

Quiz A: 8/4/14

Name _____

Assume the bid price for Microsoft is \$42.85 and that the ask price for Microsoft is \$42.87. Assume also that a call on Microsoft that expires on October 18 (75 days from today) with a strike price of \$40 has a bid price of \$3.20 and an ask price of \$3.35. Assume the equivalent put (same expiration and strike) has a bid price of \$0.62 and an ask price of \$0.64. Assume that the risk-free interest rate is 2%.

Note: Answer the following on a per-share basis. Use a “+” for inflows and a “-“ for outflows.

- a. What transactions today will lead to an arbitrage profit today?
- b. What individual and net cash flows will be created by each of your transactions (in part a) on October 18 if Microsoft stock ends up at \$45. What if Microsoft ends up at \$34?