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In the Monte Carlo simulations that follow, three bandwidth choices are parameter combination: The LSCV bandwidth, the "Stanton" bandwidth, an independent and identically distributed (IID) bandwidth. The first choice is the least squares cross validation problem (ref. LSCVfunc). The IID bandwidth for IID data, and it is defined as $h^{iid} = \hat{\sigma} T^{-1/5}$, where $\hat{\sigma}$ is the sample standard deviation and T is the sample size. The Stanton bandwidth is the one actually used in Stanton (1997). footnote

particular, "inverting" these equations yields:

$$\mu(x_t) = \frac{1}{\Delta} E[x_{t+\Delta} - x_t | x_t] + \frac{\sigma(\Delta)}{\Delta}$$
$$\sigma(x_t) = \sqrt{E[(x_{t+\Delta} - x_t)^2 | x_t] \frac{1}{\Delta} + \frac{\sigma(\Delta)}{\Delta}}$$

The essence of Stanton's approach is to apply the Nadaraya-Watson (N-W) regression estimator to construct nonparametric estimates of the conditional moments (ref. diff2) and (ref. diff2):

$$\sum_{t=1}^{T-1} (x_{t+1}^{\Delta} - x_t^{\Delta}) K\left(\frac{x_t - x_t^{\Delta}}{h}\right)$$

Screen text is reprinted from an article in the Journal of Finance.