Course Description

An introduction to the computational and mathematical techniques for practical financial applications; we will emphasize efficient algorithms. Students should be familiar with calculus, probability and linear algebra, and be comfortable with programming. MATLAB will be extremely useful. No knowledge of finance is required. The adaptive outline is (topics may be permuted, added or removed):

1. Instruments: money; bonds; stocks; options.
2. Predicting.
3. Evaluating trading systems: Sharpe ratio; MDD and Sterling ratio.
4. Optimal trading systems.
5. Entering the market.
7. Introduction to stochastic calculus.
8. Pricing (options and other derivatives).
9. The Martingale (Risk Neutral) measure and arbitrage.
12. Pricing using PDE’s.
13. The American put option.
15. Risk management and credit default prediction.
16. Data snooping and trading system design.
17. Predictive markets, market making, sequential decisions.
18. Auctions.

Learning Outcomes. Students entering this course should have a solid mathematical foundation in analysis, probability and linear algebra, in addition to a sound understanding of algorithms, data-structures and programming. This course will build from here to develop computational methods for pricing and trading of financial instruments. The student should master the concepts of arbitrage, risk and stochastic dynamics and how they combine in the computational analysis of financial instruments. The student should know and be able to apply the basic mathematical techniques used for computational finance, which would allow him/her to read and critique recent published literature in the field.

Mathematics Prerequisites: Familiarity at the level of Assignment 0 is expected (eg. MATH 1020 & 2010, MATP 4600.) Students without adequate preparation have had serious difficulty, with adverse effects on their grade.

Computing Prerequisites: Ability to program and develop algorithms in some programming language, (eg. CSCI-2300). We will not be offering “debugging help”.

Policies

Course Grade. Homeworks will be handed out roughly once every week for a total of at most 10 homeworks. The homeworks will closely follow lectures. Each homework will be worth (about) 50 points, and the homeworks will be worth a total of 500 points (50% of grade). The final exam will be in class and count for 500 points (50% of grade). **It is possible that the last homework will be due after the final exam.**

Each homework will generally consist of a few problems. Students at the 4xxx level will normally be required to do a subset of the problems and students at the 6xxx level are required to do all the problems. When you hand in your homework, make sure to indicate which level you are taking the course at.

Your final score on which your grade is based is the sum of your homework scores and your final. The 4xxx and 6xxx grades will be curved separately.

Collaboration Policy. Discussion is allowed. Copying (from anywhere other than the class notes) is not. You should write and understand all solutions yourself. Do not destroy any of your code. In the event of strange results, we may ask you to submit your code.

You are expected to treat your work with pride, and to respect the work of others. If someone else’s work is used to produce any work you will hand in to this course, to the extent that you use their results or techniques, you should: (i) indicate how this third party work was used to solve your tasks; and, (ii) acknowledge the original authors of the work in a bibliography section.

Plagiarizing someone else’s work is a serious issue. In cases of academic dishonesty, the minimum penalty will be an automatic grade of F, in addition to other institute mandated protocols.

Late Policy. Assignments are usually due one week after being handed out. Late assignments lose 20% per day (except in institute established illness or emergency). Late assignments should be turned into the TA.

Course Texts (not required).

General References