

April 2010

Option Questions: revision

1. Show how we can combine a share, a put and a call to create a risk-free position. Show can we use this to prove that the price of a call exceeds the price of a put on the same share.
2. You get advanced information that a company's shares are likely to be extremely volatile. How would you combine one call and one put to take advantage?
3. Draw a diagram to demonstrate the position that Nick Leeson took for Barings. What share price behaviour was he gambling on? Why did his position bankrupt Barings?
4. Draw a diagram to show the payoff profile from buying 4 call options, and going short on one share.
5. Draw a diagram to show the payoff from selling 3 put options, going long in 2 shares, and buying a call option.