Quiz: Assume you are planning to buy a put option on Johnson & Johnson because you believe its stock price will fall through the end of this year. Specifically, you believe that J&J’s stock price will fall from its current price of $64 per share to $45 per share by the time July options expire on 7/20/2012 (95 days from today) and to $40 per share by the time October options expire on 10/19/2012 (186 days from today). While you plan to buy an October put with a $55 strike price, you expect to hold it only through the expiration of the July option on 7/20. You have determined that over the past year, the standard deviation of returns related to J&J’s assets was 40% and on J&J’s stock was 52%. Through 7/20, you estimate that the standard deviation of returns related to J&J will be as follows: J&J’s assets = 34%, J&J’s stock = 41%, the July put on J&J with a $55 strike price = 57%, and the July call on J&J with a $55 strike price = 58%. And you estimate that through 10/19, the standard deviation of returns related to J&J will be as follows: J&J’s assets = 38%, J&J’s stock = 46%, the October put on J&J with a $55 strike price = 68%, and the October call with a $55 strike price = 67%. The return on short-term U.S. Treasuries is less than 1% but varies across maturity as follows: 4/19/2012 = 0.066%; 7/19/2012 = 0.068%; 10/18/2012 = 0.117%; 12/31/2012 = 0.160%. Set up the calculations to determine the value of this put according to the Black-Scholes option pricing model.

Note: Bonus WSJ Questions on back of page