

The third and fourth articles present new approaches to modeling some nonstandard options. Nalholm and Poulsen consider static replication of barrier options. This idea has been explored before under differing sets of assumptions. The article offers a methodology that is general enough to nest most of the previous models, yet implementable because it uses only options with strikes and maturities that are actually available in the market. Macovschi and Quittard-Pinon then offer a very nice technique for getting beyond the “hockey stick” linear payoff patterns that packages of ordinary calls and puts are able to produce. Starting with a “power option,” in which the payoff depends on the final asset price raised to some power, they show how to value options with any kind of curved payoff function that can be written as a polynomial.

The last article, by Boyle and Scott, clarifies an issue that has become important in accounting for grants of executive stock options. In order to value them at the time of issue, it is necessary to specify an expected exercise date. But because the Black-Scholes equation is nonlinear in time to maturity, the value of the option at the mean date is not equal to the mean value of options exercised over the range of dates. We are particularly pleased to have this article from Phelim Boyle, this year’s recipient of the prestigious “Financial Engineer of the Year” award given by the International Association of Financial Engineers. Congratulations to Phelim for an honor well-deserved! And thanks for the article!

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