

Subject Index

- Abnormal return(s), 255, 267, 300, 309, 310, 312, 318
- Abnormal yield to maturity, 283
- ABS (*see* Asset-backed securities)
- Absence of arbitrage opportunities, 88, 98, 104, 138, 140, 269, 346, 363, 376, 395, 431, 534
- Accrual date, 4, 6
- Accrued interest, 4, 7, 8, 16, 31, 33, 359–361, 363, 372, 569
- Act of god bond(s), 613
- Active bet(s), 307, 313, 314
- Active fixed-income portfolio management, 233–286
 - market timing, 233–240, 268
 - trading on interest-rate predictions, 233, 282
 - trading on market inefficiencies, 233, 268–280
- Active fixed-income style allocation decisions, 255
- Active manager(s), 213, 230, 282, 291, 313
- Active strategies, 240, 255, 313
- Adjustable strike cap(s), 560
- Adjustable strike floor(s), 560
- Adjustable-rate bond(s), 13
- Alpha, 300
 - analysis, 310
- Alternative investment, 266, 273, 303, 307, 308
 - convertible arbitrage, 303, 305, 308
 - fixed-income arbitrage, 266, 283
 - fixed-income strategies, 303, 305
- American option(s), 464, 482, 487, 491, 500, 502, 548
- Amortizing swap(s), 342, 343
- Anticipations, 253, 561
- APT (*see* Arbitrage pricing theory)
- Arbitrage, 367
 - absence of, 363
 - cash-and-carry (*see* Cash-and-carry arbitrage)
 - convertible (*see* Convertible arbitrage)
 - interest-rate model(s), 381, 411
 - opportunities, 43, 233, 269, 270, 283, 288, 362, 365, 367, 375
 - pricing, 222, 300, 381
 - reverse cash-and-carry (*see* Reverse cash-and-carry arbitrage)
- Arbitrage pricing theory (APT), 222, 300
- Arithmetic rate of return, 293, 314
- Ask price, 11, 14, 16, 20, 21
- Asset allocation, 266, 307, 308
- Asset price process, 426
- Asset swap, 337–339, 347
 - definition of, 337
 - margin, 334
 - pricing, 326
 - spread, 333–335
- Asset-backed securities (ABS), 607–612, 615, 616
 - credit enhancement, 607
 - market quotes, 610
 - pricing, 613, 616
- Asset–liability management, 609, 616
- At-the-money, 484
- Auction, 20
- Autocorrelation, 265
- Automobile loan(s), 4, 607–609, 612, 615
- B-cap(s), 550
- B-floor(s), 550
- B-spline(s), 108, 109
 - basis, 109
 - functions, 109
- Back-testing, 232, 265
- Backward looking, 309
- Bankers' acceptance(s), 25, 29, 33, 37
- Bankruptcy, 22, 437, 441, 447, 450, 569, 572
 - remote trust, 572
- Banks, 21, 25, 26, 28–30, 33, 85, 555, 574
- Barbell, 239, 240, 242, 282
- Barrier cap(s), 548
 - formulas, 580, 581
 - greeks, 581
 - pricing and hedging, 580
 - up-and-in, 548
 - up-and-out, 549
- Barrier floor(s), 549
 - down-and-in, 549, 581
 - down-and-out, 549
 - formulas, 581
 - greeks, 582
 - pricing and hedging, 580
- Barrier option, 579
- Basis point values (BPVs), 169, 175, 177, 180, 181
- Basis swap, 343, 346
- Benchmark, 306
 - bond, 7, 10, 18, 31, 33
 - for alternative fixed-income strategies, 303
- Bermuda Commodities Exchange, 615
- Bermudan option(s), 548, 565
- Bernoulli variables, 383
- Beta(s), 175, 223, 224, 227, 228, 232
- Beyond duration, 182–184, 186–199, 201–207
- BGM (*see* Brace–Gatarek–Musielka (1997) model)
- Biased expectations theory, 81, 86
- Bid price, 11, 333, 569
- Bid–ask spread, 11, 13, 17, 21, 31, 112, 131, 270, 273, 276, 482
- Binomial interest-rate tree model, 382
 - building a, 382
 - calibrating a, 384, 401
 - Ho and Lee (1986) model, 396, 401
- Black (1976) model, 500, 502
 - cap formula, 510
 - cap greeks, 511
 - floor formula, 510
 - floor greeks, 512
 - futures call formula, 502
 - futures call greeks, 503
 - futures put formula, 503
 - futures put greeks, 504
 - payer swaption formula, 520
 - payer swaption greeks, 522
 - receiver swaption formula, 522
 - receiver swaption greeks, 524
- Bloomberg, 6–17, 34, 96, 240, 279, 286, 333–335, 347, 353, 357, 359–362, 456, 471, 472, 502, 505–508, 515, 526, 577, 599, 611
- Bon à taux annuel normalisé (BTAN), 273
- Bon à taux fixe (BTF), 28, 37, 273
- Bond index, 213
 - funds, 213
 - return, 256, 261, 265, 266
- Bond indexing, 214, 215, 230
- Bond option(s), 502, 514, 525

- Bond picking, 233, 268, 282
- Bond portfolio performance, 296, 307
- Bond pricing, 41, 54, 142
 - five theorems of, 163
 - introduction to, 41
 - present value formula, 43
 - time-value of money, 43
- Bond relative value analysis, 268, 269
- Bond return covariance matrix, 216
 - estimation, 217
- Bond(s)
- accrual date, 6
 - accrued interest, 7, 31
 - adjustable-rate, 13
 - announcement date, 4
 - brady, 353
 - bullet, 20, 165, 373, 472
 - callable, 20, 306, 455, 459–461, 463, 464, 467–469, 491, 494, 600
 - characteristics of, 3
 - cheapest-to-deliver, 97, 174, 276, 359, 369
 - clean price, 7, 8, 33
 - CMT (*see* constant maturity Treasury bond)
 - conventional yield, 4, 7
 - convertible, 470, 471
 - corporate, 10, 21, 22, 24
 - coupon frequency, 4, 152, 169, 185
 - coupon rate, 4, 44
 - coupon type, 4
 - coupon(s), 6, 42, 83
 - credit rating(s), 438
 - credit risk of, 28, 30, 437
 - day-count type, 4
 - dirty price, 7, 34, 241
 - equivalent yield, 10
 - face value, 6, 8, 207, 442
 - federal agency, 17
 - first coupon date, 5, 6
 - fixed-coupon, 3, 16, 33–35, 41, 174, 317, 336, 338–340, 342, 351, 574
 - floating-rate, 13, 14, 60
 - full price, 8, 31
 - general characteristics, 3
 - government, 12, 21
 - gross price, 7, 8, 31
 - indexes, 213
 - inflation-indexed, 15–17, 33
 - issuance price, 5
 - issuers, 17
 - liquidity, 11, 336, 451
 - market quotes, 5, 7
 - markets, 20
 - maturity date, 3, 4, 500, 504
 - minimum amount, 6
 - municipal, 17, 18
 - nominal amount, 6
 - outstanding amount, 6
 - par amount, 6
 - par value, 373, 460
 - par yield, 54
 - perpetual, 44, 173, 177
 - principal, 3
 - putable, 459, 460
 - quoted price, 7
 - quoted spread, 10
 - quoted yield, 9
 - rating, 5, 6, 14, 16
 - redemption value, 6, 15, 27, 35, 462, 467
 - reinvestment risk, 164, 170
 - relative value, 268, 269
 - rich and cheap analysis, 129, 270
 - standard, 3
 - stripping, 12
 - total issued amount, 6
 - Treasury, 4, 5, 55, 56, 187
 - type of guarantee, 4
 - variable-rate, 13
 - yields, 47, 59, 163
 - zero-coupon, 12, 42, 96, 104, 106, 107, 133, 167, 170, 172, 178, 239, 411, 432, 433, 436, 442, 533
- Bondholder, 3, 13, 14, 21, 33, 471, 472, 478, 491, 496, 573, 574, 607, 613, 615
- Bonds by issuers, 17
- Bonds with embedded options, 459, 461, 464, 465, 494
- Bootstrapping, 96, 99, 101, 143, 147, 277
- Borrower, 3, 18, 83, 593
- Borrowing rate, 367
- Bounded barrier cap(s), 566
- Bounded barrier floor(s), 566
- Bounded cap(s), 550, 551
- Bounded floor(s), 550, 551
- Bounded polynomial functions, 109
- BPV(s) (*see* Basis point value(s))
- Brace–Gatarek–Musielà (1997) model (BGM), 500
 - calibration, 546
 - pricing of caps, 545
- Brownian motion, 388, 402, 421
 - properties of, 421
- BTAN (*see* Bon à taux annuel normalisé)
- BTF (*see* Bon à taux fixe)
- Bullet, 239
- Butterfly(s), 74, 240
 - a convex trade, 240
 - body of, 240
 - cash-and-duration neutral, 242
 - cost of carry, 246
 - fifty–fifty, 243, 244, 246, 249, 290
 - maturity-weighting, 244
 - performance of, 240, 245
 - regression-weighting, 244
 - risk measures, 248
 - spread measures, 247
 - total return measure, 245
 - wings of, 240
- Buy-and-hold strategy, 230, 235, 236, 265
- Calibration, 381, 384, 546
- Call option
 - on a coupon bond, 490
 - on a discount bond, 393, 490
 - on a zero-coupon bond, 443
- Callable (and putable) bond(s), 459
 - characteristics, 459
 - definition, 459
 - effective convexity, 468
 - effective duration, 468
 - institutional aspects, 459
 - negative convexity, 460
 - option-adjusted spread (OAS), 467
 - pricing, 460
 - uses of, 459
 - yield-to-call, 460
 - yield-to-worst, 460
- Callable range accrual swap(s), 566
- Cancelable swap(s), 551, 566
- Cap(s)
 - as portfolios of zero-coupon bond options, 514
 - definition, 508, 509
 - exercise rate, 508, 509, 514, 527
 - formula in the Black model, 510
 - greeks, 511
 - implied volatility, 514, 515
 - market quotes, 514
 - maturity, 509, 514
 - nominal amount, 502, 504, 509
 - notional, 509, 516–518, 530, 531
 - premium, 509, 510
 - pricing and hedging, 510
 - proof of the cap formula in the Black model, 534
 - reference rate, 508, 509
 - settlement frequency, 530
 - starting date, 509, 542
 - strike rate, 519
 - tenor, 561, 578
 - terminology, 508
 - uses of, 516
 - volatility, 500, 503, 510
- Capital adequacy levels, 565, 575
- Capital Asset Pricing Model (CAPM), 222, 300

- Capital gain risk, 164–166, 170, 176
 Capital reallocation, 609
 Capital risk, 234
 Caplet(s), 509
 greeks, 511, 531
 pricing, 511, 512, 535
 smile, 515
 volatility, 515, 581
 CAPM (*see* Capital Asset Pricing Model)
 Caption(s), 551
 Carry, 246
 Cash-and-carry arbitrage, 362, 367, 368, 371, 374, 375
 CAT bonds (*see* Catastrophe bonds)
 CAT swaps (*see* Catastrophe swaps)
 Catastrophe bond(s), 572, 612, 613, 615
 Catastrophe risk, 613–615
 Catastrophe swap(s), 613
 CBOT (*see* Chicago Board of Trade)
 CDS (*see* Credit default swap)
 Cell-matching, 214, 229, 230
 Central Bank, 25, 26, 33, 95, 253
 Certificate(s) of deposit (CDs), 28
 interest rate at issuance, 28
 price, 5
 yield on a money-market basis, 27, 28, 36, 37
 Change of measure, 430
 Cheapest-to-deliver bond, 97, 174, 276, 369
 Chicago Board of Trade (CBOT), 353, 355–357, 359
 Chicago Mercantile Exchange (CME), 353, 355, 356
 Cholesky factorization, 585
 Choosercap(s), 551, 552
 Chooserfloor(s), 552
 Claim, 3, 33
 Classical theories of the term structure, 63
 biased expectations theory, 81, 86
 liquidity premium theory, 81, 85, 89
 market segmentation theory, 81, 85, 95
 preferred habitat theory, 81, 89, 95
 pure expectations theory, 81, 82
 pure risk premium theory, 83–85
 Clean price, 7, 8, 33, 97
 Clearing house, 358, 370
 CLN (*see* Credit-linked notes)
 Cluster analysis, 310
 CME (*see* Chicago Mercantile Exchange)
 CMO (*see* Collateralized mortgage obligation)
 CMS (*see* Constant maturity swap)
 CMTS (*see* Constant maturity Treasury swap)
 Cointegration, 265
 Collar(s), 509–511, 514, 516–518
 Collateral, 19, 593
 pool, 599, 608, 609
 types, 607
 Collateralized mortgage, 593
 Collateralized mortgage obligation(s), 593, 597
 tranches, 597, 603
 Commercial paper(s), 25, 29, 33
 Compound interest, 47, 49
 Compound option, 446, 447
 Compounding frequency, 46, 47, 58, 170, 171, 179–182, 184–186, 201
 conventions, 46
 Concave and convex butterfly movement(s), 75
 Concavity, 74, 129
 Conduit, 25
 Consistency of dynamic models, 129
 Constant maturity swap (CMS), 325, 343
 Constant maturity Treasury bond, 13, 14
 Constant Maturity Treasury Swap (CMTS), 343
 Consumer Price Index (CPI), 15, 16, 46
 Contingent premium cap(s), 553
 Contingent premium floor(s), 553
 Continuous compounding, 47, 93
 Continuous-time model(s), 382, 383, 387, 388, 426, 490, 491
 Convergence trade(s), 268, 276, 278, 282
 Conversion factor, 174, 355, 359, 360, 370–372
 Conversion parity, 472
 Conversion ratio, 471
 Convertible arbitrage, 303, 308, 479–482, 491
 risks involved, 305
 Convertible bond(s), 470
 bond floor, 471
 conversion option, 473, 479
 conversion premium, 471, 472
 conversion ratio, 471
 conversion value, 471
 convertible arbitrage, 479, 480
 convertible price, 471
 income pickup, 471
 institutional aspects, 470
 investment value, 471, 480
 pricing, 473
 terminology, 471
 uses of, 472
 valuation, 473
 Convexity
 $\$$ convexity, 183, 184
 definition of, 183
 of a bond portfolio, 187, 197
 properties of, 185
 relative convexity, 183, 184
 Convexity adjustment, 199, 327, 344
 Corporate bond market, 22
 Corporate bond(s), 21, 22, 24, 33, 35, 256, 267, 277
 characteristics, 216
 Correlation
 between returns, 216, 230
 between the changes in the level and curvature, 253
 between the fund and the index, 216
 between the market return and the return on the value of the firm assets, 451
 between zero-coupon rate changes, 391, 411
 matrix, 70, 72, 75–78
 of rates, 447, 547
 of the forward rates changes, 547
 Correlation risk, 190
 Correlation-dependent options, 548, 575
 Corridor, 559
 Cost of carry, 246
 Coupon
 frequency, 4, 35, 55, 96, 170, 178, 180–182, 184, 186, 197, 198
 rate, 4, 6, 13, 14, 41, 44, 49
 type, 4
 Covariance, 216, 217
 Covenant, 22, 437, 446, 447
 Cox–Ingersoll–Ross (1985) model, 390
 CPI (*see* Consumer Price Index)
 Crank–Nicolson method, 587
 Credit card receivables, 607, 608, 615
 Credit default swap(s) (CDS), 567
 Credit derivatives, 548, 565
 credit default swap(s), 567
 credit spread option(s), 567, 569
 credit-linked note(s), 567, 571, 572
 total return swap(s), 566, 573
 Credit enhancement, 607, 608, 612
 forms of, 607, 608
 Credit event, 568, 607
 Credit-linked note(s) (CLN), 567, 571, 572
 Credit margin, 566
 Credit rating(s), 437, 438, 452
 Credit risk, 19
 management, 438
 models, 441
 premium, 277, 278
 Credit spread, 96, 134, 136
 Credit spread modeling, 437, 441
 Credit spread option model(s), 453
 Credit spread option(s) (CSO), 567
 strike spread, 569–571
 Credit spread term structure(s), 134, 136
 Credit zero-coupon yield curve, 96
 Creditor, 3, 22, 437, 442

- Cross-hedge risk, 190
CSO (*see* Credit spread option)
Cubic B-spline(s), 113, 115, 134, 139, 141, 273
Cubic spline(s), 331
Current yield, 49, 54, 86
Curvature factor, 74, 119, 120, 154, 394
Curve shape(s)
 decreasing, 151
 flat, 82, 94
 hump-shaped, 122, 390
 increasing, 82, 94, 118, 122, 151
 inverted, 151, 287
 U-shaped, 121, 196, 389
Curve(s)
 forward, 52, 63, 64, 66, 132
 instantaneous forward, 54
 interbank, 132, 133
 par yield, 54, 63, 64
 relative positions, 64, 66, 67
 swap, 63, 277, 279, 280, 291
 Treasury, 132, 277
 yield to maturity, 63, 349
 zero-coupon yield, 52, 53, 63, 68, 77, 78, 92–94
- Day-count
 basis, 4, 6, 14, 16, 31, 34, 96, 326, 328, 330, 331, 333, 334, 345, 363, 471, 531
 conventions, 7
 type, 4
- Debtor, 437, 452
Decay rate, 222
Default, 5, 21
 barrier, 452
 event, 568
Default-free, 41, 103, 143, 282, 388
Default premium, 22, 257, 437, 438
Default probability, 5, 440, 451, 453
Default risk, 26, 53, 97, 249, 340, 342, 370, 374, 437, 438, 444, 452, 453
Default spread, 256
Delivery month, 355
Delta, 503, 504, 512, 522, 524, 533, 581
 of a caplet, 511, 581
 of a floorlet, 512, 582
 of a payer swaption, 521
 of a receiver swaption, 524
Delta hedging, 480, 481
Delta-neutral portfolio(s), 480
Derivatives-based replication, 229
Deriving credit spread term structure(s), 136
 disjoint method(s), 136
 joint method(s), 137
- Deriving the Interbank zero-coupon rate curve, 130–134, 136
 interpolation method(s), 132
 least squares methods based on prices, 133
 least squares methods based on rates, 132
Deriving the nondefault Treasury zero-coupon yield curve, 97–113, 116–118, 120–125, 129
 bootstrapping, 96, 99
 cubic spline, 100, 102
 direct method(s), 97
 exponential spline, 103, 104, 108, 110
 indirect method(s), 103
 Nelson–Siegel, 117
 Nelson–Siegel extended, 122
Dirty price, 7, 34, 241, 288, 289
Discount bond(s), 58
 price of, 391, 396, 401, 403, 404, 407, 411, 412
Discount factor(s), 41, 42, 96, 99, 100, 108, 132, 137, 147–149, 167, 269, 280, 338, 350, 534
Discount rate, 42–44, 51, 584
Discount spread function, 137–139
Diversification, 24, 214, 215, 566
Dividend yield, 256
Dollar-weighted rate of return, 294, 295, 314
Double strike cap(s), 558
Down-and-in barrier floor(s), 549
Down-and-out barrier floor(s), 549
Duration
 δ duration, 168–170, 172
 as a neutral investment horizon, 170
 calculation of bond, 170
 level, slope and curvature, 188, 192, 197, 199
 Macaulay duration, 170, 174, 176
 modified duration, 168–170, 172
 of a bond portfolio, 169, 176
 of a perpetual bond, 173, 177
 of a zero-coupon bond, 170, 172
 of callable bonds, 468
 properties, 172, 186
 relationships, 171
Duration hedge, 339, 369
Duration/convexity hedge, 340, 369
Dynamic hedging strategies, 503, 511
Dynamic trading strategies, 308, 309, 391
- Econometric bet(s), 267
Effective convexity, 468
Effective duration, 468
Efficient market, 17
Efficient market hypothesis (EMH), 211
Eigenvalue, 72, 74, 77, 225
 of the correlation matrix, 72, 78
Embedded option(s), 3, 12, 33, 459–461, 464, 465, 467, 468, 473, 474, 481, 482, 491, 494, 601
Embedded prepayment option(s), 596
Emerging market, 566
EMH (*see* Efficient market hypothesis)
EMM (*see* Equivalent martingale measure)
Eonia (Euro overnight index average deposit rate), 30, 275, 276
Equilibrium model(s), 396
Equity market value, 443
Equity volatility, 305, 443, 456
Equivalent martingale measure (EMM), 402, 431
Estimator(s)
 factor models based, 217
 sample covariance matrix, 217, 221, 222
 shrinkage, 217, 225
EUREX (*see* European Derivatives Market)
Euribid, 30
Euribor, 130, 134, 155
European Derivatives Market (EUREX), 353, 501, 502
European option(s), 482, 483, 491, 497, 500, 502, 548
Excess return, 222, 232, 295, 296, 300, 307, 309, 312
Exchange-traded futures option(s), 500
Exotic derivatives, 548, 550, 565, 566, 575
 pricing and hedging, 565, 575
Expectations hypothesis, 81, 82
Exponential spline(s), 103, 104, 108, 110
Extended Vasicek model, 117, 195, 198, 205, 206
Extendible swap(s), 554
- Face value, 6, 36, 442, 500
Factor analysis, 261, 265
 of bond index returns, 256
Factor model(s)
 index, 301
 macro, 301
 micro, 301
 multi-index, 309
Factor models based estimator(s), 217, 225
Factor(s)
 common, 199, 214, 227
 curvature, 74, 119, 120, 123, 154, 370, 394
 level, 72, 79, 120, 154
 models, 188, 193, 195, 199, 223, 224, 341, 370, 388, 392

- PCA, 72–74
 slope, 73, 119, 120, 154, 394
- Factor-based covariance matrix, 222
- Factor-based replication, 214, 227, 229, 230
- Fannie Mae (Federal National Mortgage Association), 18, 597, 599
- Fat tails, 299
- FCS (Farm Credit System), 18
- Fed funds rate, 26
- Federal agency bond(s), 17
- Federal Reserve, 19, 26
- Feynman–Kac formula, 431
- FHLBS (Federal Home Loan Bank System), 18
- Filtration, 422, 426, 427, 430
- Financing cost, 244, 245, 248, 275, 343, 350, 367, 487, 516–518, 554, 555, 561, 564
- Finite difference methods
 Dirichlet condition, 586
 discretization scheme, 586
 explicit schemes, 587
 general presentation, 585
 grid, 586, 587
 implicit schemes, 587
 Neumann condition, 586
- Fixed-income index(es), 301
 characteristics of a good index, 301
 providers of, 302
- Fixed rate, 325, 326, 328, 509, 520, 554, 559
- Fixing, 30, 366, 559, 560
- Flattening movement(s), 74, 243, 246, 251, 287, 289
- Flexicap(s), 551, 552
- Flexifloor(s), 551, 552
- Flight-to-quality, 256
- Floating rate, 36, 325–327, 344
- Floating-rate bond(s), 13, 580
- Floating-rate note(s) (FRN), 13, 14
- Floor(s), 514
 as portfolios of zero-coupon bond options, 514
 definition, 509
 exercise rate, 581
 formula in the Black model, 510
 greeks, 511
 implied volatility, 514, 515
 market quotes, 514
 maturity, 509
 nominal amount, 553
 notional, 509, 516, 552
 premium, 509, 510, 551
 pricing and hedging, 502, 510, 580
 proof of the floor formula in the Black model, 534
 reference rate, 548, 549
 settlement frequency, 530
 starting date, 509
 strike rate, 513, 517
 tenor, 558, 561
 terminology, 508
 uses of, 516
 volatility, 513, 514
- Floorlet(s), 509, 511–515, 532, 550–552, 558, 562, 577, 578, 582, 583
- Floortion(s), 551
- Forecast, 265, 266
- Forward contract(s), 353, 362–365, 370, 536
 payoff, 364
- Forward neutral probability, 545
- Forward price, 356, 363
- Forward rate agreement(s) (FRA), 537
- Forward rate projection, 279
 method, 279, 332
- Forward rate trade(s), 278, 292
- Forward rate(s)
 as a break-even point, 53
 as a rate that can be guaranteed, 52, 364
 classical theories, 81
 continuously compounded, 54
 instantaneous, 54, 108, 111
 zero-coupon, 52
- Forward swap probability, 547
- Forward-spot parity, 362
- Forward-starting swap(s), 344, 346
- Forward trade(s), 278
- Forward yield curve, 53, 54, 63, 64
- Forward yield(s), 290
- Freddie Mac (Federal Home Loan Mortgage Corporation), 18, 597
- Frequency of coupon payments, 13
- FRNs (*see* Floating-rate notes)
- Future short-term rates, 81, 82
- Futures (contracts)
 allotment day, 355
 cash-and-carry arbitrage, 362, 367, 368
 cheapest-to-deliver bond, 276
 clearing house, 358, 370
 compared to forward contracts, 353, 366
 contract size, 506, 529
 conventions, 131
 conversion factor, 359
 cost of carry, 487
 daily price movements limits, 356
 definition, 353
 delivery day, 353
 delivery month, 355
 delivery period, 355
 euribor futures, 131, 356
 fed fund futures, 354
 grades, 369, 370
 hedging with, 368
 initial margin, 358
 interest rate futures, 501
 invoice price, 359, 360
 last trading day, 355
 leverage effect, 356, 366
 Libor futures, 354, 502, 506, 507
 maintenance margin, 358
 margin account, 358
 margin requirements, 358, 365
 market quotes, 354
 position limits, 356
 price(s), 130
 regular initial margin, 356
 repartition day, 355, 360
 reverse cash-and carry arbitrage, 362, 367
 swapnotes futures, 353
 T-bill futures, 353, 355, 356
 T-bond futures, 355, 356, 370, 501, 504, 505, 508, 537
 terminology, 354
 tick, 356
 uses of, 365
 variation margin, 358
- Futures industry association, 371
- Futures markets, 353, 359, 365, 370
- Gamma
 of a caplet, 511
 of a floorlet, 512, 582
 of a payer swaption, 522
 of a receiver swaption, 524
- Gaussian
 law, 297
 process, 253, 422
 variable, 254, 414, 421
- Gearing, 308
- Generalized least squares (GLS) program, 107, 139
- Genetic algorithm, 217
- Geometric brownian motion, 443, 451
- Geometric rate of return, 294
- Gilts, 35
- Ginnie Mae (Government National Mortgage Association), 597
- Girsanov's theorem, 430, 431, 435
- Government bond(s), 12, 13, 21, 22
- Grantor trust, 608, 609
- Heath–Jarrow–Morton (1992) model, 54
- Hedge fund(s), 283, 296, 303, 304
 index(es), 303, 305
 index providers, 303
- Hedge ratio, 174, 339, 369
- Hedging

- Hedging (*Continued*)
 a bond position, 175
 duration hedge, 351
 duration/convexity hedge, 339, 340
 hedge in a three-factor model, 195
 interest-rate risk using bonds, 174, 199
 interest-rate risk using futures, 368
 interest-rate risk using swaps, 339
 of a bond portfolio, 173, 174
 using a one-order Taylor expansion, 167, 339
 using a second-order Taylor expansion, 182
 using BPV, 175
 with a three-factor model, 195, 341, 370
 with the Nelson–Siegel model, 195, 352
 with the Svensson model, 195
- Hedging asset(s), 173, 174, 187–189
 Hedging strategy, 76, 189, 191, 552, 561
 Heteroscedastic, 106, 153
 High credit quality, 571
 High-yield
 bond index(es), 256, 267, 307, 309
 bond(s), 215, 310
 Hit ratio(s), 265, 266
 HJM (*see* Heath–Jarrow–Morton model)
 Ho and Lee (1986) model, 396
 calibrating the tree, 401
 limits of, 401
 perturbation functions, 534
 recombining tree, 397, 399
 risk-neutral probability, 398, 534
 Home equity loans, 607, 608, 615
 Homoscedastic, 105, 106, 152–154
 Hong-Kong Futures Exchange, 353
 HSBC Fixed-Income Strategy, 34, 286, 577
 HSBV (*see* HSBC Fixed-Income Strategy)
 Hull and White (1990) model, 404
 call on coupon bond, 490, 499
 call on zero-coupon bond, 499
 cap price, 539
 floor price, 539
 forward option price on Libor, 537
 forward option price on T-bond, 536
 futures option price on Libor, 538
 futures option price on T-bond, 537
 swaption price, 540
 Hull and White trinomial lattice, 413
 ascending scheme, 415
 calibrating the lattice, 416
 descending scheme, 415
 discretizing the short rate, 413
 normal scheme, 414
 option pricing, 419
 Hump-shaped curve(s), 121, 122, 196
- IAB (*see* Index amortizing bond)
 IAS (*see* Index amortizing swap)
 Illiquidity, 97, 276
 Implied repo rate, 361, 362, 368
 Implied volatility, 257, 453, 464, 515, 526
 In-the-money, 484
 Incremental fixed swap(s), 554, 578, 579
 Independent increments, 421
 Index
 bond, 12, 15
 corporate bond, 267, 307, 309
 high-yield bond, 255, 257
 mortgage-backed securities, 307, 309
 replication, 214
 returns, 213, 216, 223, 230
 Treasury bond, 307, 309, 312, 313, 318
 Index amortizing bond(s) (IAB), 555
 amortization rate, 556
 amortization schedule, 556
 base case, 556
 cleanup call, 556
 grace period, 556
 Index amortizing swap(s) (IAS), 555
 Index-linked catastrophe derivatives, 613
 Inflation rate, 15, 46
 Inflation-indexed bond(s), 12, 15–17, 33
 Inflation-linked swap(s), 344, 346
 Instantaneous forward rate, 54, 63, 96, 108, 111, 118
 Instantaneous probability of default, 448, 452, 453
 Insurance companies, 13, 17, 85, 555, 574
 Insurer-specific catastrophe bonds, 613
 Integer programming problem, 217
 Intensity-based model(s), 441, 452
 Interbank curve, 132, 133
 Interbank deposit(s), 25, 30, 33
 Interest calculation(s), 3, 4, 326
 annual compounding frequency, 170
 continuous compounding frequency, 47
 semi-annual compounding frequency, 170, 171
 Interest rates
 are affected by mean-reversion effects, 68, 69
 are not negative, 68
 changes are not perfectly correlated, 70
 correlation of, 447
 Interest-rate modeling, 500
 affine class, 389
 arbitrage models, 396
 Brace–Gatarek–Musielka (1997) model, 500, 541, 543, 546
 continuous-time model(s), 490, 491
- Cox–Ingersoll–Ross (1985) model, 490
 equilibrium model(s), 222
 good model, 596
 Heath–Jarrow–Morton (1992) model, 500, 541, 545
 Ho and Lee (1986) model, 396, 397
 Hull and White (1990) model, 404, 498
 Jamshidian (1997) model, 536, 541, 542, 547
 market model(s), 381, 500, 528, 541
 Merton (1973) model, 388–390
 multifactor model(s), 224, 312, 392, 395
 one-factor model(s), 388, 406
 Ornstein–Uhlenbeck process, 69, 389, 404
 single-factor model(s), 382, 388, 391, 393, 406
 Vasicek (1977) model, 388, 389
- Interest-rate risk
 beyond duration, 182–201
 dynamic hedging, 503, 511
- Interest-rate tree
 binomial, 382–385
 building an, 382
 calibration, 395
 Ho and Lee’s binomial lattice, 396
 Hull and White trinomial lattice, 413
 trinomial, 413
- Interim coupon, 361
 Internal rate of return (IRR), 50
 International swap dealer association (ISDA), 325, 567
- Interpolation
 cubic, 100, 102, 103
 linear, 100, 101, 132
 log-linear, 132
- Inverse floater, 14, 36
 Investment environment, 255
 Investment grade, 256
 bonds, 257, 261, 438
 Investment strategies, 211, 266, 283, 307, 318
 Invoice price, 359, 360
 IO(s) (Interest only), 597, 603
 IRR (*see* Internal rate of return)
 ISDA (*see* International swap dealer association)
 Issuer
 bond, 3
 name, 3
 type, 3
- Itô’s lemma, 402, 427–429, 432, 435
 Itô’s process(es), 429, 430
 properties of, 430

- James–Stein estimator, 223
Jamshidian (1997) model, 381, 536, 541, 542, 547
Jensen's inequality, 428
JP Morgan, 21, 97, 218, 303
Junk bond(s), 438
- Knockout option, 391
Knot point(s), 109
 optimal choice of, 113
Kurtosis, 296–298
- Ladder, 240, 250
 hedged against a slope movement, 250, 251
Lattice, 396, 403, 404
Lehman Brothers, 213, 214, 229, 256, 266, 267, 303, 306
Lender, 3, 31, 593
Lending rate, 367
Level factor, 72, 79, 120, 154, 394
Level, slope and curvature
 combinations of, 238
 δ urations, 248, 249, 276, 341, 342, 350
 factors, 188, 341, 370
Leverage effect, 356
Leverage factor, 308
Leverage ratio, 447
Libid, 30, 580
Libor, 325–328, 330–338, 340, 342–351, 501, 502, 505–509, 512–514, 516–521, 523, 527, 530–540, 545
Libor-in-arrears swap(s), 344, 345
LIFFE (*see* London International Financial Futures Exchange)
Linear interpolation, 15, 100, 101, 132, 147, 148
Liquidity premium theory, 81, 85, 89
Liquidity risk, 276
Loan pool, 599, 600, 609, 612
London International Financial Futures Exchange (LIFFE), 353, 501
Long position, 31, 271, 353, 368, 501
Long-term investors, 13
- Macaulay duration, 170, 174, 176, 218, 239, 240
Marché à Terme International de France (MATIF), 353, 501
Margin requirement(s), 358, 365, 368
Marked-to market cap(s), 557
Market model(s), 223, 528, 541
 caps, 528, 547
 swaptions, 547
Market-neutral strategy, 255, 267
Market price of risk, 451
Market segmentation theory, 81, 85, 95
Market timing, 233–253, 255–257, 261, 265–267
Markov
 process, 426
 property, 403, 426
 state variable, 403
Markovian model(s), 403
Martingale, 399, 422–425
 approach, 411, 434, 435
Mathematics of discounting, 43
Maturity date, 4, 41, 327, 344, 346
MBS (*see* Mortgage-backed securities)
Mean, 79, 271, 289
Mean reversion, 69, 70
Measure of risk, 296, 298, 299
Measure of risk-adjusted return, 296
Merrill Lynch, 302, 303
Merton (1973) model, 389
Merton (1974) model, 443
 general principles, 442
 implementation, 443
 term structure of credit spreads, 444
Mezzanine class, 607
Middle class, 607
Minimization program, 104, 105, 110, 113, 117, 121–123, 125, 137
Modeling credit spreads
 intensity-based models, 441
 Merton (1974) model, 442
 reduced-form model(s), 448
 structural model(s), 442
 subsequent model(s), 446
Modeling the credit spreads dynamics (*see* Modeling credit spreads)
Modeling the yield curve dynamics (*see* Interest-rate modeling)
Momentum cap(s), 560
Momentum floor(s), 560
Monetary fund, 275
Money-market instrument(s)
 bankers' acceptance(s), 25, 29
 certificate(s) of deposit, 28
 commercial paper(s), 29
 interbank deposit(s), 30
 interest calculation(s), 30
 T-bills, 26
Money supply, 26, 257
Monte Carlo, 465, 565
Monte Carlo simulation(s), 583
 application to fixed-income securities, 584
 generating asset paths, 584
 generating multidimensional processes, 584
 principle, 583
Montreal Stock Exchange Futures, 353
Moody's, 5, 6, 19, 96, 438, 439, 450, 455, 611
Mortality table, 449
Mortgage(s)
 adjustable-rate, 595
 agency residential, 593
 commercial, 593
 graduated payment, 595
 growing equity, 595
 residential, 593, 596
 tiered-payment, 595
Mortgage-backed securities (MBS)
 amortization mechanism, 593
 collateralized mortgage obligations, 597
 embedded prepayment option, 596
 market quotes, 598
 mortgage pass-through securities, 593, 603
 prepayment feature, 596
 pricing, 600
 stripped mortgage-backed securities, 593, 597
 weighted average life (WAL), 598, 599
Mortgagee, 593
Mortgage pass-through securities, 597, 603
Mortgage pool, 596–598, 600, 601, 603–606
Mortgage risk, 597
Mortgage yield, 307
Mortgagor, 593, 596, 600
Moving average cap(s), 557
 window period(s), 557
Moving average floor(s), 557
Multicollinearity, 109
Multifactor HJM model, 405
Multifactor model(s), 224, 392
 shortcomings of, 395
Multiple-index implicit factor model, 223
Multivariate linear model(s), 265
Municipal bond(s), 17
- Naive strategies, 236, 282
NAV (*see* Net asset value)
N-cap(s), 558, 578
N-floor(s), 558, 578
Negative amortization, 595
Negative convexity, 460
Nelson and Siegel model, 118–120, 122, 341, 350
Nelson and Siegel Extended model, 122, 123, 204, 205
Net asset value (NAV), 275
Net present value (NPV), 279
Newton's algorithm, 117, 155
Newton's three-point method, 111

- Nominal rate(s), 46
 Nonrecombining tree, 382, 403
 Nonstationarity, 191
 NPV (*see* Net present value)
 Numerical method(s), 395, 565, 575
- OAS (*see* Option-adjusted spread)
 OAT (*see* Obligation assimilable du Trésor)
 OATi, 15, 16
 Obligation assimilable du Trésor (OAT), 7, 273
 Off-the-run, 17, 18, 97, 277
 On-the-run, 17, 20, 97
 One-factor HJM model, 403, 406
 One-factor market model, 223
 One-factor model(s), 388, 406
 One-order Taylor expansion, 167
 Operational risk, 276
 Optimal exercise policy, 255
 Option-adjusted spread (OAS), 467, 468
 Option pricing, 419
 Option(s) on bonds, 488
 call option, 473, 482, 484, 486
 covered strategies, 483, 485
 definition, 482
 expiration date, 482, 483, 485
 naked strategies, 483
 option premium, 482
 option price, 482, 487
 pricing, 487
 put–call parity, 482
 put option, 482, 485, 486
 strike price, 482–484, 487
 uses of, 483, 536
 Option(s) on forward contracts
 call option on a Libor forward contract, 537
 call option on a T-bond forward contract, 536
 Option(s) on futures, 500
 call option on a Libor futures contract, 502
 call option on a T-bond futures contract, 501, 502
 futures call formula, 502
 futures call greeks, 503
 futures put formula, 503
 futures put greeks, 504
 market quotes, 505
 pricing and hedging, 502
 trading unit, 500
 uses of, 508
 Ordinary least squares (OLS) program, 105, 107, 196
 Originator, 565, 567, 573, 575
 Ornstein–Uhlenbeck process, 69, 389, 404
 Out-of-sample testing, 232, 265
 Out-of-the-money, 296, 451, 484, 485
 Overliquidity, 97, 276
 Over the counter, 30, 353, 370
 Owner trust, 608, 609
- Par asset swap, 337
 Par value, 43, 373, 460
 Par yield, 54, 93
 Parallel movement(s), 72, 193, 246, 289
 Parallel shift(s), 14, 71, 120, 173, 175, 180, 182, 199, 240, 249
 Parametrization of the discount function as a spline function, 104, 117, 129, 138, 139
 Parametrization of the zero-coupon curve as a function of different parameters, 116
 Partial differential equation (PDE), 395
 approach, 432
 Passive bet(s), 313
 Passive fixed-income portfolio management
 derivatives-based replication, 229
 factor-based replication, 214
 replication by stratified sampling, 214
 straightforward replication, 213
 tracking-error minimization, 216
 Passive manager(s), 295, 313
 Passive strategies, 295
 Pass-through securities, 593, 597, 603
 Pasting point(s)
 localization of, 137, 139
 optimal choice of, 113
 Path-dependent options, 465, 600
 Path-independent, 403
 Payoff, 98, 238, 240, 241, 249, 308, 364
 PCA (*see* Principal Components Analysis of the yield curve)
 PDE (*see* Partial differential equation)
 Performance measurement, 300, 312
 Performance of bond indices, 257–259, 262, 263
 Perpetual bond(s), 44, 173, 177
 Pickup, 471
 Plain vanilla option(s), 527
 Plain vanilla swap(s), 325–327, 329, 330, 333, 334, 339, 342, 345, 346, 349, 350
 PO(s) (Principal only), 597, 603
 Poisson process, 448
 Polynomial spline(s), 106–108, 110, 113, 129
 Pool of loans, 600
 Predictability, 255, 261, 266
 statistical, 255
 Predictable
 process, 426, 427, 430
 returns, 255
 Predictive performance, 265
 Predictive variable, 256, 265
 Preferred habitat theory, 81, 89
 Prepayment, 596
 rate, 597, 599
 risk, 596, 597
 sources of, 596
 Prepayment model(s)
 12-year prepaid life model, 601
 constant prepayment rate (CPR) model, 601
 federal home administration (FHA) experience-based model, 601
 public securities association (PSA) experience-based model, 601
 Present value formula, 43
 Pricing, 459
 of a callable bond, 461, 463, 464
 of a forward contract written on a bond, 363
 of a forward contract written on an interest rate, 364
 of an asset swap, 510
 Black model, 580
 bond, 613
 of bond option(s), 396
 of caplet(s), 511, 512
 of cap(s), 510
 of collar(s), 511
 of floorlet(s), 512
 of floor(s), 510, 511
 of forward(s), 362, 365
 of futures, 362, 365
 of mortgage-backed securities, 600
 of swap(s), 332, 522
 Pricing error(s), 97, 391
 Pricing and hedging interest-rate exotic option(s), 565
 Principal, 3
 Principal Components Analysis of the yield curve
 correlation matrix, 76
 eigenvalue, 72
 factors, 76, 77
 percentage of explanation, 76, 78
 principal components \$durations, 195
 regrouping risk factors through a, 192
 sensitivity of zero-coupon rates, 72, 76, 77, 80
 variance-covariance matrix, 76
 Principal component's sensitivity, 225
 Probability of default, 448
 historical, 450

- implied, 450, 451, 453
 risk-adjusted, 450–453
 Probability of survival, 449
 Proxy, 167, 215, 223, 227, 256, 301, 309, 313, 318
 Pure expectations theory, 82, 83, 86, 89
 Pure risk premium theory, 81, 83–85, 89
 Put option on a discount bond, 490
 Put–call parity, 482, 483, 492, 503, 530
 Puttable (and callable) bond(s), 459
 characteristics, 459
 definition, 459
 effective convexity, 468
 effective duration, 468, 469
 institutional aspects, 459
 negative convexity, 460
 option-adjusted spread (OAS), 467
 pricing, 460
 uses of, 459
 yield-to-call, 460, 461
 yield-to-worst, 460

 Q-cap(s), 558, 559
 Q-floor(s), 558
 Qualifying interest-rate risk, 166
 Quality-of-fit, 265
 Quantity cap(s), 558

 Radon–Nikodym derivative, 435, 534
 Random walk, 421
 Range accrual swap(s), 559
 Ratchet cap(s), 560
 with margin, 560
 Ratchet floor(s), 560
 Rate of return
 arithmetic, 293
 dollar weighted, 294, 295
 geometric, 294
 time-weighted, 294
 value-weighted, 294, 295
 Rating(s), 5, 438
 agencies, 5, 19
 Real coupon, 16, 20
 Real interest rate(s), 45, 46
 Recombining tree, 399, 403
 Recovery rate, 22, 438, 441, 448–450, 452
 Redemption yield, 6
 Redundant asset(s), 391, 407, 434
 REFCO (Resolution Funding Corporation), 18
 Reflex cap(s), 561, 562, 566
 Reflex floor(s), 561, 566
 Regressor(s), 265, 309, 310
 Reinsurance market, 614
 Reinsurer, 613, 614
 Reinvestment risk, 13, 32, 83–85, 164–166, 170

 Relative pricing, 142, 396
 Relative value, 268–270, 273
 bond, 268
 Rental cap(s), 562
 Rental floor(s), 562
 Repartition date, 360, 372
 Repo, 30
 Repo rate
 general-collateral, 20
 implied, 361
 special, 20
 Residual(s), 104, 106, 112
 heteroscedastic, 106, 153
 homoscedastic, 105, 106, 152, 153
 Return measure(s), 293
 arithmetic rate of return, 293
 geometric rate of return, 294
 Return/VaR ratio, 299
 Reuters, 96, 353, 502
 Reverse cash-and-carry arbitrage, 362, 367
 Reverse repo, 30–32
 Revolving period, 609, 610
 Rho
 of a caplet, 512
 of a floorlet, 512
 of a payer swaption, 523
 of a receiver swaption, 525
 Rich and cheap
 analysis, 270
 fund, 275
 Ride, 234, 236
 Riding the yield curve, 234
 analysing the strategy, 234
 is the strategy performing well?, 235
 Risk-adjusted performance evaluation, 296
 Risk-adjusted probability (ies), 385, 448
 of default, 450
 Risk factor(s), 188, 190, 192, 296, 299
 Risk-free
 arbitrage opportunity, 269, 283
 rate, 268, 300
 Risk management, 143, 548, 552, 565, 575
 credit, 438
 Risk-neutral
 investors, 450
 probability, 398
 Risk premium, 83
 bond, 81
 credit, 277
 Risk/return analysis, 268
 Risky class, 137–140
 Risky corporate zero-coupon yield curve, 96
 Role of the Central Bank, 25
 Rolling cap(s), 562
 Rolling floor(s), 562

 Rollover, 237, 238, 286
 R-squared, 265, 308, 313

 Sallie Mae (Student Loan Marketing Association), 18
 Salomon Smith Barney, 302
 Sample covariance matrix estimators, 217
 Sampling, 214
 S&P (*see* Standard & Poor's)
 Scenario Analysis, 251–253
 with the Nelson–Siegel model, 253
 SDE (*see* Stochastic differential equation)
 Second-order Taylor expansion, 156, 157, 182, 429
 Sector breakdown, 24
 of the Euro corporate bond market, 37
 of the Japan corporate bond market, 39
 of the UK corporate bond market, 38
 of the US broad investment-grade index, 19
 of the US corporate bond market, 24
 Securitization, 571, 572, 591, 612, 614, 615
 Semihedged strategies, 249, 250
 a ladder hedged against a slope movement, 250
 Semivariance, 297
 Seniority class(es), 607, 615
 junior subordinated, 441
 senior secured, 441
 senior subordinated, 441
 senior unsecured, 441
 subordinated, 441
 Sensitivity, 168
 of the bond price, 72
 of zero-coupon rates, 80
 Settlement date, 4, 5, 8
 Severity of default, 438, 441, 452
 Sharpe ratio, 296, 297, 299, 318
 Short position, 30–32, 175, 229, 276, 501
 Short rate, 69, 388, 390, 391, 393, 394, 413, 434, 496, 542, 543
 Short sales constraint(s), 218
 Shrinkage estimator(s), 217, 225
 Simple interest, 294
 Single-factor model(s), 388
 shortcomings of, 391
 Skewness, 296, 297
 Slope, 63, 102, 103, 108
 Slope factor, 73, 119, 120, 154, 232, 249
 Slope oscillation, 72, 73, 193
 Smile
 caplet, 515
 swaption, 526
 Sonia (Sterling overnight index average deposit rate), 30
 Sortino ratio, 298, 299

- SPC (*see* Special purpose company)
- Special purpose company (SPC), 572
- Special purpose vehicle (*see* SPV)
- Specification risk, 224
- Speculation, 365, 371
with futures, 374
- Speculative grade, 5, 438
bonds, 438, 441
- Speed of return, 389, 390
- Spline(s), 106
optimal number of, 112
- Spot zero-coupon rate, 396
- Spread
short-term to long-term, 124
- Spread option(s), 563
- Spread trade(s), 276
corporate-swap, 277
swap-Treasury, 277
- SPV (*see* Special purpose vehicle)
- Square root process, 390
- Standard & Poor's, 5, 19, 438, 439, 450
- Standard deviation, 254, 271, 277, 289
of returns, 296
- State variable, 383, 393, 394, 396, 406
- Steepening movement(s), 74, 287, 291
- Steepness, 73, 236
- Stochastic differential equation(s) (SDE),
387, 389, 402, 411, 413, 425, 426
- Stochastic integral, 423
properties of, 424
- Stochastic process(es), 88, 388, 420, 421,
474, 565
- Straightforward replication, 213, 214, 230
- Strategy (ies)
barbell, 239
bond indexing, 214, 215
bullet, 239
butterfly, 240
ladder, 240
market-neutral, 255, 267
naive, 236
riding the yield curve, 234
rollover, 237
semihedged, 249
- Stratified sampling, 214, 215
vs tracking-error minimization, 230
- Strip(s), 12, 13, 269
coupon, 13
principal, 13
- Stripped mortgage-backed securities, 593,
597
IO(s), 597, 603
PO(s), 597
- Style analysis, 307–310, 312–314
- Style timer, 266, 267
- Style timing model, 266
- Subordinated class, 441, 607
- Subsidized swap(s), 563, 564
- Substitution, 281
- Super chooser(s), 552, 562
- Super chooserfloor(s), 552, 562
- Svensson model, 196
- Swap(s)
accrediting, 342
amortizing, 342, 343
basis, 343
callable range accrual, 566
cancelable, 551
CMS, 325, 343
CMT, 343
conventions, 291, 325
convexity adjustment, 327
credit default, 567
definition, 325
effective date, 326
extendible, 554
fixed leg, 326
floating leg, 327, 328
forward-starting, 344
incremental fixed, 554
inflation-linked, 344
Libor, 325, 328
Libor in arrears, 344
margin, 334
market quotes, 333
nonstandard, 327, 333, 346
notional principal, 325, 326, 328
plain vanilla, 325–327, 329
price(s), 327–331
prime, 334
range accrual, 559
rate, 333, 334, 337, 343, 346
roller coaster, 342
spread(s), 333, 334
subsidized, 563
terminology, 325
uses of, 334
yield-curve, 345
zero-coupon, 327
- Swap curve, 277
- Swap discount factor(s), 281
- Swap pricing, 326, 332
a 3-month Libor swap, 331
basic principle, 326
forward projection method, 327
zero-coupon method, 327
- Swap rate, 522, 527
bid–ask, 334
- Swap spread(s), 276, 333
- Swaption(s)
american, 521
as a coupon bond option, 525
bermudan, 521
definition, 520
european, 520
exercise rate, 520
expiry date, 520
formula in the Black model, 521
greeks of a payer swaption, 522
greeks of a receiver swaption, 524
market quotes, 526
maturity, 520
payer, 520, 521
premium, 520
pricing and hedging, 521
proof of the swaption formula in the
Black model, 535
receiver, 520, 524, 527
smile, 526
strike rate, 520
terminology, 520
uses of, 526
volatility, 526, 529
- Synthetic defaultable bond, 572
- Tactical allocation model(s), 267
- Tactical asset allocation (TAA), 255, 266
- Tactical style allocation (TSA), 233, 266,
268
- Tactical style timing, 255
- Taxonomy of rates, 49
- Taylor expansion, 167, 182, 202
- TAA (*see* Tactical asset allocation)
- T-bill price
yield on a discount basis, 27
yield on a money-market basis, 28
- T-bill(s), 26–28
- T-bond(s), 6, 239, 353, 356, 501, 502
- TEC 10, 14, 556
- Tenor, 509, 558, 561
- Term spread, 257, 261
- Term structure of interest rates
classical theories, 63–65, 81
empirical properties, 72, 87
- Theta
of a caplet, 512
of a floorlet, 512
of a payer swaption, 523
of a receiver swaption, 525
- Three-factor interest rate model(s), 195
- Tick, 356, 507
- TIFFE (*see* Tokyo International Financial
Futures Exchange)
- Time basis conventions, 46
- Time-dependent options, 548
- Time-value
of a bond, 167
of money, 43

- Time-weighted rate of return, 294, 295
- Timing bets on interest-rate level, 236
 rollover, 237
 when rates are expected to decrease, 236
 when rates are expected to increase, 237
- Timing bets on no change in the yield curve, 234
- Timing bets on specific changes in the yield curve, 238
- TIPS (Treasury Inflation Protected Securities), 20
- Tokyo International Financial Futures Exchange, 353
- Total return
 rate, 50, 237, 238, 251–253, 255
- Total return swap(s), 573
- Tracking error, 217, 220, 222
 ex-post, 222
- Tracking error minimization, 214, 308
- Trading on interest-rate predictions, 233
- Trading on market inefficiencies, 268–280
 trading across markets, 276
 trading within a given market, 269
- Tranches, 597
- Transaction costs, 213, 215, 229
- Transition matrices, 439, 450, 455
- Treasury bond(s), 3, 96, 97, 105, 113, 121, 125, 188, 270
- Treasury curve, 132, 277
- Trinomial interest-rate tree(s), 382, 413
- Trinomial lattice, 404, 405, 413, 419
- TRS (*see* Total return swap)
- Trust, 572, 607
 grantor, 608, 609
 owner, 608, 609
- Trustee, 611
- TSA (*see* Tactical style allocation)
- TVA (Tennessee Valley Authority), 18
- Two-factor HJM model, 405
- Two-factor interest rate model(s), 393
- U-shaped curve(s), 121, 196, 389
- Unsecured overnight call rate, 26, 30
- Up-and-in barrier cap(s), 548
- Up-and-out barrier cap(s), 549
- US bond market, 23, 24
- Uses of callable and putable bonds, 459
- Uses of caps, floors and collars, 516
- Uses of collars, 516
- Uses of convertible bonds, 472
- Uses of forwards and futures, 365
- Uses of futures options, 508
- Uses of options on bonds, 483
- Uses of swaps, 334
- Uses of swaptions, 297–299, 526
- Value of the firm, 441–443, 446, 451, 452
- Value-at-Risk (VaR), 297–299
- Value-weighted rate of return, 294, 295
- Vanguard's Total Bond Market Index (VBMFX), 213
- VaR (*see* Value-at-Risk)
- Variable-rate bond(s), 13
- Variance, 72
 of the short-rate changes, 391
 total variance of the yield curve, 78
- Variance-covariance matrix, 76
- Variomax, 560
- Vasicek (1977) model, 389
- Vasicek and Fong (1982) spline model, 105, 106, 110
- Vega, 503, 504, 512, 523, 525
 of a caplet, 512
 of a floorlet, 512
 of a payer swaption, 523
 of a receiver swaption, 525
- Volatility curve(s)
 decreasing, 394
 hump shape, 394
 U-shape, 394
- Volatility function(s)
 for discount bonds, 404–406
 for zero-coupon rates, 404–406
- Volatility(ties)
 as a measure of risk, 296
 bond price, 163
 historical, 216
 link with curvature, 125
 of a bond, 169
 of a discount bond, 401, 406
 of long-term rates, 89
 of returns, 215, 296
 of short-term rates, 68
 of the instantaneous forward rates, 403
 of the zero-coupon rates, 404, 405
- WAC (*see* Weighted average coupon)
- WAL (*see* Weighted average life)
- Ward's minimum variance method, 310
- Weighted average coupon (WAC), 598–600, 612
- Weighted average life (WAL), 598, 599, 610, 611, 615
- Weighted ordinary least squares (OLS) program, 107
- Yield
 current, 49, 54, 59, 84, 86
 on a discount basis, 26, 27, 36, 37, 59, 356, 370
 on a money-market basis, 27, 28, 36
 par, 54, 63, 134
 to maturity (YTM), 11, 45, 58, 97, 169, 184, 237, 351, 563
 zero-coupon, 52, 63
- Yield curve
 current, 67, 68
 forward yield curve, 53, 54
 Interbank yield curve, 96, 130
 spot yield curve, 95, 202, 417
 swap yield curve, 278, 610, 615
 Treasury yield curve, 270, 278, 469
 upward sloping, 54, 234, 235, 261, 282
 zero-coupon yield curve, 63, 68, 77, 92, 93, 96, 234, 390
- Yield curve fitting, 103, 104, 129
- Yield curve movements
 concave and convex butterfly, 75
 downward shift, 72, 73
 flattening, 73, 74
 parallel, 72
 steepening, 73, 74, 246
 twist, 73, 74
 upward shift, 72, 73
- Yield curve trades, 282
- Yield enhancement, 566
- Yield to maturity (YTM), 49, 51, 97, 165, 182, 183, 237, 340, 437, 563
 as a total return rate, 50
- YTM (*see* Yield to maturity)
- Z-score, 275
 analysis, 271, 289
 criterion, 275
- Zero-coupon bond, 12, 42, 51, 53, 58–60, 96, 98, 99, 104, 106, 107, 133, 134, 137, 142, 147, 148, 167, 170, 172, 178, 239, 432
- Zero-coupon curve, 56, 57, 63, 64, 88, 98, 101, 116, 118, 122, 125, 135, 140, 141, 146–148, 151, 153, 234, 253, 276, 286, 287, 290, 389, 412
- Parametrization of, 116
- Zero-coupon interbank yield curve, 96, 139
- Zero-coupon method, 327, 329, 331, 346
 equivalence with the forward projection method, 327
- Zero-coupon nondefault Treasury yield curve, 96
- Zero-coupon price, 42, 96, 97, 142, 330
- Zero-coupon rate
 continuously compounded, 118, 132, 138, 150, 389, 503, 504, 512, 523
 volatility, 389–391, 394
- Zero-coupon swap curve, 280

