

Quiz B for 2:30 Class: 1/28/13

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 1.5% per year and bonds that mature two years from today earn 2.5% per year.

Risky securities:

<u>Security</u>	<u>Prices Today:</u>		<u>Payoff one year from today if the economy is:</u>		<u>Payoff two years from today if the economy is:</u>	
	<u>Bid</u>	<u>Ask</u>	<u>Strong</u>	<u>Weak</u>	<u>Strong</u>	<u>Weak</u>
Galaxy One	\$550	\$555	\$400	\$100	\$800	\$50
Market	\$150	\$155	\$100	\$0	\$250	\$0

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.