

Contents

Preface	xiii
A Comment on the Events of 2008	xxiii
Acknowledgments	xxv
PART ONE	
What Is a Stock?	1
CHAPTER 1	
Equity Fundamentals (Part 1): Introduction to Financial Statements	3
Introduction	3
Equity and Corporation	4
Introduction to Financial Statements	5
The Balance Sheet	6
The Income Statement	15
Statement of Cash Flows	20
Summary	24
CHAPTER 2	
Equity Fundamentals (Part 2): Financial Ratios, Valuation, and Corporate Actions	27
Introduction	27
Financial Ratios	28
Growth and Value	38
Bloomberg	39
Valuation	40
Technical Analysis	51
Corporate Actions	54
Summary	64

PART TWO**Products and Services 67****CHAPTER 3****Cash Market 69**

Introduction	69
How a Stock Exchange Functions	69
Exchange Structure	76
Order Types	81
How the Cash Trading Business Works	102
Communication	112
Purchasing a Stock in a Foreign Currency	115
Summary	121

CHAPTER 4**Equity Indices 123**

Introduction	123
Index Construction	125
What an Index Doesn't Tell Us	129
Valuation and Calculation	131
Replicating Portfolio	134
Trading an Index Portfolio	136
Index Changes	139
Index Dividend Points	142
Total Return Index Calculation	144
Multicurrency Indices	145
Equity Indices in Practice	147
International Indices	156
Summary	165

CHAPTER 5**Program Trading 167**

Introduction	167
Explanation of a Sample Trade	173
When Is Program Trading More Beneficial?	182
Portfolio Analytics	184
Transition Management	189
Principal Trades	191
Summary	201

CHAPTER 6	
Exchange-Traded Funds (ETFs)	203
Introduction	203
Trading Mechanics	205
Net Asset Value (NAV)	207
Popularity	208
Trading versus Holding	212
ETFs in Practice	214
Summary	214
 CHAPTER 7	
Forwards and Futures	217
Introduction	217
Calculation of Fair Value	219
Futures	223
Index Arbitrage	233
The Futures Roll	240
Exchange for Physical (EFP)	245
Basis Trades	254
Futures Contracts in Practice	259
Technical Comment on the Accuracy of Approximations	263
Summary	264
 CHAPTER 8	
Swaps	267
Introduction	267
Motivation for a Swap	267
A Long Equity Swap Example	269
The Swap in Detail: Definitions and Terminology	272
Calculation of Payments	277
Short Swap	279
Back-to-Back Swaps	280
Swaps as a Trading Tool	281
A Comment on Hedging	286
Swap Valuation: Accrual versus NPV	287
Currency Exposure	289
ISDA	293
Risks and Other Considerations	294
Summary	296

CHAPTER 9**Options (Part 1) 299**

Introduction	299
Definitions and Terminology	300
Payoff Structure	301
Option Values Prior to Maturity	311
Quantitative Considerations	323
The Black-Scholes Derivation	326
Types of Volatility	337
Summary	341

CHAPTER 10**Options (Part 2) 343**

Volatility Trading	343
Option Sensitivities: The “Greeks”	354
Implied Volatility Revisited	374
OTC and Exotic Options	377
Summary	383

CHAPTER 11**The Trading Floor 385**

Introduction	385
Organization of the Sales and Trading Businesses	386
Other Groups	390
Summary	404

PART THREE**Economics 405****CHAPTER 12****Macroeconomics for Trading and Sales 407**

Introduction	407
Capital Asset Pricing Model (CAPM)	408
Overview of Macroeconomics	408
The Fed	417
Moving beyond the Big Three: Other Macroeconomic	
Concepts	424
Other Variables	426

A Final Observation	428
Summary	429
CHAPTER 13	
Economic Data Releases	431
Introduction	431
Preliminary Definitions	433
Principal U.S. Economic Indicators	436
Rest of the World Economics	456
Europe	457
European Economic Statistics	462
Asia	466
The Market's Reaction Function	471
What the Market Tells Us about the Economy	476
Summary	480
APPENDIX	
Mathematical Review	481
Introduction	481
Functions	482
Compound Interest and Exponential Growth	483
Calculus	487
Random Variables, Probability, and Statistics	494
Summary	505
Notes	507
About the Author	519
Index	521