

NAG Library Routine Document

S30BBF

Note: before using this routine, please read the Users' Note for your implementation to check the interpretation of *bold italicised* terms and other implementation-dependent details.

1 Purpose

S30BBF computes the price of a floating-strike lookback option together with its sensitivities (Greeks).

2 Specification

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SUBROUTINE S30BBF (CALPUT, M, N, SM, S, T, SIGMA, R, Q, P, LDP, DELTA,      &
                  GAMMA, VEGA, THETA, RHO, CRHO, VANNA, CHARM, SPEED,      &
                  COLOUR, ZOMMA, VOMMA, IFAIL)
INTEGER          M, N, LDP, IFAIL
REAL (KIND=nag_wp) SM(M), S, T(N), SIGMA, R, Q, P(LDP,N), DELTA(LDP,N),  &
                  GAMMA(LDP,N), VEGA(LDP,N), THETA(LDP,N),              &
                  RHO(LDP,N), CRHO(LDP,N), VANNA(LDP,N),                &
                  CHARM(LDP,N), SPEED(LDP,N), COLOUR(LDP,N),            &
                  ZOMMA(LDP,N), VOMMA(LDP,N)
CHARACTER(1)    CALPUT

```

3 Description

S30BBF computes the price of a floating-strike lookback call or put option, together with the Greeks or sensitivities, which are the partial derivatives of the option price with respect to certain of the other input parameters. A call option of this type confers the right to buy the underlying asset at the lowest price, S_{\min} , observed during the lifetime of the contract. A put option gives the holder the right to sell the underlying asset at the maximum price, S_{\max} , observed during the lifetime of the contract. Thus, at expiry, the payoff for a call option is $S - S_{\min}$, and for a put, $S_{\max} - S$.

For a given minimum value the price of a floating-strike lookback call with underlying asset price, S , and time to expiry, T , is

$$P_{\text{call}} = Se^{-qT}\Phi(a_1) - S_{\min}e^{-rT}\Phi(a_2) + Se^{-rT} \frac{\sigma^2}{2b} \left[\left(\frac{S}{S_{\min}} \right)^{-2b/\sigma^2} \Phi\left(-a_1 + \frac{2b}{\sigma}\sqrt{T}\right) - e^{bT}\Phi(-a_1) \right],$$

where $b = r - q \neq 0$. The volatility, σ , risk-free interest rate, r , and annualised dividend yield, q , are constants.

The corresponding put price is

$$P_{\text{put}} = S_{\max}e^{-rT}\Phi(-a_2) - Se^{-qT}\Phi(-a_1) + Se^{-rT} \frac{\sigma^2}{2b} \left[- \left(\frac{S}{S_{\max}} \right)^{-2b/\sigma^2} \Phi\left(a_1 - \frac{2b}{\sigma}\sqrt{T}\right) + e^{bT}\Phi(a_1) \right].$$

In the above, Φ denotes the cumulative Normal distribution function,

$$\Phi(x) = \int_{-\infty}^x \phi(y)dy$$

where ϕ denotes the standard Normal probability density function

$$\phi(y) = \frac{1}{\sqrt{2\pi}} \exp(-y^2/2)$$

and

$$a_1 = \frac{\ln(S/S_m) + (b + \sigma^2/2)T}{\sigma\sqrt{T}}$$

$$a_2 = a_1 - \sigma\sqrt{T}$$

where S_m is taken to be the minimum price attained by the underlying asset, S_{\min} , for a call and the maximum price, S_{\max} , for a put.

The option price $P_{ij} = P(X = X_i, T = T_j)$ is computed for each minimum or maximum observed price in a set $S_{\min}(i)$ or $S_{\max}(i)$, $i = 1, 2, \dots, m$, and for each expiry time in a set T_j , $j = 1, 2, \dots, n$.

4 References

Goldman B M, Sosin H B and Gatto M A (1979) Path dependent options: buy at the low, sell at the high *Journal of Finance* **34** 1111–1127

5 Arguments

- 1: CALPUT – CHARACTER(1) *Input*
On entry: determines whether the option is a call or a put.
 CALPUT = 'C'
 A call; the holder has a right to buy.
 CALPUT = 'P'
 A put; the holder has a right to sell.
Constraint: CALPUT = 'C' or 'P'.
- 2: M – INTEGER *Input*
On entry: the number of minimum or maximum prices to be used.
Constraint: $M \geq 1$.
- 3: N – INTEGER *Input*
On entry: the number of times to expiry to be used.
Constraint: $N \geq 1$.
- 4: SM(M) – REAL (KIND=nag_wp) array *Input*
On entry: SM(i) must contain $S_{\min}(i)$, the i th minimum observed price of the underlying asset when CALPUT = 'C', or $S_{\max}(i)$, the maximum observed price when CALPUT = 'P', for $i = 1, 2, \dots, M$.
Constraints:
 $SM(i) \geq z$ and $SM(i) \leq 1/z$, where $z = X02AMF()$, the safe range parameter, for $i = 1, 2, \dots, M$;
 if CALPUT = 'C', $SM(i) \leq S$, for $i = 1, 2, \dots, M$;
 if CALPUT = 'P', $SM(i) \geq S$, for $i = 1, 2, \dots, M$.
- 5: S – REAL (KIND=nag_wp) *Input*
On entry: S , the price of the underlying asset.
Constraint: $S \geq z$ and $S \leq 1.0/z$, where $z = X02AMF()$, the safe range parameter.

- 6: T(N) – REAL (KIND=nag_wp) array *Input*
On entry: T(*i*) must contain T_i , the *i*th time, in years, to expiry, for $i = 1, 2, \dots, N$.
Constraint: $T(i) \geq z$, where $z = X02AMF()$, the safe range parameter, for $i = 1, 2, \dots, N$.
- 7: SIGMA – REAL (KIND=nag_wp) *Input*
On entry: σ , the volatility of the underlying asset. Note that a rate of 15% should be entered as 0.15.
Constraint: SIGMA > 0.0.
- 8: R – REAL (KIND=nag_wp) *Input*
On entry: the annual risk-free interest rate, r , continuously compounded. Note that a rate of 5% should be entered as 0.05.
Constraint: $R \geq 0.0$ and $\text{abs}(R - Q) > 10 \times \text{eps} \times \max(\text{abs}(R), 1)$, where $\text{eps} = X02AJF()$, the **machine precision**.
- 9: Q – REAL (KIND=nag_wp) *Input*
On entry: the annual continuous yield rate. Note that a rate of 8% should be entered as 0.08.
Constraint: $Q \geq 0.0$ and $\text{abs}(R - Q) > 10 \times \text{eps} \times \max(\text{abs}(R), 1)$, where $\text{eps} = X02AJF()$, the **machine precision**.
- 10: P(LDP, N) – REAL (KIND=nag_wp) array *Output*
On exit: P(*i, j*) contains P_{ij} , the option price evaluated for the minimum or maximum observed price $S_{\min}(i)$ or $S_{\max}(i)$ at expiry T_j for $i = 1, 2, \dots, M$ and $j = 1, 2, \dots, N$.
- 11: LDP – INTEGER *Input*
On entry: the first dimension of the arrays P, DELTA, GAMMA, VEGA, THETA, RHO, CRHO, VANNA, CHARM, SPEED, COLOUR, ZOMMA and VOMMA as declared in the (sub)program from which S30BBF is called.
Constraint: LDP \geq M.
- 12: DELTA(LDP, N) – REAL (KIND=nag_wp) array *Output*
On exit: the leading $M \times N$ part of the array DELTA contains the sensitivity, $\frac{\partial P}{\partial S}$, of the option price to change in the price of the underlying asset.
- 13: GAMMA(LDP, N) – REAL (KIND=nag_wp) array *Output*
On exit: the leading $M \times N$ part of the array GAMMA contains the sensitivity, $\frac{\partial^2 P}{\partial S^2}$, of DELTA to change in the price of the underlying asset.
- 14: VEGA(LDP, N) – REAL (KIND=nag_wp) array *Output*
On exit: VEGA(*i, j*), contains the first-order Greek measuring the sensitivity of the option price P_{ij} to change in the volatility of the underlying asset, i.e., $\frac{\partial P_{ij}}{\partial \sigma}$, for $i = 1, 2, \dots, M$ and $j = 1, 2, \dots, N$.
- 15: THETA(LDP, N) – REAL (KIND=nag_wp) array *Output*
On exit: THETA(*i, j*), contains the first-order Greek measuring the sensitivity of the option price P_{ij} to change in time, i.e., $-\frac{\partial P_{ij}}{\partial T}$, for $i = 1, 2, \dots, M$ and $j = 1, 2, \dots, N$, where $b = r - q$.

- 16: RHO(LDP,N) – REAL (KIND=nag_wp) array Output
On exit: RHO(i, j), contains the first-order Greek measuring the sensitivity of the option price P_{ij} to change in the annual risk-free interest rate, i.e., $-\frac{\partial P_{ij}}{\partial r}$, for $i = 1, 2, \dots, M$ and $j = 1, 2, \dots, N$.
- 17: CRHO(LDP,N) – REAL (KIND=nag_wp) array Output
On exit: CRHO(i, j), contains the first-order Greek measuring the sensitivity of the option price P_{ij} to change in the annual cost of carry rate, i.e., $-\frac{\partial P_{ij}}{\partial b}$, for $i = 1, 2, \dots, M$ and $j = 1, 2, \dots, N$, where $b = r - q$.
- 18: VANNA(LDP,N) – REAL (KIND=nag_wp) array Output
On exit: VANNA(i, j), contains the second-order Greek measuring the sensitivity of the first-order Greek Δ_{ij} to change in the volatility of the asset price, i.e., $-\frac{\partial \Delta_{ij}}{\partial T} = -\frac{\partial^2 P_{ij}}{\partial S \partial \sigma}$, for $i = 1, 2, \dots, M$ and $j = 1, 2, \dots, N$.
- 19: CHARM(LDP,N) – REAL (KIND=nag_wp) array Output
On exit: CHARM(i, j), contains the second-order Greek measuring the sensitivity of the first-order Greek Δ_{ij} to change in the time, i.e., $-\frac{\partial \Delta_{ij}}{\partial T} = -\frac{\partial^2 P_{ij}}{\partial S \partial T}$, for $i = 1, 2, \dots, M$ and $j = 1, 2, \dots, N$.
- 20: SPEED(LDP,N) – REAL (KIND=nag_wp) array Output
On exit: SPEED(i, j), contains the third-order Greek measuring the sensitivity of the second-order Greek Γ_{ij} to change in the price of the underlying asset, i.e., $-\frac{\partial \Gamma_{ij}}{\partial S} = -\frac{\partial^3 P_{ij}}{\partial S^3}$, for $i = 1, 2, \dots, M$ and $j = 1, 2, \dots, N$.
- 21: COLOUR(LDP,N) – REAL (KIND=nag_wp) array Output
On exit: COLOUR(i, j), contains the third-order Greek measuring the sensitivity of the second-order Greek Γ_{ij} to change in the time, i.e., $-\frac{\partial \Gamma_{ij}}{\partial T} = -\frac{\partial^3 P_{ij}}{\partial S \partial T}$, for $i = 1, 2, \dots, M$ and $j = 1, 2, \dots, N$.
- 22: ZOMMA(LDP,N) – REAL (KIND=nag_wp) array Output
On exit: ZOMMA(i, j), contains the third-order Greek measuring the sensitivity of the second-order Greek Γ_{ij} to change in the volatility of the underlying asset, i.e., $-\frac{\partial \Gamma_{ij}}{\partial \sigma} = -\frac{\partial^3 P_{ij}}{\partial S^2 \partial \sigma}$, for $i = 1, 2, \dots, M$ and $j = 1, 2, \dots, N$.
- 23: VOMMA(LDP,N) – REAL (KIND=nag_wp) array Output
On exit: VOMMA(i, j), contains the second-order Greek measuring the sensitivity of the first-order Greek Δ_{ij} to change in the volatility of the underlying asset, i.e., $-\frac{\partial \Delta_{ij}}{\partial \sigma} = -\frac{\partial^2 P_{ij}}{\partial \sigma^2}$, for $i = 1, 2, \dots, M$ and $j = 1, 2, \dots, N$.
- 24: IFAIL – INTEGER Input/Output
On entry: IFAIL must be set to 0, -1 or 1. If you are unfamiliar with this argument you should refer to Section 3.4 in How to Use the NAG Library and its Documentation for details.
 For environments where it might be inappropriate to halt program execution when an error is detected, the value -1 or 1 is recommended. If the output of error messages is undesirable, then the value 1 is recommended. Otherwise, if you are not familiar with this argument, the recommended value is 0. **When the value -1 or 1 is used it is essential to test the value of IFAIL on exit.**
On exit: IFAIL = 0 unless the routine detects an error or a warning has been flagged (see Section 6).

6 Error Indicators and Warnings

If on entry IFAIL = 0 or -1, explanatory error messages are output on the current error message unit (as defined by X04AAF).

Errors or warnings detected by the routine:

IFAIL = 1

On entry, CALPUT = $\langle value \rangle$ was an illegal value.

IFAIL = 2

On entry, M = $\langle value \rangle$.
Constraint: $M \geq 1$.

IFAIL = 3

On entry, N = $\langle value \rangle$.
Constraint: $N \geq 1$.

IFAIL = 4

On entry, $SM(\langle value \rangle) = \langle value \rangle$.
Constraint: $\langle value \rangle \leq SM(i) \leq \langle value \rangle$ for all i .
On entry with a call option, $SM(\langle value \rangle) = \langle value \rangle$.
Constraint: for call options, $SM(i) \leq \langle value \rangle$ for all i .
On entry with a put option, $SM(\langle value \rangle) = \langle value \rangle$.
Constraint: for put options, $SM(i) \geq \langle value \rangle$ for all i .

IFAIL = 5

On entry, S = $\langle value \rangle$.
Constraint: $S \geq \langle value \rangle$ and $S \leq \langle value \rangle$.

IFAIL = 6

On entry, $T(\langle value \rangle) = \langle value \rangle$.
Constraint: $T(i) \geq \langle value \rangle$ for all i .

IFAIL = 7

On entry, SIGMA = $\langle value \rangle$.
Constraint: SIGMA > 0.0.

IFAIL = 8

On entry, R = $\langle value \rangle$.
Constraint: $R \geq 0.0$.

IFAIL = 9

On entry, Q = $\langle value \rangle$.
Constraint: $Q \geq 0.0$.

IFAIL = 11

On entry, LDP = $\langle value \rangle$ and M = $\langle value \rangle$.
Constraint: $LDP \geq M$.

IFAIL = 12

On entry, R = $\langle value \rangle$ and Q = $\langle value \rangle$.
Constraint: $|R - Q| > 10 \times \text{eps} \times \max(|R|, 1)$, where eps is the *machine precision*.

IFAIL = -99

An unexpected error has been triggered by this routine. Please contact NAG.

See Section 3.9 in How to Use the NAG Library and its Documentation for further information.

IFAIL = -399

Your licence key may have expired or may not have been installed correctly.

See Section 3.8 in How to Use the NAG Library and its Documentation for further information.

IFAIL = -999

Dynamic memory allocation failed.

See Section 3.7 in How to Use the NAG Library and its Documentation for further information.

7 Accuracy

The accuracy of the output is dependent on the accuracy of the cumulative Normal distribution function, Φ . This is evaluated using a rational Chebyshev expansion, chosen so that the maximum relative error in the expansion is of the order of the *machine precision* (see S15ABF and S15ADF). An accuracy close to *machine precision* can generally be expected.

8 Parallelism and Performance

S30BBF is threaded by NAG for parallel execution in multithreaded implementations of the NAG Library.

Please consult the X06 Chapter Introduction for information on how to control and interrogate the OpenMP environment used within this routine. Please also consult the Users' Note for your implementation for any additional implementation-specific information.

9 Further Comments

None.

10 Example

This example computes the price of a floating-strike lookback put with a time to expiry of 6 months and a stock price of 87. The maximum price observed so far is 100. The risk-free interest rate is 6% per year and the volatility is 30% per year with an annual dividend return of 4%.

10.1 Program Text

```

Program s30bbfe
!      S30BBF Example Program Text
!      Mark 26 Release. NAG Copyright 2016.
!
!      .. Use Statements ..
Use nag_library, Only: nag_wp, s30bbf
!      .. Implicit None Statement ..
Implicit None
!      .. Parameters ..
Integer, Parameter          :: nin = 5, nout = 6
!      .. Local Scalars ..
Real (Kind=nag_wp)         :: q, r, s, sigma
Integer                    :: i, ifail, j, ldp, m, n
Character (1)              :: calput
!      .. Local Arrays ..
Real (Kind=nag_wp), Allocatable :: charm(:,,:), colour(:,,:), crho(:,,:), &

```

```

                                delta(:,,:), gamma(:,,:), p(:,,:),      &
                                rho(:,,:), sm(:), speed(:,,:), t(:),      &
                                theta(:,,:), vanna(:,,:), vega(:,,:),      &
                                vomma(:,,:), zomma(:,,:)
!      .. Executable Statements ..
Write (nout,*) 'S30BBF Example Program Results'

!      Skip heading in data file
Read (nin,*)

Read (nin,*) calput
Read (nin,*) s, sigma, r, q
Read (nin,*) m, n

ldp = m
Allocate (charm(ldp,n), colour(ldp,n), crho(ldp,n), delta(ldp,n),      &
          gamma(ldp,n), p(ldp,n), rho(ldp,n), sm(m), speed(ldp,n), t(n), theta(ldp,n), &
          vanna(ldp,n), vega(ldp,n), vomma(ldp,n), zomma(ldp,n))

Read (nin,*)(sm(i),i=1,m)
Read (nin,*)(t(i),i=1,n)

ifail = 0
Call s30bbf(calput,m,n,sm,s,t,sigma,r,q,p,ldp,delta,gamma,vega,theta,      &
            rho,crho,vanna,charm,speed,colour,zomma,vomma,ifail)

Write (nout,*)
Write (nout,*) 'Floating-Strike Lookback'

Select Case (calput)
Case ('C','c')
  Write (nout,*) 'European Call :'
Case ('P','p')
  Write (nout,*) 'European Put :'
End Select

Write (nout,99997) ' Spot      = ', s
Write (nout,99997) ' Volatility = ', sigma
Write (nout,99997) ' Rate      = ', r
Write (nout,99997) ' Dividend  = ', q

Write (nout,*)

Do j = 1, n
  Write (nout,*)
  Write (nout,99999) t(j)
  Write (nout,*) 'S-Max/Min      Price      Delta      Gamma' //      &
                ' Vega      Theta      Rho      CRho'

  Do i = 1, m
    Write (nout,99998) sm(i), p(i,j), delta(i,j), gamma(i,j), vega(i,j), &
              theta(i,j), rho(i,j), crho(i,j)
  End Do

  Write (nout,*) 'S-Max/Min      Price      Vanna      Charm' //      &
                ' Speed      Colour      Zomma      Vomma'

  Do i = 1, m
    Write (nout,99998) sm(i), p(i,j), vanna(i,j), charm(i,j),      &
              speed(i,j), colour(i,j), zomma(i,j), vomma(i,j)
  End Do

End Do

99999 Format (1X,'Time to Expiry : ',1X,F8.4)
99998 Format (8(1X,F9.4))
99997 Format (A,1X,F8.4)
End Program s30bbfe

```

10.2 Program Data

S30BBF Example Program Data
 'P' : Call = 'C', Put = 'P'
 87.0 0.3 0.06 0.04 : S, SIGMA, R, Q
 1 1 : M, N
 100.0 : SM(I), I = 1,2,...M
 0.5 : T(I), I = 1,2,...N

10.3 Program Results

S30BBF Example Program Results

Floating-Strike Lookback

European Put :

Spot = 87.0000
 Volatility = 0.3000
 Rate = 0.0600
 Dividend = 0.0400

Time to Expiry : 0.5000

S-Max/Min	Price	Delta	Gamma	Vega	Theta	Rho	CRho
100.0000	18.3530	-0.3560	0.0391	45.5353	-11.6139	-32.8139	-23.6374
S-Max/Min	Price	Vanna	Charm	Speed	Colour	Zomma	Vomma
100.0000	18.3530	1.9141	-0.6199	0.0007	0.0221	-0.0648	76.1292
