

Quiz A for 4:00 Class: 8/29/12

Name _____

Assume that you can buy or sell (or short-sell) any of the following securities:

Risk-free bonds: bonds that mature one year from today earn 2.5% per year and bonds that mature two years from today earn 3.5% per year.

Risky securities:

<u>Security</u>	<u>Price Today</u>	Payoff one year from today if the economy is:		Payoff two years from today if the economy is:	
		<u>Strong</u>	<u>Weak</u>	<u>Strong</u>	<u>Weak</u>
Private Buy	\$250	\$70	\$20	\$500	\$0
Market	\$500	\$50	\$0	\$750	\$250

What set of transactions today will generate an arbitrage profit for you today. In your answer list all transactions required today and all individual and total cash flows today, a 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.

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