I sincerely appreciate the opportunity to study fixed-income derivatives! I’m leaving some final thoughts on the chapter below for personal use. Feedback is always welcomed if time permits.

Page 693 states:

The models presented in Chapter 29 for bond options … are all examples of the “two-step” procedure.

This raises the *issue*  is it always correct to value European style derivatives by using the “two-step” procedure. ***The answer is no!***

For ***nonstandard interest rate*** derivatives, it is sometimes necessary to modify the two-step procedure so that an adjustment is made to the forward value of the variable in the first step.

***What does Hull mean by two step?***

***How is “nonstandard interest rate” defined?***

- Is LIBOR nonstandard?

- What about stochastic interest rate models?

One Factor

* Hull-White
* Ho-Lee
* CIR
* Rendleman-Bartter model
* Mertons model
* Black-Derman-Toy
* Black-Karasinski
* Kalotay-Williams-Fabozzi model

Two Factor

* Longstaff-Schwartz model
* Chen model

There are many equations. Time may permit us to only master a few models. Based upon the 80-20 rule, which models are used most frequently? For example, when pricing American stock options, binomial tree, and monte carlo are used frequently even though more complex models exist.

Reference