

Applied Mathematical Finance >

Volume 1, 1994 - [Issue 1](#)

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# Delta, gamma and bucket hedging of interest rate derivatives

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Pages 21-48 | Received 01 Apr 1994, Published online: 28 Jul 2006

🗨️ Cite this article   🔗 <https://doi.org/10.1080/13504869400000002>

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## Abstract

The paper describes a framework for delta and gamma hedging an interest rate portfolio using a multifactor form of the Heath et al. (1992) model. A formal description of bucket hedging is given along with a discussion of some of the issues surrounding the choice of bucket lengths. Given that a small number of factors can describe the evolution of the term structure, the bucket deltas are defined in terms of these factors. The hedging of corporate bonds is also addressed.

Keywords:

delta hedging

gamma hedging

bucket hedging

interest rate derivatives

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