

Index

- Absolute constant, 119
Absolute moments metric, 75
Absolute risk aversion
 decrease, 147, 152
 formal measure, 146
Absolute value, removal, 306
Active portfolio return, 318
 definition, 288
Active strategy
 expectations, 287
 usage, 289–290
Affine, 52n
Allegheny Energy Inc., stock, 301n
Allied Capital Corp., stock, 301n
Almost everywhere identity, 84–85
Alpha. *See* Portfolio
 threshold. *See* Expected alpha
Alpha quantile (α -quantile), 16
 obtaining. *See* Continuous probability
 distributions
Alpha stable (α -stable), 121
Alpha-stable distributions. *See* Lévy
 alpha-stable distributions
AMB Property Corp., stock, 301n
Analytic functions, 277
Approximation of Poisson, 103
Arbitrary random variable, 31
Arbitrary real numbers, limits, 53
Archimedean axiom, 162
Arrow, Kenneth, 140
Asset pricing theory, 17
Assets
 continuous return (log-return),
 assumption, 25
 expected returns, 43
 grouping constraints, portfolio manager
 imposition, 275
 prices
 correspondence, 25–26
 dependence structure, 25
 random return, 250
 return. *See* Expected assets return
 covariances, 249
Asymmetric phenomenon, 172
Asymmetry, probability distribution function
 descriptor, 13–14
Asymptotic negligibility, 117
 condition, 131–132
 holding, 132
Attraction, domain. *See* Domain of attraction
Auxiliary variables, vector, 261
AVaR. *See* Average VaR
Average active return, 344
 calculation, STARR (usage), 318
Average compound metric, selection,
 305–306
Average loss, calculation, 129–130
Average metric. *See* Distribution function
Average portfolio underperformance,
 measurement, 306
Average realized active portfolio return, 329
 comparison, 326
Average VaR (AVaR), 200, 207–214. *See*
 also Return; Tail probability
 absolute difference, upper bound
 (possibility), 226
 alternative, 230
 appendix, 227–243
 backtesting, 220–222
 failure, 221
 bibliography, 244
 change, 240–241
 coherent risk measure, example, 197–198
 computation, 212. *See also* Portfolio
 AVaR
 contrast. *See* Expected tail loss
 definition
 connection, 212
 consequence, 214n
 quantile function, integral, 232–233
 empirical observations, 215
 estimation, 214–217
 hybrid method, adaptation, 218
 sample, usage, 223–224, 263
 ETL, relationship, 237–238
 examples, 226
 fluctuation, boxplot diagrams, 220f
 geometric interpretation, 212

- Average VaR (AVaR), 200, 207–214. *See also* Return; Tail probability
(*Continued*)
geometric representation, 211f
introduction, 207–208
linearization, 352
minimization formula, 232–235
numbers, 219
optimization problem, 260
risk measure selection, 246
selection, 260
tail probability, 332
usage. *See* Stable distributions
- Average VaR of order one, 231
- Aversion coefficient, 269
- Axiomatic construction, 73–74. *See also* Probability
- Axiomatic description, 178–179
- Axioms, usage, 305–307
- Backtesting. *See* Value-at-Risk
- Backward-looking tracking error (ex post tracking error), 289
- Basel Committee on Banking Supervision, 172n–173n
amendments, release, 182
- Bayes formula, 18
- Benchmark
deviation, 86
portfolio, return, 319, 345
complication, 323
relationship. *See* Probability metrics
risk profile, matching, 289–290
- Benchmark return
inverse distribution function, 303
reduction, 337f
risk-free rate, equivalence, 342
standard deviation, 299
variance, 314, 323
- Benchmark tracking, 85
appendix, 304–315
bibliography, 315
numerical example, 300–304
- Benchmark tracking problems, 300
equations, application, 312–313
introduction, 287–288
setting, 306
examples, 311–312
- Bernoulli, Daniel, 142–143
- Bernoulli, Jacob, 103
- Bernoulli-distributed random variable, 3
- Bernoulli distribution, 3
natural generalization, 4
- Berry-Essen result, 105
- Berry-Essen theorem, 119n
- Binomial c.d.f., result, 111f
- Binomial c.d.f.s. *See* Centered binomial c.d.f.s.; Normalized binomial c.d.f.s.
- Binomial coefficient, 106–107
- Binomial distribution, 3–4
probabilistic properties, 109
usage, 107–108
- Binomial path, path closeness, 111
- Binomial trees, construction, 111
- Birnbaum-Orlicz average distance, 96
- Birnbaum-Orlicz compound average distance, 98
- Birnbaum-Orlicz compound metric, 86
selection, 305
usage. *See* Symmetry axiom
- Birnbaum-Orlicz compound uniform distance, 98
- Birnbaum-Orlicz distance, definition, 102
- Birnbaum-Orlicz metric, 126
- Birnbaum-Orlicz quasisemimetric, consideration, 311
- Birnbaum-Orlicz uniform distance, 96
- Black-Scholes equation, 104
- Borel sets, 2n
- Bounded interval, 235
- Bounded risk spectra, 242
- Box-and-whiskers diagram, 191n
- Box-type constraints, 275
- Boxplot, 191n
diagrams. *See* Average VaR; 99% VaR
- Brownian motion, 104
- Cambanis-Simons-Stout theorem, 100
applicability, 309
application, 100–101
Fréchet-Hoeffding inequality, relationship, 102
usage, 308–309
- Capital Asset Pricing Model (CAPM), 340
- Capital market line, 257f
generation, mean-variance analysis (usage), 353–354
quasiconcave ratios, relationship, 353–356
Sharpe ratio, relationship, 340–343
- Capital reserve, VaR equivalence, 182
- CAPM. *See* Capital Asset Pricing Model
- Cash invariance, 196
- Cauchy-Bunyakovski-Schwarz inequality, 89
c.d.f. *See* Cumulative distribution function

- c.d.f.s. *See* Cumulative distribution functions; Discrete cumulative distribution functions
- Centered binomial c.d.f.s., 113f
- Centered moment of order, 15
- Centered normal distribution, limit distribution, 112–113
- Centered portfolio return, distance measurement, 295
- Centered sum
denotation, 119, 133
distribution, convergence, 115, 117
- Centering, procedure. *See* Random variables
- Central absolute moments, 178–179
- Central Limit Theorem (CLT), 4, 61. *See also* Classical CLT; Generalized CLT; Max-stable CLT
application. *See* Financial assets
conditions, 131–133
holding, 117
implication, 115
necessary conditions, 133
result, 113
special case, 103–104
statement, 10
sufficient conditions, 133
- Central moment. *See* Second central moment
rescaling. *See* Fourth central moment;
Third central moment
- Characteristic function, 121
- Chebyshev's inequality, 30–31
demonstration, 30
geometric illustration, 31f
usage, 175
- Choice
axioms, 161–163
problem. *See* Portfolio uncertainty, impact
appendix, 161–169
bibliography, 169–170
choice, 139
introduction, 139–141
- Classical CLT, 105–119
general case, 112–118
regularity conditions, 115–117
- Closed-form solution, obtaining, 279
- Closeness, determination, 290
- CLT. *See* Central Limit Theorem
- Codomain, 41n
- Coefficients, determination, 239
- Coherent reward measure, 282
- Coherent risk measures, 173–174
assumption, 267, 319n
- axioms, 210
class, identification, 266
identification, 194–198
subfamily, dispersion measures (connection), 268
usage, 232
- Coins
independent tosses. *See* Unfair coins
pair, joint distributions. *See* Fair coins
tosses, experiment, 112–113
tossing experiment, 193
- Commodities, state-contingent bundles (consideration), 140
- Common stocks
daily log-returns, observation, 123
equal shares, 180
inclusion. *See* Portfolio price
consideration, 114
random variable, description, 155
return distribution, 76
description, random variables (usage), 78, 83
- Var, 79
- Complementary slackness conditions, 55
- Completeness, 162
- Compound distances, 97–98
- Compound functional, 92–93
- Compound metrics, 62–63. *See also*
Birnbaum-Orlicz compound metric; Ky
Fan metric; p -average compound metric
category, 84–86
upper bound, 88
usage, 72–90
- Compound r.d. metrics, 296
- Concave function, 41
- Concave order, equivalence. *See*
Rothschild-Stiglitz stochastic dominance
- Concave utility function, 146
- Concavity, assumption, 151
- Condition of Lindeberg-Feller. *See*
Lindeberg-Feller
- Conditional distribution, tail variance, 229
- Conditional loss
c.d.f., inverse distribution function, 230
dispersion, 229
distributions, characteristics, 228–230
median, 213n
- Conditional probability, 11
explanation, 18
- Conditions, tail behavior (basis). *See* Spectral risk measures

- Confidence intervals, 190–191. *See also*
 Exceedances
 calculation. *See* 95% VaR
- Confidence levels
 parameters, 182
 VaRs (absolute differences, sum), 81–82
- Consistency rule, 93
 pair satisfaction, 93–94
- Constrained optimization, 48–58. *See also*
 Unconstrained optimization
- Constraint set, 35
 identification, 48
 linear equalities/inequalities, 58
- Constraints. *See* Box-type constraints
 types, 274–276
- Continuity condition, 162
- Continuous c.d.f., assumption, 233
- Continuous distribution
 function, expectation, 233f
 parameters, formulae, 15f
- Continuous probability distributions, 5–12
 alpha quantile, obtaining, 16n
 formula, 15, 16
- Continuous random variable, 5
 zero value, 6–7
- Contour lines. *See* Tangential contour line;
 Two-dimensional quasiconvex function
 representation, 39f
 transformation. *See* Copula density
- Convergence, induction, 98
- Convex dispersion, 173
- Convex functions, 40–46, 101
 application. *See* Risk management
 continuousness, 42
 definition, illustration, 41f
 differentiation, absence, 42
 domain, 42
 local minima, 42
 properties, 42
 satisfaction, 41
 sum, 42–43
- Convex optimization
 problem, 284–285
 subcases, 49
- Convex problems, 35
- Convex programming, 49
 problem, 348–352
 programs, form, 52–53
 usage, 52–55
- Convex reward measure, ratio, 356
- Convex risk measures, 201–202
 assumption, 319n
 ratio, 356
- Convex sublevel sets, 47f
- Convexity, 201
 assumption, 280
 implication. *See* Optimization
 property, 279–280, 351
- Copula. *See* Maximal copula; Minimal
 copula
 etymology, 26
 function, 27
 indifference, 26
 probability distribution, equivalence, 32
 usage, advantages, 26
- Copula density. *See* Two-dimensional
 normal distribution
 contour lines, transformation, 27–28
 correspondence, 27
 increase, 29
- Copula functions, 25–30
 mathematical perspective, 26
- Correlation, 20–21
 coefficient, bounds, 89
 covariance relationship, 21
 matrix, equation, 250
- Covariance, 20–21
 denotation, 21
 determination, 187
 matrix. *See* Stocks; Variance-covariance
 matrix
 examination, 250
 inverse, denotation, 342–343
 representation, 93–94
- Credit risk, 172–173
 contrast, 11
- Cumulative distribution function (c.d.f.),
 5–8. *See also* Discrete cumulative
 distribution functions; Normal
 distribution
 argument, 19
 cross, 208
 description, 143
 formula, 12
 inverse distribution function. *See*
 Conditional loss
 involvement, 147
 n -th integral, 164
 possibility, 120n
 properties, 357–358
 result. *See* Binomial c.d.f.
 speed, 119
 terms, expression, 236–237
 usage, 27
- Cumulative distribution functions (c.d.f.s.),
 245

- Cumulative probability function, 7–8
 Cumulative prospect theory, 140–141
 Curve area, calculation, 7
- de Moivre, Alexander (theorem), 103
 de Moivre-Laplace, theorem, 103–104
 adaptation, 110
 local theorem, 109n
 usage, 108–109
 Debreu, Gérard, 140
 Debt obligations, default (consideration), 2–3
 Decision making (theory), uncertainty (impact), 140
 Decomposition, application, 268–269
 Default
 annualized probability, 3
 intensity, 11
 rate, 11
 Degree of freedom, 12
 Degree of homogeneity, impact, 303–304
 examination, 301
 Degrees. *See* Positive homogeneity of degrees
 Densities
 absolute difference, 127f
 plots, 209f
 uniform distance, 127–128
 uniform metric
 illustration, 82f
 usage, 92–93, 126
 Density function, 6. *See also* Probability density function; *t*-distribution
 argument, 19
 denotation, 6
 distances, measurement, 127
 Density generator, 25
 Density graphs. *See* Negatively skewed distribution; Positively skewed distribution
 Dependence
 local structure, 28–29
 measure, 25
 Derivatives, calculation, 45n. *See also* Partial derivatives
 Deviation. *See* Standard deviation
 measures, 179, 198. *See also* Symmetric deviation measures
 characteristics. *See* Downside deviation measure
 r.d. metrics, relationship, 305
 Die
 c.d.f.s., plot, 67f
 faces, probabilities, 63t
 inverse c.d.f.s., plot, 68f
 Differentiable function, minima/maxima, 37–40
 Discrete cumulative distribution functions (c.d.f.s.), 66. *See also* Centered binomial c.d.f.s.; Inverse c.d.f.s.; Normalized binomial c.d.f.s.
 absolute differences, 76f, 78f
 deviation, 118
 plot, 67f
 Discrete distribution, parameters (formulae), 15f
 Discrete probability distributions, 2–5
 moment of order, calculation, 15
 Discrete random variables
 characteristics, 65–66
 example, 63
 payoff, 145
 Dispersion, probability distribution function descriptor, 13
 Dispersion measures, 173, 349. *See also* Downside dispersion measure 177–178; Upside dispersion measure
 axiomatic introduction, 333
 contrast. *See* Risk
 relationship. *See* Probability metrics; Risk measures
 Distances, measurement, 293. *See also* Centered portfolio return
 characteristics, sets, 63–64
 discrete case, 62–72
 Distribution
 convergence, metrizing, 134n
 functional, 174n
 mean, 172
 Distribution function, 7, 64–68. *See also* Cumulative distribution function; Normal distributions; Probability; Two-dimensional random variable
 coincidence, 84
 consideration. *See* *n*-dimensional random vector
 continuousness, absence, 8
 differentiation, absence, 8
 first-order partial derivatives, 19
 first-order Taylor series approximation, 83n
 illustration, 298f, 299f
 inverse, 183
 involvement, 84
 jump, existence, 9f
 L_p -metrics, 79, 126
 probability, 159f
 simple metrics, 75

- space, average metric, 80–81
- Diversification
 effect, recognition, 185–186
 variance, degree (measurement), 258
- Domain, 41n. *See also* Codomain
- Domain of attraction, 10
 property, 104n
- Downside deviation measure, characteristics, 180
- Dual stochastic order, 161
- Ducats, payoff, 142n
- Economic agent
 preference, 144
 preference relation/order, 144
- Efficient frontier. *See* Mean-risk efficient frontier
 frontier; Mean-variance efficient frontier
 concave shape, 265–266
 correspondence, 252
 description, 258
 generation, minimal tracking error problem (usage), 291f
 illustration, 263, 290
 linear section, nonunique tangent portfolios, 347f
 plot, 264f
 portfolios, selection, 265f
 representation, standard deviation (usage), 253–254
 tangent portfolio
 mean-shifted risk plane, 322f
 relationship, 321f
- Efficient portfolios, 320
 relationship. *See* Reward-to-risk ratio; Reward-to-variability ratio set, 262
- Efficient sets, 154
- Elements. *See* Random elements
- Elliptical distributions, 23–25. *See also* n -dimensional random vector
- EMC Corp/Massachusetts, stock, 301n
- Empirical inverse distribution functions, 314
- Empirical r.d. metric, simplification, 314–315
- Engineer's metric, 75
- Enhanced indexing, 290
- Equality constraints
 defining, 53
 zero value, 49
- Equally weighted portfolio
 inverse distribution function, 302f
 usage, 301
- Equity portfolios
 consideration, 293–294
 strategies, classification, 290n
- Equivalence, meaning, 91–92
- ETL. *See* Expected tail loss
- Euclidean metric
 appearance, 91
 example, 90
- Event. *See* Rare events
 dependence. *See* Extreme events
 joint probability, 18
 probability, 6f, 20. *See also* Random variable
 equivalence, 106
- Ex ante analysis, 289
- Ex ante forward-looking tracking error, 289–290
- Ex post analysis, 288–289. *See also* Strategies performance
- Ex post tracking error. *See* Backward-looking tracking error
- Exceedances, confidence interval, 193
- Excess kurtosis, 15
- Expectations bounded coherent risk measure, decomposition, 327
- Expected alpha
 lower bound, imposition, 295–296
 threshold, 290
- Expected assets return, 248
- Expected payoff, 142
 increase, 148–149
- Expected portfolio return, 248
 equation, 250
 impact, 267–268
 lower bound, 259
 representation, 278
- Expected returns. *See* Portfolio; Stocks constraint, variance, 252
 portfolio. *See* Maximum expected return portfolio
 variances, equivalence, 74
- Expected risks/rewards, balancing, 35
- Expected shortfall, 209
- Expected tail loss (ETL), 228. *See also* Tail probability
 AVaR, contrast, 236–241
 graphs, 240f
 natural estimator, 238–239
 reduction, 241
 relationship. *See* Average VaR
 step function. *See* Tail probability
- Expected utility
 maximization problem, relationship. *See* Mean-variance analysis

- representation, uniqueness, 165
- theory, 139–140
- usage, 141–147
- Expected value, 14
- Exponential distribution, 10–11
 - centered sum
 - c.d.f.s., 116f
 - density functions, 116f
 - convergence, 115
 - normalized sum
 - c.d.f.s., 116f
 - density functions, 116f
- Exponential smoothing algorithm, 188
- Exponential utility function, 147
- Exponentially declining weights, attachment.
 - See* Historical returns
- Extrema, 37
 - characterization, 37–38
- Extreme events, dependence, 26
- Extreme value distribution, 12. *See also*
 - Fréchet-type extreme value distribution;
 - Generalized extreme value distribution;
 - Gumbel-type extreme value distribution;
 - Weibull-type extreme value distribution
- Failure rate, 11
 - function, 167–168
- Fair coins (pair)
 - heads, occurrence (probabilities), 108f, 108t
 - independent tosses, 111f
 - indistinguishability, 69
 - joint distributions, 68–69
 - one-dimensional distributions, metric (application), 71–72
 - outcomes, joint probabilities, 69t, 71t
 - maximal metric, 71
 - minimal metric, yield, 70t
- Fat-tailed distribution, application details, 123n
- Feasible points, set. *See* Set of feasible points
- Feasible portfolios
 - portfolio return, 346
 - set, 275–276, 278
 - zero/negative risk, 324
- Feasible set, tangential contour line, 57f
- Feasible set of portfolios, convexity, 324n
- Feasible solutions, set, 35
- Financial assets
 - consideration, 248
 - modeling
 - CLT, application, 117–118
 - stable distributions, usage, 122–124
- Financial institutions, 173
- Financial variables, summation (meaning), 113–115
- Finite mathematical expectation, 95
- First difference pseudomoment, 80–81
- First-order condition
 - representation, 38
 - solution. *See* Unconstrained optimization
 - sufficiency, 40
- First-order partial derivatives. *See* Distribution function
- First-order stochastic dominance (FSD), 141, 148–149
 - illustration, 149f
 - order, 154, 157
 - characterization, 200
 - consideration, 160
- First-order Taylor series approximation. *See* Distribution function
- First quartile, 15
- Fisher's kurtosis, 15
- Fisher's skewness, 14–15
- Ford Motor Company, survival (condition), 11
- 40% tail probability, 263
- Forward-looking tracking error. *See*
 - Medium-sized forward-looking tracking error;
 - Small-sized forward-looking tracking error
- Foundation of Statistics, The* (Savage), 140
- Fourier transform, 120n
- Fourth central moment, rescaling, 14
- Fractional problem, solution, 348
- Fractional program, 345–346. *See also*
 - Quasiconcave fractional program
- Fréchet-Hoeffding inequality, 32
 - distribution function, relationship, 101–102
 - relationship, 102
 - two-dimensional case, 32
 - upper bound, 309
 - usage, 308–309
- Fréchet lower bound, 32
- Fréchet-type extreme value distribution, 12
- Fréchet upper bound, 32
- Freedom, degree. *See* Degree of freedom
- FSD. *See* First-order stochastic dominance
- Function
 - mathematical rule, 41n
 - real number, assignment, 41n
- Function gradient, 38

- Functional. *See* Compound functional;
Distribution; Maximal functionals;
Minimal functionals; Translation
invariant functional; Weakly regular
functional
definition, 41n, 73n
equations, usage, 297
generation, deviation measure (usage),
296
- Functional Limit Theorem, 104
- Functional limit theorems, 61
- Funding cost, 77
- Future return, probability, 18
- Generalized CLT, 61, 104
context, 124
knowledge, 222
limit distributions, 123
problems, study, 125
stable distributions, 120–122
usage, 120–124
- Generalized extreme value distribution, 12
- Generalized Rachev ratio, 357–358
- Gini-type ratio, 356
- Glivenko-Cantelli theorem, 241n
- Global minimum. *See* Objective function
attaining, 36
minimal value, 47
- Global minimum risk portfolio, 263
impact, 272
solution, 267–268
value, coinciding, 269n
- Global minimum variance portfolio
obtaining, 252
portfolio, calculation, 255
- Government security earning return, 197
- Gradient. *See* Zero gradient
components, computation, 45n
- Gumbel-type extreme value distribution, 12
- H-average compound distance, 97
- Hazard rate, 11
function, 167–168
- Heads
occurrence, 106
probability, 108t
- Higher-order AVaR, 213
monotonic sequence, 232
notion, 227–228
usage, 230–232
- Higher-order tail moments, 228–229
- Hill estimator, 222
- Historical method. *See* Portfolio AVaR;
Portfolio VaR
- Historical returns, exponentially declining
weights (attachment), 188
- Homogeneity, impact (examination). *See*
Degree of homogeneity
- Homogeneity property, 125
financial interpretation, 125
- Hybrid method. *See* Portfolio AVaR;
Portfolio VaR
- Hypercube. *See* Unit hypercube
- Ideal metrics, 105
finiteness, guarantee, 134
identification, 124–125
interpretations, 128–131
remarks, 133–136
- Ideal probability metrics, 103
appendix, 131–136
bibliography, 136–137
introduction, 103–105
- Identity axiom, 125
- Identity matrix, denotation, 330
- Identity property, 91
identification, 91
- Independence axiom, 162
- Independent and identically distributed
(i.i.d.). *See* Summands
infinite variance random variables, 104
observations, 188
random variables, convergence, 120
- Independent distribution. *See* Random
variable
- Independent identically distributed (i.i.d.),
61
- Independent tosses, 106, 107
- Index of stability. *See* Stability
- Indexing. *See* Enhanced indexing; Passive
strategy
- Indicator-type events, number, 194
- Individuals, preferences (von
Neumann-Morgenstern
characterization), 141
- Inequality
change, 242
constraints, 340
defining, 53
implication, 119
satisfaction, 239
- Infinite variance random variables. *See*
Independent and identically distributed
infinite variance random variables
- Initial investment, size, 195

- Integer-valued random variables. *See* Positive integer-valued random variables
- Integral calculus, 7
- Integration range, 165
- Interarrival times, 11
- Interquartile range, 178–179
identification, 191n
- Interval
probabilities, 176f
splitting, 114
standard normal density, 176f
- Invariance, 201
property, 196–198
usage, 282
- Invariance Principle, 104
- Inverse c.d.f., properties (usage), 358
- Inverse c.d.f.s., 67–68. *See also* Random variables
absolute differences, 80f
plot, 81f
graph, 211f
area, closure, 233
plot, 68f
terms, expression, 236–237
- Inverse distribution functions. *See* Conditional loss
comparison, 301–303
illustration, 298f, 299f
 L_p -metrics, 80–82, 126
uniform metric
illustration, 80f
usage, 79–80
- Investments
opportunities, sets (distributional properties), 18
returns, description, 129
- Investors
preferences, 145–146
utility function
consistency, 255
usage, 155
- Ito processes, theory, 104
- Joint distribution, 68–72
knowledge, 69
maximal metric, achievement, 71
- Joint normal distribution, 312–313
hypothesis, 312
- Joint probabilities
consideration, 86n
replacement, 309
- Joint probability distributions, 17–30
definition, 19
- JP Morgan, contribution, 182
- k -th derivative, denotation, 166
- Kahneman, Daniel, 140–141
- Kantorovich distance, 95
- Kantorovich metric, 78–79. *See also* Weighted Kantorovich metric
definition, 126
usage, 226
illustration, 78f
interpretation, 79
protominimal, 88
selection, 160
usage, 124–125
- Karush-Kuhn-Tucker (KKT) conditions, 49
analytic method, 54–55
necessity, 53
reduction, 55
- Karush-Kuhn-Tucker (KKT) theorem, 283
- Kolmogorov metric, 76–77, 83
asymmetric version, 311
background, 119n
conversion, 79
definition, 126
illustration, 76f
insensitivity, 77
maximum deviation, 77
obtaining, 96
selection, 159f
- Kolmogorov-Rachev metric, 136
- Kolmogorov-Smirnov test, 194
- Kolmogorov test, 194
- Kurtosis, 14. *See also* Excess kurtosis;
Fisher's kurtosis; Pearson's kurtosis
- Ky Fan distance, 97–98
- Ky Fan metric, 85–86
parametric family, 97
- $I_1(X, Y)$ metric, 81–82
- Lagrange, Joseph-Louis, 255n
- Lagrange multipliers, 49–52
method, 50
gradient condition, 55
parameter, 255n
real numbers, equivalence, 50
steps, 51–52
usage, 279
- Lagrangian function, 51
- Laplace distributions, 24
- Law of Large Numbers, 17
usage, 103–104

- Lebesgue spaces of functions, denotation, 241–242
- Level curves, concept, 24n
- Leveraged portfolio, 341
- Lévy, Paul, 104
work, 120n
- Lévy alpha-stable distributions, 104
- Lévy metric, 77–78. *See also* Parametrized Lévy metric
parametric extension, 96
- Lévy stable, 120, 120n
distributions, tails (usage), 221
- Liability-driven indexes, development, 317
- Limit cases. *See* Relative deviation metric
- Limit distribution. *See* Centered normal distribution; Generalized CLT
distance, estimation, 118–119
- Limit relation, sums truth, 113
- Limit theorems
appeal. *See* Probability merits, 105
usefulness, 104
- Limiting maxstable distribution, 104
- Lindeberg-Feller, condition, 131
- Linear function, surface, 57f
- Linear problems, 35
convex problem, reduction, 280
obtaining, 215–216
- Linear programming, 49. *See also* Two-dimensional linear programming
- Linear programming problems, 55–57
derivation, 329
identification, 261–262
restrictions, 352–353
- Linear property, 162
- Linear Technology Corp., stock, 301n
- Linear utility function, 146
- Linearized STARR (LSTARR), 328
- Liquidity considerations, 247
- Local dependence structure. *See* Multidimensional random variable
- Local extrema, points, 38
- Local maxima, 38
function, plot, 39f
saddle point, 39f
- Local minima. *See* Convex functions
- Local minimum, 36. *See also* Objective function
global tendencies, absence, 37
- Location
invariance, 294–295
property, insufficiency, 298–299
parameter, 9, 121
mean, equivalence, 187
probability distribution function
descriptor, 13
- Location-scale invariance, 9. *See also* Normal distribution
- Logarithmic utility function, 146–147
graph, 153f
- Logistic distributions, 24
- London Interbank Offered Rate (LIBOR), percentage (change), 1
event, 2
- Long-only portfolio, construction, 196–197
- Loss
description, 218n
optimal solution, inverse distribution function, 303
distribution
assumption, 222
median, 213n
realization, 18
thresholds 79
- Lottery. *See* St. Petersburg Paradox
discussion, 143
individual (preference), von Neumann-Morgenstern numerical representation, 143
interpretation. *See* von Neumann-Morgenstern theory
- Lower partial moment
selected order, 331
usage, 130–131
- Lower partial moment of order, 129–130
- Lower-range-dominated deviation measures, 198
- Lower tail probability, 333
- L_p -metrics. *See* Distribution function; Inverse distribution functions
extension, 95
- LRR. *See* Reward-to-risk ratio
- LSTARR. *See* Linearized STARR
- Lyapunov's conditions, 104
- M-R. *See* Mean-risk
- M-V. *See* Mean-variance
- MAD. *See* Mean absolute deviation
- Mapping, notation, 295
- Marginal distributions, 19–20
function, 27
- Marginals, 27. *See also* Zero-mean normal marginals
- Market
crashes, 124

- portfolio, 256
 - location, 257
 - risky assets, 340
- risk, 172–173
 - variables, 172–173
- Mathematical tractability/convenience, gain, 5
- MATLAB, usage, 235, 278, 280, 314
- Matrix. *See* Nonsparse matrix; Sparse matrix
 - determinant, denotation, 22
 - notation, usage, 187
- Max-stable CLT, 61
- Maxima. *See* Differentiable function; Local maxima
- Maximal absolute difference, calculation, 66
- Maximal copula, 32
- Maximal distance, 70–71
 - explicit forms, 101
 - probability metric, 88
 - usage, 99–102
- Maximal functionals, 100
- Maximal metric
 - achievement. *See* Joint distribution
 - illustration, 89
 - obtaining, process, 89
 - usage, 72, 86–90
- Maximal RR ratio portfolio, 321–322
- Maximum expected return portfolio, 265–266
- Mean absolute deviation (MAD), 86
 - identification, 176–177
 - nonnegative number, 177
- Mean-deviation efficient frontier, tangent portfolio (relationship), 337f
- Mean-deviation efficient portfolio, containing, 273
- Mean-deviation optimal portfolios, sub-optimal characteristic, 272–273
- Mean-deviation plane, efficient portfolios, 271f
- Mean-risk (M-R) analysis, 258–274
 - drawback, 268
 - principle, basis, 259
 - SSD, relationship, 266–267
- Mean-risk (M-R) efficient frontier, 262–266
 - additions, 270
 - containing, 273
 - extension, 269–271
 - obtaining, 263–265
 - optimal portfolio coordinates, 272f
 - portfolios, addition, 271f
 - shape, 264–266
- Mean-risk (M-R) efficient portfolios, 336
- Mean-risk (M-R) optimization problem, 259–262
 - M-V optimization problem, contrast, 260
- Mean-risk (M-R) plane
 - efficient frontier, 264f, 270f
 - portfolios, plotting, 271–272
- Mean-risk (M-R) problems, solutions, 279–281
- Mean-shifted risk plane, 322
- Mean-standard deviation plane, 256
- Mean-variance (M-V) analysis, 245–246
 - drawback, 268
 - expected utility maximization problem, relationship, 277
 - inconsistency. *See* Second-order stochastic dominance
 - SSD, relationship, 254–256
 - usage, 247–258
- Mean-variance (M-V) efficient frontier, 251–254
 - illustration, 257f
 - plots, 252, 253f
 - set, change, 256–257
- Mean-variance (M-V) optimization
 - problems, 49
 - contrast. *See* Mean-risk optimization problem
 - type, 342
 - usage, 247–251
- Mean-variance (M-V) plane, efficient frontier, 253f
- Mean-variance (M-V) problems, solutions, 278–279
- Means of something, 17
- Median tail loss (MTL), 230
- Medium-sized forward-looking tracking error, 290
- Metrics. *See* Absolute moments metric; Engineer's metric; Kantorovich metric; Kolmogorov metric; Lévy metric; Smoothing metrics; Total variation metric; Uniform metric
 - construction, 68–69
 - function, notion, 90
 - indication, 128
 - selection, 93, 135
 - space, 90–91
 - example, 91
 - usage, 73
- Microsoft Corp., stock, 262–263
 - funds, loss, 2
 - percentage change, 1
- Minima. *See* Differentiable function

- Minimal copula, 32
- Minimal distances, 99–102
 explicit forms, 101
 mathematical proof, 99n
- Minimal functionals, 100
- Minimal metric, 70–71
 definition, 88
 illustration, 89
 importance, 87
 obtaining, process, 89
 relationship, 71–72. *See also* Minimal metric; Simple metrics
 usage, 72, 86–90
 zero distance, obtaining, 71
- Minimal r.d. metrics, 307–310
 construction, 308–309
 determination, 309
- Minimal standard deviation, portfolio yield, 339
- Minimal tracking error problem
 form, 290
 restatement, 291–292
 usage. *See* Efficient frontier
- Minimization formula. *See* Average VaR
- appeal, 215
 objective, 234–235
 representation, 212
- Minimum acceptable return level, 329
- Minkowski inequality, 351
- Modern portfolio theory (MPT), 246
- Moment-based conditions, 241–242
 summarization, 242
- Moment of order, 15. *See also* Tails calculation. *See* Discrete probability distributions
 centering. *See* Centered moment of order
- Moments, 14. *See also* Sample moments; Second moment; Statistical moments; True moments
 functions, 99–100
 metric. *See* Absolute moments metric
 rescaling. *See* Fourth central moment
- Monetary loss, 171
- Monotonicity, 201
 property, 194–195
 usage, 281
- Monte Carlo method. *See* Portfolio AVaR; Portfolio VaR
 artifact, 218
 merits, 191–192
 steps, 189
- Monthly log-return, 114
- Morgenstern, Oskar, 139
- MPT. *See* Modern portfolio theory
- MTL. *See* Median tail loss
- Multidimensional random variable, local dependence structure, 29–30
- Multivariate normal assumption, 216–217
- Multivariate normal distribution, 21–23
 covariance matrix, usage, 313
 density function, representation, 22
 example, 24
 mean/covariance, specification, 254
 random vector, joint distribution, 22
- Multivariate probability distribution, function. *See* Random vector
- Multivariate t -distribution, 24
- n -dimensional random vector
 distribution function, consideration, 31–32
 elliptical distribution, 24
 spherical distribution, 24
- n -dimensional space, points/gradients, 38
- n -dimensional vector space, 91
- n -th order stochastic dominance, 157
- $n \times n$ symmetric matrix, 43
- Negative probabilities, implication, 7n
- Negative semistandard deviation, definition, 177
- Negative skewness, measurement, 13–14
- Negatively skewed distribution, density graphs, 14f
- 95% confidence interval, calculation, 190t
- 95% VaR, equality, 211f
- 99% AVaR. *See* Standard normal distribution
 fluctuations, 219
- 99% VaR. *See* Standard normal distribution
 boxplot diagrams, 191f
- Non-Gaussian stable laws, 120n
- Non-random quantity, 282
- Nonconvex quadratic function, 43
- Nondecreasing property, 145–146
- Nondegenerate limit, obtaining, 112
- Nonlinear equality, 50
- Nonnegative convex function, 100
- Nonnegative portfolio weights, 48
- Nonnegative third derivative, 152
- Nonparametric method, 188
- Nonquasiconcave performance measures, 356–357
- Nonrandom monthly return, 184
- Nonsatiable investors, 141, 145
 preference, 148

- representation, 146, 156f
- risk aversion, 156
- Nonsatiable risk-averse investors
 - concern, 254
 - preference, 149–150
- Nonsparse matrix, 280
- Nonunique tangent portfolios. *See* Efficient frontier
- Nonzero probability, 8
 - states, 70
- Normal distribution, 8–10. *See also*
 - Multivariate normal distribution adoption, 110
 - binomial approximation, 105–111
 - c.d.f., 110
 - class, 9
 - closed-form expressions, 213
 - covariance matrix, usage, 314
 - density, 109
 - explicit form, 313
 - location-scale invariance, 9
 - mean/variance, 110
 - probability density function. *See*
 - Two-dimensional normal distribution summation stability, 10
 - usage, 213
 - variance, equivalence, 133
- Normal distributions, distribution functions 159f
- Normalized binomial c.d.f.s., 113f
- Normalized sum
 - denotation, 119, 133
 - distribution, convergence, 115, 117
- Normalizing, procedure. *See* Random variables
- Normative theory, 141
- Numerical integration, 235

- Objective function, 35. *See also* Quadratic
 - objective function
 - contour lines, 53
 - global minimum, 36
 - local minimum, 36–37
 - quadratic function, equivalence, 50
 - values, 51f
 - variable, 48
- One-dimensional distributions, fixed position, 89
- One-dimensional function,
 - minimization/maximization (relationship), 37f
- One-dimensional probabilities, nonchange, 70

- One-dimensional random variables, 73
- One-sided variability ratio, 318
 - usage, 331–332
- Operational risk, 172–173
- Optimal portfolio, 35
 - appearance, 269
 - appendix, 274–285
 - bibliography, 285
 - classification, 273f
 - compositions, 264f, 270f
 - generation, 273
 - introduction, 245–247
 - inverse distribution function, 302f
 - position, indication, 253f
 - problem. *See* Reward-dispersion optimal portfolio problem
 - benchmark-tracking type, 320
 - STARR, basis, 332
 - theory, 58
- Optimal ratio problem, example, 350
- Optimal RR ratio problem
 - analysis, 355
 - benchmark return, 335
 - geometric reasoning, 336
- Optimality, condition (providing), 52
- Optimization, 35. *See also* Constrained optimization; Unconstrained optimization
 - bibliography, 59–60
 - introduction, 35–36
 - solutions, statistical estimation-related problems, 288
 - theory, convexity (implication), 42
- Optimization problems. *See* Mean-risk optimization problem
 - example, 249–250
 - r.d. metrics, involvement, 304
 - result, 261–262
 - simplification, 334–335
 - solution, 216
 - statement, 249–250
 - structure, simplification, 280
 - types, distinction, 48–49
- Option contract, consideration, 2–3
- Option payments, S&P500 index value (impact), 3t
- Option pricing, binomial approach, 111
- Oracle Corp., stock, 262–263, 301n
- Order
 - absolute moment, 134
 - lower partial moment. *See* Lower partial moment of order
 - moment. *See* Moment of order

- Order (*Continued*)
 stochastic dominance relation, 163–164
- Orlicz's condition, 95
- Outcome, 2
 joint probabilities. *See* Fair coins
 subjective probabilities, 140
 unions, 66
 value, 65
- Outperformance, tracking error treatment, 291
- p -average compound metric, 85, 98
 minimal metrics, relationship, 87–88
- p -average metric, 97, 126
- p -tangent portfolio, 321
- Parameters
 formulae. *See* Continuous distribution;
 Discrete distribution
 hat, symbol, 17n
- Parametric bootstrap, 191
- Parametric model, assumption, 313–314
- Parametrized Lévy metric, 96–97
- Pareto distribution, 243
- Pareto power-type decay, 120n
- Partial derivatives, calculation, 52
- Passive portfolio construction strategies, 225
- Passive strategy (indexing), 287
- Path-dependent derivatives, pricing, 111
- Payoff
 contrast. *See* Return
 distributions
 description, random variables (usage), 238
 quantile, 185
 space, 156
 level, 152
 space, 156f
 utility, consideration, 142
- Peakedness, measurement, 14
- Pearson's kurtosis, 15
- Pearson's skewness, 15
- Percentage returns, construction, 182
- Percentiles, 16
- Performance
 improvement, 327
 level, absolute deviations, 130
- Performance band, width (decrease), 86
- Performance measures. *See* Nonquasiconcave performance measures; Quasiconcave performance measures
 appendix, 343–358
 bibliography, 359
 introduction, 217–218
- Poisson approximation. *See* Approximation of Poisson
 of Poisson
 Poisson-distributed random variable, 4–5
 Poisson distribution, 3, 4–5
 relationship, 11
- Polyhedral feasible set, surface, 57f
- Polyhedral set. *See* Unbounded polyhedral set formation, 56
- Polyhedral set of feasible of points, 56
- Portfolio. *See* Optimal portfolio
 alpha, 288–289
 equivalence, 289
 assets, return, 345
 AVaR calculation, 261
 cash conversion, 128
 c.d.f.s., 135
 centered random return, 297–298
 choice problem, 154
 one-period problem, treatment, 247
 common stocks, inclusion, 186
 composition
 assumption, 254
 quantity, independence, 187–188
 construction, 197
 strategies. *See* Passive portfolio construction strategies
 expected return, 186–187
 investment decision, 248
 loss, relationship, 310–311
 managers, investment style, 139
 maximal ratio, yield, 349
 optimal ratio, yield, 346–347
 outperformance/underperformance, minimization, 306–307
 past performance, 319
 processing, 192
 profits, consideration, 154–155
 random wealth, 294
 realized monthly returns, example, 338
 risk-free asset, inclusion, 256
 standard deviation, 339
 value, 195
 decrease, 183
 weights. *See* Nonnegative portfolio weights
 convex function, 319–320
 vector, 187
- Portfolio AVaR, computation, 216–220
 historical method, 217
 hybrid method, 217–218
 Monte Carlo method, 218–220
- Portfolio returns, 184. *See also* Expected portfolio return

- change, 293–294
- consideration, 154–155
- distribution, 191–192
 - distance, 225–226
- joint distribution, 334
- observation, 214n
- standard deviation, 299
- upper bound, 247
- variance, 248–249
 - equivalence, 250
- Portfolio risk
 - calculation, 189
 - estimation, 192
 - minimization, 171–172
 - upper bound, 259, 262
 - identification, 283
- Portfolio selection theory, 18
 - elliptical distributions, properties, 23–24
- Portfolio VaR, 185
 - computation, 186–192
 - historical method, 188
 - hybrid method, 188–189
 - Monte Carlo method, 189–192
 - RiskMetrics Group approach, 186–188
- Positive homogeneity, 202
 - axiom, 202
 - consequence, 235–236
 - property, 195
 - implication, 196
 - usage, 282, 284
- Positive homogeneity of degrees, 293–294
- Positive integer-valued random variables, 67
- Positive linear transform, 155n
- Positive random variable, 179
- Positive semidefinite matrix, 44
- Positive semistandard deviation, definition, 177
- Positive shift, 284
 - property, replacement, 179
- Positive skewness, measurement, 14
- Positively skewed distribution, density
 - graphs, 14f
- Positivity, 284
- Power utility function, 147
- Preference order, representation, 162
- Preference relation/order. *See* Economic agent
- Primary distances, 95
- Primary metrics, 62–63
 - category, 74–75
 - usage, 72–90
- Primary r.d. metrics, 296
- Probabilistic inequalities, 30–32
- Probability. *See* Event; Nonzero probability
 - axiomatic framework, 305
 - basic concepts, 2
 - concepts, 1
 - bibliography, 33
 - convergence. *See* Real-valued random variables
 - differences, 78–79
 - distances, 91, 94
 - examples, 94–98
 - function. *See* Cumulative probability function
 - introduction, 1
 - perspective, 2n
 - quantity, ratio, 11
 - quasidistance, 94
 - quasimetric, 94
 - quasisemidistance, 94
 - quasisemimetric, 94
 - semidistance, 94
 - semimetric, 94
 - space, consideration, 64
 - theory, limit theorems (appeal), 114–115
- Probability density function, 5–8. *See also* Two-dimensional normal distribution
 - level lines. *See* Two-dimensional probability density function
 - plot, 22
 - possibility, 120n
 - probability distribution, mathematical
 - connection, 8
 - providing, 6
- Probability distribution. *See* Continuous probability distributions; Joint probability distributions
 - assumption, 184–185
 - c.d.f., 163
 - characterization, 8
 - function, 5–8
 - description, 13
 - skewness, distribution, 13
 - symmetry/asymmetry, 13–14
- Probability metrics, 61, 73, 94, 118n
 - appendix, 90–102
 - application, 294n
 - axiomatic construction, 72, 73–74
 - remarks, 91–94
 - background, 119n
 - benchmark, relationship, 292–296
 - bibliography, 102
 - classes, identification, 61–62
 - classes, relationship, 86–87
 - consideration, 306–307

- Probability metrics, 61, 73, 94, 118n
(Continued)
construction, 124–131
definition, 125–126
deviation measures, relationship, 201–205
dispersion measures, relationship,
180–181
equations, demonstration, 203, 204
examples, 126–131
ideal metric of order, 134
introduction, 61–62
measurements, 75–76
notion, 173
performance measures, relationship,
357–358
quantification, 158–159
relationship. *See* Risk measures
selection, 225
suitability, 160
stochastic dominance, relationship,
157–161
theory, 62, 87, 357
theory, application potential, 292–293
Prospect, domination, 141
Protominimal, 88. *See also* Kantorovich
metric; Simple metric
- Quadratic expected utilities, maximization,
255
Quadratic function, 43. *See also* Nonconvex
quadratic function
equivalence. *See* Objective function
Quadratic objective function, 58
Quadratic problems, 35
Quadratic programming, 49
explanation, 57–58
Quadratic programming problems, 57–58
formulation, 278n
identification, 278–279
optimization problem, equivalence,
339–340
Quadratic utility function, 146
description, accuracy, 246
set, denotation, 254–255
theoretic plausibility, 274
usage, 255
Quantiles, 13–17. *See also* Alpha quantile
probability distribution function
descriptor, 16
Quantitative element, addition, 158
Quasi-antitone functions, 100–101
verification, 101
Quasiconcave fractional program, 347–348
Quasiconcave performance measures,
345–353
Quasiconcave ratios, relationship. *See*
Capital market line
Quasiconvex functions, 46–48
properties, 46–47
Quasidistance. *See* Probability
Quasimetrics, 91. *See also* Probability
Quasisemidistance. *See* Probability
Quasisemimetric. *See* Probability
consideration. *See* Birnbaum-Orlicz
quasisemimetric
max function, usage, 306
- R-R. *See* Reward-risk
R-ratio. *See* Rachev ratio
Rachev ideal metric, 129–131
concentration, 130
suitability, 160–161
Rachev metric. *See* Kolmogorov-Rachev
metric
Rachev metric, ideal of order, 135–136
Rachev ratio (R-ratio), 318. *See also*
Generalized Rachev ratio
global maximum, finding, 356
usage, 332–333
Random elements, 62
Random loss, description, 167
Random payoff, 194
interpretation, 183
Random percentage returns, 195
Random profit, VaR, 183
Random quantities, distance (measurement),
292
Random returns, 195
description, 183
Random variables. *See* Arbitrary random
variable; Bernoulli-distributed random
variable; Continuous random variable;
Discrete probability distributions;
Poisson-distributed random variable
behavior, 241–242
c.d.f., 237f
c.d.f.s. plot, 159
centering, procedure, 112
confidence level, 183f
consideration, 174
densities, 83–84, 167
dependence, 20, 87
dependencies, 308
description. *See* Common stocks;
Symmetric random variables
distance, 63

- calculation, 69
 - distribution, 120n
 - function, 308
 - event, probability, 7f
 - example. *See* Discrete random variables
 - finite moments, 75
 - function, coincidence, 65–66
 - independent distribution, 20
 - inequality, 298
 - infinite moments, 277
 - inverse c.d.f., 210
 - illustration, 237f
 - mathematical definition, 1n
 - normalizing, procedure, 112
 - objects, 73n
 - one-dimensional observations, 261
 - pair, joint distribution, 69–70
 - probability
 - convergence. *See* Real-valued random variables
 - distribution. *See* Single random variable
 - real-valued number, assignation, 194
 - second lower partial moment, 153
 - subspace. *See* Zero-mean random variables
 - sum, variance, 21
 - tails, 167
 - technical condition, 100
 - treatment, 86
 - uncorrelation. *See* Uncorrelated random variables
- Random vector
 - joint distribution. *See* Multivariate normal distribution
 - multivariate probability distribution, function, 26
 - usage, 22
- Rare events, 4n
- r.d. *See* Relative deviation
- Real-valued number, assignation, 194
- Real-valued random variables, 210
 - probability, convergence, 85
- Rectangle area, geometric interpretation, 31
- Regularity property, 126
 - financial interpretation, 126
- Relative deviation (r.d.) metric, 288. *See also*
 - Minimal r.d. metrics
 - asymmetry, 312
 - computation, practice, 311–315
 - definition, 296
 - estimation, sample (usage), 313–315
 - examples, 296–300
 - explicit calculation, possibility, 299
 - functional, 297
 - identification, 292
 - limit cases, 310–311
 - relationship. *See* Deviation
 - simplification. *See* Empirical r.d. metric
 - zero value, assumption, 298
- Return
 - description, random variable (usage), 169
 - distributions
 - AVaR, 211f
 - description, random variables (usage), 238
 - payoff, contrast, 154–157, 164–166
 - portfolio. *See* Maximum expected return portfolio
 - stochastic dominance, contrast, 164–166
- Reward-deviation optimization problem, 285
- Reward-dispersion optimal portfolio problem, 283–284
- Reward-dispersion optimization problem, 285
- Reward measure, 281
 - calculation, 319
 - usage, 345
- Reward-risk (R-R) analysis, 281–285
 - optimal portfolio problem, 354
 - principles, formulation, 282
- Reward-risk (R-R) efficient frontier, 283–284
- Reward-risk (R-R) model, 247
- Reward-to-risk (RR) ratio, 317–318
 - application, limitation, 324–325
 - efficient portfolios, relationship, 320–323
 - linearized form (LRR), 325
 - portfolio. *See* Maximal RR ratio portfolio
 - simplification, 319
 - usage, 318–333
- Reward-to-variability (RV) ratio, 317
 - efficient portfolios, relationship, 335–337
- Right-hand side inequalities, unification, 242n
- Risk. *See* Shifted risk
 - aversion function, 231
 - aversion parameter, 255
 - calculation, 319
 - chances, 279
 - difference, 171
 - features, 172
 - measures
 - coherence. *See* Coherent risk measures
 - dispersion measures, contrast, 267–274
 - plane. *See* Mean-shifted risk plane
 - proxy, 246

- Risk. *See* Shifted risk (*Continued*)
 spectrum, 222–223. *See also* Bounded risk spectra
 inverse, 243
 uncertainty, synonym, 171–172
- Risk, uncertainty (relationship), 171
 bibliography, 205
 introduction, 171–174
- Risk-averse coefficient, 325
- Risk-averse investors, 141, 149
 class, 150–151
 portfolio preference, 266
 preference, 158
 prospect, preference, 151–152
 representation, 156f
- Risk-averse portfolio manager,
 concentration avoidance, 275
- Risk-aversion function, 222–223
 choices, 224
 examples, 223f
 graph, 223
 inverse, 243
 properties, 223
 satisfaction, 241
- Risk-aversion property, 152
- Risk-free asset
 addition, 256–258, 353–354
 combination, 340
 inclusion. *See* Portfolio variance, zero level, 256
 weight, 341
- Risk-free rate
 level, 197
 vertical axis representation, 258
- Risk management, convex functions (application), 40
- Risk measures, 173. *See also* Coherent risk measures; Spectral risk measures
 absence, 180
 dispersion measures, relationship, 198–199
 examples, 181
 interpretation, 196
 probability metrics, relationship, 224–227
 stochastic orders, relationship, 199–200
 usage, 79, 181–198
- Risk-neutral investors, 146
- Risk/return, optimal trade-off, 258–259
- RiskMetrics Group, 182
 approach, 190. *See also* Portfolio VaR
- Risky assets
 investment, 354–355
 portfolio, 257
 weight, expression, 341
- Rothschild-Stiglitz dominance, 129
- Rothschild-Stiglitz stochastic dominance (RSD), 150–151
 concave order, equivalence, 150n
 order, quantification, 160
- RR. *See* Reward-to-risk
- RSD. *See* Rothschild-Stiglitz stochastic dominance
- RV. *See* Reward-to-variability
- Saddle point, 38. *See also* Local maxima
- Sample moments, 16–17
 calculation, 17t
 estimates, 16
- Sample space, 2
- Sand Technology, Inc., stock, 301n
- Savage, Leonard, 140
- Scale parameter, 9, 121
- Scaled random variables, 127f
 densities, 127
- Scaled tracking error, 312–313
- Scenario
 generation, 189
 VaR basis, 191
- Second
 Second central moment, 14
 Second derivatives, matrix, 39–40
 Second lower partial moment. *See* Random variables
- Second moment, 64
- Second-order stochastic dominance (SSD), 141, 149–150
 condition, 152–153
 illustration, 151f
 consistency, 169, 266
 example, 199
 M-V analysis, inconsistency, 246
 order, consistency, 200
 relationship. *See* Mean-risk analysis; Mean-variance analysis
 RR ratio, consistency, 325
 TSD, relationship, 153
- Second quartile, 16
- Semidistance. *See* Probability
- Semimetrics, 91. *See also* Probability
- Semistandard deviation, 177–178
 definition. *See* Negative semistandard deviation; Positive semistandard deviation
- Set of feasible points, 35. *See also* Polyhedral set of feasible of points

- boundary, 53–54
 - correspondence, 54f
 - identification, 48
- Set of feasible portfolios, 293
- Set of feasible solutions, 35
- Shape parameter, 9
- Sharpe ratio, 317
 - ex post analysis, 338
 - future performance, 339
 - introduction, 338
 - relationship. *See* Capital market line
 - usage, 337–340
- Shifted risk, 322
- Short-hand notation, usage, 109
- Sigma-field (sigma-algebra), 2n
- Simple distance, 95–97
- Simple metrics, 62–63
 - category, 75–84
 - minimal metrics, relationship, 87–88
 - protominimals, 88
 - usage, 72–90
- Simple probability distances, 99–100
- Simple r.d. metrics, 296
- Simplex method, 56
- Single random variable, probability
 - distribution, 18
- Skewness, 13–14. *See also* Fisher's skewness; Pearson's skewness; Probability measurement. *See* Negative skewness; Positive skewness
 - parameter, 121
- Small-sized forward-looking tracking error, 290
- Smoothing metrics, 136
- Smoothly truncated stable distributions, 123–124
- Sortino ratio, 317
 - usage, 329–330
- Sortino-Satchell ratio, 317–318
 - ex ante analysis, 331
 - ex post analysis, 330–331
 - maximization, 350–351
 - problem, 351–352
 - usage, 330–331
- Space, average metric. *See* Distribution function
- Sparse matrix, 280
- Spectral risk measures, 222–224
 - absolute difference, 227
 - conditions, tail behavior (basis), 242–243
 - definition, 242
 - estimation, 224
 - examples, 227
 - remarks, 241–243
- Spherical distribution. *See* *n*-dimensional random vector
- SSD. *See* Second-order stochastic dominance
- St. Petersburg Paradox, 141–143
 - explanation, 142–143
 - lottery, 143t
- Stability, index, 121
- Stable distributions, 243. *See also* Generalized CLT
 - AVaR, usage, 235–236
 - class, 10
 - properties, 121
 - usage. *See* Financial assets
- Stable hypothesis, infinite variance, 123
- Stable laws, density functions, 122f
- Stable Paretian, 120
 - distributions, 123
 - usage, 120n
- Stable tail-adjusted return ratio (STARR). *See* Linearized STARR
 - equivalence, 326
 - extensions, 343–345
 - negative AVaR, impact, 327
 - problem, discussion, 352–353
 - reduction, impact, 327
 - usage, 325–329. *See* Average active return
- Standard and Poor's 500 (S&P500)
 - daily return, 16
 - observation, 193f
 - index, inverse distribution function, 302f
 - illustration, 303f
 - value, impact. *See* Option payments
- Standard deviation
 - compound metric, 89
 - denotation, 21
 - equivalence, 175
 - measure, 174–176
 - obtaining, 13
 - scale parameter, 187
 - usage, 258–259
- Standard normal density. *See* Interval
- Standard normal distribution, 9
 - independent observations, 239
 - 99% AVaR, 219t
 - 99% VaR, 190t
- STARR. *See* Stable tail-adjusted return ratio
- Statistical dispersion, measure, 175
- Statistical model
 - parameters, estimation, 189
 - selection, 189

- Statistical moments, 13–17
 probability distribution function
 descriptor, 14–16
- Stochastic dominance, 147–157
 contrast. *See* Return
 order
 assumption, 168
 quantification, 159–160
 relation, 141, 157, 166–169. *See also*
 Order
 relationship. *See* Probability metrics
- Stochastic independence, 20
- Stochastic order, 161
 interest, 168
 M-V analysis, consistency, 255–256
 relationship. *See* Risk measures
- Stock portfolio
 rebalancing, 77–78
 return distribution description, random
 variable (usage), 77
 returns, description, 85
- Stock price
 daily log-returns, 118
 log-return distribution, 122–123
- Stocks
 expected return, 251
 returns, covariance matrix, 187
 S&P500 index placement, 262
- Strategies performance, measurement (ex
 post analysis), 318
- Strict inequality, 55
- Strictly expectation-bounded coherent risk
 measures, 198
- Strictly expectation-bounded risk measures,
 198
- Student's t -distribution, 11–12, 243
 degrees of freedom, 208
 usage, 213–214
- Sub-optimal portfolios, conclusion, 271–272
- Subadditivity, 179
 property, 196
 implication, 196
- Subclasses, relationship, 199
- Subjectivity, appearance, 171
- Sublevel sets, 42. *See also* Convex sublevel
 sets
- Summands
 i.i.d., characteristic, 117
 independence, assumption, 115
 large value, probability, 132
 number, fixation, 118
 positive value, 306–307
- Summation stability. *See* Normal distribution
- Sun Microsystems
 stock, 262–263, 301n
 weight, increase, 263
- Superadditivity, 282
- SYM. *See* Symmetry axiom
- Symmetric deviation measures, 179–180
 axioms, explanation, 203
 degree 1, 296–297
 family, 181
- Symmetric random variables, description,
 178n
- Symmetry, 91
 property, appearance, 299–300
 range, 178n
- Symmetry axiom (SYM), 73–74
 breakage, Birnbaum-Orlics compound
 metric (usage), 307
 dissatisfaction, 305
 property, 125
 usage, 92
- T. Rowe Price Group Inc., stock, 301n
- t -distribution. *See* Student's t -distribution
 density function, 11–12
- Tail probability, 79. *See also* 40% tail
 probability; Lower tail probability;
 Upper tail probability
- AVaR, 209–210, 221, 231
 yield, 223
 bounded capability, 226
 continuous nonincreasing function,
 324
 ETL, 236
 step function, 240–241
 identification, 182–183
 portfolio return, AVaR, 217
 selection, 326
 VaR, 224
- Tails
 concentration (probability distribution
 function descriptor), 13, 14
 distribution, heaviness, 121
 exponent, 121
 fatness, measurement, 14
 moment of order, 228
 moments, application, 229–230
 structure, 221
 thickness, 209f
 truncation method, 123–124
 variance. *See* Conditional distribution
- Tangency portfolio, 257
- Tangent line, 321
 horizontality, 323

- Tangent portfolio
 obtaining, 337f
 relationship. *See* Efficient frontier;
 Mean-deviation efficient frontier
- Tangential contour line, 50. *See also* Feasible set
- Technical continuity conditions, 163
 preference order, 144
- Theory of *Games and Economic Behavior*
 (von Neumann/Morgenstern), 139
- Third central moment, rescaling, 14
- Third-order stochastic dominance (TSD),
 141
 usage, 152–153
- Third quartile, 16
- Three-dimensional random vector, 93
- Topological structure, 291n
- Tosses (number), heads occurrence
 (probabilities), 109f
- Total sum variability (description), standard
 deviation (usage), 132
- Total variation metric, 83–84
 definition, 136
 expression, 128
 probabilities, maximum absolute
 difference, 84
 usage, 124–125
- Tracking error. *See* Scaled tracking error
 identification, 289
 optimal solution, 300–301
 positive value, 300
 problem, 288–292
 providing, mean-variance analysis (usage),
 287
 reduction, 225
 zero value, 300
- Transitivity, 162
 axiom, 162
- Translation invariance, 179, 202
 axioms, 180, 202
 identification, 196
- Translation invariant functional, 294
- Translation invariant probability metric,
 296–297
- Translation invariant probability semimetric,
 296–297
- Translation invariant r.d. metrics, class, 297
- Triangle inequality, 91
 abstract version, 74
 holding, 99
 parameter K , inclusion, 92
 property, 125
 relaxation, 94–95
- True moments, 16
- True parameter, estimation, 17n
- TSD. *See* Third-order stochastic dominance
- Tversky, Amos, 140–141
- Two-average compound metric, 89
- Two-dimensional convex quadratic function
 convex quadratic constraint, 54f
 objective function, 53
 surface, 44f, 54f
 contour lines, 44f
- Two-dimensional density function, contour
 lines, 23
- Two-dimensional linear programming,
 problem, 56
- Two-dimensional normal distribution
 copula density, 28f
- Two-dimensional normal distribution,
 probability density function, 23f
- Two-dimensional optimization problem,
 consideration, 53
- Two-dimensional probability density
 function level lines, 24f
- Two-dimensional projections, 93–94
- Two-dimensional quadratic objective
 function, surface, 51f
- Two-dimensional quasiconvex function
 contour lines, 47f
 example, 47f
- Two-dimensional random variable,
 distribution function, 100
- Two-fund separation theorem, 340
- Unbiased estimator, 338
- Unbounded polyhedral set, 56
- Uncertainty
 features, description, 198
 impact. *See* Choice; Decision making
 measure, example, 172, 176
 synonym. *See* Risk
- Unconstrained optimization, 36–48
 first-order condition, solution, 52
- Unconstrained problems, notation, 48
- Uncorrelated random variables, 21
- Underlying instrument, 111
- Underperformance, tracking error treatment,
 291
- Unfair coins, independent toss, 110
- Uniform metric, 76
 illustration. *See* Inverse distribution
 functions
 usage, 124–125. *See also* Densities;
 Distribution function
- Unit hypercube, 28

- Univariate distribution, 18
- Upper tail probability, 333
quantile, 344
- Upside dispersion measure, 177–178
- Utility function, 139. *See also* Concave utility function
derivatives, properties (imposition), 163–164
quadratic approximations, 276–277
set, 163
shape, 145–146
Taylor series approximation, 276–277
types, 145–147
usage, 148
- Utility theory. *See* Expected utility theory
appeal, 141
- Value-at-Risk (VaR). *See* Common stocks; Random profit; Standard normal distribution
absolute differences, sum, 81
absolute value, 80
average, 210
backtesting, 192–194
statistical test, basis, 194
calculation, 79
computation, 190
consideration, 181–182
deviations, aggregate information, 81
differences, 184
disadvantage, 208–209
estimation, 223–224
methods, 173
examples, 226
levels, 80
measure, 182
adoption, 207
computation, 189
measurement, 16
negative, 193f
properties, 173
usage, 182–186
weighted average, consideration, 222
- Value distribution. *See* Extreme value distribution; Generalized extreme value distribution
- Value function, introduction, 140–141
- VaR. *See* Value-at-Risk
- Variables. *See* Random variables
log-returns, 114–115
summation, meaning. *See* Financial variables
- Variance
calculation, 64
example, 172
- Variance-covariance matrix, 25
- Vector notation, usage, 22
- Ventures, c.d.f., 148
- Volatility, 77
clustering, 192
- von Neumann, John, 139
- von Neumann-Morgenstern theory
basis, 161
lotteries, interpretation, 164–165
publication, 140
- von Neumann-Morgenstern utility theory, 145–145
- Weakly regular functional, 294
- Weibull-type extreme value distribution, 12
- Weighted Kantorovich metric, 227
- Whiskers, 191n
diagram. *See* Box-and-whiskers diagram
- Yield curve, shape, 73
daily movement, 292
- Zero gradient, 38
points, 38–39
- Zero-mean normal marginals, 89
- Zero-mean random variables
consideration, 298
subspace, 295n
- Zolotarev ideal metric, 128–129