Quiz A for 2:30 Class: 1/23/13

Given the following information you have collected on two risk-free bonds, what set of transactions today will generate an arbitrage profit for you today. In your answer list all transactions required today and two years from today and all individual and total cash flows today, one year from today, and two years from today. Use a “+” for an inflow of cash and a “-“ for an outflow of cash. Note: I recommend setting up a table like is in the notes, but this is not required.

<table>
<thead>
<tr>
<th>Bond</th>
<th>Bid</th>
<th>Ask</th>
<th>Payment in: One year</th>
<th>Two years</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>$183</td>
<td>$184</td>
<td>$100</td>
<td>$100</td>
</tr>
<tr>
<td>B</td>
<td>$361</td>
<td>$363</td>
<td>$200</td>
<td>$200</td>
</tr>
<tr>
<td>2A</td>
<td>366</td>
<td>368</td>
<td>0</td>
<td>200</td>
</tr>
</tbody>
</table>

Wall Street Journal Questions are on the back of this page.

\[
\begin{align*}
\text{Trans} & \quad \text{CF}_0 \\
\text{Buy B} & \quad +5 \\
\text{Short 2A} & \quad -363 \\
\text{Total} & \quad +3 +5
\end{align*}
\]

\[
\begin{align*}
\text{CF}_1 & \quad +5 \quad \text{CF}_2 \\
+200 & \quad +200 \\
-200 & \quad -200 \\
\emptyset & \quad \emptyset +5
\end{align*}
\]

Trans

Bond matures +5

Make up cashflow +5

Buy back bond

\[+5\]