



UNSW SCIENCE
School of Maths and Statistics

Course outline

**MATH5965 Discrete Time Financial
Modelling**

Term 2, 2021

Staff

Position	Name	Email	Room
Lecturer-in-charge	Dr Donna Salopek	dm.salopek@unsw.edu.au	RC-1030

Please refer to your Timetable on MyUNSW for your Lecture Tut, Lab enrolment days and times.

Administrative Contacts

Please visit the School of Mathematics and Statistics website for a range of information on School Policies, Forms and Help for Students.

For information on Courses, please go to “Current Students” and either Undergraduate and/or Postgraduate”, Course Homepage” for information on all course offerings,

The “Student Notice Board” can be located by going to the “Current Students” page; Notices are posted regularly for your information here. Please familiarise yourself with the information found in these locations. The School web page is: <https://www.maths.unsw.edu.au>

If you cannot find the answer to your queries on the web you are welcome to contact the Student Services Office directly by phone.

By email Postgraduate pg.mathsstats@unsw.edu.au

By phone: 9385 7053

Should we need to contact you, we will use your official UNSW email address of in the first instance. **It is your responsibility to regularly check your university email account. Please state your student number in all emails.**

Course Aims

The course provides an overview of the most important classes of financial contracts that are traded either on exchanges or over-the-counter between financial institutions and their clients. In particular, options of European and American style, futures contracts and forward contracts are discussed.

We introduce the basic ideas of arbitrage pricing within the set-up of a one-period model. In the next step, we analyse the valuation and hedging of European and American options and general

contingent claims in the framework of the classic Cox-Ross-Rubinstein binomial model of the stock price.

Finally, a general theory of arbitrage free discrete time models of spot and futures markets is presented. In particular, we prove the so-called Fundamental Theorems of Asset Pricing (FTAP) for a finite model of security markets. The first FTAP establishes the equivalence between the no-arbitrage property of a security market model and the existence of a martingale probability measure. The second FTAP shows that the model completeness can be characterised in terms of the uniqueness of a martingale probability measure.

Course Description

The course provides an overview of the most important classes of financial contracts that are traded either on exchanges or over-the counter between financial institutions and their clients. We discuss options of European and American style, futures contracts and forward contracts. The basic ideas of arbitrage pricing are studied in the framework of the classical Cox-Ross-Rubinstein binomial model of stock price.

Subsequently, we analyse the valuation and hedging of European and American options and general contingent claims. We also prove the so-called fundamental theorems of asset pricing for finite models of security markets which furnish a theoretical underpinning of the modern theory of derivatives pricing in stochastic models of security markets.

Assessment and Deadlines

Assessment	Weighting %	Due date if applicable
Assignment 1 (individual work provided as Moodle Quiz)	10%	Week 3
Assignment 2 (individual or group work)	15%	Week 7
Assignment 3 (individual or group work)	15%	Week 10
Final exam	60%	
	100%	Total

Late Assessment Penalty Notice

A late penalty of 5% of the awarded mark will be applied per day or part day any assessment task is submitted more than 1 hour late. (Where "late" in this context means after any extensions granted for Special Consideration or Equitable Learning Provisions.) So, for example an assessment task that was awarded 75% would be given 65% if it were 1-2 days late. Any assessment task submitted 7 or more days late will be given zero.

Note that the penalty does not apply to:

- Assessment tasks worth less than 5% of the total course mark, e.g. weekly quizzes, weekly class participation, or weekly homework tasks.
- Examinations and examination-style class tests
- Pass/Fail Assessments

Course Schedule

The course will include material taken from some of the following topics. This is should only serve as a guide as it is not an extensive list of the material to be covered and the timings are approximate. The course content is ultimately defined by the material covered in lectures.

Weeks	Topic	Reading (if applicable)
1	Introduction to Financial Derivatives	Lecture notes
2	The Markov Property; Binomial Model Pricing and Hedging; and Application to Exotic Options; Stopping Times and American Options	Lecture notes
3	State Prices and The Cox-Ross-Rubinstein Model	Lecture notes
4	Security Markets in Discrete-Time	Lecture notes
5	Random Walk; First Passage Times; Reflection Principle; Perpetual American Options	Lecture notes
7	Applications to pricing Barrier options and Lookback options	Lecture notes
8	Special topic - TBA	Lecture notes
9	Special topic - TBA	Lecture notes
10	Special topic - TBA	Lecture notes

Suggested Textbooks

- Steven E. Shreve: *Stochastic Calculus for Finance I. The Binomial Asset Pricing Model*. Springer, 2004.
- Stanley R. Pliska: *Introduction to Mathematical Finance: Discrete Time Models*. Blackwell Publishers, Oxford, 1997.
- Marek Musiela and Marek Rutkowski: *Martingale Methods in Financial Modelling*. Springer-Verlag, Berlin Heidelberg New York, Second edition, 2005.

- John C. Hull: *Options, Futures, and Other Derivatives*. Prentice-Hall, Englewood Cliffs, 1997.
- Martin W. Baxter and Andrew Rennie: *Financial Calculus. An Introduction to Derivative Pricing*. Cambridge University Press, Cambridge, 1997.
- Hans Foellmer and Alexander Schied: *Stochastic Finance: An Introduction in Discrete-Time*. De Gruyter, 2000.
- Nicholas Privault, *Lectures notes on Mathematical Finance*.

Course Learning Outcomes (CLO)

- Recognise which analysis procedure is appropriate for a given research problem.
- Apply probability theory and stochastic analysis to practical problems.
- Understand the usefulness of probability and stochastic analysis in your professional area.

Moodle

Log in to Moodle to find announcements, general information, notes, lecture slide, classroom tutorial and assessments etc.

<https://moodle.telt.unsw.edu.au>

School and UNSW Policies

The School of Mathematics and Statistics has adopted a number of policies relating to enrolment, attendance, assessment, plagiarism, cheating, special consideration etc. These are in addition to the Policies of The University of New South Wales. Individual courses may also adopt other policies in addition to or replacing some of the School ones. These will be clearly notified in the Course Initial Handout and on the Course Home Pages on the Maths Stats web site.

Students in courses run by the School of Mathematics and Statistics should be aware of the School and Course policies by reading the appropriate pages on the Maths Stats web site starting at:

<https://www.maths.unsw.edu.au/currentstudents/assessment-policies>

The School of Mathematics and Statistics will assume that all its students have read and understood the School policies on the above pages and any individual course policies on the Course Initial Handout and Course Home Page. Lack of knowledge about a policy will not be an excuse for failing to follow the procedure in it.

Academic Integrity and Plagiarism

UNSW has an ongoing commitment to fostering a culture of learning informed by academic integrity. All UNSW staff and students have a responsibility to adhere to this principle of academic integrity. Plagiarism undermines academic integrity and is not tolerated at UNSW. *Plagiarism at UNSW is defined as using the words or ideas of others and passing them off as your own.*

The **UNSW Student Code** provides a framework for the standard of conduct expected of UNSW students with respect to their academic integrity and behaviour. It outlines the primary obligations of students and directs staff and students to the Code and related procedures.

In addition, it is important that students understand that it is not permissible to buy essay/writing services from third parties as the use of such services constitutes plagiarism because it involves using the words or ideas of others and passing them off as your own. Nor is it permissible to sell copies of lecture or tutorial notes as students do not own the rights to this intellectual property.

If a student breaches the Student Code with respect to academic integrity, the University may take disciplinary action under the **Student Misconduct Procedure**.

The UNSW Student Code and the Student Misconduct Procedure can be found at:
<https://student.unsw.edu.au/plagiarism>

An online Module “[Working with Academic Integrity](https://student.unsw.edu.au/aim)” (<https://student.unsw.edu.au/aim>) is a six-lesson interactive self-paced Moodle module exploring and explaining all of these terms and placing them into your learning context. It will be the best one-hour investment you’ve ever made.

Plagiarism

Plagiarism is presenting another person's work or ideas as your own. Plagiarism is a serious breach of ethics at UNSW and is not taken lightly. So how do you avoid it? A one-minute video for an overview of how you can avoid plagiarism can be found <https://student.unsw.edu.au/plagiarism>.

Additional Support

ELISE (Enabling Library and Information Skills for Everyone)

ELISE is designed to introduce new students to studying at UNSW.

Completing the ELISE tutorial and quiz will enable you to:

- analyse topics, plan responses and organise research for academic writing and other assessment tasks

- effectively and efficiently find appropriate information sources and evaluate relevance to your needs
- use and manage information effectively to accomplish a specific purpose
- better manage your time
- understand your rights and responsibilities as a student at UNSW
- be aware of plagiarism, copyright, UNSW Student Code of Conduct and Acceptable Use of UNSW ICT Resources Policy
- be aware of the standards of behaviour expected of everyone in the UNSW community
- locate services and information about UNSW and UNSW Library

Some of these areas will be familiar to you, others will be new. Gaining a solid understanding of all the related aspects of ELISE will help you make the most of your studies at UNSW.

The *ELISE* training webpages:

<https://subjectguides.library.unsw.edu.au/elise/aboutelise>

Equitable Learning Services (ELS)

If you suffer from a chronic or ongoing illness that has, or is likely to, put you at a serious disadvantage, then you should contact the Equitable Learning Services (previously known as SEADU) who provide confidential support and advice.

They assist students:

- living with disabilities
- with long- or short-term health concerns and/or mental health issues
- who are primary carers
- from low SES backgrounds
- of diverse genders, sexes and sexualities
- from refugee and refugee-like backgrounds
- from rural and remote backgrounds
- who are the first in their family to undertake a bachelor-level degree.

Their web site is: <https://student.unsw.edu.au/els/services>

Equitable Learning Services (ELS) may determine that your condition requires special arrangements for assessment tasks. Once the School has been notified of these, we will make every effort to meet the arrangements specified by ELS.

Additionally, if you have suffered significant misadventure that affects your ability to complete the course, please contact your Lecturer-in-charge in the first instance.

Academic Skills Support and the Learning Centre

The Learning Centre offers academic support programs to all students at UNSW Australia. We assist students to develop approaches to learning that will enable them to succeed in their academic study. For further information on these programs please go to:

<http://www.lc.unsw.edu.au/services-programs>

Applications for Special Consideration for Missed Assessment

Please adhere to the Special Consideration Policy and Procedures provided on the web page below when applying for special consideration.

<https://student.unsw.edu.au/special-consideration>

Please note that the application is not considered by the Course Authority, it is considered by a centralised team of staff at the Nucleus Student Hub.

The School will contact you (via student email account) after special consideration has been granted to reschedule your missed assessment, for a *lab test or paper-based test* only.

For applications for special consideration for *assignment extensions*, please note that the new submission date and/or outcome will be communicated through the special consideration web site only, no communication will be received from the School.

For Dates on Final Term Exams and Supplementary Exams please check the “Key Dates for Exams” ahead of time to avoid booking holidays or work obligations.

<https://student.unsw.edu.au/exam-dates>

If you believe your application for Special Consideration has not been processed, you should email specialconsideration@unsw.edu.au immediately for advice.

Course Evaluation and Development (MyExperience)

Student feedback is very important to continual course improvement. This is demonstrated within the School of Mathematics and Statistics by the implementation of the UNSW online student survey *myExperience*, which allows students to evaluate their learning experiences in an anonymous way. *myExperience* survey reports are produced for each survey. They are released to staff after all student assessment results are finalised and released to students. Course convenor will use the feedback to make ongoing improvements to the course.