
Contents

1	Gaussian Stochastic Calculus of Variations	1
1.1	Finite-Dimensional Gaussian Spaces, Hermite Expansion	1
1.2	Wiener Space as Limit of its Dyadic Filtration	5
1.3	Stroock–Sobolev Spaces of Functionals on Wiener Space	7
1.4	Divergence of Vector Fields, Integration by Parts	10
1.5	Itô’s Theory of Stochastic Integrals	15
1.6	Differential and Integral Calculus in Chaos Expansion	17
1.7	Monte-Carlo Computation of Divergence	21
2	Computation of Greeks and Integration by Parts Formulae	25
2.1	PDE Option Pricing; PDEs Governing the Evolution of Greeks	25
2.2	Stochastic Flow of Diffeomorphisms; Ocone-Karatzas Hedging	30
2.3	Principle of Equivalence of Instantaneous Derivatives	33
2.4	Pathwise Smearing for European Options	33
2.5	Examples of Computing Pathwise Weights	35
2.6	Pathwise Smearing for Barrier Option	37
3	Market Equilibrium and Price-Volatility Feedback Rate	41
3.1	Natural Metric Associated to Pathwise Smearing	41
3.2	Price-Volatility Feedback Rate	42
3.3	Measurement of the Price-Volatility Feedback Rate	45
3.4	Market Ergodicity and Price-Volatility Feedback Rate	46

4	Multivariate Conditioning and Regularity of Law	49
4.1	Non-Degenerate Maps	49
4.2	Divergences	51
4.3	Regularity of the Law of a Non-Degenerate Map	53
4.4	Multivariate Conditioning	55
4.5	Riesz Transform and Multivariate Conditioning	59
4.6	Example of the Univariate Conditioning	61
5	Non-Elliptic Markets and Instability in HJM Models	65
5.1	Notation for Diffusions on \mathbb{R}^N	66
5.2	The Malliavin Covariance Matrix of a Hypoelliptic Diffusion	67
5.3	Malliavin Covariance Matrix and Hörmander Bracket Conditions	70
5.4	Regularity by Predictable Smearing	70
5.5	Forward Regularity by an Infinite-Dimensional Heat Equation	72
5.6	Instability of Hedging Digital Options in HJM Models	73
5.7	Econometric Observation of an Interest Rate Market	75
6	Insider Trading	77
6.1	A Toy Model: the Brownian Bridge	77
6.2	Information Drift and Stochastic Calculus of Variations	79
6.3	Integral Representation of Measure-Valued Martingales	81
6.4	Insider Additional Utility	83
6.5	An Example of an Insider Getting Free Lunches	84
7	Asymptotic Expansion and Weak Convergence	87
7.1	Asymptotic Expansion of SDEs Depending on a Parameter	88
7.2	Watanabe Distributions and Descent Principle	89
7.3	Strong Functional Convergence of the Euler Scheme	90
7.4	Weak Convergence of the Euler Scheme	93
8	Stochastic Calculus of Variations for Markets with Jumps .	97
8.1	Probability Spaces of Finite Type Jump Processes	98
8.2	Stochastic Calculus of Variations for Exponential Variables	100
8.3	Stochastic Calculus of Variations for Poisson Processes	102

8.4 Mean-Variance Minimal Hedging
and Clark–Ocone Formula 104

A Volatility Estimation by Fourier Expansion 107

A.1 Fourier Transform of the Volatility Functor 109

A.2 Numerical Implementation of the Method 112

**B Strong Monte-Carlo Approximation
of an Elliptic Market** 115

B.1 Definition of the Scheme \mathcal{S} 116

B.2 The Milstein Scheme 117

B.3 Horizontal Parametrization 118

B.4 Reconstruction of the Scheme \mathcal{S} 120

**C Numerical Implementation
of the Price-Volatility Feedback Rate** 123

References 127

Index 139