1:25 Quiz B: 4/2/12 Name & Time ____________________________

Quiz: Assume that a firm has issued bonds that mature for $300,000 five years from today. Show on a graph how the payoff on the bond can be duplicated by creating a portfolio consisting of a long or short position in a risk-free bond that pays $300,000 five years from today and a long or short position in an option on the firm's assets that expires five years from today. Be sure to label each part of the graph. Show (on the graph) that the payoff on the bond and the combined payoffs on the parts of the portfolio are the same if the value of the firm equals $125,000 five years from today and if the value of the firm equals $400,000 five years from today.

Note: Bonus WSJ Questions on back of page