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Books are written for use，and the best compliment that the community in the field could have paid to the first edition of 1998 was to buy out the printrun，and that of the corrected printing，as happened. Meanwhile the fast-developing field of mathematical finance had moved on，as had our thinking，and it seemed better to recognize this and undertake a thorough-going re-write for the second edition than to tinker with the existing text.

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N.H.Bingham

The main focus of this book is the pricing of financial assets. Price formation in financial markets may be explained in an absolute manner in terms of fundamentals, as, e.g. in the so-called rational expectation model, or, more modestly, in a relative manner explaining the prices of some assets in terms of other given and observable asset prices. The second approach, which we adopt, is based on the concept of arbitrage. This remarkably simple concept is independent of beliefs and tastes preferences of the actors in the financial market. The basic assumption simply states that all participants in the mar-ket prefer more to less, and that any increase in consumption opportunities must somehow be paid for. Underlying all arguments is the question: Is it possible for an investor to restructure his current portfolio the assets currently owned in such a way that he has to pay less today for his restructure dportfolio and still has the same or a higher return at a future date
 If such an opportunity exists, the arbitrageur can consume the difference today and has gained a free lunch. Following our relative pricing approach, we think of financial assets as specific mixtures of some fundamental building blocks. A key observation will be that the economics involved in the relative pricing lead to linearity of the price formation. Consequently, if we are able to extract the prices of these fundamental building blocks from the prices of the financial assets traded in the market, we can create and price new assets simply by choosing new mixtures of the building blocks. It is this special feature of financial asset pricing that allows the use of modern martingale-based probability theory and made the subject so special to us .

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