

# Contents

	Preface	vii
	The parable of the bookmaker	1
<b>Chapter 1</b>	<b>Introduction</b>	3
	1.1 Expectation pricing	4
	1.2 Arbitrage pricing	7
	1.3 Expectation vs arbitrage	9
<b>Chapter 2</b>	<b>Discrete processes</b>	10
	2.1 The binomial branch model	10
	2.2 The binomial tree model	17
	2.3 Binomial representation theorem	28
	2.4 Overture to continuous models	41
<b>Chapter 3</b>	<b>Continuous processes</b>	44
	3.1 Continuous processes	45
	3.2 Stochastic calculus	51
	3.3 Itô calculus	57
	3.4 Change of measure – the C-M-G theorem	63
	3.5 Martingale representation theorem	76
	3.6 Construction strategies	80
	3.7 Black–Scholes model	83
	3.8 Black–Scholes in action	92

<b>Chapter 4</b>	<b>Pricing market securities</b>	99
	4.1 Foreign exchange	99
	4.2 Equities and dividends	106
	4.3 Bonds	112
	4.4 Market price of risk	116
	4.5 Quantos	122
<b>Chapter 5</b>	<b>Interest rates</b>	128
	5.1 The interest rate market	129
	5.2 A simple model	135
	5.3 Single-factor HJM	142
	5.4 Short-rate models	149
	5.5 Multi-factor HJM	158
	5.6 Interest rate products	163
	5.7 Multi-factor models	172
<b>Chapter 6</b>	<b>Bigger models</b>	178
	6.1 General stock model	178
	6.2 Log-normal models	181
	6.3 Multiple stock models	183
	6.4 Numeraires	189
	6.5 Foreign currency interest-rate models	193
	6.6 Arbitrage-free complete models	196
<b>Appendices</b>	A1 Further reading	201
	A2 Notation	205
	A3 Answers to exercises	209
	A4 Glossary of technical terms	216
<b>Index</b>		228