Index

-field, 475
ABS, see asset-backed security
absolute loss, 88
acceptability functional, 301
accrued interest, 230, 233
active constraint, 711
active portfolio management, 49, 358
actuarially fair, 282
adapted process, 447
adjustable robust optimization, 688
admissible policy, 677
affine
 function, 622
 independence, 702
 transformation, 290
affine policy, 684
affine term structure, 585
algebra (of sets), 430, 470
alpha, 354
ambiguity, 69
distributional, 281
American-style option, 507
anchoring, 401
annual percentage rate, 150
annuity, 177
APR, see annual percentage rate
APT, see arbitrage pricing theory
arbitrage
dynamic, 105
instantaneous, 105
opportunity, 50, 52, 125, 155, 468, 722, 725
static, 105
strategy, 104
arbitrage pricing theory, 388
arbitrageur, 52
artificial variable, 723
ask price, 51
asset, 13, 15
 exchange-traded vs. over-the-counter., 14
 liquid vs. illiquid, 14
 marketable, 20
 real vs. financial, 14
 tradable, 20
 tradable vs. nontradable, 14
 valuation vs. pricing, 102
 asset–liability management, 50, 69, 262, 263, 266, 417, 668
asset-backed security, 20, 240
attainable
 payoff, 128
 portfolio, 327
 set, 327
augmented Lagrangians, 712
average
 arithmetic, 7
 geometric, 7
backwardation, 490
balance sheet, 15
bank
 commercial, 48
 investment, 48
 retail, 48
bank discount, 234
banker’s acceptance, 239
barrier function, 706, 726
barrier option, 555
basic
 solution, 721
 variable, 721
basis point, 160, 238
price value, 257
basis risk, 494
Bayes’ theorem, 406
Bayesian estimation
  normal distribution, 408
Bayesian statistics, 404
behavioral factor, 365
Bellman
  equation, 677
  principle, 678
bequest (utility from), 79
Bermudan-style option, 507
beta
  distribution, 407
  function, 407
beta-neutral portfolio, 367, 370
bias–variance tradeoff, 356, 606
bid price, 51
bid–offer spread, see bid–ask spread, 51
big-M constraint, 633
binary option, 545
binomial distribution, 407, 527
binomial model, 112, 519
bisection method, 554
Black Monday (of 1987), 36, 563
Black’s formula, 558
Black’s model, 562, 602
Black–Litterman estimator, 385
Black–Scholes–Merton
  equation, 533
  formula, 531, 534
bond, 24, 109, 584
  callable, 44, 240
  clean price, 233
  convertible, 43, 237
  convexity, 99, 587
  coupon bearing, 25
  coupon rate, 25
  dirty price, 233
  duration, 587, 610
  face value, 25
floating-rate, 26, 188, 221, 232
duration, 254
futures, 239, 265
high yield, 233
indenture, 26, 232
inflation-indexed, 163, 232
junk, 233
maturity, 25
nominal value, 25
off-the-run, 22
on-the-run, 21
option, 593
par value, 25
price, 165
rating, 233
structured, 44
theta, 587
trading at discount, 167
trading at par, 167
trading at premium, 167
zero-coupon, 25, 83
book value, 16, 19
book-to-market ratio, 16, 365
bootstrapping (interest rates), 93, 169
box constraint, 619
box uncertainty, 687
branch-and-bound method, 624, 715
broker, 51
BSM, see Black–Scholes–Merton
bundling, 45, 119
butterfly spread, 110
buying on margin, 55
càdlàg function, 426
CAL, see capital allocation line
calibration, 128
call option, 24
canonical form, 723
capital allocation, 320
capital allocation line, 320, 323, 336, 376, 630, 631
capital asset pricing model, 191, 337, 375
capital budgeting, 641
capital gain, 22
capital market, 4, 232
capital market line, 376
capital structure, 23
caplet, 238, 518
CAPM, see capital asset pricing model
CARA, see constant absolute risk aversion
cardinality constraint, 132, 329, 634
cash flow
  matching, 262
  unbundling, 45
cash-and-carry, 483
CDF, see cumulative probability function
CDO, see collateralized debt obligation
CDS, see credit default swap
central path, 728
certainty effect, 402
ertainty equivalent, 290
certificate of deposit, 239
chain rule, 258, 447, 452
chance constraint, 284, 652
  individual, 656
  joint, 284, 656
chance-constrained optimization, 656
change of measure, 541
cheapest-to-deliver bond, 239, 265
chi-square
  distribution
    noncentral, 594
    noncentral, 588, 594
CIR, see Cox–Ingersoll–Ross
clearinghouse, 35
CML, see capital market line
CMS, see swap, constant maturity
coefficient of variation, 285
collateral, 26, 36, 240
collateralized debt obligation, 241
common risk factor, 353
complementary slackness, 711, 725
complete market, 115
compounding, 150
  daily, 152
  quarterly, 150
  semiannual, 150
computational complexity, 719
concave
  optimization problem, 623
  function, 289, 340, 621, 714
  problem, 720
conditional
  distribution, 423
  expectation, 432, 540
  probability, 433
conditional value-at-risk, 304, 308, see also value-at-risk, conditional, 659
cone, 130, 643
  closed, 645
confidence interval, 404, 465
confidence level, 87, 404
conic
  combination, 645, 720
  duality, 654
  hull, 645
  optimization, 643, 728
  optimization problem, 644
consol bond, 180
constant absolute risk aversion, 294
constant relative risk aversion, 294
constraint qualification, 710
consumption–saving problem, 69, 77
contango, 489
contingent claim, 118
continuation
  region, 516
  value, 515
continuous compounding, 151
continuous relaxation, 638, 734
continuous-time stochastic process, 420
contrarian strategy, 55, 692
control variable, 76
convenience yield, 490
conversion factor, 239
convex
  combination, 289
  function, 252, 460, 620
  polyhedral, 620
  strictly, 620
hull, 638, 702
optimization problem, 622
problem, 720
set, 132, 619
convexity, 184, 301, 619
  bond, 84, 266
  correction, 219
dollar, 267
  of a bond, 185
cornering, 239
corporate finance, 23
correlation, 96
  instantaneous, 461
correlation risk, 19, 241, 242
cost-of-carry, 557
counterparty risk, 35
counting process, 426
coupon stripping, 45
cover cut, 642
coverage, 404
covered position, 520
Cox–Ingersoll–Ross model, 461, 588, 610
credit default swap, 233, 241
credit rating, 418, 424
credit risk, 146
cross rate, 29
cross-currency option, 559
cross-hedging, 95, 495
cross-sectional data, 421
crossover strategy, 719
CRR lattice calibration, 524
CRRA, see constant relative risk aversion
cumulative probability function, 421
currency
  base, 28
  quoted, 28
currency risk, 171
curse of dimensionality, 680
CV@R, see conditional value-at-risk
DARA, see decreasing absolute risk aversion
data-driven optimization, 687
day count, 209, 231
dealer, 51
debt restructuring, 26
debtor, 241
decision
  adapted to a filtration, 476
  nonanticipative, 476
decision problem
  multistage, 277
  static, 277
decision variable, 70, 76, 618
  semicontinuous, 633
decreasing absolute risk aversion, 294
decreasing relative risk aversion, 294
default, 307
default correlation, 241
default risk, 26, 46, 172, 233
delta, 84
delta-hedging, 532, 538, 547, 566
delta-neutral portfolio, 548, 565
deposit- vs. non-deposit taking intermediary, 48
derivative, 29
diagonal model, 353
difference equation, 418
differential (of a stochastic process), 441
differential equation, 418
digital option, 545
dimensionality, 353
discount curve, 169
discount factor, 154
    forward, 199
    subjective, 79
discounted price process, 118
discounting, 154
discrete-event stochastic process, 420, 426
discrete-time stochastic process, 420
discretization error, 445, 464
distribution
    beta, 407
    binomial, 407
    cumulative function, 534
    geometric, 436
distributional ambiguity, 694
disturbance, 76
diversification, 301
dividend, 22
    policy, 23
divisor, 61
DJIA, see Dow Jones Industrial Average
dollar duration, 255, 265
dollar-neutral portfolio, 368, 370
dominant strategy, 121
Dow Jones Industrial Average, 60
down-and-out put, 555
DP, see dynamic programming
drift, 458, 459
    coefficient, 445
    function, 457
DRRA, see decreasing relative risk aversion, see increasing relative risk aversion
dual
    cone, 647, 728
    function, 713
    norm, 648
    problem, 134, 714
    simplex algorithm, 725
    variable, 713, 726
duality, 133, 647
gap, 715, 724, 730
linear programming, 124, 133, 689, 723
    theory, 713
dualization (of a constraint), 713
duration, 84, 182, 248
    as investment horizon, 258
    analytical formula, 186
    Macauley, 183
    modified, 183
dynamic problem, 68
dynamic programming, 676
EAR, see effective annual rate
earnings per share, 17
effective annual rate, 151
efficient
    frontier, 74, 129, 130, 319, 325, 328, 332
    solution, 129, 130
efficient market hypothesis, 103, 382, 399, 423
ellipsoidal uncertainty, 687
elliptical distribution, 343
EMH, see efficient market hypothesis
epigraph, 620
epoch, 3
EPS, see earnings per share
equity, 15, 263
equity tranche, 241
equivalent martingale measure, 438, 600
ETF, see exchange-traded fund, see exchange-traded fund
Euclidean norm, 605, 632, 649
Euler discretization scheme, 464
EURIBOR, 60, 208
eurodollar, 217
    futures, 216, 265
European-style option, 507
event, 469
    family of, 470
    field of, 470
ex-dividend date, 22
excess return, 321, 353
exchange-traded fund, 50, 634
execution uncertainty, 116
exercise region, 516
expectation hypothesis, 199
expected shortfall, 300
expected utility, 401
exponential
distribution, 436
random variable, 425
factor analysis, 398
factor model, 80, 353
linear, 82
fat tail, 85
feasible
region, 618
set, 70, 618
Feynman–Kac theorem, 539, 583
field, 430, 470
generated by a partition, 472
filtration, 432, 447, 475
decision adapted to, 476
financial ratio, 16
firefly algorithm, 718
first-order immunization, 549
Fisher’s equation, 162
fix-and-relax, 736
fixed charge, 632
fixed leg, 220
fixed-income market, 26
fixed-mix portfolio, 692
floater, 26, 188, 232
reverse, 232
floating leg, 220
floorlet, 238, 518
foreign exchange
direct quotation, 28
indirect quotation, 28
market, 27
foreign-exchange risk, 26
FOREX, see foreign exchange
forward
contract, 31, 601
curve, 197
discount factor, 212
price, 31, 482
forward contract, 193
forward rate, 580
discretely compounded, 197
forward rate agreement, 194, 209
forward risk-neutral measure, 484, 562, 601
FRA, see forward rate agreement
Frobenius product, 650
functional, 288, 299
risk, 283
vs. function, 281
fund
hedge, 50
mutual, 49
fundamental analysis, 399
fundamental factor, 365
fundamental theorem of calculus, 441
futures
eurodollar, 217
option, 559
price, 35
gain, 6, 296
additive, 120
discounted, 121
vs. profit, 7
gamma, 84
Gaussian process, 423
Gaussian quadrature, 463, 671
GBM, see geometric Brownian motion
generalized inequality, 647
generalized inverse function, 87, 306
generalized Wiener process, 443
genetic algorithm, 716
geometric Brownian motion, 88, 445, 457, 523, 531
geometric random variable, 425
geometric series, 148
Girsanov theorem, 420, 590
Glass–Steagall Act, 49
global optimization, 604
global optimum, 708
growth stock, 366
haircut, 240
Harry Markowitz, 75
heavy tail, 85
hedge tailing, 95
hedger, 51
hedging, 33, 483, 521, 581
minimum variance, 95
perfect, 94
quantity-based, 493, 501
ratio, 494, 496, 582
value-based, 501
Heston model, 462, 568, 611
Ho–Lee model, 219
holding period return, 6
homogeneous function, 337
hurdle rate, 191, 380
hyperbola, 345
hyperparameter, 409
IARA, see increasing absolute risk aversion
idiosyncratic risk, 326
factor, 353
ill-conditioned problem, 608
implied volatility, 60, 104
importance sampling, 671
inactive constraint, 712
income statement, 16
incomplete market, 115
increasing absolute risk aversion, 294, 341
increasing relative risk aversion, 294
independent increments, 427, 439, 440, 462
index
futures, 326, 368
market-value-weighted, 61
price-based, 61
tracking, 634
infinitely divisible distribution, 441
inflation, 161, 365
rate, 161
inflation risk, 18, 26, 172
information ratio, 361
initial public offering, 47
inner product, 643
for matrices, 650, 653
innovation (in a stochastic process), 423
inside quote, 54
insurance, 11
integrating factor, 589
integrator function, 448
interest rate, 421
cap, 238, 518
compounded, 147
floor, 238, 518
forward, 194
simple, 147
spot, 193
interest rate risk, 18, 26, 172
interest rate swap, 30, 220, 255, 266, 518
interior-point method, 627, 719, 728
internal rate of return, 192
interval uncertainty, 687
intrinsic value, 529
inverse problem, 553, 584
IPO, see initial public offering
IRR, see internal rate of return
irreducible variance, 607
Islamic finance, 145
Itô
isometry, 452, 589
lemma, 454, 455, 532, 582, 589, 597
process, 446
stochastic integral, 449
Jensen’s inequality, 289, 460
jump–diffusion process, 427, 440
Karush–Kuhn–Tucker conditions, 711
KKT, see Karush–Kuhn–Tucker conditions
knapsack problem, 641
kurtosis, 86, 91, 455, 467
excess, 438
L'Hôpital’s rule, 294
Lagrange multiplier, 330, 707, 726
Lagrangian function, 707
lasso regression, 608, 691
lattice calibration, 523
law of large numbers, 285
law of one price, 108, 113, 120, 517, 519
learning sample, 605
least-squares, 97, 171
   nonlinear, 603
   ordinary, 605
Lebesgue integral, 473
leverage, 16, 55
leveraged portfolio, 324
Lévy flight, 441, 718
Lévy process, 427, 440, 462
LGD, see loss given default
liability, 15
LIBOR rate, 60, 202, 208, 225, 238, 581
life insurance, 50
likelihood function, 406
limit order book, 53, 462
limit-buy order, 55
limit-sell order, 55
limited liability, 8, 23, 117
linear algebra, 117
linear combination, 118
linear matrix inequality, 653, 731
linear pricing, 165
linear program, 123
linear programming, 73, 117, 263, 300, 624, 625, 662, 719
   canonical form, 626
   relaxation, 638
   standard form, 133, 626
linear regression, 99, 353
linear scenarios, 463
linear space, 118
linker, 26, 232
liquidity, 14, 20, 116, 168
liquidity preference theory, 200
local regression, 606
local volatility, 611
log-return, see logarithmic return
logarithm (natural), 9
logarithmic return, 9
lognormal
distribution, 10, 445, 458, 459
variable, 460
long position, 31
Long Term Capital Management, 21, 65, 116
long–short portfolio, 367
longevity risk, 18
longitudinal data, 421
lookback
call, 510
option, 434
put, 510
Lorentz cone, 645
loss given default, 233
lottery, 278
low-discrepancy sequence, 463, 671
LP, see linear programming
LP relaxation, 734
LTCM, see Long Term Capital Management
Macauley duration, 248
Maclaurin series, 9
macroeconomic factor, 365
maintenance margin, 56
margin, 36, 55
   buying on, 55
   call, 36, 56, 108
   maintenance, 36
   ratio, 56
   trading, 20
marginal distribution, 428
mark to market, 36
market
capitalization, 24
complete, 119
completeness, 128
friction, 51
incomplete, 119
index, 487
maker, 51, 237
micro-structure, 69
neutral portfolio, 367
portfolio, 376
price of risk, 321, 378, 383, 398, 584, 599
primary, 47, 53
secondary, 47
Markov chain
  continuous-time, 425
discrete-time, 79, 424
Markov process, 77, 423, 430, 433
Markov property, 433
martingale, 115, 430, 436, 451, 457, 562, 597, 600
equivalent measure, 115, 128
property, 125
mathematical programming, 619
matheuristic, 736
matrix
  positive semidefinite, 624
  transposed, 71
maturity
  bond, 5
derivative, 30
maximization problem, 619
maximum likelihood, 691
MBS, see mortgage-backed security
mean reversion, 461, 588
mean squared error, 607
mean value function, 444, 460
mean–risk
  model, 73
  plane, 129
mean–variance
  efficient frontier, 74
  portfolio optimization, 70, 319, 629, 673
mean-preserving spread, 288
memoryless
  continuous distribution, 425
discrete distribution, 425
property, 436
mental accounting, 401
mergers and acquisitions, 24
metaheuristics, 716
mezzanine tranche, 241
MILP, see mixed-integer linear programming
minimum variance curve, 331
minimum variance hedging, 495
MIQP, see mixed-integer quadratic programming
mixed-integer linear programming, 624
mixed-integer quadratic programming, 624, 636
model calibration, 171, 553, 584, 603, 691, 715
model risk, 100, 107, 202, 231, 506, 568, 611, 679
model selection, 606
Modern Portfolio Theory, 75
modern portfolio theory, 279, 319, 341
moment generating function, 455
moment matching, 463, 467, 523, 672
momentum, 365, 399
momentum strategy, 55
money market, 4, 232
monotonicity, 301
Monte Carlo sampling, 444, 463, 671
mortgage-backed security, 45, 240
MPT, see modern portfolio theory
MSE, see mean squared error
multifactor model, 270
multiobjective optimization, 74
multiperiod vs. multistage, 76
multistage decision model, 277 vs. multiperiod, 277
naked position, 520
NASDAQ, 60
NAV, see net asset value
Nelder–Mead method, 702
Nelson–Siegel model, 171
net asset value, 50
net income, 16
net present value, 153, 191, 380
Newton method
  for nonlinear equations, 728
  optimization, 701
NLP, see nonlinear programming
no-arbitrage argument, 154
no-arbitrage principle, 102, 165
non-convex set, 634
non-satiation, 289
nonbasic variable, 721
noncentrality parameter, 594
nondirectional trade, 552
nondominated solution, 129, 130
nonhomogeneous equation, 592
nonlinear programming, 604, 624, 691, 700
nonparametric risk model, 93
norm
  cone, 646
  properties, 646
  self-dual, 649
normal backwardation, 490
normal distribution
  Bayesian estimation, 408
  standard, 534
notional, 209
NPV, see net present value
numeraire, 115, 118, 129, 161, 597
objective function, 618
obligor, 233
ODE, see ordinary differential equation
OLS, see least-squares, ordinary
optimal stopping, 511
optimality condition
  first-order, 700
optimization
  constrained problem, 619
  model, 70, 580, 584
  multiobjective, 129
  semi-infinite, 652
  uncertain problem, 686
  unconstrained problem, 619
  vector, 129
option
  American-style, 40
  American-style put call, 529
  Asian, 43, 45, 508
  at-the-money, 507
  average rate, 510
  average strike, 510
  barrier, 508, 566
  Bermudan-style, 45
  binary, 566
  call, 39, 106
  delta, 521, 546, 563
  European-style, 39
  European-style call, 526
  exotic, 41, 508
  gamma, 99, 547, 566
  Greeks, 546
  hedging, 417
  holder, 39
  in-the-money, 507
  intrinsic value, 507
  knock-in, 508
  knock-out, 508
  long position, 39
  lookback, 508
  maturity, 39
  out-of-the-money, 507
  own-and-out put, 508
  put, 39, 94, 106
  quanto, 559
  rainbow, 45, 508
  sensitivity, 546
  short position, 39
  theta, 550, 564
  time value, 507
  up-and-out, 566
  vanilla, 39, 41
  vanna, 565, 573
  vega, 552, 564
  writer, 39
ordinary differential equation, 586
ordinary least-squares, 353
Ornstein–Uhlenbeck process, 461, 588
orthodox statistics, 404
OTC, see over the counter
out-of-sample performance, 606
over the counter, 14, 43, 508
overnight rate, 239
panel data, 421
par yield, 222
parity relationship, 509, 517, 518
partial differential equation, 533
particle swarm optimization, 717
partition, 432, 471
passive fund, 634
passive portfolio management, 49, 358
payoff (derivative), 30
PDE, see partial differential equation
PDF, see probability density function
PE, see price to earnings
pecking order, 232
penalty function, 703
exerior, 705
interior, 706
pension capital, 148
pension fund, 148
defined-benefit, 50
defined-contribution, 50
perpetuity, 179
PMF, see probability mass function
pointed cone, 645
Poisson
process, 421, 425
compound, 427, 462
inhomogeneous, 427
random variable, 426
polyhedral cone, 645
polyhedral uncertainty, 687
polytopic uncertainty, 687
portable alpha, 370
portfolio
fully invested, 71
insurance, 563
weight, 71
positive homogeneity, 301
positive semidefinite matrix, 624
posterior distribution, 406
precision, 410
prepayment risk, 240
price to earnings, 17
pricing
vs. valuation, 30
pricing equation, 583
pricing functional, 118
linear, 120
non-negative, 124
primal problem, 134, 713
primal variable, 713
primal-dual algorithm, 726
prime rate, 146
principal component analysis, 100, 271, 398, 580, 673
prior distribution, 406
private equity, 23
probability
measure, 469
space, 468
probability density function, 421
probability mass function, 421
probability measure, 430
probability space, 430, 469
prospect theory, 402
protective put, 42
PSO, see particle swarm optimization
purchasing power, 161
put–call parity, 107, 536, 546, 558, 563
QCQP, see quadratic program, quadratically constrained
QP, see quadratic programming
quadratic program
quadratically constrained, 74
quadratic programming, 73, 300, 624, 628, 707
quadratic utility, 341
quadratically constrained quadratic programming, 624, 631
quantile, 87
quanto, 559
quantum PSO, 718
quasi-Monte Carlo
  sampling, 463
  simulation, 671
quasi-Newton method, 702
quasiconcave function, 341, 622, 629
quasiconvex function, 622
Radon–Nikodym derivative, 420
rainbow option, 681
random field, 163, 422
random variable, 5, 471
  measurable, 473
  notation, 72
random walk, 423, 441
rating agency, 233
real option, 193
recombining lattice, 463
recourse
  action, 657
  function, 658
  matrix, 658
reduced cost, 722
regime-switching model, 435
regression tree, 606
regularization, 608
reinsurance, 11
reinvestment risk, 27, 44, 46, 150, 172, 240, 581, 601
replicating portfolio, 113
repo
  agreement, 57
  market, see also repurchase agreement, 269
  rate, 240
repurchase agreement, 57, 240
reset date, 188, 232
return
  continuously compounded, 459
  gross, 6
  holding period, 6
  logarithmic, see logarithmic return
  net, 6
  rate of, 6
  total, 6
return attribution, 398
return on assets, 17, 57
return on equity, 17, 49, 57
ridge regression, 608, 691
Riemann integral, 446, 448, 473
Riemann–Stieltjes integral, 448
risk
  aversion, 287, 290, 322, 693
  coefficient of absolute aversion, 292
  coefficient of relative aversion, 293
  coherent measure, 93
  common factor, 80, 82
  counterparty, 100
  credit, 100
  currency, 100
  factor, 98
  functional, 283, 300
  inflation, 100
  interest rate, 100
  linear model, 81
  management, 11, 80
  market, 100
  measure, 80, 300, 580
    coherent, 300
  model, 80, 101
  noise trader, 116
  operational, 102
  political, 101
  pooling, 11, 46
  premium, 11, 290, 321, 332, 437, 630
    relative, 293
  regulatory, 101
  specific factor, 80, 82
  subadditive measure, 93
  symmetric measure, 84
  systemic, 49
INDEX

transfer, 11
volatility, 100
volume, 101
risk factor, 659
  common, 353
  idiosyncratic, 353
  specific, 353
  systematic, 353
risk nonlinear model, 81
risk-free
  asset, 10, 171, 296
  rate, 10, 171
  return, 10
risk-neutral
  decision maker, 73
  decision-maker, 79
  measure, 114, 438, 519, 541, 561, 562
  option pricing, 380
  probability measure, 127
ROA, see return on assets
robust counterpart, 686
robust optimization, 569
ROE, see return on equity
rolling horizon, 675
sample covariance, 352
sample mean, 352
sample path, 12, 117, 421
sample path generation, 444
sample space, 430
sampling error, 464
scalarization, 131, 347
scenario, 12, 117, 421, 473
  fan, 6
  generation, 671
  tree, 12, 463
SDP, see semidefinite programming
seasoned offering, 53
second-order cone, 646
  programming, 74, 624
securitization, 11, 20, 46, 240
security, 20
security market line, 379
self-dual cone, 647
self-financing portfolio, 539, 684
semi-infinite problem, 618
semi-infinite programming, 688
semicontinuous variable, 620, 633
semidefinite programming, 624, 653
  inequality form, 653
  standard form, 653
senior tranche, 241
sensitivity analysis, 192
separation of variables, 585
separation property, 337, 376
set
  difference, 469
  intersection, 469
  union, 469, 471
shadow price, 712
shareholder, 19
Sharpe ratio, 323, 336, 337, 356, 361, 378, 599, 622, 629
  maximization, 629
short position, 31, 94
short rate, 443
short-selling, 58
short-squeeze, 58
shortfall probability, 300
shrinkage
  estimation, 374, 382
  estimator, 356, 608
shrinking horizon, 675
sigma
  algebra, 471
  field, 471
simplex, 702
  algorithm, 626
  method, 719
  search, 702
single-index model, 353, 409, 498
skew (positive), 280
skewness, 85
slack variable, 625, 726
Slater
  condition, 710, 715
  constraint qualification, 730
sliding horizon, 675
small world PSO, 718
SML, see security market line
smooth pasting, 516
SOCP, see second-order cone
programming
sojourn time, 425, 436
solution
efficient, 130
nondominated, 130
solvent, 263
special purpose vehicle, 240
specialist, 51
specific risk factor, 353
speculator, 51
spinoff, 24
spot price, 31
spot rate curve, 163
spot–forward convergence, 194, 484
spot–forward parity, 482, 511, 557
spread option, 508
SPV, see special purpose vehicle
square-root diffusion, 461, 588, 594
square-root rule, 89, 550
St. Petersburg paradox, 287
stability
in sample, 674
out of sample, 674
stable distribution, 92
stack-and-roll, 495
standard form (in LP), 720
standard Wiener process, 438
state of the world, 117
state variable, 76, 423
static decision problem, 277
static model, 75
static problem, 68
stationarity condition, 700
stationary increments, 427, 439, 440, 462
steepest descent, 701
direction, 708
stochastic continuity, 440
stochastic differential equation, 443, 582
stochastic dominance
first-order, 311
second-order, 313
stochastic dynamic optimization, 511
stochastic dynamic programming, 676
stochastic integral, 442, 447
stochastic process, 12, 117, 163, 419, 420, 473
predictable, 173
self-similar, 89
stochastic programming, 263, 300
stochastic volatility, 568, 611
stock price, 473
stock repurchase, 24
stock share
common, 23
preferred, 23
split, 24
stock-index futures, 497
stockholder, 19
stop-buy order, 55
stop-loss order, 54
stopping time, 527, 680
Stratonovich stochastic integral, 449, 453
strike price, 39
stripping, 26, 168
strong duality, 714, 724
subadditivity, 301
sublevel set, 621
subordinated bond, 232
subprime mortgage, 46, 240
swap
accrediting, 238
amortizing, 238
basis, 238
constant maturity, 238
curve, 225
dollar duration, 258
forward start, 220
rate, 220, 237
spot start, 220
valuation, 221
swaption, 225, 238
systematic risk, 496
systematic risk factor, 353
T-bill, 26
tail expectation, 308
tail risk, 91
tailing the hedge, 219, 265, 499
tangency portfolio, 336, 376
Taylor expansion, 9, 84, 98, 291, 454
first-order, 248
second-order, 266
technical analysis, 399
tenor, 209
term structure, 248
estimation, 168
of interest rates, 163, 580
test sample, 605
TEV, see tracking error variance
time
bucket, 3
instant, 3
period, 3
time consistency, 301
time value, 4
TIPS, 232
total probability theorem, 406
trace (of a matrix), 650
tracking error variance, 635
tranching, 46, 241
transaction cost, 116, 669
transition density, 433
transition function, 418
transition probability, 424, 433
translation invariance, 301
transposition, 71
treasury
bond, 26
note, 26
Treynor–Black model, 358
triangular inequality, 646
trust region method, 702
two-fund separation theorem, 348
unbiased estimator, 356
unbounded solution, 722
unbundling, 119, 168
unbundling cash flows, 26
uncertainty set, 609, 686
unconditional distribution, 423
uniform prior, 407
up-and-out call, 566
utility
CARA, 294
CRRA, 294, 297
DARA, 294
DRRA, 294
expected, 288, 670
function, 79, 322, 341, 665, 669, 691
IARA, 294
IRRA, 294
logarithmic, 294, 296
ordinal, 290
power, 294
quadratic, 295
Von Neumann–Morgenstern, 288
value function, 677
value process, 120
discounted, 121
value stock, 366
value-at-risk, 87, 260, 303, 659
absolute, 88
conditional, 304
historical, 93
relative, 88
vanilla option, 507
variance reduction, 465
Vasicek model, 461, 588, 610
vector norm, 605
vector transposition, 71
vega, 84
VIX, 60
volatility, 84, 260, 404, 435, 458, 459
coefficient, 445
function, 457
historical, 553
implied, 553
smile, 554
stochastic, 462
surface, 554
trading, 552, 564

warrant, 43, 237
Wiener process
  correlated, 461
  generalized, 443
  standard, 438
worst-case optimization, 686

yield, 83, 155
  volatility, 260
yield-to-maturity, 145, 175, 179,
  250
YTM, see yield-to-maturity

zero, see bond, zero-coupon
zero curve, 163
zero-coupon bond, 154, 582, 590,
  601