END OF CHAPTER EXERCISES

Chapter 19 : Derivatives Markets : An Overview

Investments : Spot and Derivatives Markets

(Keith Cuthbertson, Dirk Nitzsche)

1. Why are futures and options contracts generically referred to as "derivatives".

2. In what ways is an agreement to marry Vito Corleone's daughter in one years time, a type of futures or forward contract? Which one does it most closely resemble?

3. What is the difference between a European and an American option, as far as the buyer and the writer are concerned?

4. If K = 150 and the put premium is P = 5 should you exercise the option if the spot price at expiry is S_T = 148. What is your profit ?

5. The strike price for a put is K = 100 and the put premium is P = 2. Why is the put payoff (for the long), at expiration T equal to 5, if the stock price at expiry is 95?

6. Under what circumstances would you make a profit at maturity from a long position in futures contract on 'live hogs'?

7. How does going long a futures contract give you 'leverage' compared with going long in the spot market. Take stocks as an example and use F_0 = \$101 and S_0 = \$100, with outturn values (3 months later) of F_1 = \$111 and S_1 = \$110.