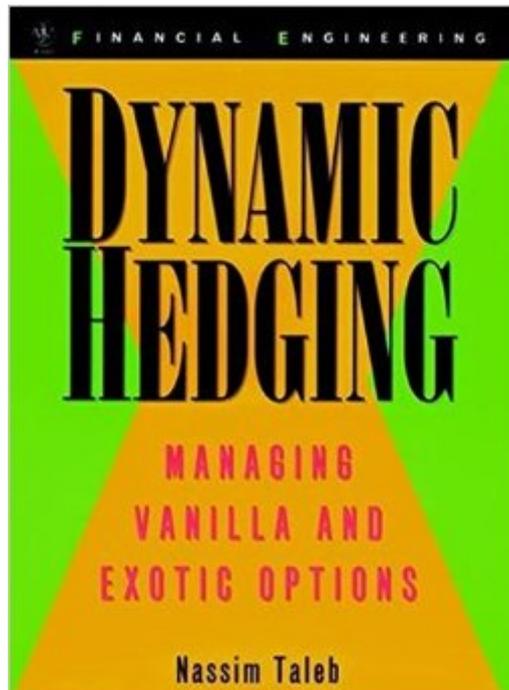


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Dynamic Hedging: Managing Vanilla And Exotic Options



Synopsis

Dynamic Hedging is the definitive source on derivatives risk. It provides a real-world methodology for managing portfolios containing any nonlinear security. It presents risks from the vantage point of the option market maker and arbitrage operator. The only book about derivatives risk written by an experienced trader with theoretical training, it remolds option theory to fit the practitioner's environment. As a larger share of market exposure cannot be properly captured by mathematical models, noted option arbitrageur Nassim Taleb uniquely covers both on-model and off-model derivatives risks. The author discusses, in plain English, vital issues, including: The generalized option, which encompasses all instruments with convex payoff, including a trader's potential bonus. The techniques for trading exotic options, including binary, barrier, multiasset, and Asian options, as well as methods to take into account the wrinkles of actual, non-bellshaped distributions. Market dynamics viewed from the practitioner's vantage point, including liquidity holes, portfolio insurance, squeezes, fat tails, volatility surface, GARCH, curve evolution, static option replication, correlation instability, Pareto-Levy, regime shifts, autocorrelation of price changes, and the severe flaws in the value at risk method. New tools to detect risks, such as higher moment analysis, topography exposure, and nonparametric techniques. The path dependence of all options hedged dynamically. Dynamic Hedging is replete with helpful tools, market anecdotes, at-a-glance risk management rules distilling years of market lore, and important definitions. The book contains modules in which the fundamental mathematics of derivatives, such as the Brownian motion, Ito's lemma, the numeraire paradox, the Girsanov change of measure, and the Feynman-Kac solution are presented in intuitive practitioner's language. Dynamic Hedging is an indispensable and definitive reference for market makers, academics, finance students, risk managers, and regulators. The definitive book on options trading and risk management "If pricing is a science and hedging is an art, Taleb is a virtuoso." -Bruno Dupire, Head of Swaps and Options Research, Paribas Capital Markets "This is not merely the best book on how options trade, it is the only book." -Stan Jonas, Managing Director, FIMAT-Society GARCH "Dynamic Hedging bridges the gap between what the best traders know and what the best scholars can prove." -William Margrabe, President, The William Margrabe Group, Inc. "The most comprehensive, insightful, intuitive work on the subject. It is instrumental for both beginning and experienced traders." - "A tour de force. That rare find, a book of great practical and theoretical value. Taleb successfully bridges the gap between the academic and the real world. Interesting, provocative, well written. Each chapter worth a fortune to any current or prospective derivatives trader." -Victor Niederhoffer, Chairman, Niederhoffer Investments

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Customer Reviews

This book provides a healthy dose of practical wisdom for options traders so that they don't blindly follow their mathematical models into oblivion. The author (Taleb) has a PhD in finance, but also has traded in the pits, he knows both theory and practice and where they diverge. Taleb focuses on hedging, which is a trader's main task when running a large portfolio of options. Instead of using a flood of equations, Taleb relies on charts, graphs, and tables to make his points. Most of the equations & heavy mathematics are relegated to the appendix, presumably because quants (or software) will price the instruments. He covers the behavior of the Greeks (delta, gamma, vega, theta, etc.) for vanilla options as well as behavior of exotic options, and delves into the practicalities of volatility, hedging at discontinuities, and various other topics. The book is very popular on trading desks, and although I found it pretty good, I didn't find it to be outstanding. Also, notably, the book does NOT cover credit & interest rate derivatives at all; hopefully this will be corrected in the next edition. So if you need a book on the practicalities of hedging a portfolio of vanilla/exotic options, then get this book. On the other hand, if you want some basic options theory, or want to focus more in pricing, or need a basic introduction, look elsewhere (perhaps to Hull's or Wilmott's books).

I would not recommend this book to build up an academic background but rather to develop an understanding and an intuition of how dynamic options are. As a hedge fund options trader this book has been very valuable to me to validate my own observations and where necessary to correct those observations, which at the time seemed correct, but which the author through market experience manages to convey the proper meaning. This book is not only factual but also provides

you with the right frame of mind to think about options. I believe you can also use the author's experience to boost your own practical experience.

Yes, this book could use an editor - there are all sorts of errors everywhere. While it makes the reading pretty tough, I think this is really one of the most useful books on options around. It's a little like Campbell/Lo/MacKinlay's book on empirical finance, but with a more experienced and real-life perspective. It's a bit refreshing after all the copycat books on option pricing that still don't contribute much beyond what Hull has written. No question, top 5 in practical finance reading.

this book has helped me in NUMEROUS interviews over the years... it is a book that always keeps me fresh... HOWEVER, thank god i have a solid background in derivatives - otherwise, the 107 errors i found (mathematics, definitions, explanations, etc) would have driven me to a point of complete confusion... NEVER have aloof traders edit your book - get someone who understands derivatives and is separated from the world of day-to-day trading... this book could have been the bible of understanding the risks in options - including exotic options... instead, it is just a good book... well done Taleb... but could you have been more slack with the editing?

Taleb's writing style is unique, to say the least. If you can get past it, though, his material is solid gold! The structure of the book is very disjointed and information dense. I typically read 4-5 pages, spent a day or two figuring out what nuance he was trying to communicate, and then was absolutely floored by the insight. I've read the book several times over and expect re-read it several more. Taleb's risk management perspective is at odds with "pricing" but right-on for "risk management". He would willingly trade a small certain loss for a possibly large gain rather than vice versa. This perspective is probably consistent with most dynamic hedgers; you expect the hedge to be a drain on income but also to save you from catastrophic events. As a non-trader implementing dynamic hedging programs, Taleb's perspective and insights have proven invaluable. I have avoided countless pitfalls into which I would otherwise have fallen. I look forward to future editions of this book!

It is nearly impossible to write a book that is both mathematically rigorous and sufficiently down to earth to be accessible to the professional trader. This book is a step in the right direction. It maintains the mathematical accuracy and depth without bogging the reader down with technical derivation of formulae. At the same time, it is written by a trader whose experience in the real

market compels him to constantly question the 'nice' assumptions used to derive these formulae. Taleb is first a market practitioner who uses models and pricing formulae to enhance trading and not the other way around. If there is a discrepancy between theory and reality he doesn't blame the markets. The book is very personal and leaves no doubt what the author's opinion is on VAR, continuous hedging and other sacred cows of modern finance. The debacle in the financial markets in 1998 and the apologetic excuses by famous traders and theoreticians indicates that there is more than a grain of truth in Taleb's skepticism. The importance of this book is that whether one agrees or disagrees with Taleb, it forces the reader to question his basic assumptions and rethink common truths. The book is unique: it is stylish, philosophical, literary, and if one may say so of a hardcore financial book - it is very entertaining.

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