Contents

Preface xv

PART I A PROCEDURAL MONTE CARLO METHOD IN VBA 1

1 The Monte Carlo Method 3
   1.1 The Monte Carlo valuation method 3
   1.2 Issues with Monte Carlo 8
   1.3 Computational issues 12
   1.4 Summary 16
   1.5 Exercises 16

2 Levels of Programming Sophistication 19
   2.1 What makes a good application? 19
   2.2 A high-level design 19
   2.3 Progressing towards the ideal 21
   2.4 Summary 22
   2.5 Exercises 22

3 Procedural Programming: Level 1 25
   3.1 Designing a Monte Carlo valuation application 25
   3.2 Deficiencies of the level 1 code 35
   3.3 Summary 36
   3.4 Exercises 36

4 Validation and Error Handling: Level 2 39
   4.1 Validation and error handling 40
   4.2 Encapsulating functionality 45
   4.3 The level 2 main() 48
   4.4 Summary 50
   4.5 Exercises 51
## PART II  OBJECTS AND POLYMORPHISM  

### 5 Introducing Objects: Level 3  
5.1 Objects in VBA  
5.2 An example: The StopWatch object  
5.3 Further helpful VBA features  
5.4 Objects in the Monte Carlo application  
5.5 Summary  
5.6 Exercises  

### 6 Polymorphism and Interfaces: Level 4  
6.1 Polymorphism  
6.2 Interfaces in VBA  
6.3 Implementing a polymorphic stopwatch  
6.4 Polymorphism and the Monte Carlo application  
6.5 Assessment of the polymorphic design  
6.6 Summary  
6.7 Exercises  

### 7 A Slice-Based Monte Carlo  
7.1 The revised Monte Carlo application object  
7.2 The option object  
7.3 The evolver object  
7.4 Summary  
7.5 Exercises  

### 8 An Embryonic Factory: Level 5  
8.1 Events  
8.2 The Level 5 Monte Carlo application  
8.3 The Factory object  
8.4 Output  
8.5 Summary  
8.6 Exercises  

## PART III  USING FILES WITH VBA  

### 9 Input and Output to File in VBA  
9.1 File handling in VBA  
9.2 The TextStream and FileSystemObject objects  
9.3 Intrinsic VB language functions  
9.4 Example: Reading and writing to sequential and random files  
9.5 Summary  
9.6 Exercises  

### 10 Valuing a Book of Options  
10.1 Outline of the application  
10.2 Timings
<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>10.3</td>
<td>Summary</td>
<td>176</td>
</tr>
<tr>
<td>10.4</td>
<td>Exercises</td>
<td>176</td>
</tr>
<tr>
<td><strong>PART IV POLYMORPHIC FACTORIES IN VBA</strong></td>
<td></td>
<td>177</td>
</tr>
<tr>
<td>11</td>
<td>The VBE Object Library and a Simple Polymorphic Factory</td>
<td>179</td>
</tr>
<tr>
<td>11.1</td>
<td>Using the VBE object library</td>
<td>179</td>
</tr>
<tr>
<td>11.2</td>
<td>A simple factory illustration</td>
<td>183</td>
</tr>
<tr>
<td>11.3</td>
<td>Summary</td>
<td>190</td>
</tr>
<tr>
<td>11.4</td>
<td>Exercises</td>
<td>190</td>
</tr>
<tr>
<td>12</td>
<td>A Fully Polymorphic Factory: Level 6</td>
<td>193</td>
</tr>
<tr>
<td>12.1</td>
<td>Conceptual features</td>
<td>193</td>
</tr>
<tr>
<td>12.2</td>
<td>The polymorphic factory</td>
<td>197</td>
</tr>
<tr>
<td>12.3</td>
<td>Using the <code>Factory</code> object</td>
<td>206</td>
</tr>
<tr>
<td>12.4</td>
<td>Summary</td>
<td>208</td>
</tr>
<tr>
<td>12.5</td>
<td>Exercises</td>
<td>209</td>
</tr>
<tr>
<td>13</td>
<td>A Semi-Polymorphic Factory: Meta-Classes</td>
<td>211</td>
</tr>
<tr>
<td>13.1</td>
<td>The structure of the application</td>
<td>211</td>
</tr>
<tr>
<td>13.2</td>
<td>Meta-class objects</td>
<td>212</td>
</tr>
<tr>
<td>13.3</td>
<td>The semi-polymorphic factory</td>
<td>216</td>
</tr>
<tr>
<td>13.4</td>
<td>Summary</td>
<td>228</td>
</tr>
<tr>
<td>13.5</td>
<td>Exercises</td>
<td>228</td>
</tr>
<tr>
<td><strong>PART V PERFORMANCE ISSUES IN VBA</strong></td>
<td></td>
<td>231</td>
</tr>
<tr>
<td>14</td>
<td>Performance and Cost in VBA</td>
<td>233</td>
</tr>
<tr>
<td>14.1</td>
<td>Arithmetic operations</td>
<td>236</td>
</tr>
<tr>
<td>14.2</td>
<td>Procedure calls</td>
<td>242</td>
</tr>
<tr>
<td>14.3</td>
<td>Data typing issues</td>
<td>244</td>
</tr>
<tr>
<td>14.4</td>
<td>Summary</td>
<td>247</td>
</tr>
<tr>
<td>14.5</td>
<td>Exercises</td>
<td>248</td>
</tr>
<tr>
<td>15</td>
<td>Level and Performance</td>
<td>249</td>
</tr>
<tr>
<td>15.1</td>
<td>Variations of the level 0 application</td>
<td>249</td>
</tr>
<tr>
<td>15.2</td>
<td>Effect of level on times</td>
<td>254</td>
</tr>
<tr>
<td>15.3</td>
<td>Summary</td>
<td>258</td>
</tr>
<tr>
<td>15.4</td>
<td>Exercises</td>
<td>259</td>
</tr>
<tr>
<td>16</td>
<td>Evolution and Data Structures</td>
<td>261</td>
</tr>
<tr>
<td>16.1</td>
<td>Data structures in VBA</td>
<td>261</td>
</tr>
<tr>
<td>16.2</td>
<td>Using VBA containers</td>
<td>264</td>
</tr>
<tr>
<td>16.3</td>
<td>Numerical comparisons</td>
<td>271</td>
</tr>
<tr>
<td>16.4</td>
<td>Summary</td>
<td>277</td>
</tr>
<tr>
<td>16.5</td>
<td>Exercises</td>
<td>277</td>
</tr>
</tbody>
</table>
PART VI VARIANCE REDUCTION IN THE MONTE CARLO METHOD

17 Wiener Sample Paths and Antithetic Variates 283
   17.1 Generating Wiener sample paths 283
   17.2 Antithetic variates 283
   17.3 Numerical assessment 288
   17.4 Summary 289
   17.5 Exercises 289

18 The Wiener Process and Stratified Sampling 291
   18.1 Stratified sampling 291
   18.2 Implementing stratified sampling 298
   18.3 Numerical assessment 298
   18.4 Summary 304
   18.5 Exercises 305

19 Low-Discrepancy Sampling 307
   19.1 Low-discrepancy sampling 307
   19.2 Implementing LD sampling 310
   19.3 Numerical assessment 314
   19.4 Summary 316
   19.5 Exercises 316

20 Variance Reduction with Control Variates 317
   20.1 Control variates 317
   20.2 Examples of control variates 319
   20.3 Auxiliary model control variates 325
   20.4 Summary 331
   20.5 Exercises 331

21 Implementing Control Variates 333
   21.1 A control variate application 333
   21.2 Numerical assessment 338
   21.3 Summary 344
   21.4 Exercises 344

22 Extreme Options and Importance Sampling 345
   22.1 Importance Sampling 345
   22.2 Valuing an OTM digital option 346
   22.3 Choices for the IS density 348
   22.4 Implementing importance sampling 352
   22.5 Numerical assessment 362
   22.6 Summary 368
   22.7 Exercises 368

23 Combining Variance Reduction Methods 371
   23.1 Combining CV and IS 371
   23.2 Implementing variance reduction methods in combination 372
PART VII  THE MONTE CARLO METHOD: CONVERGENCE AND BIAS  

24  The Monte Carlo Method: Convergence and Bias  
   24.1  Reducing bias  
   24.2  Bias reduction methods  
   24.3  Bias and barrier options  
   24.4  Summary  
   24.5  Exercises  

25  Discretization Methods  
   25.1  Discretization and convergence  
   25.2  Itô–Taylor discretization schemes  
   25.3  Schemes in 1-dimension  
   25.4  Predictor–corrector simulation  
   25.5  Numerical assessment for benchmark processes  
   25.6  Summary  
   25.7  Exercises  

26  Applications to Models  
   26.1  The CIR process  
   26.2  Simulating discount factors  
   26.3  Summary  
   26.4  Exercises  

27  Valuation in the Heston Model  
   27.1  Discretizing the Heston model  
   27.2  Convergence in the Heston model  
   27.3  Option valuation in the Heston model  
   27.4  Summary  
   27.5  Exercises  

PART VIII  VALUING AMERICAN OPTIONS BY SIMULATION  

28  Valuing American and Bermudan Options  
   28.1  American options  
   28.2  Monte Carlo and American options  
   28.3  Summary  
   28.4  Exercises  

29  Estimating the Early Exercise Boundary  
   29.1  Approximating the continuation value function  
   29.2  Choices for basis functions  
