STUDENTS ARE EXPECTED TO HAVE COMPLETED
Target Audience: This course is adequate for any student in the master (she could be an Economics, 
Engineering, Matematicians, Physicist or from Business Administration bachelor).
Course Language: This course is totally taught in English.
The courses of Computer Science for Finance (First Term) and Financial Markets (First Term) should have been 
completed previously.
The exercises will be solved using a calculator and/or mathematical software.

COMPETENCES AND SKILLS THAT WILL BE ACQUIRED AND LEARNING RESULTS.
The student will learn how to price and use vanilla derivative products written on equity and commodities. This 
includes designing a hedging strategy against financial and commodity price risk using positions in forwards, futures 
options and volatility. This requires the skills to compute precisely the value of any position in derivatives at any given 
point in time as well as to foresee its dynamics over time as a response to changes in the underlying variables.

Instructors of the course:
1.- Pedro Serrano (Associate Professor University Carlos III of Madrid, PhD)
2.- Miguel Artola (Bankinter, Teaching fellow at University Carlos III of Madrid, PhD)

DESCRIPTION OF CONTENTS: PROGRAMME
The course provides a thorough grounding in the theory and practice of financial derivatives and 
financial engineering. The emphasis is on the application of derivatives pricing and hedging 
methodology to equity and commodity derivatives.
This syllabus lists and describes the topics covered in this course. In a nutshell, the course aims to 
cover the basics in derivatives theory, and to apply them to financial securities and commodity 
multas, with an introduction to recent products in the equity and volatility derivative worlds. We 
review selected exercises and case studies based on current data in order to gain a better 
understanding of their practical usage. We also implement the models numerically in Excel and e-views.

DETAILED PROGRAM OF THE COURSE

Lecture 1: Introduction to Derivatives. Forwards and futures.

1.1 Introduction to Derivatives
1.2 Mechanics of Futures Markets
1.3 Hedging Strategies with Futures
1.4 Interest Rates
1.5 Determination of Futures Prices

Lecture 2: Options and Binomial Trees

2.1 Mechanics of Options Markets
2.2 Properties of Stock Options
2.3 European and American Call and Put prices
2.4 Binomial Trees
2.5 Continuous Time Limit

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Lecture 3: Introduction to Continuous Time Stochastic Processes

3.1. The Markov Property
3.2. Wiener Processes
3.3. Ito Process
3.4. Ito’s Lemma

Lecture 4: Continuous Time Stochastic Processes

4.1 Martingale Property
4.2 Geometric Brownian Motion
4.3 The Lognormal Property


5.1 Derivation of Black-Scholes-Merton Differential equation
5.2 Black-Scholes pricing formulas
5.3 Options on stock indices, currencies, and futures
5.4 Options as Volatility Instruments
5.5 Volatility term structure and volatility smile
5.6 The VIX index and volatility derivatives

Lecture 6: The Greeks and Their Uses

6.1 Naked, Covered Positions and Stop-Loss
6.2 Delta and Delta hedging
6.3 Gamma
6.4 Vega
6.5 Theta and Rho
6.6 Trading Strategies and Risk Management

LEARNING ACTIVITIES AND METHODOLOGY

The course comprises different learning activities and methodologies:
1.- Teaching: Professor presents the main theoretical concepts using slides.
2.- Weekly problem sets in classes: students work on different problem sets based on real situations of the market. Students have to submit an individual report of the exercises every week.
3.- Programming: complementary to the teaching courses, Lectures 3 and 4 end with a program implementation of the theoretical concepts using mathematical software.

ASSESSMENT SYSTEM

Grades consist of:

- Exercise sets (40%). For any student, this mark is obtained by averaging the individual grade of each homework sets.
- A final examination (60%). It consists of a two-hour written exam. This exam comprises the usage of Excel for solving some cases and some theoretical questions related to the day-to-day classes.

IMPORTANT: Final exam consists of two parts. There is a minimum requirement of 4.0 out of 10.0 in EACH part of the final exam for passing the course.

% end-of-term-examination: 60
% of continuous assessment (assigments, laboratory, practicals...): 40

BASIC BIBLIOGRAPHY

- John Hull Options, Futures, and Other Derivatives, Pearson Prentice Hall, 2006
ADDITIONAL BIBLIOGRAPHY
- John Cochrane Asset Pricing, Princeton University Press, 2005