

# Tomas Bjork Arbitrage Theory In Continuous Time Solutions

Tomas Bjork Arbitrage Theory In Continuous Time Solutions tomas bjork arbitrage theory in continuous time solutions Understanding the complexities of modern financial markets requires deep insights into arbitrage opportunities and the mathematical frameworks that underpin derivative pricing and risk management. Tomas Bjork, a renowned figure in financial mathematics, has significantly contributed to this field through his development of arbitrage theory in continuous time, providing elegant solutions that are foundational to modern quantitative finance. This article explores Bjork's arbitrage theory in continuous time solutions, explaining its core principles, mathematical underpinnings, practical applications, and significance within the broader scope of financial modeling.

Introduction to Arbitrage Theory in Continuous Time Arbitrage refers to the practice of taking advantage of price discrepancies between different markets or instruments to secure riskless profit. In continuous time finance, arbitrage theory becomes more sophisticated, involving stochastic calculus and differential equations to model the evolution of asset prices dynamically. Bjork's work primarily focuses on formalizing the conditions under which arbitrage opportunities can or cannot exist within continuous markets, and how these conditions influence the valuation of derivatives and other financial instruments. His approach integrates the fundamental theorem of asset pricing, martingale measures, and stochastic processes to create a comprehensive framework that aligns with real-world market behaviors.

Core Concepts of Bjork's Arbitrage Theory in Continuous Time

1. No-Arbitrage Condition and Market Completeness Bjork's theory emphasizes the no-arbitrage condition, a cornerstone in financial mathematics. It asserts that in an efficient market, there should be no possibility of riskless profit with zero net investment. This condition ensures the existence of a risk-neutral measure (also called an equivalent martingale measure), under which discounted asset prices follow a martingale process. In addition, market completeness—where every contingent claim can be perfectly hedged—plays a vital role. Bjork explores how these properties influence the existence and uniqueness of solutions for derivative pricing models.
2. Stochastic Calculus and Asset Price Dynamics At the heart of continuous-time models are stochastic differential

equations (SDEs), which describe how asset prices evolve randomly over time. Bjork employs Ito calculus to analyze these dynamics, providing solutions to SDEs that model stock prices, interest rates, and other financial variables. An example is the classic Black-Scholes model, which assumes that the stock price  $(S_t)$  follows a geometric Brownian motion:  $[ dS_t = \mu S_t dt + \sigma S_t dW_t ]$  where:  $(\mu)$  is the drift,  $(\sigma)$  is the volatility,  $(W_t)$  is a standard Brownian motion. Bjork's solutions extend and generalize such models, accommodating features like stochastic volatility, jumps, and interest rate dynamics.

3. Risk-Neutral Valuation and Martingale Measures A central result in Bjork's arbitrage theory is the risk-neutral valuation principle. Under the risk-neutral measure, the expected discounted payoff of a derivative equals its current price. This measure transforms the original probability space into one where asset prices discounted at the risk-free rate are martingales. Mathematically, if  $(Q)$  is the risk-neutral measure, then for a derivative with payoff  $(X)$  at time  $(T)$ :  $[ V_0 = e^{-rT} \mathbb{E}_Q [X] ]$  where:  $(V_0)$  is the current fair value,  $(r)$  is the risk-free interest rate,  $(\mathbb{E}_Q)$  is the expectation under measure  $(Q)$ . Bjork's solutions involve deriving these measures explicitly, especially in models with complex features.

Mathematical Framework of Bjork's Solutions

1. Stochastic Differential Equations (SDEs) Bjork models asset prices using SDEs, which incorporate randomness via Brownian motions or other Lévy processes. The solutions to these equations provide the basis for pricing and hedging strategies. For example, the general SDE:  $[ dS_t = \mu(t, S_t) dt + \sigma(t, S_t) dW_t ]$  has solutions that depend on the drift and volatility functions. Bjork's approach involves solving these SDEs analytically or numerically, ensuring the no-arbitrage condition holds.

2. Girsanov's Theorem and Change of Measure Girsanov's theorem is fundamental in changing the probability measure from the real-world measure  $(P)$  to the risk-neutral measure  $(Q)$ . Bjork leverages this theorem to derive the dynamics of asset prices under the risk-neutral measure, which simplifies the valuation problem. The theorem states that under certain conditions, the process:  $[ W_t^Q := W_t + \int_0^t \theta_s ds ]$  is a Brownian motion under the measure  $(Q)$ , where  $(\theta_s)$  is the market price of risk.

3. Derivation of Pricing PDEs Using stochastic calculus, Bjork derives partial differential equations (PDEs) governing the price of derivatives. For a European option, the price  $(V(t, S))$  satisfies the famous Black-Scholes PDE in the classical case:  $[ \frac{\partial V}{\partial t} + rS \frac{\partial V}{\partial S} + \frac{1}{2} \sigma^2 S^2 \frac{\partial^2 V}{\partial S^2} - rV = 0 ]$  Bjork extends this framework to more complex models, resulting in generalized PDEs that incorporate stochastic volatility, jumps, and other features.

Practical Applications of Bjork's Arbitrage Solutions

1. Derivative Pricing Bjork's

solutions enable precise valuation of derivatives in markets with complex features. Whether dealing with vanilla options, exotic derivatives, or structured products, his models provide the mathematical tools to derive fair prices consistent with no-arbitrage conditions.

2. Risk Management and Hedging Accurate modeling of asset dynamics allows traders and risk managers to design effective hedging strategies. By understanding the underlying stochastic processes, they can construct portfolios that minimize risk exposure.

3. Market Completeness and Incompleteness Analysis Bjork's framework helps determine whether a market is complete and whether perfect hedging is feasible. In incomplete markets, his methods guide the selection of optimal hedging strategies and the assessment of residual risks.

4. Pricing in Markets with Jumps and Stochastic Volatility Real-world markets often exhibit jumps and changing volatility. Bjork's models accommodate these phenomena, leading to more realistic pricing and risk assessment tools that reflect market imperfections.

Significance of Tomas Bjork's Arbitrage Theory in Continuous Time Bjork's contribution has a profound impact on both theoretical finance and practical trading. His rigorous mathematical approach provides a solid foundation for modern financial engineering, allowing practitioners to develop models that are both mathematically sound and aligned with market realities. Key takeaways include:

- Ensuring no arbitrage opportunities exist in complex markets through rigorous conditions.
- Developing generalized models that incorporate features like stochastic volatility, jumps, and interest rate dynamics.
- Providing solutions that are applicable to a wide range of financial instruments and risk management strategies.
- Bridging the gap between pure mathematical theory and practical financial applications.

Conclusion Tomas Bjork's arbitrage theory in continuous time solutions represents a cornerstone of modern quantitative finance. By integrating stochastic calculus, measure theory, and PDEs, his work offers comprehensive tools for derivative valuation, risk management, and market analysis. Understanding his models equips financial professionals with the ability to navigate complex markets, identify arbitrage opportunities, and develop robust strategies grounded in rigorous mathematics. As markets evolve, Bjork's framework continues to serve as a vital reference point for researchers and practitioners striving to understand and model the intricate dynamics of financial assets.

Question Answer What is Tomas Bjork's arbitrage theory in continuous time finance? Tomas Bjork's arbitrage theory in continuous time finance provides a rigorous mathematical framework for modeling and analyzing markets free of arbitrage opportunities using stochastic calculus and measure theory, emphasizing the fundamental theorem of asset pricing. How does Bjork's approach differ from traditional arbitrage pricing models? Bjork's approach incorporates a more comprehensive measure-theoretic foundation, emphasizing the

existence of equivalent martingale measures and the role of continuous-time stochastic processes, offering a more general and flexible framework than traditional models like Black-Scholes. What are the key solutions provided by Bjork's arbitrage theory in continuous time? Bjork's theory offers solutions for pricing derivatives, constructing complete and incomplete markets, and identifying equivalent martingale measures, all within a rigorous continuous-time stochastic framework. Can Bjork's arbitrage theory be applied to real-world financial markets? Yes, Bjork's continuous-time arbitrage theory underpins many modern quantitative finance models, aiding in derivative pricing, risk management, and market completeness analysis, though practical implementation requires calibration to market data. 5 What mathematical tools are essential for understanding Bjork's arbitrage solutions? Key mathematical tools include stochastic calculus, measure theory, martingale theory, and the theory of stochastic differential equations, which are fundamental to deriving and understanding the solutions in Bjork's framework. How does the concept of market completeness feature in Bjork's arbitrage solutions? In Bjork's framework, market completeness relates to whether every contingent claim can be replicated via trading strategies; the solutions explicitly characterize conditions under which markets are complete or incomplete in continuous time. What are some limitations of applying Bjork's arbitrage theory solutions to practical trading? Limitations include assumptions of frictionless markets, continuous trading, and perfect information, which are idealizations; real markets involve transaction costs, liquidity constraints, and model risk that can affect the applicability. How has Bjork's arbitrage theory influenced modern financial mathematics? Bjork's rigorous measure-theoretic approach has significantly contributed to the development of modern asset pricing theory, the formulation of the fundamental theorem of asset pricing, and the advancement of derivative pricing models in continuous time. What ongoing research areas relate to solutions of arbitrage theory in continuous time as proposed by Bjork? Current research explores market imperfections, incomplete markets, stochastic volatility, jump processes, and numerical methods for solving complex models based on Bjork's theoretical framework, aiming to enhance real-world applicability. Tomas Bjork Arbitrage Theory in Continuous Time Solutions has emerged as a pivotal framework in the realm of mathematical finance, especially for those involved in derivatives pricing, risk management, and quantitative analysis. Bjork's work meticulously bridges the gap between theoretical arbitrage principles and their practical implementations within continuous-time models, offering both elegance and rigor to the field. This comprehensive review delves into the core concepts of Bjork's arbitrage theory, its mathematical foundations, practical applications, and critical evaluations to help readers appreciate its significance and limitations.

Introduction to Arbitrage Theory in Continuous Time Arbitrage, a fundamental concept in finance, refers to the possibility of riskless profit with zero net investment. Classical arbitrage principles underpin modern financial mathematics, forming the basis for derivative pricing and market consistency. Tomas Bjork's contribution to this domain is distinguished by his systematic approach to arbitrage pricing within continuous-time models, emphasizing the importance of no-arbitrage conditions, market completeness, and the construction of equivalent martingale measures. Bjork's arbitrage theory is set against the backdrop of stochastic calculus, where asset prices are modeled as stochastic processes, typically semimartingales. His approach emphasizes the importance of martingale measures—probability measures under which discounted asset prices follow martingale dynamics—serving as the cornerstone for derivative valuation and hedging strategies. Fundamental Principles of Bjork's Arbitrage Theory

**No-Arbitrage and Market Viability** At the heart of Bjork's framework lies the no-arbitrage principle, which ensures that there are no opportunities for riskless profits. This concept leads to the formulation of equivalent martingale measures (EMMs), which transform the real-world probability measure into a risk-neutral measure. Under the risk-neutral measure, the discounted price processes of tradable assets become martingales, facilitating the derivation of fair prices for derivatives and contingent claims. Features:

- The model assumes frictionless markets (no transaction costs, perfect liquidity).
- Asset prices are modeled as continuous semimartingales.
- The existence of an EMM guarantees no-arbitrage.

**Market Completeness and Replication** Bjork's theory extends to the notion of market completeness, where every contingent claim can be perfectly replicated by trading in underlying assets. This property is crucial because it ensures the uniqueness of the risk-neutral measure and simplifies the valuation process. Features:

- Completeness allows for unique pricing.
- Incomplete markets require additional criteria or preferences to determine prices.

**Martingale Measures and Pricing** The core mathematical structure involves changing the probability measure to a risk-neutral or martingale measure, under which the discounted asset prices are martingales. This change of measure is facilitated through Radon-Nikodym derivatives, leading to the Fundamental Theorem of Asset Pricing in continuous time. Features:

- Ensures consistency in pricing across different assets.
- Provides a systematic method for derivative valuation.

**Mathematical Foundations** Stochastic Calculus and Semimartingales Bjork's solutions are deeply rooted in stochastic calculus, particularly the theory of semimartingales. Asset prices are modeled as stochastic processes with specific properties, allowing the application of Itô calculus to derive dynamics and valuation formulas. The Fundamental Theorem of Asset Pricing Bjork's exposition of the

Fundamental Theorem emphasizes two main parts: 1. Existence of an EMM: The absence of arbitrage is equivalent to the existence of at least one EMM. 2. Completeness: The market's completeness corresponds to the uniqueness of the EMM. Pricing via Expectation under the Risk-Neutral Measure Once the appropriate measure is identified, the value of a contingent claim is calculated as the discounted expectation of its payoff under the EMM. Mathematically: 
$$V_t = \mathbb{E}^Q \left[ e^{-\int_t^T r_s ds} \cdot \text{Payoff} \mid \mathcal{F}_t \right]$$
 where  $(\mathbb{Q})$  is the risk-neutral measure,  $(r_s)$  is the short rate, and  $(\mathcal{F}_t)$  is the filtration up to time  $(t)$ .

Practical Applications of Bjork's Arbitrage Solutions Derivative Pricing Bjork's framework provides a rigorous foundation for pricing a wide array of derivatives, including options, forwards, and exotic instruments. The continuous-time models, such as the Black-Scholes-Merton framework, are special cases within his broader theory. Risk Management and Hedging The theory facilitates the construction of hedging strategies, notably delta hedging, by replicating Tomas Bjork Arbitrage Theory In Continuous Time Solutions 7 payoffs using underlying assets. It also aids in understanding the sensitivities and risks associated with complex portfolios. Model Calibration and Market Consistency Bjork's solutions support the calibration of models to market data, ensuring that the theoretical prices align with observed market prices, which enhances the practical relevance of the models.

Advantages and Strengths of Bjork's Arbitrage Theory - Mathematically Rigorous: The framework rests on solid stochastic analysis, ensuring consistency and robustness. - Generalized: It accommodates a wide class of models, including stochastic interest rates and jumps. - Extensible: The theory adapts to various market settings, including incomplete markets and multi-asset models. - Unified Approach: Provides a common language and methodology for pricing, hedging, and risk assessment. Limitations and Challenges - Market Assumptions: - Assumes frictionless markets, which are idealizations. - Real markets involve transaction costs, liquidity constraints, and market impact. - Model Complexity: - The mathematical sophistication may pose barriers to practitioners. - Calibration of models can be challenging in practice. - Incomplete Markets: - Many real-world markets are incomplete, leading to non-unique EMMs and ambiguous prices. - Additional criteria or preferences are necessary for valuation. - Dynamic and High-Dimensional Settings: - As models incorporate more assets and features, computational complexity increases.

Critical Evaluation and Future Directions Bjork's arbitrage theory in continuous time remains a cornerstone of quantitative finance, providing clarity and structure to derivative pricing and risk management. Its reliance on stochastic calculus and measure theory grants it both elegance and precision. However, practical implementation often requires adjustments to

account for market imperfections, data limitations, and computational constraints. Future research directions include: - Extending the models to incorporate market frictions and transaction costs. - Developing robust calibration techniques for high-dimensional models. - Integrating machine learning methods to approximate complex solutions. - Exploring arbitrage opportunities in less liquid or emerging markets where assumptions of frictionless trading do not hold. Conclusion Tomas Bjork's arbitrage theory in continuous time solutions offers a comprehensive and mathematically rigorous framework that underpins much of modern quantitative finance. Its emphasis on no-arbitrage principles, equivalent martingale measures, and stochastic calculus provides a unified approach to asset pricing, hedging, and risk management. While the theory's assumptions and complexity pose challenges for real-world application, its foundational insights continue to influence both academic research and practical financial modeling. As markets evolve and new financial instruments emerge, Bjork's framework remains a vital reference point, guiding innovations and fostering a deeper understanding of arbitrage and pricing in continuous time. Tomas Bjork, arbitrage theory, continuous time finance, stochastic calculus, financial modeling, martingale measures, no-arbitrage condition, pricing derivatives, stochastic Tomas Bjork Arbitrage Theory In Continuous Time Solutions 8 differential equations, financial mathematics

Arbitrage Theory in Continuous Time ARBITRAGE THEORY IN CONTINUOUS TIME Arbitrage Theory in Continuous Time Term-Structure Models Handbook of the Geometry of Banach Spaces An Intuitive Introduction to Finance and Derivatives Handbooks in Operations Research and Management Science: Financial Engineering Modern Computational Finance Risk-Neutral Valuation Understanding Financial Risk Management Paris-Princeton Lectures on Mathematical Finance ... Asymptotic Theory in Probability and Statistics with Applications Market-Consistent Prices Arbitrage Theory Arbitrage Theory Encyclopedia of Actuarial Science The British National Bibliography Report of the Annual Meeting of the South African Association for the Advancement of Science Actuarial Research Clearing House Three Essays in International Macroeconomics and Finance Tomas Björk TOMAS. BJOERK Damir Filipovic Alex Backwell John R. Birge Antoine Savine Nicholas H. Bingham Angelo Corelli T. L. Lai Pablo Koch-Medina Jochen E.M. Wilhelm Jochen E M Wilhelm Bjørn Sundt Arthur James Wells Enrique Martinez-Garcia Arbitrage Theory in Continuous Time ARBITRAGE THEORY IN CONTINUOUS TIME Arbitrage Theory in Continuous Time Term-Structure

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the second edition of this popular introduction to the classical underpinnings of the mathematics behind finance continues to combine sound mathematical principles with economic applications concentrating on the probabilistic theory of continuous arbitrage pricing of financial derivatives including stochastic optimal control theory and Merton's fund separation theory the book is designed for graduate students and combines necessary mathematical background with a solid economic focus it includes a solved example for every new technique presented contains numerous exercises and suggests further reading in each chapter in this substantially extended new edition Bjork has added separate and complete chapters on measure theory probability theory Girsanov transformations LIBOR and swap market models and martingale representations providing two full treatments of arbitrage pricing the classical delta hedging and the modern martingales more advanced areas of study are clearly marked to help students and teachers use the book as it suits their needs

changing interest rates constitute one of the major risk sources for banks insurance companies and other financial institutions modeling the term structure movements of interest rates is a challenging task this volume gives an introduction to the mathematics of term structure models in continuous time it includes practical aspects for fixed income markets such as day count conventions duration of coupon paying bonds and yield curve construction arbitrage theory short rate models the Heath Jarrow Morton methodology consistent term structure parametrizations affine diffusion processes and option pricing with Fourier transform LIBOR market models and credit risk the focus is on a mathematically straightforward but rigorous development of the theory students researchers and practitioners will find this

volume very useful each chapter ends with a set of exercises that provides source for homework and exam questions readers are expected to be familiar with elementary itô calculus basic probability theory and real and complex analysis

the handbook presents an overview of most aspects of modernbanach space theory and its applications the up to date surveys authored by leading research workers in the area are written to be accessible to a wide audience in addition to presenting the state of the art of banach space theory the surveys discuss the relation of the subject with such areas as harmonic analysis complex analysis classical convexity probability theory operator theory combinatorics logic geometric measure theory and partial differential equations the handbook begins with a chapter on basic concepts in banachspace theory which contains all the background needed for reading any other chapter in the handbook each of the twenty one articles in this volume after the basic concepts chapter is devoted to one specific direction of banach space theory or its applications each article contains a motivated introduction as well as an exposition of the main results methods and open problems in its specific direction most have an extensive bibliography many articles contain new proofs of known results as well as expositions of proofs which are hard to locate in the literature or are only outlined in the original research papers as well as being valuable to experienced researchers in banach space theory the handbook should be an outstanding source for inspiration and information to graduate students and beginning researchers the handbook will be useful for mathematicians who want to get an idea of the various developments in banach space theory

this book gives a self contained intuitive overview of some of the most important topics of finance such as investment risk market pricing and market efficiency arbitrage hedging and the pricing and application of financial derivatives it provides a first principles introduction to the relevant material and concepts emphasising intuition financial terminology and the understanding implicit therein is carefully introduced the books starts with finance in the most general terms and gradually specialises to investment theory and then derivatives this book is tailor made for readers new to finance such as graduate students entering or interested in finance or financial practitioners moving to a more quantitative role

the remarkable growth of financial markets over the past decades has been accompanied by an equally remarkable explosion in financial

engineering the interdisciplinary field focusing on applications of mathematical and statistical modeling and computational technology to problems in the financial services industry the goals of financial engineering research are to develop empirically realistic stochastic models describing dynamics of financial risk variables such as asset prices foreign exchange rates and interest rates and to develop analytical computational and statistical methods and tools to implement the models and employ them to design and evaluate financial products and processes to manage risk and to meet financial goals this handbook describes the latest developments in this rapidly evolving field in the areas of modeling and pricing financial derivatives building models of interest rates and credit risk pricing and hedging in incomplete markets risk management and portfolio optimization leading researchers in each of these areas provide their perspective on the state of the art in terms of analysis computation and practical relevance the authors describe essential results to date fundamental methods and tools as well as new views of the existing literature opportunities and challenges for future research

arguably the strongest addition to numerical finance of the past decade algorithmic adjoint differentiation aad is the technology implemented in modern financial software to produce thousands of accurate risk sensitivities within seconds on light hardware aad recently became a centerpiece of modern financial systems and a key skill for all quantitative analysts developers risk professionals or anyone involved with derivatives it is increasingly taught in masters and phd programs in finance danske bank s wide scale implementation of aad in its production and regulatory systems won the in house system of the year 2015 risk award the modern computational finance books written by three of the very people who designed danske bank s systems offer a unique insight into the modern implementation of financial models the volumes combine financial modelling mathematics and programming to resolve real life financial problems and produce effective derivatives software this volume is a complete self contained learning reference for aad and its application in finance aad is explained in deep detail throughout chapters that gently lead readers from the theoretical foundations to the most delicate areas of an efficient implementation such as memory management parallel implementation and acceleration with expression templates the book comes with professional source code in c including an efficient up to date implementation of aad and a generic parallel simulation library modern c high performance parallel programming and interfacing c with excel are also covered the book builds the code step by step while the code illustrates the concepts and notions developed in the book

since its introduction in the early 1980s the risk neutral valuation principle has proved to be an important tool in the pricing and hedging of financial derivatives following the success of the first edition of risk neutral valuation the authors have thoroughly revised the entire book taking into account recent developments in the field and changes in their own thinking and teaching in particular the chapters on incomplete markets and interest rate theory have been updated and extended there is a new chapter on the important and growing area of credit risk and in recognition of the increasing popularity of lévy finance there is considerable new material on infinite divisibility and lévy processes lévy based models in incomplete markets further material such as exercises solutions to exercises and lecture slides are also available via the web to provide additional support for lecturers

financial risk management is a topic of primary importance in financial markets it is important to learn how to measure and control risk how to be primed for the opportunity of compensative return and how to avoid useless exposure

presents a collection of 18 papers many of which are surveys on asymptotic theory in probability and statistics with applications to a variety of problems this volume comprises three parts limit theorems statistics and applications and mathematical finance and insurance it is suitable for graduate students in probability and statistics

arbitrage theory provides the foundation for the pricing of financial derivatives and has become indispensable in both financial theory and financial practice this textbook offers a rigorous and comprehensive introduction to the mathematics of arbitrage pricing in a discrete time finite state economy in which a finite number of securities are traded in a first step various versions of the fundamental theorem of asset pricing i e characterizations of when a market does not admit arbitrage opportunities are proved the book then focuses on incomplete markets where the main concern is to obtain a precise description of the set of market consistent prices for nontraded financial contracts i e the set of prices at which such contracts could be transacted between rational agents both european type and american type contracts are considered a distinguishing feature of this book is its emphasis on market consistent prices and a systematic description of pricing rules also at intermediate dates the benefits of this approach are most evident in the treatment of american options which is novel in terms of both the presentation and the scope while also presenting new results the focus on discrete time finite state models makes it

possible to cover all relevant topics while requiring only a moderate mathematical background on the part of the reader the book will appeal to mathematical finance and financial economics students seeking an elementary but rigorous introduction to the subject mathematics and physics students looking for an opportunity to get acquainted with a modern applied topic and mathematicians physicists and quantitatively inclined economists working or planning to work in the financial industry

the present introductory lectures on arbitrage based financial asset pricing are a first attempt to give a comprehensive presentation of arbitrage theory in a discrete time framework by the way all the results given in these lectures apply to a continuous time framework but probably in continuous time we could achieve stronger results of course at the price of stronger assumptions it has been turned out in the last few years that capital market theory as derived and evolved from the capital asset pricing model capm in the middle sixties can to an astonishing extent be based on arbitrage arguments only rather than on mean variance preferences of investors on the other hand arbitrage arguments provided access to a wider range of results which could not be obtained by standard capm methods e g the valuation of contingent claims derivative assets or the investigation of futures prices to some extent the presentation will loosely follow historical lines a selected set of capital asset pricing models will be derived according to their historical progress and their increasing complexity as well it will be seen that they all share common structural properties after having made this observation the presentation will become an axiomatic one it will be stated in precise terms what arbitrage is about and what the consequences are if markets do not allow for risk free arbitrage opportunities the presentation will partly be accompanied by an illustrating example two state option pricing

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