

# NUS Business School

## FIN2004 Finance

### Tutorial 11

**#1:**

You notice that shares of stock in the Patel Corporation are going for \$50 per share. Call options with an exercise price of \$35 per share are selling for \$10. What's wrong here? Describe how you can take advantage of this mispricing if the option expires today.

**#2 :**

True or false: The unsystematic risk of a share of stock is irrelevant in valuing the stock because it can be diversified away; therefore, it is also irrelevant for valuing a call option on the stock. Explain.

**#3 :**

Suppose a certain stock currently sells for \$30 per share. If a put option and a call option are available with \$30 exercise prices, which do you think will sell for more, the put or the call? Explain.

**#4:**

T-bills currently yield 5.6%. Stock in Santa Maria Manufacturing is currently selling for \$66 per share. There is no possibility that the stock will be worth less than \$60 per share in one year

- What is the value of a call option with a \$55 exercise price? What is the intrinsic value?
- What is the value of a call option with a \$45 exercise price? What is the intrinsic value?
- What is the value of a put option with a \$55 exercise price? What is the intrinsic value?

**#5:**

Use the option quote information shown here to answer the questions that follow. The stock is currently selling for \$85.

Option	Expiration	Strike	Calls		Puts	
		price	Vol.	Last	vol.	Last
RWJ						
	Mar	80	230	2.80	160	0.80
	Apr	80	170	6	127	1.40
	Jul	80	139	8.05	43	3.90
	Oct	80	60	10.20	11	3.65

- a. Are the call options in the money? What is the intrinsic value of an RWJ Corp. call option?
- b. Are the put options in the money? What is the intrinsic value of an RWJ Corp. put option?
- c. Two of the options are clearly mispriced. Which ones? At a minimum, what should be the mispriced options sell for? Explain how you could profit from the mispricing in each case.