Quiz A for 9:45 Class: 8/1/12 Name ____________________________

Assume you are planning to buy a put on the stock of Mega Bank Inc. that expires two years from today with a strike price of $40. Assume also that Mega's current stock price is $36 and its stock price will increase by $6 or fall by $4 each of the next two years. Finally, assume that the risk-free interest rate equals 3% per year and is not expected to change.

a. Calculate the current value of the put.
b. Assume that instead of buying the put, you construct an equivalent portfolio. Calculate the number of shares you would need to buy or sell to rebalance your portfolio a year from today if Mega's stock price rises by a year from today.