

Quiz B for 9:45 Class: 7/16/13

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 3% per year and bonds that mature two years from today earn 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>
Private Dell	\$203	\$207	\$100	\$50	\$200	\$100
MS Machine	\$183	\$186	\$0	\$0	\$300	\$100

Golden Fleece ETF: Golden Fleece ETF holds the following positions (per share): long 3 shares of Private Dell, short 1 share of MS Machine, short \$100 of risk-free bonds that mature one year from today, and long \$200 of risk-free bonds that mature two years from today. The bid price for this ETF is \$530 and the ask price for the ETF is \$535.

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.