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The origin of this book can be traced to courses on financial mathematics taught by us at the University of New South Wales in Sydney    Technical University of Warsaw    Politechnika Watszawska    and Institut National Polytechnique de Grenoble. Our initial aim was to write a short text around the material used in two one-semester graduate courses attended by students with diverse disciplinary backgrounds    mathematics    physics    computer science    engineering    economics and commerce    . The anticipated diversity of potential readers explains the somewhat unusual way in which the book is written. It starts at a very elementary mathematical level and does not assume any prior knowledge of financial markets. Later    it develops into a text which requires some familiarity with concepts of stochastic calculus    the basic relevant notions and results are collected in the appendix    . Over time    what was meant to be a short text acquired a life of its own and started to grow. The final version can be used as a textbook for three one-semester courses one at undergraduate level    the other two as graduate courses.

We shall now describe following Hull 1997 the basic features of tradi-tiorial stock and options markets as opposed to computerized online trading. The most common system for trading stocks is a specialist system Under this system an individual known as the specialist is responsible for being a market maker and for keeping a record of limit orders - that is orders that can only be executed at the speafied price or a more favorable price. Options usually trade under a market maker system. A market maker for a given option is an individual who will quote both a bid and an ask price on the option whenever he is asked to do so. The bid price is the price at which the market maker is prepared to buy and the ask price is the price at which he is prepared to sell. At the time the bid and ask prices are quoted the market maker does not know whether the trader who asked for the quotes wants to buy or sell the option. The amount by which the ask exceeds the bid is referred to as the bid-ask spread. To enhance the efficiency of trading the exchange may set upper limits for the bid-ask spread. The existence of the market maker ensures that buy and sell orders can always be executed at some price without delay. The market makers them-selves make their profits from the bid-ask spread. When an investor writes options he is required to maintain funds in a margin account. The size of the margin depends on the circumstances e.g. whether the option is covered or naked - that is whether the option writer does possess the underlying shares or not. Let us finally mention that one contract gives the holder the right to buy or sell 100 shares; this is convenient since the shares themselves are usually traded in lots of 100. ……

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