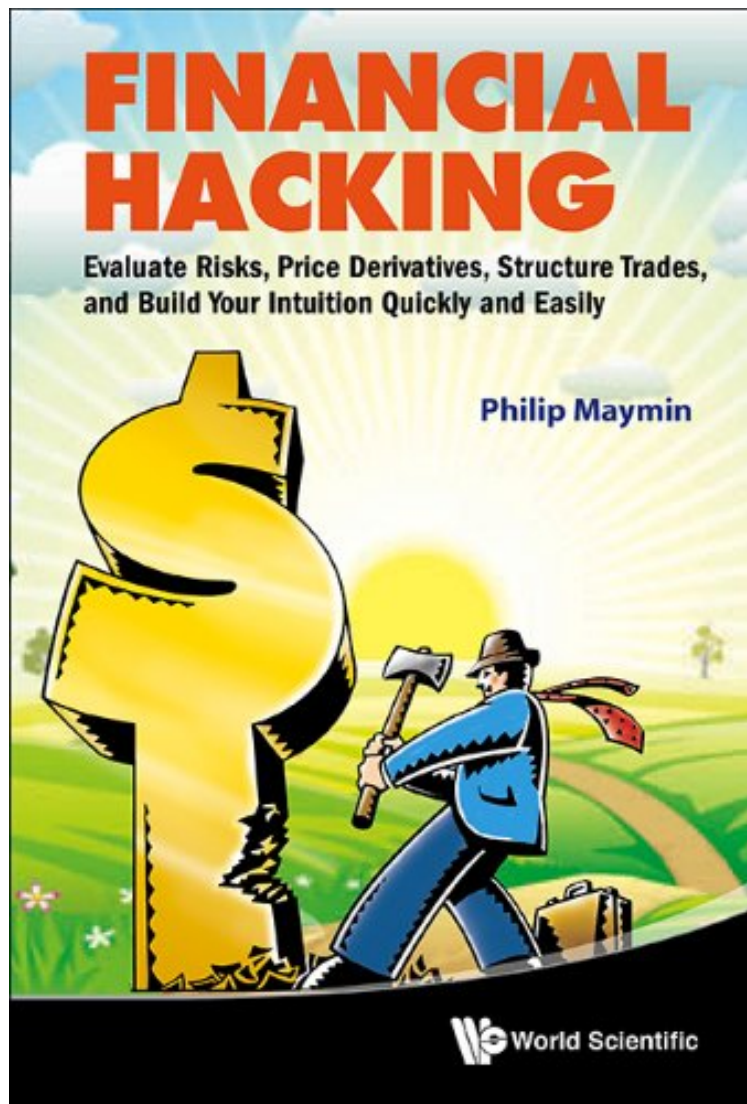


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Financial Hacking: Evaluate Risks, Price Derivatives, Structure Trades, and Build Your Intuition Quickly and Easily

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differential. It's not that the "best trade in the world"? If you think so, as I did, then this book will show you in an incredibly clear way why you are wrong. Even if you already know that this isn't the best trade in the world, you will absolutely benefit from similar thought provoking and challenging questions throughout the book. When dealing with derivatives, often one focuses too much on the theory and mathematical formulas and forgets about the practical and intuitive ways of dealing with market realities. This book is really unique in that it isn't another book that re-hashes the same stuff you already saw a million times before. This is a book that will build your intuition, reinforce the stuff that you already know, and corrects the misconception that you have. I especially liked the author's conversational style, benefiting from his teaching experience, while gaining tremendous insight from his trading experience also. This is, in my mind, the ultimate combination of academic and market knowledge that any person can benefit from. The material is very accessible and doesn't get into the intimidating math that scares lots of people. This book is truly exceptional.

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5 of 5 people found the following review helpful. Invaluable wisdom you won't find many other places
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This is a unique book that transmits a lot of useful wisdom for financial quants, wisdom that is seldom taught in a classroom or textbook. The author acquired it through years of quantitative trading at the highest levels, plus some hard thinking and learning from others. It's not a bunch of equations or rules for getting rich quickly, it's an attitude toward attacking financial tasks with sensible energy. There is a minimum of jargon and complexity, the author strives to show the balance of theory and common sense that is valued in finance. For example, the author proposes the puzzle, what would it be worth to you to know the SP500 in one month will be exactly the same value as today? This sort of question comes up frequently in interviews for financial quants. If you answer, "nothing, because it you can't make money either buying or selling stocks," then you are not ready for even this book. Read some basic quantitative financial stuff first. If you think about selling one-month at-the-money put and call options on the SP500, but can't take the answer further, this book is for you. Just thinking of options won't get you a job, or help you much if you do get one, but it's a start. An interviewer will expect you to know that a reasonable one-month SP500 volatility is 5% (at the moment, anyway, the answer would have been different in 2008 or 2014) and an at-the-money option sells for about 0.4 times the total volatility over the option period. So you could make 2% of the notional amount selling puts, and 2% selling calls. You might instead think of waiting for the SP500 to move away from the current value, and sell if it moves up and buy if it moves down. You might know or be able to quickly derive that using Kelly bets and ignoring transaction costs this will multiply your initial wealth by e (2.72). There are other ways to think about the problem. These or the kind of answers above might get you to the next round, or might not, but won't be much help on the job. You have to start asking more practical questions, like why the first method suggests a 4% profit and the second 172%. The answer is the first answer didn't take advantage of leverage, while the second assumes the availability of infinite leverage (a secondary reason is that transaction costs are minor for the first strategy, but theoretically infinite for the second). Another question is why the first strategy depends on the expected volatility of the SP500, but the second doesn't (however the second contains the hidden assumption that you know the actual future volatility exactly). You would not be expected to know the leverage a firm could apply to these strategies (when the author worked for Long Term Capital Management the answer was "a lot"). A good candidate for a financial quant job could figure out that 3:1 leverage is reasonable for a serious retail investor in the first strategy, so she could profit 12% of the investment capital you could raise (again, this could be different at different times and for different types of investors). You might be able to go as high as 40:1 leverage in the second strategy, but this limit cuts your returns. A back of the envelope guess of the effect of transaction costs and leverage limits would reduce the expected profit on the trading strategy to 100% or so. Why is there still such a discrepancy? The second strategy makes more efficient use of the information. If the information is false, the first strategy has zero expected return, the options are sold at their fair value. If the information is sort-of true and the SP500 moves a little, the first strategy still makes money. Even if the information is worthless, there is no expected loss, and a loss of more than 30% of capital or so would be rare. The second strategy in theory loses everything if the SP500 is even a hair different in a month. Thus in practice, with uncertain information, the option strategy might well be preferred. You should also think about what happens over time. If the SP500 moves more than expected in a short period of time, the option strategy will lose money, and options will have to be bought back at a loss, cutting into profits. On the other hand, if time passes with little SP500 movement, the option strategy will make money, money that can be rebet to increase profits. The Kelly strategy has the opposite behavior. A big move creates unexpectedly large profit opportunities, while time passing without movement cuts into profit. Losses in either strategy can cause margin problems, because they're both levered aggressively. Therefore combining them is likely better than doing either one on its own. Candidates who can discuss leverage, margin, counterparty relations and scenarios will impress interviewers and have a head start if hired. The most important message of this book is that quantitative finance is real, not a video game or multiple choice exam (the author is fond of posing multiple choice questions then making fun of all the answers). People who understand this, and are willing to engage their brains in navigating it, can succeed where people with higher IQs or better schools or more experience fail. This book is a valiant attempt at teaching brain engagement. Even if it fails at that, it should do a good job of letting the reader know whether or not her brain is engageable in useful financial ways.

This book teaches financial engineering in an innovative way: by providing tools and a point of view to quickly and easily solve real front-office problems. Projects and simulations are not just exercises in this book, but its heart and soul. You will not only learn how to do state-of-the-art simulations and build exotic derivatives valuation models, you will also learn how to quickly make reasonable inferences based on incomplete information. This book will give you the expertise to make significant progress in understanding brand new derivatives given only a preliminary term sheet, thus making you extraordinarily valuable to banks, brokerage houses, trading floors, and hedge funds. Financial Hacking is not about long, detailed mathematical proofs or brief summaries of conventional financial theories; it is about engineering specific, useable answers to imprecise but important questions. It is an essential book both for students and for practitioners of financial engineering. MBAs in finance learn case-method and standard finance mainly by talking. Mathematical finance students learn the elegance and beauty of formulas mainly by manipulating symbols. But financial engineers need to learn how to build useful tools, and the best way to do that is to actually build them in a test environment, with only hypothetical profits or losses at stake. That's what this book does. It is like a trading desk sandbox that prepares graduate students or others looking to move closer to trading operations.

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From the Inside Flap This book teaches financial engineering the way it ought to be taught: as tools and a way of thinking to solve real-world problems. Projects and simulations are not just exercises in this book, but its heart and soul. You will not only learn how to do state-of-the-art simulations and build exotic derivatives valuation models, you will also learn how to quickly make reasonable inferences based on incomplete information. This book will give you the expertise to make significant progress in understanding brand new derivatives given only a preliminary term sheet, thus making you extraordinarily valuable to banks, brokerage houses, trading floors, and hedge funds. Financial Hacking is not about long, detailed mathematical proofs or brief summaries of conventional financial theories; it is about engineering specific, useable answers to imprecise but important questions. It is an essential book both for students and for practitioners of financial engineering. MBAs in finance learn case-method and standard finance mainly by talking. Mathematical finance students learn the elegance and beauty of formulas mainly by manipulating symbols. But financial engineers need to learn how to build useful tools, and the best way to do that is to actually build them in a test environment, with only hypothetical profits or losses at stake. That's what this book does. It is like a trading desk sandbox that prepares graduate students or others looking to move closer to trading operations.

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