T} L_1(\tau^*_t, e_t) / T, \quad \text{MLF}_2 = \frac{1}{T} \sum_{t=1}^{T} L_2(\tau^*_t, e_t) / T,
\]

where \( \tau^*_t \) is the optimal vector that defines the asymmetry of the loss.

(iii) **Mean distance error (MDE)** between the fitted and actual intervals (Arroyo, González-Rivera, & Maté, 2011).

Let \( D_q(\hat{y}_t, y_t) \) be a distance measure of order \( q \) between the fitted and the actual intervals; the mean distance error is defined as \( \text{MDE}_q(\{\hat{y}_t\}, \{y_t\}) = \frac{1}{T} \sum_{t=1}^{T} D_q^q(\hat{y}_t, y_t) / T \). We consider \( q = 1 \) and \( q = 2 \), with a distance measure such as

\[
D_1(\hat{y}_t, y_t) = \frac{1}{2} (|\hat{y}_{lt} - y_{lt}| + |\hat{y}_{ut} - y_{ut}|),
\]

\[
D_2(\hat{y}_t, y_t) = \frac{1}{\sqrt{2}} [(|\hat{y}_{lt} - y_{lt}|)^2 + (|\hat{y}_{ut} - y_{ut}|)^2]^{1/2}.
\]

Note that \( \text{MDE}_1 \) and \( \text{MDE}_2 \) are equal to a half of \( \text{MLF}_1 \) and \( \text{MLF}_2 \) respectively if \( \tau = 0 \).
In Table 4 we report the in-sample evaluation of the linear and nonparametric models for BAC and AMZN stock returns at both 5-minute and 1-minute frequencies. The Supporting Information contains similar tables (S12–S16) with the evaluation results for the remaining five stocks. The first finding is that the nonparametric regressions are superior to the IAR-TS and IAR-MTS specifications as they deliver, in most cases, the smallest losses across loss functions and for both BAC and AMZN stocks at both 5-minute and 1-minute frequencies. Within the six nonparametric models, the preferred specification is Model 1 across loss functions and for the two stocks. Model 4 is a competitor to Model 1, indicating that in some cases omitting trading intensity may not be very detrimental to the performance of the model. It is interesting to observe that trading intensity alone (Model 6) is far from being an optimal specification: It is the interaction of the three regressors that are most helpful to estimate the conditional means of the extreme bounds of the interval. For most cases, Model 3, with regressors estimated by the “point value approach,” is dominated by Model 1, whose regressors depend on the features of the interval—that is, centers and range.

In Table 5 we report Diebold–Mariano tests to formally test the superiority of Model 1 versus the parametric linear model and the remaining five nonparametric models for BAC and AMZN at both 5-minute and 1-minute frequencies. Similar tables (S17–S21) for the remaining five stocks are in the Supporting Information. For BAC at both frequencies, the linear IAR-TS but superior to Models 5 and 6. At the 1-minute frequency, Model 1 seems equivalent to Model 4 but superior to Models 2, 3, 5, and 6. The evidence with respect to the linear model IAR-TS is mixed and depends on the loss function. When the norm of the loss function is \( p = 1 \), Model 1 is superior to the linear specification. For the remaining five stocks, we find similar patterns. For the banking stocks, Model 1 outperforms other parametric and nonparametric models in most cases at both frequencies. For the technology stocks, at the 5-minute frequency, Model 1 is still one of the preferred specifications, but at the 1-minute frequency the linear specification is a contender to Model 1 for GOOG and AAPL stocks.

Overall, Model 1 is a superior specification for the banking stocks at both frequencies and for the technology stocks at the 5-minute frequency; these results confirm that the joint inclusion of the three regressors—that is, center, range, and intensity—are needed to produce the best fit for the bounds of the interval. For the technology stocks at the 1-minute frequency, we observe that the linear specification and Model 1 seem to be equivalent under quadratic loss functions.
In Figures 2–5 we plot the estimated conditional surfaces of the lowest and highest returns for BAC and AMZN provided by the nonparametric Model 1. Similar figures (Figures S4–S13) for the remaining five stocks are in the Supporting Information. We plot the expected $y_{hr}$ and $y_{ur}$ as a function of $\hat{\alpha}_t$ and $\hat{\lambda}_t$, keeping $\hat{\alpha}_t$ fixed at its sample median. The variable $\hat{\alpha}_t$ is the conditional expected range and proxies the volatility of the underlying latent return process, and the variable $\hat{\lambda}_t$ is the conditional expected trading intensity. The surfaces clearly indicate the nonlinear behavior of the function. The direction of the arrows in the horizontal axis (volatility and intensity) and in the vertical axis (low and high returns) indicates that the values go from low to high. In general, we find that the relationship of extreme returns with trading intensity and volatility goes in the expected direction. For both frequencies, the higher the volatility and the trading intensity, the larger is the magnitude of the extreme returns; that is, the high return goes up and the low return goes down (by examining the surfaces along the diagonals). The response of extreme returns to trading intensity depends on the level of volatility. For low levels of volatility, extreme returns tend to be flat as trading activity intensifies but, when the volatility is moderate to high, both extreme returns are very responsive to increasing trading intensity, and the low

<table>
<thead>
<tr>
<th>Table 5</th>
<th>In-sample Diebold–Mariano tests of Model 1 versus other models for BAC and AMZN</th>
</tr>
</thead>
<tbody>
<tr>
<td>Model</td>
<td>BAC 5-minute freq.</td>
</tr>
<tr>
<td>M. 1 vs. M. 2</td>
<td>MSE: lower</td>
</tr>
<tr>
<td></td>
<td>MSE: upper</td>
</tr>
<tr>
<td></td>
<td>MLF: p = 1</td>
</tr>
<tr>
<td></td>
<td>MLF: p = 2</td>
</tr>
<tr>
<td></td>
<td>MDE: q = 1</td>
</tr>
<tr>
<td></td>
<td>MDE: q = 2</td>
</tr>
<tr>
<td>M. 1 vs. M. 3</td>
<td>MSE: lower</td>
</tr>
<tr>
<td></td>
<td>MSE: upper</td>
</tr>
<tr>
<td></td>
<td>MLF: p = 1</td>
</tr>
<tr>
<td></td>
<td>MLF: p = 2</td>
</tr>
<tr>
<td></td>
<td>MDE: q = 1</td>
</tr>
<tr>
<td></td>
<td>MDE: q = 2</td>
</tr>
<tr>
<td>M. 1 vs. M. 4</td>
<td>MSE: lower</td>
</tr>
<tr>
<td></td>
<td>MSE: upper</td>
</tr>
<tr>
<td></td>
<td>MLF: p = 1</td>
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<tr>
<td></td>
<td>MLF: p = 2</td>
</tr>
<tr>
<td></td>
<td>MDE: q = 1</td>
</tr>
<tr>
<td></td>
<td>MDE: q = 2</td>
</tr>
<tr>
<td>M. 1 vs. M. 5</td>
<td>MSE: lower</td>
</tr>
<tr>
<td></td>
<td>MSE: upper</td>
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<tr>
<td></td>
<td>MLF: p = 1</td>
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<tr>
<td></td>
<td>MLF: p = 2</td>
</tr>
<tr>
<td></td>
<td>MDE: q = 1</td>
</tr>
<tr>
<td></td>
<td>MDE: q = 2</td>
</tr>
<tr>
<td>M. 1 vs. M. 6</td>
<td>MSE: lower</td>
</tr>
<tr>
<td></td>
<td>MSE: upper</td>
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<tr>
<td></td>
<td>MLF: p = 1</td>
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<td></td>
<td>MLF: p = 2</td>
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<tr>
<td></td>
<td>MDE: q = 1</td>
</tr>
<tr>
<td></td>
<td>MDE: q = 2</td>
</tr>
</tbody>
</table>

Note: The p-values are calculated under the alternative hypothesis $H_0: L_p(e) < L_u(e)$; that is, our proposed Model 1 has higher predictive accuracy than the other competing models.
returns more so. The profiles of the surfaces in both frequencies are very similar. The 5-minute extreme returns exhibit a larger range than the 1-minute extreme returns and, as expected, the 1-minute surfaces are noisier than the 5-minute surfaces.
5 | CONCLUSION

In contrast to existing regression-type models for interval-valued data, we have exploited the extreme nature of the lower and upper bounds of intervals to propose a semiparametric model for interval-valued time series data that is rooted in the limiting results provided by the extreme value theory. We have assumed that there are two stochastic processes that generated the interval-valued data. The first process \( \{Y_t\} \) is latent—for example, the process of financial returns—and follows some unknown conditional density. The second process \( \{N_t\} \) is observable and consists of a collection of random draws—for example, the process of number of trades. In this framework, the upper and lower bounds of the interval—for example, the highest and the lowest returns at time \( t \), are the realized extreme observations within the sample of random draws at time \( t \). We have shown that the conditional mean of extreme returns is a nonlinear function of the conditional moments of the latent process and of the conditional intensity of the process for the number of draws. This specification provides a natural context to test the relationship between extreme returns and intensity of trading. Asymmetric information models of market microstructure claim that trading volume is a proxy for latent information on the value of a financial asset. With interval-valued time series of 5-minute and 1-minute returns for seven stocks of banks and technology companies, we have found that indeed there is a nonlinear relationship between extreme returns and intensity of trading, which is superior to linear specifications.

The proposed semiparametric model has advantages over the existing models. It is general enough to accommodate linear specifications when these are granted, but the most important advantage is that the model is robust to misspecification of the conditional density of the latent process. We have estimated the conditional mean of the extremes, which is nonlinear on the conditional moments of the latent process, with nonparametric methods. In doing so, we have avoided choosing a specific functional form of the conditional density, which, according to extreme value theory, is the driver of the nonlinearity. However, the nonparametric function depends on regressors that are generated in a first step. We have shown that the effect of the first-step parameter uncertainty into the second-step nonparametric estimator is asymptotically negligible, and therefore our two-step estimator has a typical nonparametric convergence rate and it is asymptotically normal.

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**FIGURE 5** One-minute low/high returns versus intensity and volatility: (a) 1-minute low return; (b) 1-minute high return [Colour figure can be viewed at wileyonlinelibrary.com]
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OPEN RESEARCH BADGES

This article has earned an Open Data Badge for making publicly available the digitally-shareable data necessary to reproduce the reported results. The data is available at http://qed.econ.queensu.ca/jae/datasets/lin003/.

REFERENCES


SUPPORTING INFORMATION

Additional supporting information may be found online in the Supporting Information section at the end of the article.

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APPENDIX A: RELAXING THE I.I.D. ASSUMPTION OF THE RANDOM DRAWS \{N_t\}

According to extreme value theory for stationary process, the i.i.d. assumption of the random draws within each sampling time interval can be substantially relaxed to strict stationarity with certain regularity conditions, which allows the \(y_{it}\) sequence in \(S_t\) to be weakly dependent without gravely affecting our model specifications. For notational simplicity, we drop the time subscript \(t\). Let \(\{Y_i\}\) be a strictly stationary process, where the subscript \(i = 1, 2, \ldots, N\) denotes the time order of total \(N\) transactions happening during each time period. Let \(M_N = \max\{Y_1, \ldots, Y_N\}\) be its sample maximum. Define \(\{\tilde{Y}_i\}\) as the i.i.d. process associated with \(\{Y_i\}\) if the two processes share a common marginal distribution function \(F(y) = P(Y \leq y) = P(\tilde{Y} \leq y)\), and \(\tilde{M}_N = \max\{\tilde{Y}_1, \ldots, \tilde{Y}_N\}\) as its sample maximum. If the distribution function \(F(\cdot) \in \text{MDA}(H)\), the limit distribution of the sample maximum \(\tilde{M}_N\) of the associated i.i.d. process \(\{\tilde{Y}_i\}\) is \(H\)—that is, as \(N \to \infty\),

\[
c_n^{-1}(\tilde{M}_N - d_N) \xrightarrow{d} H.
\]

If the process \(\{Y_i\}\) satisfies the conditions \(D(u_N)\) and \(D'(u_N)\) given below, the limit distribution of the sample maximum \(M_N\) of the stationary process \(\{Y_i\}\) is also \(H\)—that is, as \(N \to \infty\),

\[
c_n^{-1}(M_N - d_N) \xrightarrow{d} H,
\]

with the same centering and normalizing terms \(c_N\) and \(d_N\).

**Condition 1.** \(D(u_N)\): for each \(y \in \mathbb{R}\) the sequence \(u_N = c_Ny + d_N\) satisfies that, for any integers \(p\) and \(q\), with \(p + q\) different numbers picked out from the sequence of the time-ordered subscript \(i = 1, 2, \ldots, N\) such that \(1 \leq i_1 < \cdots < i_p < j_1 < \cdots < j_q \leq N\) and \(j_1 - i_p \geq 1\), we have

\[
P \left( \max_{i \in A_1} Y_i \leq u_N \right) - P \left( \max_{i \in A_2} Y_i \leq u_N \right) P \left( \max_{i \in A_3} Y_i \leq u_N \right) \leq \alpha_{N,i},
\]

where \(A_1 = \{i_1, \ldots, i_p\}, A_2 = \{j_1, \ldots, j_q\}\), \(\alpha_{N,i} \to 0\) as \(N \to \infty\) for some sequence \(l = l_N = \omega(N)\).

**Condition 2.** \(D'(u_N)\): for each \(y \in \mathbb{R}\) the sequence \(u_N = c_Ny + d_N\) satisfies that

\[
\lim_{k \to \infty} \limsup_{N \to \infty} \sum_{j=2}^{[n/k]} P(Y_j > u_N, Y_j > u_N) = 0.
\]

Condition \(D(u_N)\) describes a specific type of asymptotic independence. As a distributional mixing condition, it is weaker than most of the classical forms of dependence restrictions. Condition \(D'(u_N)\) means that joint exceedance of \(U_N\) by every pair \((Y_i, Y_j)\) is very unlikely as \(N\) approaches \(\infty\). These two conditions are discussed extensively in Leadbetter, Lindgren, and Rootzén (1983). Direct verification of these two conditions is tedious. However, for Gaussian stationary linear process, \(Y_i = \sum_{j=-\infty}^{\infty} \psi_j Z_{i-j}, i \in \mathbb{Z}\), where \(\{Z_t\}\) is an i.i.d. Gaussian innovation process, the conditions \(D(u_N)\) and \(D'(u_N)\) boil down to a very weak and intuitive one: The autocovariance function \(\gamma(h) = \text{cov}(Y_i, Y_{i+h})\) of the process \(\{Y_i\}\) approaches to 0 faster than \((\ln h)^{-1}\) as \(h \to \infty\); that is, \(\gamma(h) \ln h \to 0\). It even includes a Gaussian fractional autoregressive integrated moving average process with the order of difference \(d \in (0, 0.5)\) whose autocovariances are not absolutely summable. Moreover, the Gaussian distribution of innovations \(Z_i\) can be further relaxed to subexponential distributions, and the sample maxima of the subexponential linear process may still have a nondegenerate limit distribution. See Leadbetter and Rootzén (1988) for more details.