
The Newsletter of the EURO Working Group on Financial Modelling

NEWSFLOW

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NEWSFLOW

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Subscription is free for members of the EURO Working Group on Financial Modelling. See back cover for information on membership.

Invitation to readers

Readers are invited to actively contribute to the newsletter. Examples are book reviews, announcements, opinions, lists of published papers, etc.

NEW!!!!

You can now find information about the Euro Working Group on the internet.
See the site www.finance-on-eur.nl and select 'Research'.

NEWSFLOW is published twice a year (March and October) by the EURO Working Group on Financial Modelling under a grant from the Erasmus University Rotterdam. Circulation: over 400 to 38 countries.

Editorial

FINANCIAL RISK AND UNCERTAINTY IN SMALL OPEN ECONOMIES

Transformation of accession countries of Central and Eastern Europe into competition of the free market conditions open attractive economic perspectives and challenge the emergence and analysis of abundance of financial models and macroeconomic processes. A rapid development of information technologies helps integrate once disparate businesses and science. Research and education now more than ever are the keystones to successful orientation in the new environment. As far back as John Kenneth Galbraight (1970) called the rest of the century an era of risk and uncertainty. Globalization processes and an accelerating origin of progress threaten that the scale of risk and uncertainty can lead to chaos, if adequate methods of thinking, teaching and decision-making will not prevail over deterministic capture of future. A collision of the coming market and going away command ideologies aggravates the component of risk and uncertainty in transition societies, strengthening it in particular, because most economies in these societies can be considered as small open economies. Challenges to meet rapidly growing needs of the financial service sector require to understand the financial situation and to answer, how the banks and financial institutions themselves should be equipped both in terms of manpower and networks, how to meet the demand of funds for the development of infrastructure.

The convergence period is aimed at closing the gap between the level of development of EU and transition economies, because, although there are common features, the accession countries present now quite different pictures in terms of the stage of their market economies. The issues of fiscal policy and exchange rate regime have occupied an important part in the economic discussion throughout the reform process. The context of the regime change has justified the early adoption of fixed pegs used as anchors to stabilise the system of relative prices and serve as a visible signal of the regime change. The questions that we want to ask is whether there is any rationale for a prolonged fixed rate regime in small open economies? How to meet the need for adequate statistics on the nominal and real convergence of the specific case of fiscal criteria? The answers to these questions allow us to understand better how the exchange rate regime can be used as a tool to facilitate the risk and uncertainty in economic policy.

Leonidas Sakalauskas

Call for papers EJOR

Thusfar, the European Journal of Operational Research has published a number of special issues on Financial Modelling:

Issue 74/2, edited by T. Martikainen, I Virtanen and P. Yli-Olli;

Issue 91/2, edited by E. Castagnoli and J. Spronk. In 1998, the European Journal of Operational Research together with the EURO Working Group on Financial Modelling decided to start a more regular series of feature issues.

A feature issue on financial modelling is an issue of EJOR partly or wholly devoted to financial modelling. The intended frequency of these feature issues on financial modelling is once or twice per year.

Papers on financial modelling are solicited that help to solve financial-economic decision problems in practice. Papers may relate to new insights, both theoretical and empirical, into the environment in which decision makers operate, new tools available to the decision makers and to the integration of these tools within frameworks for financial-economic decision making. Papers that stimulate and strengthen the interaction between financial economic theory and the practice of financial decision making, will be especially welcome.

The first feature issue was published as Issue Volume 114, Number 2, April 16, 1999, and edited by J. Spronk. The second feature issue was edited by N. v.d. Wijst and J. Spronk and will be published soon.

Authors who want to submit to the upcoming feature issue are kindly invited to submit four copies of their paper to the Guest Editor Financial Modelling:

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With respect to format and other requirements of submitted work, the authors are kindly referred to the Instructions to Authors, that can be found in every issue of EJOR. For the feature papers there is a separate board of editors, consisting of

Wolfgang Bühler, University of Mannheim, Germany

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29th EWG Meeting

Originally, Rita d'Ecclesia and Sara Simonelli had planned to organise their meeting in Capri in Autumn 2001. Because of circumstances this meeting is now planned for Spring 2002.

The venue of the Autumn 2001 meeting is to be announced at a later moment.

Vilnius 3-5 May 2001

Program

The Program of this meeting and other information can be found on the internet site:

<http://www.science.mii.lt/EWGFM-28>

Information

This meeting is organized by:

Dr. Leonidas L. Sakalauskas

For further information please contact him at:

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More information about this meeting can be found on the internet site

<http://www.science.mii.lt/EWGFM-28>

Next meeting(s)

The Spring 2002 meeting will be organized in Capri, by Rita d'Ecclesia and Sara Simonelli.

The Autumn 2002 meeting will be organized by Stavros Zenios in Cyprus.

The Spring 2003 meeting will be organized in Sheffield, U.K., by Chris Adcock.

Offers to organise one of the future meetings are welcome.

Euro XVIII

From July 9-11, 2001 in Rotterdam. For more information:

<http://www.fbk.eur.nl/PRJ/EURO2001/content.html>

New book(s)

Efficient Methods for Valuing Interest Rate Derivatives

By A. Pelsser, Erasmus University Rotterdam
Springer-Verlag, Series Springer Finance

Abstract:

Efficient Methods for Valuing Interest Rate Derivatives provides an overview of the models that can be used for valuing and managing interest rate derivatives. Split into two parts, the first discusses and compares the traditional models, such as spot- and forward-rate models, while the second concentrates on the more recently developed Market models. Unlike most of his competitors, the author's focus is not only on the mathematics: Antoon Pelsser draws on his experience in industry to explore the practical issues, such as the implementation of models, and model selection. Aimed at people with a solid quantitative background, this book will be of particular interest to risk managers, interest rate derivative traders, quantitative researchers, portfolio and fund managers, and students of mathematics and economics, but it will also prove invaluable to anyone looking for a good overview of interest rate derivative modelling.

Working Papers

From the *Rotterdam Institute for Business Economic Studies* (RIBES), Erasmus University Rotterdam, Room H16-19, P.O. Box 1738, 3000 DR Rotterdam, The Netherlands, the following papers can be ordered:

- | | | | |
|--------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|--------------------------------------------------------------------------------------------------------------------------------------------------|
| 9401/F | Hallerbach, W.G., Duration and bond return approximation, The quaso-convexity effect, January 1994. | 9615/O/F | Bruining, J., A.C.C. Herst and D. Citron, Loan convenience relationship banking and MBO's in default: a comparative study of the UK and Holland. |
| 9405/F | Smit, J.T.J., The flexibility value of strategic investments under competition, March 1994. | 9616/F | Soppe, A.B.M., De rol van rente, geld en vermogen in het wereld economisch proces: een ethische beschouwing. |
| 9414/F | Spronk, Jaap and Erik M. Vermeulen, Interfirm performance evaluation under uncertainty: A multi-dimensional framework, September 1994. | 9707/F | Post, Th. and J. Spronk, Bank performance bench-marking in stochastic environments using log-linear mean-variance data envelopment analysis. |
| 9422/F | Brouwer, Frank, Paul C. van Aalst and Nico L. van der Sar, Investment risk and risk management revisited, November 1994. | 9711/F | Groenendijk, A.A. and J. Spronk, Portfolio performance through the eyes of monkeys. |
| 9426/F | Hallerbach, Winfried G., A simple approximation to the normal distribution function with an application to the Black & Scholes option pricing model, December 1994. | 9713/F | Spronk, J. and E.M. Vermeulen, Interfirm performance evaluation under uncertainty. |
| 9502/F | Higson, Chris and Jamie Elliott, Post-takeovers returns - The UK evidence, March 1995. | 9719/F | Meulen, J. van der and J. van der Voort, Er valt wat te zeggen voor passief beleggen. |
| 9503/F | Groenendijk, A.A. and E.E. Hagen, Solving the capital structure puzzle: The government as a stakeholder in the firm, March 1995. | 9721 | Post, G.T., Transconcave Data Envelopment Analysis |
| 9504/F | Vermeulen, Erik M., Jaap Spronk and Nico van der Wijst, Analysing risk and performance using the multi-factor concept, april 1995. | 9822 | Kouwenberg, R., Dynamic Portfolio Insurance: A Stochastic Programming Approach |
| 9505/F | Vermeulen, Erik M., Jaap Spronk and Nico van der Wijst, A Framework for conditional failure prediction, April 1995. | 9824 | Soppe, A., Capital, Interest and Ethics: Some Empirical Explorations of an Ethical Approach of economic growth |
| 9508/F | Brännback, M. and J. Spronk, A multidimensional framework for strategic decisions, June 1995 | 9847 | Post, G.T., Estimating non-convex production sets using transconcave DEA |
| 9509/F | Hallerbach, W.G. and J.Spronk, Portfolio management for the non-average investor, June 1995. | 9905 | Post, G.T., Nonparametric efficiency estimation in stochastic environments |
| 9520/F | Soppe A., De duurzaamheid van het internationale geld en bankstelsel: Een ethische beschouwing, September 1995. | 9911 | Kuosmanen, T. and G.T. Post, Robust Efficiency Measurement. Dealing with outliers in Data Envelopment Analysis |
| 9526/F | Groenendijk, A.A., Investeren, kasstroomprojectie en ondernemingswaarde, December 1995. | 9913 | Hallerbach, W.G. and J. Spronk, A Multicriteria Framework for Risk Analysis |
| 9606/F | Greco S, The splitting property of fuzzy financial laws, September 1996. | 9922 | Spronk, J. and W.G. Hallerbach, Het "redelijk rendement" voor ondernemingsactiviteiten vanuit financieel-economisch perspectief |
| 9612/F | Post, T. and J. Spronk, Interactive data envelopment analysis, September 1996. | 9933 | Post, G.T. and J. Spronk, Evaluating productive performance under uncertainty |
| | | 9934 | Kuosmanen, T. and G.T. Post, Measuring economic efficiency with incomplete price information. |

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| 9801 | Roy Kouwenberg, A stochastic programming model for asset liability management for pension funds. | 9903 | Philip Hans Franses and Patrick J.F. Groenen, Visualizing time-varying correlations across stock markets. |
| 9802 | Dick van Dijk, Philip Hans Franses and André Lucas, Short patches of outliers, ARCH and volatility modeling. | 9904 | Pauline Bod, David Blitz, Philip Hans Franses and Roy Kluitman, An unbiased variance estimator for overlapping returns. |
| 9803 | Philip Hans Franses and Richard Paap, Modeling day-of-the-week seasonality in the S&P 500 index. | 9905 | Martin Martens and Ser-Huang Poon, Correlation dynamics between international stock markets using synchronous data. |
| 9804 | Jenke ter Horst, Theo Nijman and Frans de Roon, Style analysis and performance evaluation of Dutch mutual funds. | 9906 | Jaap Hoek, Patrick Houweling and Frank Kleibergen, The joint estimation of term structures and credit spreads. |
| 9805 | Jenke ter Horst, Theo Nijman and Frans de Roon, Performance analysis of international mutual funds incorporating market frictions. | 9907 | Winfried Hallerbach and Bert Menkveld, Value at risk as a diagnostic tool for corporates: the airline industry. |
| 9806 | Monique Donders, Roy Kouwenberg and Ton Vorst, Options and earnings announcements: an empirical study of volatility, trading volume, open interest and liquidity. | 9908 | Ser-Huang Poon and Peter F. Pope, Tests of option market efficiency: a high frequency data and common volatility component approach. |
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| 9808 | Jon Danielsson, Philip Hartmann and Casper de Vries, The cost of conservatism: extreme returns, value-at-risk, and the Basle multiplication factor. | 9910 | Jon Danielsson, Bjorn N. Jorgensen and Casper G. de Vries, VoF or VAR? Firm Value and Risk Management. |
| 9809 | Antoon Pelsser and Ton Vorst, Pricing of flexible and limit caps. | 2001 | Ton Vorst, Optimal Portfolios under a Value at Risk Constraint. |
| 9810 | Phil Hunt, Joanne Kennedy and Antoon Pelsser, Markov-functional interest rate models. | 2002 | Bert Menkveld and Ton Vorst, A Pricing Model for American Options with Stochastic Interest Rates. |
| 9811 | Antoon Pelsser, Pricing double barrier options using analytical inversion of Laplace transforms. | 2003 | Henk Grootveld and Winfried G. Hallerbach, Upgrading Value-at-Risk from Diagnostic Metric to Decision Variable. |
| 9812 | Phil Hunt and Antoon Pelsser, Arbitrage-free pricing of quan-to-swaptions | 2004 | Philip Hans Franses and Roy Kluitman, Unbiased Variance Estimators for overlapping Returns when the Returns have First-Order Dynamics. |
| 9813 | Roy Kouwenberg, Dynamic portfolio insurance: a stochastic programming approach. | 2005 | Arjan Berkelaar and Roy Kouwenberg, Retirement Saving with Contribution Payments and Labor Income as a Benchmark for Investments. |
| 9901 | Dick van Dijk, Philip Hans Franses, André Lucas and Nick Taylor, SETS, arbitrage activity, and stock price dynamics. | 2006 | Arjan Berkelaar and Roy Kouwenberg, Dynamic Asset Allocation and Downside-Risk Aversion. |
| 9902 | Jan Annaert and Marc J.K. de Ceuster, The big mac: more than a junk asset allocator? | 2007 | Yulia Veld-Merkoulova, Price Limits in Futures Markets: Effect on the Price Discovery Process and Volatility |

EURO Working Group on Financial Modelling

The EURO Working Group on Financial Modelling was founded in September 1986 in Lisbon. The primary field of interest for the Working Group can be described as “financial models that help to solve problems faced by financial decision makers in the firm, intermediaries and the investment community”. From this the following objectives of the Working Group are distinguished:

- providing an international forum for exchange of information and experience on financial modelling;
- encouraging research in financial modelling (new techniques, methodologies, empirical studies, software, etc.);
- stimulating and strengthening the interaction between financial economic theory and the practice of financial decision making;
- cooperating and exchanging information with other universities and financial institutions throughout Europe.

It can be stated safely that the Working Group has become an established one. To give an idea: over 300 members, 28 international meetings and an own newsletter (*NEWSFLOW*) are three examples of the success until now.

Meetings

The meetings of the Working Group are organized twice a year, in April/May and in October/November. Earlier meetings were held in Belgium, Curaçao, Cyprus, Finland, France, Hungary, Italy, the Netherlands, United Kingdom, Germany, Greece, Croatia, Poland and Spain. There are now members in 34 countries spread over 4 continents. The meetings are attended by 80-100 members on average, most of them scientists but also representatives from the financial institutions, and are usually organized on Thursday, Friday and Saturday morning. The organizers are expected to schedule three types of sessions: a round table session with invited speaker(s), regular sessions with the presentation of refereed papers and balloon sessions in which unrefereed papers, new topics and ‘loose’ ideas can be discussed.

Newsletter

NEWSFLOW, the newsletter of the Working Group is published twice a year, about one month before each meeting. It contains general information about the Working Group and the next meeting(s), abstracts of the papers of the next meeting, letters from readers, announcements of financial seminars, calls for papers, a list of working papers, etc. For information about *NEWSFLOW* or for publication of your contributions please contact the editor: H  l  ne Molenaar, address below.

Membership

For information about membership of the EURO Working Group on Financial Modelling, you may write to:

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