Quiz A: 4/4/12 Name & Time ____________________________

Quiz: Assume a firm's stock price currently equals $27 and that its stock price will either rise by $5 or fall by $3 one year from today. Assume also that the risk free rate of return is 3% and that you are evaluating a call with a strike price of $25.

a. What are the potential payoffs on the long call?
b. What portfolio of stocks and risk-free bonds will duplicate the payoffs on the call?
c. What payoff would each part of the portfolio generate if the stock price rises by $5 next year?
d. What payoff would each part of the portfolio generate if the stock price falls by $3 next year?
e. What is the value of the long call today?

Note: Bonus WSJ Questions on back of page