

CONTENTS

Preface

viii

1 FINANCIAL CLAIMS

1.1	What are financial claims?	1
1.2	Financial claims and balance sheets	2
1.3	Financial intermediation	6
1.4	Parties with financial claims and their wealth	9
1.5	The main claims held against households	11
1.6	The main claims held against governments	13
1.7	The main claims held against companies	14
1.8	The main claims held against financial intermediaries	16
1.9	Time periods and interest rates	20
1.10	Euroclaims	21
	Summary	23
	Questions	23
	Reference	24

2 SECURITIES

2.1	What are securities?	25
2.2	Zero-interest securities	26
2.3	Fixed-interest securities	32
2.4	Variable-interest securities	40
2.5	Equities or ordinary shares	43
2.6	Investment trusts	49
2.7	Share indices	51
2.8	Duration	56
	Summary	60
	Questions	61
	References	62

3 RETURNS AND PORTFOLIOS

3.1	Why are returns and portfolios related?	63
3.2	Returns and risk	64
3.3	Samples, expected values, variance and standard deviation	68
3.4	Expected returns and their risks	69
3.5	Attitudes to risk	77
3.6	Portfolio choice	80
3.7	The capital asset pricing model (CAPM)	85

3.8	Arbitrage pricing theory (APT)	93
3.9	Market efficiency	97
3.10	Term structures	103
	Summary	106
	Questions	107
	References	108
4	FORWARDS	
		109
4.1	What are forwards?	110
4.2	The parties who make forward contracts	112
4.3	Forward bid and ask prices	115
4.4	Forward prices and spot prices	119
4.5	Forward prices and expected future prices	124
4.6	Closing out with forwards	126
4.7	Examples of forwards	129
4.8	Forward rate agreements	133
4.9	Repurchase agreements	134
	Summary	135
	Questions	136
	References	
5	FUTURES	
		137
5.1	What are futures?	138
5.2	General features of futures contracts	142
5.3	Types of futures contract and their agreed values	150
5.4	Payment times and marking-to-market	155
5.5	Opportunities and risks with closing out	159
5.6	Examples of futures exchanges and futures contracts	168
5.7	Hedging with standardised contracts	172
5.8	Further uses of futures contracts	177
	Summary	178
	Questions	179
	Reference	
6	OPTIONS	
		180
6.1	What are options?	181
6.2	Call options and put options	185
6.3	American style options and European style options	186
6.4	Over-the-counter options and traded options	189
6.5	Examples of option exchanges and option contracts	200
6.6	Exotic options	202
6.7	Using a combination of options	214
6.8	Warrants	215
	Summary	216
	Questions	

7 FACTORS AFFECTING OPTION PRICES

7.1	Why are the factors that affect option prices important?	218
7.2	Call options	219
7.3	Put options	228
7.4	Futures call options	236
7.5	Futures put options	244
7.6	Changes in option prices	250
	Summary	256
	Questions	257

8 MODELS FOR ESTIMATING OPTION PRICES

8.1	Why do investors want models that estimate option prices?	258
8.2	The concept of a theoretically correct price	259
8.3	Expressing the risk-free rate as a continuously compounded rate	267
8.4	Estimating volatility	268
8.5	The Black–Scholes model and ordinary equity options	274
8.6	The Black–Scholes model and other options	283
8.7	The binomial model and ordinary equity options	287
8.8	The binomial model and other options	299
8.9	Comparing fair values and actual option prices	309
	Summary	311
	Questions	313
	References	314

9 SWAPS

9.1	What are swaps?	315
9.2	Vanilla interest rate swaps	315
9.3	Variant types of interest rate swap	321
9.4	Other types of swap	323
	Summary	327
	Questions	328

INDEX

329