

1. Record Nr.	UNINA9910830708703321
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Titolo	Volatility and Correlation [[electronic resource]] : The Perfect Hedger and the Fox
Pubbl/distr/stampa	Hoboken, : Wiley, 2005
ISBN	1-118-67353-0 1-280-26910-3 9786610269105 0-470-09140-1
Edizione	[2nd ed.]
Descrizione fisica	1 online resource (866 p.)
Collana	The Wiley Finance Series
Altri autori (Persone)	RebonatoRiccardo
Disciplina	332.6323 332.64/53
Soggetti	Interest rate futures Interest rate futures - Mathematical models Mathematical models Options (Finance) - Mathematical models Options (Finance) Prices Securities Securities - Prices - Mathematical models Investment & Speculation Finance Business & Economics
Lingua di pubblicazione	Inglese
Formato	Materiale a stampa
Livello bibliografico	Monografia
Note generali	Description based upon print version of record.
Nota di contenuto	Volatility and Correlation 2(nd) Edition; Contents; Preface; 0.1 Why a Second Edition?; 0.2 What This Book Is Not About; 0.3 Structure of the Book; 0.4 The New Subtitle; Acknowledgements; I Foundations; 1 Theory and Practice of Option Modelling; 1.1 The Role of Models in Derivatives Pricing; 1.1.1 What Are Models For?; 1.1.2 The Fundamental Approach; 1.1.3 The Instrumental Approach; 1.1.4 A Conundrum (or, 'What is Vega Hedging For?'); 1.2 The Efficient Market Hypothesis and Why It Matters for Option Pricing; 1.2.1 The Three Forms of the EMH;

1.2.2 Pseudo-Arbitrageurs in Crisis
 1.2.3 Model Risk for Traders and Risk Managers
 1.2.4 The Parable of the Two Volatility Traders; 1.3 Market Practice; 1.3.1 Different Users of Derivatives Models; 1.3.2 In-Model and Out-of-Model Hedging; 1.4 The Calibration Debate; 1.4.1 Historical vs Implied Calibration; 1.4.2 The Logical Underpinning of the Implied Approach; 1.4.3 Are Derivatives Markets Informationally Efficient?; 1.4.4 Back to Calibration; 1.4.5 A Practical Recommendation; 1.5 Across-Markets Comparison of Pricing and Modelling Practices; 1.6 Using Models; 2 Option Replication; 2.1 The Bedrock of Option Pricing
 2.2 The Analytic (PDE) Approach
 2.2.1 The Assumptions; 2.2.2 The Portfolio-Replication Argument (Deterministic Volatility); 2.2.3 The Market Price of Risk with Deterministic Volatility; 2.2.4 Link with Expectations - the Feynman-Kac Theorem; 2.3 Binomial Replication; 2.3.1 First Approach - Replication Strategy; 2.3.2 Second Approach - 'Naive Expectation'; 2.3.3 Third Approach - 'Market Price of Risk'; 2.3.4 A Worked-Out Example; 2.3.5 Fourth Approach - Risk-Neutral Valuation; 2.3.6 Pseudo-Probabilities; 2.3.7 Are the Quantities (1) and (2) Really Probabilities?
 2.3.8 Introducing Relative Prices
 2.3.9 Moving to a Multi-Period Setting; 2.3.10 Fair Prices as Expectations; 2.3.11 Switching Numeraires and Relating Expectations Under Different Measures; 2.3.12 Another Worked-Out Example; 2.3.13 Relevance of the Results; 2.4 Justifying the Two-State Branching Procedure; 2.4.1 How To Recognize a Jump When You See One; 2.5 The Nature of the Transformation between Measures: Girsanov's Theorem; 2.5.1 An Intuitive Argument; 2.5.2 A Worked-Out Example; 2.6 Switching Between the PDE, the Expectation and the Binomial Replication Approaches; 3 The Building Blocks
 3.1 Introduction and Plan of the Chapter
 3.2 Definition of Market Terms; 3.3 Hedging Forward Contracts Using Spot Quantities; 3.3.1 Hedging Equity Forward Contracts; 3.3.2 Hedging Interest-Rate Forward Contracts; 3.4 Hedging Options: Volatility of Spot and Forward Processes; 3.5 The Link Between Root-Mean-Squared Volatilities and the Time-Dependence of Volatility; 3.6 Admissibility of a Series of Root-Mean-Squared Volatilities; 3.6.1 The Equity/FX Case; 3.6.2 The Interest-Rate Case; 3.7 Summary of the Definitions So Far; 3.8 Hedging an Option with a Forward-Setting Strike
 3.8.1 Why Is This Option Important? (And Why Is it Difficult to Hedge?)

Sommario/riassunto

In Volatility and Correlation 2nd edition: The Perfect Hedger and the Fox, Rebonato looks at derivatives pricing from the angle of volatility and correlation. With both practical and theoretical applications, this is a thorough update of the highly successful Volatility & Correlation - with over 80% new or fully reworked material and is a must have both for practitioners and for students. The new and updated material includes a critical examination of the 'perfect-replication' approach to derivatives pricing, with special attention given to exotic options; a t
