Manual for SOA Exam FM/CAS Exam 2.

Chapter 6. Variable interest rates and portfolio insurance.

Section 6.2. Arbitrage.

Extract from:
"Arcones' Manual for the SOA Exam FM/CAS Exam 2,
Financial Mathematics. Fall 2009 Edition",
available at http://www.actexmadriver.com/

Arbitrage

In economics, **arbitrage** is the practice of taking advantage of a state of imbalance between two (or possibly more) markets by a combination of matching deals to make a profit. A simple case of arbitrage consists in buying something in one place and selling it in another place at the same time. Suppose that the exchange rates (after taking out the fees for making the exchange) in London are £5 = ¥10 and the exchange rates in Tokyo are £6 = ¥10. Converting ¥10 to £6 in Tokyo and converting that £6 into ¥12 in London, for a profit of ¥2, would be arbitrage.

