

Contents

1. Introduction	1
1.1 Bond Markets	1
1.2 Forward Curve Fitting Methods and Factor Models	3
1.3 The HJM Methodology	4
1.4 Invariant Manifolds	7
1.5 Outline	9
1.6 Remark on Notation	10
2. Stochastic Equations in Infinite Dimensions	13
2.1 Infinite Dimensional Brownian Motion	13
2.2 The Stochastic Integral	16
2.3 Fundamental Tools	19
2.3.1 Itô's Formula	19
2.3.2 The Stochastic Fubini Theorem	20
2.3.3 Girsanov's Theorem	21
2.4 Stochastic Equations	23
2.4.1 Mild, Weak and Strong Solutions	23
2.4.2 Existence and Uniqueness	26
3. Consistent State Space Processes	29
3.1 Itô Process Factor Models	29
3.2 Exponential-Polynomial Families	33
3.3 Auxiliary Results	38
3.4 The Case $BEP(1, n)$	41
3.5 The General Case $BEP(K, n)$	44
3.6 The Diffusion Case	51
3.7 Applications	54
3.7.1 The Nelson-Siegel Family	54
3.7.2 The Svensson Family	54
3.8 Conclusions	56
4. The HJM Methodology Revisited	57
4.1 Term Structure Movements	57
4.2 The Musiela Parametrization	58

4.3 Arbitrage-free Term Structure Movements	60
4.4 Contingent Claim Valuation	66
4.4.1 When Is $Z(\cdot, T)$ a True \mathbb{Q} -Martingale?	66
4.4.2 The Forward Measure	67
4.4.3 Forward LIBOR Rates	68
4.4.4 Caps	69
4.5 What Is a Model?	70
5. The Forward Curve Spaces H_w	75
5.1 Definition of H_w	75
5.2 Volatility Specification	81
5.3 The Yield Curve	83
5.4 Local State Dependent Volatility	84
5.5 Functional Dependent Volatility	87
5.6 The BGM Model	89
6. Invariant Manifolds for Stochastic Equations	95
6.1 Finite Dimensional Submanifolds in Banach Spaces	95
6.2 Invariant Manifolds	101
6.3 Proof of Theorems 6.2.1–6.2.4	103
6.4 Consistency Conditions in Local Coordinates	109
7. Consistent HJM Models	113
7.1 Consistency Problems	113
7.2 A Simple Regularity Criterion for G	115
7.3 Regular Exponential-Polynomial Families	117
7.3.1 The Nelson–Siegel Family	121
7.3.2 The Regular Svensson Family	122
7.4 Affine Term Structure	122
7.4.1 The Cox–Ingersoll–Ross (CIR) Model	124
7.4.2 The Vasicek Model	125
8. Appendix: A Summary of Conditions	127
8.1 Axioms for the Forward Curve Space	127
8.2 Conditions on the Forward Curve Movements	127
8.3 Conditions for HJM Models	128
8.4 Assumptions for Characterizing Invariant Manifolds	128
References	129
Index	133