

Quiz A for 1:15 Class: 8/1/12

Name _____

Assume you are planning to buy a call on the stock of Mega Bank Inc. that expires two years from today with a strike price of \$35. 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 call.
- b. Assume that instead of buying the call, you construct an equivalent portfolio. Calculate the number of bonds you would need to buy or sell to rebalance your portfolio a year from today if Mega's stock price falls by a year from today.