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Editor's Letter

Joseph M. Pimbley

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It is my honor to write to you now as the Editor of *The Journal of Derivatives* (see the September 10 press release at http://www.maxwell-consulting.com/jod_editor_announcement.pdf). I inherit this role for a journal that I consider a leading research source for practitioners and academics in the derivatives field. I am grateful for this opportunity.

I succeeded the founder, Professor Stephen Figlewski, in this position. The excellence of JOD content is truly the excellence of Professor Stephen Figlewski. His wide-ranging expertise and in-depth reviews created a continuum of excellent issues over a span exceeding 25 years.

The press release I link above and my website (maxwell-consulting.com) show my background. In brief, I have mixed heritage. My education is theoretical physics. My first career encompassed applied physics, mathematics, and electrical engineering with industrial research and academic employers. Lured to Citibank in the early 1990s to create derivative risk and pricing models, I learned and practiced quantitative finance, risk and portfolio management, derivative trading, executive roles, and financial investigations over the course of the subsequent quarter-century. My financial employers have been banks, a rating agency, bond insurers, an asset manager, and consulting firms.

The “world of derivatives” is both huge and hugely impactful to the global economy. The content and concepts “we”—meaning “readers, authors, reviewers, production editors, Board members, and the publisher”—create have the potential to improve our world. This thought is a great entrée to state our published mission at <http://jod.ijournals.com/journal-information>:

“To connect people in the derivatives markets, encouraging vibrant exchange and informed discussions on the key issues facing derivatives professionals today. JOD aims to set the standard for derivatives research and publication for the institutional investment community and beyond.”

To all of the “we” I list above, I invite your ideas, suggestions, and comments regarding how we will continue to fulfill, and to expand, this mission. Of course, I also invite your articles! As one method to enable this correspondence, connect with me here (<https://www.linkedin.com/in/joepimbley/>) on LinkedIn.

Please also see our Editorial Board (<http://jod.ijournals.com/editorial-board>). I’ve made some early changes in this Board and am proud to welcome new members Dr. Andrey Itkin (New York University), Professor Radu Tunaru (University of Kent), and

Dr. Frank Fabozzi (EDHEC Business School). Just as I invite you to communicate with me, please feel welcome to share constructive ideas with the Board members.

The six articles of this issue span a wide range of interests. Hüttner and Mai, of the Technical University of Munich and XAIA Investment GmbH, respectively, show how to compute an analytical lower bound on the price of a convertible bond. The advantage of this bound, rather than a straight valuation, is the efficiency of the lower bound determination and its utility in assisting a true (numerical) pricing model which is, of course, still necessary. This result is impressive. It should be difficult to derive new and useful results for convertible bonds, which have been an interesting and important target for researchers for many decades.

Wu and Liu of the University of Chinese Academy of Sciences provide a survey of the large extant literature on curve fitting for implied volatility in derivatives markets. The survey is comprehensive, readable, and also links to the literature for the term structure of interest rates. The authors carefully compare twelve distinct curve-fitting methods. As an abbreviated summary, the Carr-Wu model and a quadratic regression technique are best performers among the twelve methods.

Malkiel (Princeton University), Rinaudo, and Saha (Data Science Partners) propose and analyze an investment strategy that incorporates the current level of the CBOE Volatility Index (VIX). The first element of the strategy is the sale of covered call options. In the authors' implementation, this element is a long position in the S&P 500 index and the sale of a matching size call option against this index. The second element is simply to execute this trade conditionally based on the prevailing VIX level. Analysis of historical data implies that this VIX-conditional Buy-Write strategy outperforms both the S&P 500 Total Return Index and the unconditional Buy-Write strategy.

Owners of debt instruments, whom we may also call creditors, suffer losses during inflationary periods. One perspective is simply that the money the debtor will repay to the creditor in the future will have less value than the money the debtor originally borrowed. In deflationary times, though, the creditor will gain, all else equal, while the debtor suffers. (The success of the creditors will be ephemeral if deflation is sufficiently severe to push debt default rates higher.) US Treasury inflation-protected securities (TIPS) protect bondholders from inflation. Chuang (Feng Chia University), Lin, and Chiang (National Chengchi University) begin their analysis of TIPS with the provocative observation that TIPS also protect against *deflation*. Their research creates a model that is able to quantify this “deflation protection option.”

Hu (CTBC Financial Management College) and Huang (National Chiao Tung University) find asymmetric dynamics between “informed trading activity” of a firm's equity and credit default swap (CDS) levels of its debt. The association between the two is not simple. The authors find that the level of informed trading activity in stocks contributes significantly to the CDS prices.

Costabile of the University of Calabria employs the Cox-Ross-Rubinstein (CRR) model to compute risk information for life insurance policies. He first summarizes current models of life insurance risk measurement. As the CRR binomial model is not influenced by the change of measure inherent to life insurance risk calculations, the author argues that this technique has efficiency and accuracy advantages relative to existing methods of the insurance industry. The natural future research will incorporate stochastic interest rates and stochastic volatilities of market parameters.

Joseph M. Pimbley
Editor