3 Other Considerations

3.1 Categorical Predictors

What to do when X_i categorical?

So far we have assumed all variables in our linear model are quantitiative.

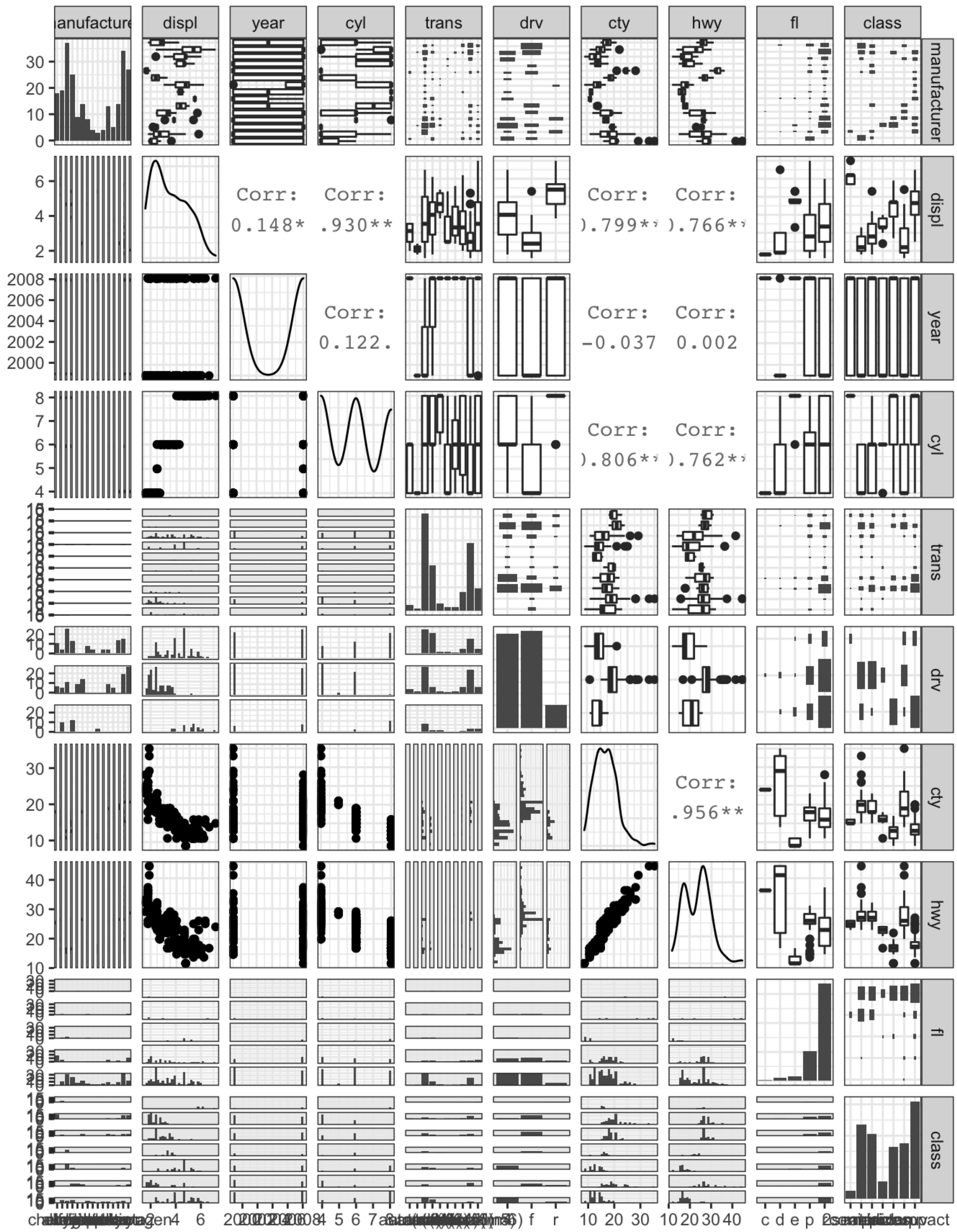
For example, consider building a model to predict highway gas mileage from the `mpg` data set.

```
head(mpg)
```

```
## # A tibble: 6 x 11
##   manufacturer model displ  year   cyl trans      drv     cty   hwy fl    class
##   <chr>        <chr> <dbl> <int> <int> <chr>      <chr> <int> <int> <chr> <chr>
## 1 audi         a4      1.8  1999     4 auto(l5)   f        18    29 p     compa
## 2 audi         a4      1.8  1999     4 manual(m5) f        21    29 p     compa
## 3 audi         a4      2    2008     4 manual(m6) f        20    31 p     compa
## 4 audi         a4      2    2008     4 auto(av)   f        21    30 p     compa
## 5 audi         a4      2.8  1999     6 auto(l5)   f        16    26 p     compa
## 6 audi         a4      2.8  1999     6 manual(m5) f        18    26 p     compa
```

```
library(GGally)

mpg %>%
  select(-model) %>% # too many models
  ggpairs() # plot matrix
```

makes $\frac{(p+1)(p)}{2}$ plots to look at each pair of variables in a df (p predictors + 1 response).



chooses appropriate plot for us for each pair of variables.

y_{ii}
$hwy = \beta_0 + \beta_1 drv + \varepsilon$

To incorporate these categorical variables into the model, we will need to introduce $k-1$ dummy variables, where $k =$ the number of levels in the variable, for each qualitative variable.

For example, for `drv`, we have 3 levels: `4`, `f`, and `r`. $K=3$

$x_{i1} = \begin{cases} 1 & \text{if } i\text{th car is front wheel drive} \\ 0 & \text{otherwise.} \end{cases}$

$x_{i2} = \begin{cases} 1 & \text{if } i\text{th car is RWD} \\ 0 & \text{otherwise.} \end{cases}$

instead

$y_i = \beta_0 + \beta_1 x_{i1} + \beta_2 x_{i2} + \varepsilon_i = \begin{cases} \beta_0 + \beta_1 + \varepsilon_i & \text{if } i\text{th car is FWD} \\ \beta_0 + \beta_2 + \varepsilon_i & \text{if } i\text{th car is RWD} \\ \beta_0 + \varepsilon_i & \text{if } i\text{th car is 4WD} \end{cases}$ $\Rightarrow$

y ~ predictors

$\beta_0 =$ avg hwy mpg for 4WD cars

$\beta_1 =$ difference in avg hwy mpg between FWD & 4WD cars.

$\beta_2 =$ difference in avg hwy mpg btw/ RWD & 4WD cars.

```
lm(hwy ~ displ + cty + drv, data = mpg) %>%
  summary()
```

quantitative

categorical.

```
##
## Call:
## lm(formula = hwy ~ displ + cty + drv, data = mpg)
##
## Residuals:
##     Min      1Q  Median      3Q     Max
## -4.6499 -0.8764 -0.3001  0.9288  4.8632
##
## Coefficients:
##             Estimate Std. Error t value Pr(>|t|)
## (Intercept)  3.42413    1.09313   3.132  0.00196 **
## displ       -0.20803    0.14439  -1.441  0.15100
## cty          1.15717    0.04213  27.466  < 2e-16 ***
## drvf         2.15785    0.27348   7.890 1.23e-13 ***
## drvr         2.35970    0.37013   6.375 9.95e-10 ***
## ---
## Signif. codes:  0 '***' 0.001 '**' 0.01 '*' 0.05 '.' 0.1 ' ' 1
##
## Residual standard error: 1.49 on 229 degrees of freedom
## Multiple R-squared:  0.9384, Adjusted R-squared:  0.9374
## F-statistic: 872.7 on 4 and 229 DF,  p-value: < 2.2e-16
```

$\hat{\beta}_i$ $SE(\hat{\beta}_i)$ individual tests of significance

R^2

F test

3.2 Extensions of the Model

The standard regression model provides interpretable results and works well in many problems. However it makes some very strong assumptions that may not always be reasonable.

1. linear relationship
2. constant error variance
3. iid Normal errors uncorrelated w/ predictors X

Additive Assumption

The additive assumption assumes that the effect of each predictor on the response is not affected by the value of the other predictors. What if we think the effect should depend on the value of another predictor?

```
lm(sales ~ TV + radio + TV*radio, data = ads) %>%
  summary()
```

interaction term.

```
##
## Call:
## lm(formula = sales ~ TV + radio + TV * radio, data = ads)
##
## Residuals:
##     Min      1Q  Median      3Q     Max
## -6.3366 -0.4028  0.1831  0.5948  1.5246
##
## Coefficients:
##              Estimate Std. Error t value Pr(>|t|)
## (Intercept) 6.750e+00  2.479e-01  27.233   <2e-16 ***
## TV          1.910e-02  1.504e-03  12.699   <2e-16 ***
## radio       2.886e-02  8.905e-03   3.241   0.0014 **
## TV:radio    1.086e-03  5.242e-05  20.727   <2e-16 ***
## ---
## Signif. codes:  0 '***' 0.001 '**' 0.01 '*' 0.05 '.' 0.1 ' ' 1
##
## Residual standard error: 0.9435 on 196 degrees of freedom
## Multiple R-squared:  0.9678, Adjusted R-squared:  0.9673
## F-statistic:  1963 on 3 and 196 DF,  p-value: < 2.2e-16
```

(TV : radio

$\hat\beta_i$ $SE(\hat\beta_i)$ indiv. tests.

$\hat\beta_2$ $\hat\beta_3$

F stat

$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_1 X_2 + \varepsilon.$

$= \beta_0 + \underbrace{(\beta_1 + \beta_3 X_2)}_{\text{changes based on the value of } X_2} X_1 + \beta_2 X_2 + \varepsilon$

$R^2 = 0.89$ without interaction term

Big increase in R^2

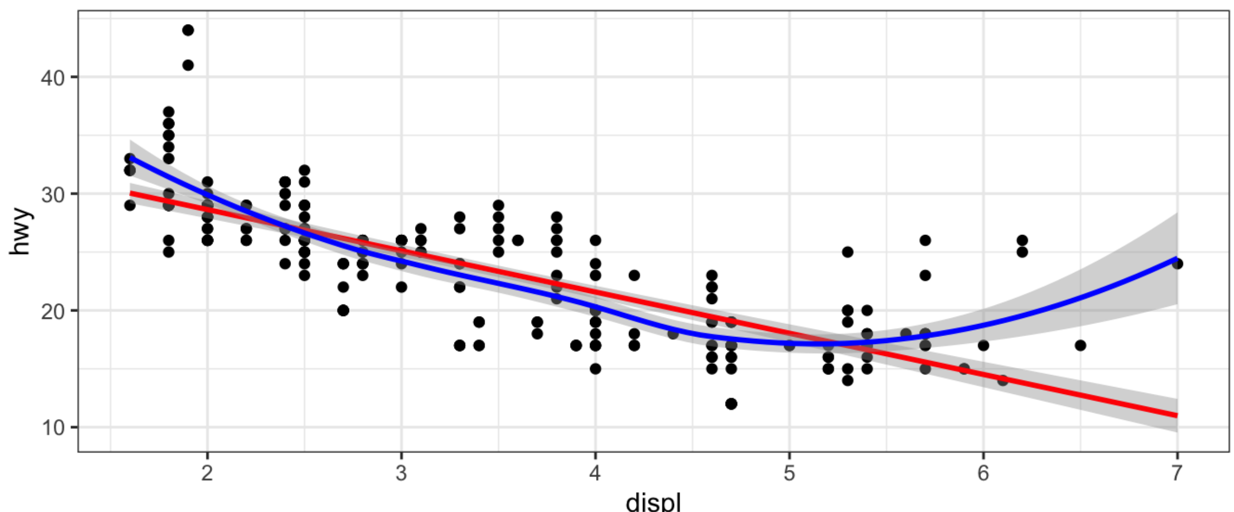
If we add interaction terms, be sure to keep original variables, otherwise very confusing to interpret results.

" an increase of \$1000 in radio advertising will be associated w/ an average increase in sales of $\$(\hat\beta_2 + \hat\beta_3 TV)1000 = \$(29 + 1.1 \times TV)$

Linearity Assumption

The linear regression model assumes a linear relationship between response and predictors. In some cases, the true relationship may be non-linear.

```
ggplot(data = mpg, aes(displ, hwy)) +
  geom_point() +
  geom_smooth(method = "lm", colour = "red") +
  geom_smooth(method = "loess", colour = "blue")
```



may be non linear

How to include nonlinear terms in the model?

"Identity"

```r
lm(hwy ~ displ + I(displ^2), data = mpg) %>%
  summary()
```

$y = \beta_0 + \beta_1 x + \beta_2 x^2 + \varepsilon$

```
##
## Call:
## lm(formula = hwy ~ displ + I(displ^2), data = mpg)
##
## Residuals:
##     Min      1Q  Median      3Q     Max
## -6.6258 -2.1700 -0.7099  2.1768 13.1449
##
## Coefficients:  β̂i
##             Estimate Std. Error t value Pr(>|t|)
## (Intercept)  49.2450     1.8576  26.510  < 2e-16 ***
## displ       -11.7602     1.0729 -10.961  < 2e-16 ***
## I(displ^2)    1.0954     0.1409   7.773 2.51e-13 *** significant.
## ---
## Signif. codes:  0 '***' 0.001 '**' 0.01 '*' 0.05 '.' 0.1 ' ' 1
##
## Residual standard error: 3.423 on 231 degrees of freedom
## Multiple R-squared:  0.6725, Adjusted R-squared:  0.6696
## F-statistic: 237.1 on 2 and 231 DF,  p-value: < 2.2e-16
```

Be careful throwing higher level polynomial powers → will lead to overfitting & very bad prediction on edges of the space.

3.3 Potential Problems

1. Non-linearity of response-predictor relationships

   diagnosis:
   plot residuals vs. fitted ↗ or vs. each predictor
   see pattern.

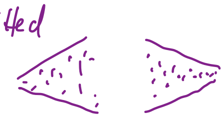
   Solutions
   - add polynomial terms
   - transform predictors.
   - not use MLR.

2. Correlation of error terms

   diagnosis:
   understanding of how data is collected
   e.g. time series? spatial data?

   solutions
   use models formulated for these correlated errors (not this class).

3. Non-constant variance of error terms

   diagnosis
   plot residuals vs. fitted
   see funnel pattern 

   solutions
   transform Y try $\log Y$ or $\sqrt{Y}$

4. Outliers

   diagnosis
   plot data

   solutions
   Is your data wrong? i.e. error in collection? fix it.
   otherwise - maybe missing a predictor?

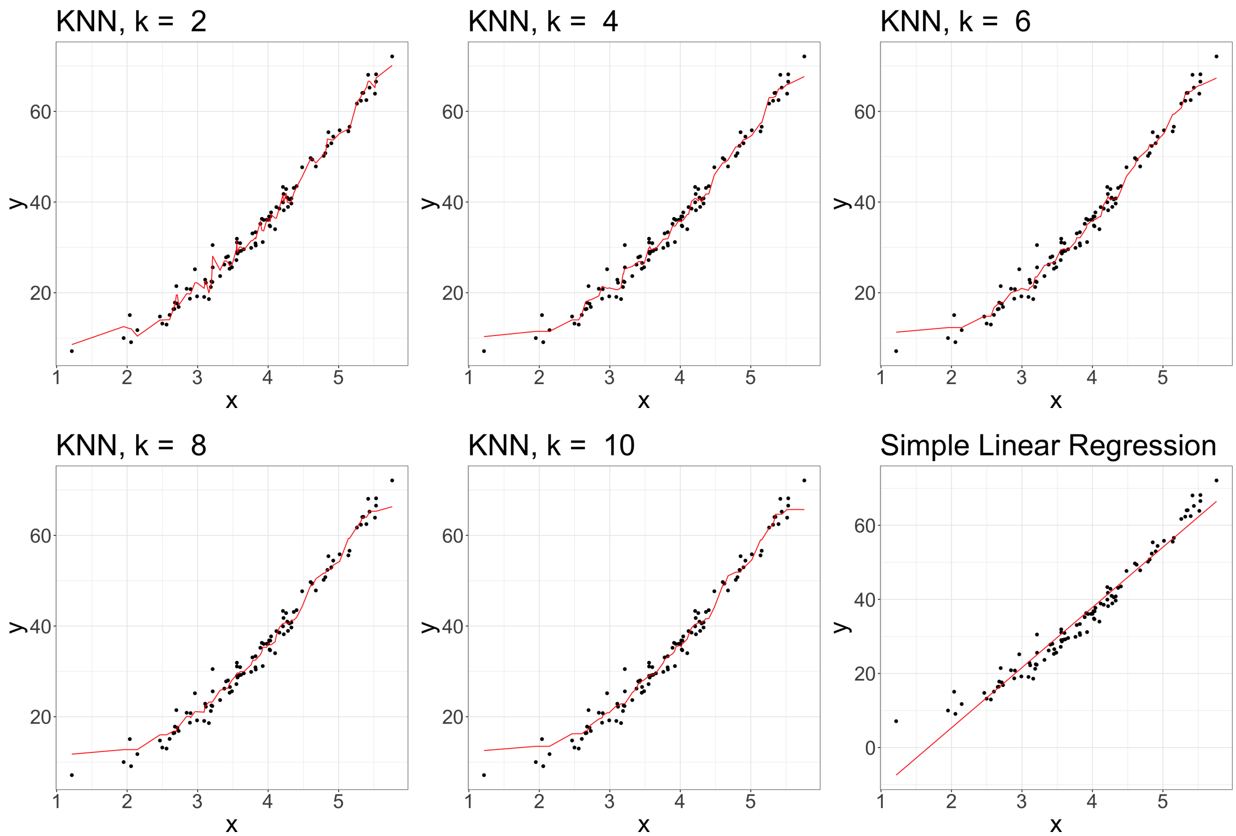
4 K-Nearest Neighbors

In Ch. 2 we discuss the differences between *parametric* and *nonparametric* methods. Linear regression is a parametric method because it assumes a linear functional form for $f(X)$.

A simple and well-known non-parametric method for regression is called K-nearest neighbors regression (KNN regression).

Given a value for K and a prediction point x_0, KNN regression first identifies the K training observations that are closest to x_0 ($\mathcal{N}_0$). It then estimates $f(x_0)$ using the average of all the training responses in $\mathcal{N}_0$,

```r
library(caret) # package for knn
set.seed(445) #reproducibility

x <- rnorm(100, 4, 1) # pick some x values
y <- 0.5 + x + 2*x^2 + rnorm(100, 0, 2) # true relationship
df <- data.frame(x = x, y = y) # data frame of training data

for (k in seq(2, 10, by = 2)) {
  knn_model <- knnreg(y ~ x, data = df, k = k) # fit knn model

  ggplot(df) +
    geom_point(aes(x, y)) +
    geom_line(aes(x, predict(knn_model, df)), colour = "red") +
    ggtitle(paste("KNN, k = ", k)) +
    theme(text = element_text(size = 30)) -> p

  print(p) # knn plots
}

ggplot(df) +
    geom_point(aes(x, y)) +
    geom_line(aes(x, lm(y ~ x, df)$fitted.values), colour = "red") +
    ggtitle("Simple Linear Regression") +
    theme(text = element_text(size = 30)) # slr plot
```


KNN, k = 2
KNN, k = 4
KNN, k = 6
KNN, k = 8
KNN, k = 10
Simple Linear Regression
x
y