NAG Library Routine Document

S30SAF

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

S30SAF computes the Asian geometric continuous average-rate option price.

2 Specification

```
SUBROUTINE S30SAF(CALPUT, M, N, X, S, T, SIGMA, R, B, P, LDP, IFAIL)
INTEGER           M, N, LDP, IFAIL
double precision  X(M), S, T(N), SIGMA, R, B, P(LDP,N)
CHARACTER*1       CALPUT
```

3 Description

S30SAF computes the price of an Asian geometric continuous average-rate option for constant volatility, σ, risk-free rate, r, and cost of carry, b (see Kemna and Vorst (1990)). For a given strike price, X, the price of a call option with underlying price, S, and time to expiry, T, is

$$P_{\text{call}} = Se^{(\bar{b}-r)T}\Phi(\bar{d}_1) - Xe^{-rT}\Phi(\bar{d}_2),$$

and the corresponding put option price is

$$P_{\text{put}} = Xe^{-rT}\Phi(-\bar{d}_2) - Se^{(\bar{b}-r)T}\Phi(-\bar{d}_1),$$

where

$$\bar{d}_1 = \frac{\ln(S/X) + (\bar{b} + \bar{\sigma}^2/2)T}{\bar{\sigma}\sqrt{T}}$$

and

$$\bar{d}_2 = \bar{d}_1 - \bar{\sigma}\sqrt{T},$$

with

$$\bar{\sigma} = \frac{\sigma}{\sqrt{3}}, \qquad \bar{b} = \frac{1}{2}\left(b - \frac{\sigma^2}{6}\right).$$

Φ is the cumulative Normal distribution function,

$$\Phi(x) = \frac{1}{\sqrt{2\pi}}\int_{-\infty}^{x} \exp(-y^2/2)\,dy.$$

4 References

Kemna A and Vorst A (1990) A pricing method for options based on average asset values *Journal of Banking and Finance* **14** 113–129

5 Parameters

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 strike prices to be used.

Constraint: M ≥ 1.

3: N – INTEGER *Input*

On entry: the number of times to expiry to be used.

Constraint: N ≥ 1.

4: X(M) – ***double precision*** array *Input*

On entry: X(i) must contain X_i, the ith strike price, for $i = 1, 2, \ldots, \mathrm{M}$.

Constraint: X(i) $\geq z$ and X(i) $\leq 1/z$, where $z =$ X02AMF(), the safe range parameter, for $i = 1, 2, \ldots, \mathrm{M}$.

5: S – ***double precision*** *Input*

On entry: S, the price of the underlying asset.

Constraint: S $\geq z$ and S $\leq 1/z$, where $z =$ X02AMF(), the safe range parameter.

6: T(N) – ***double precision*** array *Input*

On entry: T(i) must contain T_i, the ith time, in years, to expiry, for $i = 1, 2, \ldots, \mathrm{N}$.

Constraint: T(i) $\geq z$, where $z =$ X02AMF(), the safe range parameter, for $i = 1, 2, \ldots, \mathrm{N}$.

7: SIGMA – ***double precision*** *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 – ***double precision*** *Input*

On entry: r, the annual risk-free interest rate, continuously compounded. Note that a rate of 5% should be entered as 0.05.

Constraint: R ≥ 0.0.

9: B – ***double precision*** *Input*

On entry: b, the annual cost of carry rate. Note that a rate of 8% should be entered as 0.08.

10: P(LDP,N) – ***double precision*** array *Output*

On exit: the $m \times n$ array P contains the computed option prices.

11: LDP – INTEGER *Input*

On entry: the first dimension of the array P as declared in the (sub)program from which S30SAF is called.

Constraint: LDP $\geq$ M.

12: IFAIL – INTEGER *Input/Output*

On entry: IFAIL must be set to 0, -1 or 1. If you are unfamiliar with this parameter you should refer to Section 3.3 in the Essential Introduction for details.

On exit: IFAIL $= 0$ unless the routine detects an error (see Section 6).

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 parameter, the recommended value is 0. **When the value -1 or 1 is used it is essential to test the value of IFAIL on exit.**

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 $\neq$ 'C' or 'P'.

IFAIL $= 2$

On entry, M ≤ 0.

IFAIL $= 3$

On entry, N ≤ 0.

IFAIL $= 4$

On entry, X$(i) < z$ or X$(i) > 1/z$, where $z =$ X02AMF(), the safe range parameter.

IFAIL $= 5$

On entry, S $< z$ or S $> 1/z$, where $z =$ X02AMF(), the safe range parameter.

IFAIL $= 6$

On entry, T$(i) < z$, where $z =$ X02AMF(), the safe range parameter.

IFAIL $= 7$

On entry, SIGMA ≤ 0.0.

IFAIL $= 8$

On entry, R < 0.0.

IFAIL $= 11$

On entry, LDP $<$ M.

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 Further Comments

None.

9 Example

This example computes the price of an Asian geometric continuous average-rate put with a time to expiry of 3 months, a stock price of 80 and a strike price of 85. The risk-free interest rate is 5% per year, the cost of carry is 8% and the volatility is 20% per year.

9.1 Program Text

```
*     S30SAF Example Program Text
*     Mark 22 Release. NAG Copyright 2008.
*     .. Parameters ..
      INTEGER          NIN, NOUT
      PARAMETER        (NIN=5,NOUT=6)
      INTEGER          LDP, MMAX, NMAX
      PARAMETER        (LDP=50,MMAX=50,NMAX=50)
*     .. Local Scalars ..
      DOUBLE PRECISION B, R, S, SIGMA
      INTEGER          I, IFAIL, J, M, N
      CHARACTER        PUT
*     .. Local Arrays ..
      DOUBLE PRECISION P(LDP,NMAX), T(NMAX), X(MMAX)
*     .. External Subroutines ..
      EXTERNAL         S30SAF
*     .. Executable Statements ..
      WRITE (NOUT,*) 'S30SAF Example Program Results'
      WRITE (NOUT,*)
      WRITE (NOUT,*) 'Asian Option: Geometric Continuous Average-Rate'
*     Skip heading in data file
      READ (NIN,*)
*     Read problem parameters.
      READ (NIN,*) PUT
      READ (NIN,*) S, SIGMA, R, B
      READ (NIN,*) M, N
*
      IF (M.LE.MMAX .AND. N.LE.NMAX) THEN
*        Read array of strike/exercise prices, X
         READ (NIN,*) (X(I),I=1,M)
         READ (NIN,*) (T(I),I=1,N)
*
         IFAIL = 1
*
         CALL S30SAF(PUT,M,N,X,S,T,SIGMA,R,B,P,LDP,IFAIL)
*
         IF (IFAIL.EQ.0) THEN
*
            IF (PUT.EQ.'C' .OR. PUT.EQ.'c') THEN
               WRITE (NOUT,*) 'Asian Call :'
            ELSE IF (PUT.EQ.'P' .OR. PUT.EQ.'p') THEN
               WRITE (NOUT,*) 'Asian Put :'
            END IF
            WRITE (NOUT,'(A,1X,F8.4)') '  Spot          = ', S
            WRITE (NOUT,'(A,1X,F8.4)') '  Volatility    = ', SIGMA
            WRITE (NOUT,'(A,1X,F8.4)') '  Rate          = ', R
            WRITE (NOUT,'(A,1X,F8.4)') '  Cost of carry = ', B
            WRITE (NOUT,*)
```

```
            WRITE (NOUT,*) '   Strike    Expiry    Option Price'
*
            DO 40 I = 1, M
               DO 20 J = 1, N
                  WRITE (NOUT,99999) X(I), T(J), P(I,J)
   20          CONTINUE
   40       CONTINUE
         ELSE
            WRITE (NOUT,*)
            WRITE (NOUT,99998) IFAIL
         END IF
*
      END IF
*
99999 FORMAT (1X,2(F9.4,1X),6X,F9.4)
99998 FORMAT (1X,' ** S30SAF returned with IFAIL = ',I5)
      END
```

9.2 Program Data

```
S30SAF Example Program Data
 'P'                : Call = 'C', Put = 'P'
 80.0 0.2 0.05 0.08 : S, SIGMA, R, B
 1 1                : M, N
 85.0               : X(I), I = 1,2,...M
 0.25               : T(I), I = 1,2,...N
```

9.3 Program Results

```
 S30SAF Example Program Results

 Asian Option: Geometric Continuous Average-Rate
 Asian Put :
  Spot          =   80.0000
  Volatility    =    0.2000
  Rate          =    0.0500
  Cost of carry =    0.0800

    Strike    Expiry    Option Price
   85.0000    0.2500          4.6922
```