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existing forward contracts; 2.5 PRICING FUTURES CONTRACTS; 2.6 SWAPS; 2.6.1 Introduction; 2.6.2 Interest rate swaps; 2.6.3 Commodity swaps; 2.6.4 Commodity swap valuation; 2.6.5 Commodity swaps with variable notional and price; 2.6.6 Currency swaps; 2.6.7 Equity swaps; SUMMARY; 3 Derivatives: Options and Related Strategies; 3.1 CALL OPTIONS; 3.1.1 Definition; 3.1.2 Examples; 3.1.3 Scenario analysis for the S&P 500 Index call option; 3.2 PUT OPTIONS 3.2.1 Definition 3.2.2 Examples; 3.2.3 Scenario analysis for put options; 3.3 BOUNDARY CONDITIONS FOR CALL AND PUT OPTIONS PRICES; 3.3.1 Introduction and basic notation; 3.3.2 A call option cannot be worth more than the price of the underlying asset; 3.3.3 The price of a put option cannot be higher than the present value of the strike price, K ; 3.3.4 Lower boundaries for call options on non-dividend paying stocks; 3.3.5 Lower boundaries for put options on non-dividend paying stocks; 3.4 PUT-CALL PARITY; 3.5 SWAPTIONS; 3.6 OPTIONS STRATEGIES; 3.6.1 Introduction to option strategies 3.6.2 Option spreads 3.6.3 Directional strategies using vertical spreads; 3.6.4 Risk reversal and collars; 3.6.5 Volatility strategies with puts and calls; SUMMARY; 4 Binomial Option Pricing; 4.1 ONE-PERIOD BINOMIAL TREE: REPLICATION APPROACH; 4.2 RISK-NEUTRAL VALUATION; 4.2.1 Introduction to risk-neutral valuation; 4.2.2 An alternative way to think of the option price; 4.2.3 Risk-neutral probabilities; 4.3 TWO-PERIOD BINOMIAL TREE: VALUING BACK DOWN THE TREE; 4.4 THE BINOMIAL TREE: A GENERALIZATION; 4.5 EARLY EXERCISE AND AMERICAN OPTIONS; 4.6 VOLATILITY CALIBRATION; SUMMARY

5 The Fundamentals of Option Pricing

Sommario/riassunto

The only guide focusing entirely on practical approaches to pricing and hedging derivatives One valuable lesson of the financial crisis was that derivatives and risk practitioners don't really understand the products they're dealing with. Written by a practitioner for practitioners, this book delivers the kind of knowledge and skills traders and finance professionals need to fully understand derivatives and price and hedge them effectively. Most derivatives books are written by academics and are long on theory and short on the day-to-day realities of derivatives trading. Of the few
