Contents

Contributors xv
Preface xxiii
Guide to the Handbook of Finance xxv
Index 779

Volume I

PART 1 Market Players and Markets 1
1. Overview of Financial Instruments and Financial Markets
   Frank J. Fabozzi 3
2. Fundamentals of Investing
   Frank J. Fabozzi 9
3. The American Banking System
   R. Philip Giles 17
   David M. Jones and Ellen J. Rachlin 29
5. Institutional Aspects of the Securities Markets
   James R. Thompson, Edward E. Williams, and M. Chapman Findlay, III 37
6. Investment Banking
   K. Thomas Law 51
7. Securities Innovation
   John D. Finney 61
8. An Arbitrage Perspective of the Purpose and Structure of Financial Markets
   Robert Dubil 93
9. Complete Markets
   Luu Cutha 107
10. Introduction to Islamic Finance
    Mahmoud A. El-Gamal 115

PART 2 Common Stock 123

Cash Instruments
11. The U.S. Equity Markets
    Frank J. Jones and Frank J. Fabozzi 125

Equity Derivatives
12. The Information Content of Short Sales
    Steven L. Jones and Glen Larsen 151
13. Emerging Stock Market Investment
    Larry Speidel and Jarrod W. Wilcox 163

PART 3 Fixed Income Instruments 205

Basics
17. Bonds: Investment Features and Risks
    Frank J. Fabozzi 207
18. Residential Mortgages
    Frank J. Fabozzi, Anand K. Bhattacharya, and William S. Berliner 221
19. Reverse Mortgages
    Laurie S. Goodman 231

Nonmortgage Related Fixed Income Securities and Money Market Instruments
20. U.S. Treasury Securities
    Frank J. Fabozzi 237
21. Federal Agency Securities
    Frank J. Fabozzi and George P. Kegler 243
22. Municipal Securities
    Frank J. Fabozzi 249
23. Corporate Fixed Income Securities
    Frank J. Fabozzi 259
24. The Eurobond Market
    Moorad Choudhry 271

vii
## Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Pages</th>
</tr>
</thead>
<tbody>
<tr>
<td>25.</td>
<td>The Euro Government Bond Market</td>
<td>285</td>
</tr>
<tr>
<td>26.</td>
<td>The German Pfandbrief and European Covered Bonds Market</td>
<td>295</td>
</tr>
<tr>
<td>27.</td>
<td>Commercial Paper</td>
<td>305</td>
</tr>
<tr>
<td>28.</td>
<td>Money Market Calculations</td>
<td>313</td>
</tr>
<tr>
<td>29.</td>
<td>Convertible Bonds</td>
<td>319</td>
</tr>
<tr>
<td>30.</td>
<td>Syndicated Loans</td>
<td>325</td>
</tr>
<tr>
<td>31.</td>
<td>Emerging Markets Debt</td>
<td>339</td>
</tr>
<tr>
<td>Structured Products</td>
<td></td>
<td></td>
</tr>
<tr>
<td>32.</td>
<td>Introduction to Mortgage-Backed Securities</td>
<td>347</td>
</tr>
<tr>
<td>33.</td>
<td>Structuring Collateralized Mortgage Obligations and Interest-Only/Principal-Only Securities</td>
<td>355</td>
</tr>
<tr>
<td>34.</td>
<td>Commercial Mortgage-Backed Securities</td>
<td>367</td>
</tr>
<tr>
<td>35.</td>
<td>Nonmortgage Asset-Backed Securities</td>
<td>375</td>
</tr>
<tr>
<td>36.</td>
<td>Synthetic Asset-Backed Securities</td>
<td>385</td>
</tr>
<tr>
<td>37.</td>
<td>Catastrophe Bonds</td>
<td>389</td>
</tr>
<tr>
<td>38.</td>
<td>Collateralized Debt Obligations</td>
<td>395</td>
</tr>
<tr>
<td>Fixed Income and Inflation Derivatives</td>
<td></td>
<td></td>
</tr>
<tr>
<td>39.</td>
<td>Interest Rate Futures and Forward Rate Agreements</td>
<td>411</td>
</tr>
<tr>
<td>40.</td>
<td>Interest Rate Swaps</td>
<td>421</td>
</tr>
<tr>
<td>41.</td>
<td>Interest Rate Options and Related Products</td>
<td>427</td>
</tr>
<tr>
<td>42.</td>
<td>Introduction to Credit Derivatives</td>
<td>435</td>
</tr>
<tr>
<td>PART 4</td>
<td>Real Estate</td>
<td>481</td>
</tr>
<tr>
<td>43.</td>
<td>Fixed Income Total Return Swaps</td>
<td>447</td>
</tr>
<tr>
<td>44.</td>
<td>Bond Market Transparency</td>
<td>455</td>
</tr>
<tr>
<td>45.</td>
<td>Bond Spreads and Relative Value</td>
<td>463</td>
</tr>
<tr>
<td>46.</td>
<td>The Determinants of the Swap Spread and Understanding the LIBOR Term Premium</td>
<td>469</td>
</tr>
<tr>
<td>PART 5</td>
<td>Alternative Investments</td>
<td>535</td>
</tr>
<tr>
<td>47.</td>
<td>Real Estate Investment</td>
<td>483</td>
</tr>
<tr>
<td>48.</td>
<td>Investing in Commercial Real Estate for Individual Investors</td>
<td>495</td>
</tr>
<tr>
<td>49.</td>
<td>Types of Commercial Real Estate</td>
<td>505</td>
</tr>
<tr>
<td>50.</td>
<td>Commercial Real Estate Loans and Securities</td>
<td>515</td>
</tr>
<tr>
<td>51.</td>
<td>Commercial Real Estate Derivatives</td>
<td>525</td>
</tr>
<tr>
<td>PART 6</td>
<td>Investment Companies, ETFs, and Life Insurance Products</td>
<td>619</td>
</tr>
<tr>
<td>52.</td>
<td>Alternative Asset Classes</td>
<td>537</td>
</tr>
<tr>
<td>53.</td>
<td>Hedge Funds</td>
<td>543</td>
</tr>
<tr>
<td>54.</td>
<td>Introduction to Venture Capital</td>
<td>561</td>
</tr>
<tr>
<td>55.</td>
<td>Assessing Hedge Fund Investment Risk in Common Hedge Fund Strategies</td>
<td>575</td>
</tr>
<tr>
<td>56.</td>
<td>Diversify a Portfolio with Tangible Commodities</td>
<td>585</td>
</tr>
<tr>
<td>57.</td>
<td>The Fundamentals of Commodity Investments</td>
<td>593</td>
</tr>
<tr>
<td>58.</td>
<td>Art Finance</td>
<td>605</td>
</tr>
<tr>
<td>59.</td>
<td>Investing in Life Settlements</td>
<td>611</td>
</tr>
<tr>
<td>60.</td>
<td>Investment Companies</td>
<td>621</td>
</tr>
</tbody>
</table>
CONTENTS

61. Exchange-Traded Funds 633
   Gary L. Gastineau

62. Investment-Oriented Life Insurance 643
   Frank J. Jones

63. Stable Value Investment Options for Defined Contribution Plans 657
   Brian K. Haendiges

PART 7 Foreign Exchange 675

64. An Introduction to Spot Foreign Exchange 677
   Shani Shamah

65. An Introduction to Foreign Exchange Derivatives 687
   Shani Shamah

66. Introduction to Foreign Exchange Options 701
   Shani Shamah

PART 8 Inflation-Hedging Products 715

67. Inflation-Linked Bonds 717
   P. Brett Hammond

68. Introduction to Inflation Derivatives 729
   P. Brett Hammond

PART 9 Securities Finance 741

69. An Introduction to Securities Lending 743
   Mark C. Faulkner

70. Mechanics of the Equity Lending Market 757
   Jeff Cohen, David Haushalter, and Adam V. Reed

71. Securities Lending, Liquidity, and Capital Market-Based Finance 761

72. Repurchase Agreements and Dollar Rolls 769
   Frank J. Fabozzi and Steven V. Mann

Volume II

PART 1 Investment Management 1

Foundations

1. Portfolio Selection 3
   Frank J. Fabozzi, Harry M. Markowitz, and Francis Gupta

2. Asset Pricing Models 15
   Frank J. Fabozzi

3. Stochastic Growth and Discretionary Wealth 25
   Jarrod W. Wilcox

   Jarrod W. Wilcox

5. Quantitative Investment Management: Today and Tomorrow 43
   Peter N. Kolm, Sergio M. Focardi, Frank J. Fabozzi, and Dessislava A. Pachamanova
### PART 2 Equity Portfolio Management

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Pages</th>
</tr>
</thead>
<tbody>
<tr>
<td>24.</td>
<td>Overview of Active Common Stock Portfolio Strategies</td>
<td>239</td>
</tr>
<tr>
<td>25.</td>
<td>Investment Analysis: Profiting from a Complex Equity Market</td>
<td>249</td>
</tr>
<tr>
<td>26.</td>
<td>Investment Management: An Architecture for the Equity Market</td>
<td>259</td>
</tr>
<tr>
<td>27.</td>
<td>Portfolio Construction with Active Managers: An Integrated Approach</td>
<td>271</td>
</tr>
<tr>
<td>28.</td>
<td>Quantitative Modeling of Transaction and Trading Costs</td>
<td>283</td>
</tr>
<tr>
<td>29.</td>
<td>Quantitative Equity Portfolio Management</td>
<td>289</td>
</tr>
<tr>
<td>30.</td>
<td>Growth and Value Investing—Keeping in Style</td>
<td>299</td>
</tr>
<tr>
<td>31.</td>
<td>Fundamental Multifactor Equity Risk Models</td>
<td>307</td>
</tr>
<tr>
<td>32.</td>
<td>Tracking Error and Common Stock Portfolio Management</td>
<td>319</td>
</tr>
<tr>
<td>33.</td>
<td>Long-Short Equity Portfolios</td>
<td>325</td>
</tr>
<tr>
<td>34.</td>
<td>A Support Level for Technical Analysis</td>
<td>335</td>
</tr>
<tr>
<td>35.</td>
<td>Volatility and Structure: Building Blocks of Classical Chart Pattern Analysis</td>
<td>347</td>
</tr>
<tr>
<td>37.</td>
<td>The Blindness of Hindsight in Finance</td>
<td>369</td>
</tr>
<tr>
<td>38.</td>
<td>Are Stock Prices Predictable?</td>
<td>373</td>
</tr>
<tr>
<td>39.</td>
<td>Dynamic Factor Approaches to Equity Portfolio Management</td>
<td>381</td>
</tr>
<tr>
<td>40.</td>
<td>Statistical Arbitrage</td>
<td>393</td>
</tr>
<tr>
<td>41.</td>
<td>The Use of Derivatives in Managing Equity Portfolios</td>
<td>399</td>
</tr>
</tbody>
</table>

### PART 3 Fixed Income Portfolio Management

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Pages</th>
</tr>
</thead>
<tbody>
<tr>
<td>42.</td>
<td>A Valuation Framework for Selecting Option Strategies</td>
<td>413</td>
</tr>
<tr>
<td>43.</td>
<td>Bond Portfolio Strategies for Outperforming a Benchmark</td>
<td>421</td>
</tr>
<tr>
<td>44.</td>
<td>Fixed Income Portfolio Investing: The Art of Decision Making</td>
<td>431</td>
</tr>
<tr>
<td>45.</td>
<td>Analysis and Evaluation of Corporate Bonds</td>
<td>447</td>
</tr>
<tr>
<td>46.</td>
<td>Analyzing and Interpreting the Yield Curve</td>
<td>455</td>
</tr>
<tr>
<td>47.</td>
<td>Creating an Optimal Portfolio to Fund Pension Liabilities</td>
<td>463</td>
</tr>
<tr>
<td>48.</td>
<td>Convertible Bond Arbitrage</td>
<td>485</td>
</tr>
<tr>
<td>49.</td>
<td>Maturity, Capital Structure, and Credit Risk: Important Relationships for Portfolio Managers</td>
<td>493</td>
</tr>
<tr>
<td>50.</td>
<td>A Unified Approach to Interest Rate Risk and Credit Risk of Cash and Derivative Instruments</td>
<td>499</td>
</tr>
<tr>
<td>51.</td>
<td>Swaps for the Modern Investment Manager</td>
<td>507</td>
</tr>
<tr>
<td>52.</td>
<td>Overview of ABS Portfolio Management</td>
<td>513</td>
</tr>
</tbody>
</table>

### PART 4 Alternative Investments

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Pages</th>
</tr>
</thead>
<tbody>
<tr>
<td>53.</td>
<td>Integrating Alternative Investments into the Asset Allocation Process</td>
<td>523</td>
</tr>
<tr>
<td>54.</td>
<td>Some Considerations in the Use of Currencies</td>
<td>531</td>
</tr>
</tbody>
</table>

### PART 5 Corporate Finance

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Pages</th>
</tr>
</thead>
<tbody>
<tr>
<td>55.</td>
<td>Introduction to Financial Management and Analysis</td>
<td>541</td>
</tr>
<tr>
<td>56.</td>
<td>Introduction to International Corporate Financial Management</td>
<td>551</td>
</tr>
</tbody>
</table>
CONTENTS xi

87. Corporate Strategy and Financial Planning
Frank J. Fabozzi and Pamela P. Drake 563
88. Corporate Governance
Mark J. P. Anson and Frank J. Fabozzi 583
89. Measuring the Performance of Corporate Managers
Harold Bierman, Jr. 591

Capital Structure and Dividend Policy
90. Capital Structure Decisions in Corporate Finance
Frank J. Fabozzi and Pamela P. Drake 601
91. Capital Structure: Lessons from Modigliani and Miller
Frank J. Fabozzi and Pamela P. Drake 617
92. Bondholder Value versus Shareholder Value
Claus Huber 623
93. Recapitalization of Troubled Companies
Enrique R. Arzac 631
94. Dividend and Dividend Policies
Frank J. Fabozzi and Pamela P. Drake 645

Capital Budgeting
95. The Investment Problem and Capital Budgeting
Frank J. Fabozzi and Pamela P. Drake 563
96. Estimating Cash Flows of Capital Budgeting Projects
Frank J. Fabozzi and Pamela P. Drake 659
97. Capital Budgeting Techniques
Frank J. Fabozzi and Pamela P. Drake 671
98. Capital Budgeting and Risk
Pamela P. Drake and Frank J. Fabozzi 685
99. Real Options
John D. Finnerty 697
100. Real Options and Modern Capital Investment Decisions
William T. Moore 715
101. Hurdle Rates for Overseas Projects
Thomas J. O’Brien 727

Structured Finance
102. Structured Finance
Frank J. Fabozzi, Henry A. Davis, and Moorad Choudhry 737
103. Introduction to Securitization
Anand K. Bhattacharya, Frank J. Fabozzi, and W. Alexander Roever 745
104. Issuer Prospective in Structuring Asset-Backed Securities Transactions
Frank J. Fabozzi and Vinod Kothari 757

75. Structuring Efficient Asset-Backed Transactions
Len Blum and Chris DiAngelo 765
76. Funding through the Use of Trade Receivable Securitizations
Adrian Katt and Jeremy Blatt 779
77. Operational Issues in Securitization
Vinod Kothari 789
78. Project Financing
Henry A. Davis and Frank J. Fabozzi 799
79. The Fundamentals of Equipment Leasing
Frank J. Fabozzi 815
80. Leveraged Leasing
Frank J. Fabozzi 825
81. Lease versus Borrow-to-Buy Analysis
Frank J. Fabozzi 837

Working Capital Management
82. Basic Treasury Management Concepts
James Sagner and Michele Almun-World 851
83. Advanced Treasury Management Concepts
James Sagner and Michele Almun-World 861
84. Management of Accounts Receivable
Pamela P. Drake and Frank J. Fabozzi 871
85. Inventory Management
Pamela P. Drake and Frank J. Fabozzi 877

Mergers and Acquisitions
86. Acquisitions and Takeovers
Aswath Damodaran 883
87. Taking Control of a Company
Pascal Quiry, Maurizio Dallocchio, Yann Le Fur, and Antonio Salvi 903
88. Mergers and Demergers
Pascal Quiry, Maurizio Dallocchio, Yann Le Fur, and Antonio Salvi 915
89. Leveraged Buyouts
Pascal Quiry, Maurizio Dallocchio, Yann Le Fur, and Antonio Salvi 925

Volume III

PART 1 Risk Management 1

General Principles
1. Risk and the French Connection
Peter L. Bernstein 3
2. Risk: Traditional Finance versus Behavioral Finance
Victor Riccardi 11
3. Overview of Risk Management and Alternative Risk Transfer
Erik Barks 39
## Contents

4. Risk and Risk Management  
   Christopher L. Caip  
5. Risk Management for Asset Management Firms  
   Noël Amenc, Jean-René Giraud, Lionel Martellini, and Véronique Le Sourd  
6. Catastrophe and Risk  
   Erik Banks  
7. Overview of Enterprise Risk Management  
   James Lam

### Risk Models

8. Model Risk  
   Kevin Dowd
   Kevin Dowd
10. Risk Measures and Portfolio Selection  
    Stoecklitz T. Rachev, Christian Menn, and Frank J. Fabozzi
11. Statistical Models of Operational Loss  
    Carol Alexander
12. Risk Management in Freight Markets with Forwards and Options Contracts  
    Juby George and Radu Tunaru

### Fixed Income Risk Management

13. Fixed Income Risk Modeling  
    Ludovic Breger and Oren Cheyette
14. Effective Duration and Convexity  
    Gerald W. Buetow, Jr. and Robert R. Johnson
15. Duration Estimation for Bonds and Bond Portfolios  
    Frank J. Fabozzi
16. Yield Curve Risk Measures  
    Frank J. Fabozzi and Steven V. Mann
17. Improving Guidelines for Interest Rate and Credit Derivatives  
    Steven K. Kreider, Scott F. Richard, and Frank J. Fabozzi
18. Modeling Portfolio Credit Risk  
    Shrikant Ramamurthy
19. The Basics of Cash-Market Hedging  
    Shrakunt Ranaumarty
20. Hedging Fixed Income Securities with Interest Rate Swaps  
    Shrakunt Ranaumarty
21. Yield Curve Risk Management  
    Robert R. Reitano

### PART 2 Interest Rate Modeling

22. The Concept and Measures of Interest Rate Volatility  
    Alexander Levin
23. Short-Term Structure Models  
    Alexander Levin

### PART 3 Credit Risk Modeling and Analysis

24. Credit Risk  
    Frank J. Fabozzi
25. Credit Risk Modeling Using Structural Models  
    Mark J.P. Anson, Frank J. Fabozzi, Ren-Raw Chen, and Moorad Choudhry
26. Credit Risk Modeling Using Reduced-Form Models  
    Mark J.P. Anson, Frank J. Fabozzi, Ren-Raw Chen, and Moorad Choudhry
27. The Credit Analysis of Municipal Bonds  
    Syllistia G. Feldstein and Frank Fabozzi

### PART 4 Valuation

28. Introduction to Valuation  
   Ananth Damodaran
29. Applied Equity Valuation: Discounted Cash Flow Method  
    Glen A. Larsen, Jr.
30. Applied Equity Valuation: Relative Valuation Method  
    Glen A. Larsen, Jr.
31. Dividend Discount Models  
    Pamela P. Drake and Frank J. Fabozzi
32. Equity Analysis Using Traditional and Value-Based Metrics  
    Frank J. Fabozzi and James L. Grant
33. The Franchise Factor Approach to Firm Valuation  
    Martin L. Leibowitz and Stanley Kogelman
34. IPO Valuation  
    Kuntara Pukthuanthong-Le
35. The Valuation of Private Firms  
    Stanley Jay Feldman

### Valuing Fixed Income Securities

36. General Principles of Bond Valuation  
    Frank J. Fabozzi and Steven V. Mann
37. Yield Curves and Valuation Lattices  
    Frank J. Fabozzi, Andrew Kalotay, and Michael Dorigan
38. Using the Lattice Model to Value Bonds with Embedded Options, Floaters, Options, and Caps/Floors  
    Frank J. Fabozzi, Andrew Kalotay, and Michael Dorigan
39. Valuing Mortgage-Backed and Asset-Backed Securities  
    Frank J. Fabozzi
CONTENTS xiii

40. A Framework for Valuing Treasury Inflation-Protected Securities 439
Priya Misra, Kodjo Apedjinou, and Anshul Pradhan
41. Quantitative Models to Value Convertible Bonds 445
Filippo Stefanini

Derivatives Valuation

42. Introduction to the Pricing of Futures/Forwards and Options 451
Frank J. Fabozzi
43. Black-Scholes Option Pricing Model 459
Svetlozar T. Rachev, Christian Menn, and Frank J. Fabozzi
44. Valuing a Plain Vanilla Swap 467
Gerald W. Buetow and Frank J. Fabozzi
45. Valuing Swaptions 477
Frank J. Fabozzi and Gerald W. Buetow
46. Pricing Options on Interest Rate Instruments 495
Rada Tanara and Brian Eades
47. Credit Default Swaps Valuation 507
Ren-Raw Chen, Frank J. Fabozzi, and Dominic O’Kane
48. The Valuation of Fixed Income Total Return Swaps 519
Ren-Raw Chen and Frank J. Fabozzi
49. Valuing Inflation Derivatives 523
Jeroen Kerkhof

Valuing Commodity, Foreign Exchange, and Real Estate Products

50. The Pricing and Economics of Commodity Futures 535
Mark J. P. Anson
51. Introduction to Currency Option Pricing Models 545
Shani Shamul
52. Pricing Commercial Real Estate Derivatives 557
David Célter and Jeffrey D. Fisher

PART 5 Mathematical Tools and Techniques for Financial Modeling and Analysis

Basic Tools and Analysis

53. Cash-Flow Analysis 569
Pamela P. Drake and Frank J. Fabozzi

54. Financial Ratio Analysis 581
Pamela P. Drake and Frank J. Fabozzi
55. Mathematics of Finance 597
Pamela P. Drake and Frank J. Fabozzi
56. Calculating Investment Returns 617
Bruce J. Feibel

Statistical Tools

57. Basic Data Description for Financial Modeling and Analysis 633
Markus Hoechstetter, Svetlozar T. Rachev, and Frank J. Fabozzi
58. Elementary Statistics 645
Robert Whaley
59. Regression Analysis 669
Svetlozar T. Rachev, Stefan Mittnik, Frank J. Fabozzi, Sergio Focardi, and Teo Jasic

60. ARCH/GARCH Models in Applied Financial Econometrics 689
Robert F. Engle, Sergio M. Focardi, and Frank J. Fabozzi
61. Cointegration and Its Application in Finance 701
Bala Arshanapalli and William Nelson
62. Moving Average Models for Volatility and Correlation, and Covariance Matrices 711
Carol Alexander
63. Introduction to Stochastic Processes 725
Svetlozar T. Rachev, Christian Menn, and Frank J. Fabozzi
64. Bayesian Probability for Investors 739
Jarrod W. Wilcox

Optimization and Simulation Tools

65. Monte Carlo Simulation in Finance 751
Dessislava A. Pachamanova
66. Principles of Optimization for Portfolio Selection 763
Stegun V. Stegeman, Svetlozar T. Rachev, and Frank J. Fabozzi
67. Introduction to Stochastic Programming and Its Applications to Finance 775
Konry D. Simsek
68. Robust Portfolio Optimization 785
Dessislava A. Pachamanova, Peter N. Kolm, Frank J. Fabozzi, and Sergio M. Focardi