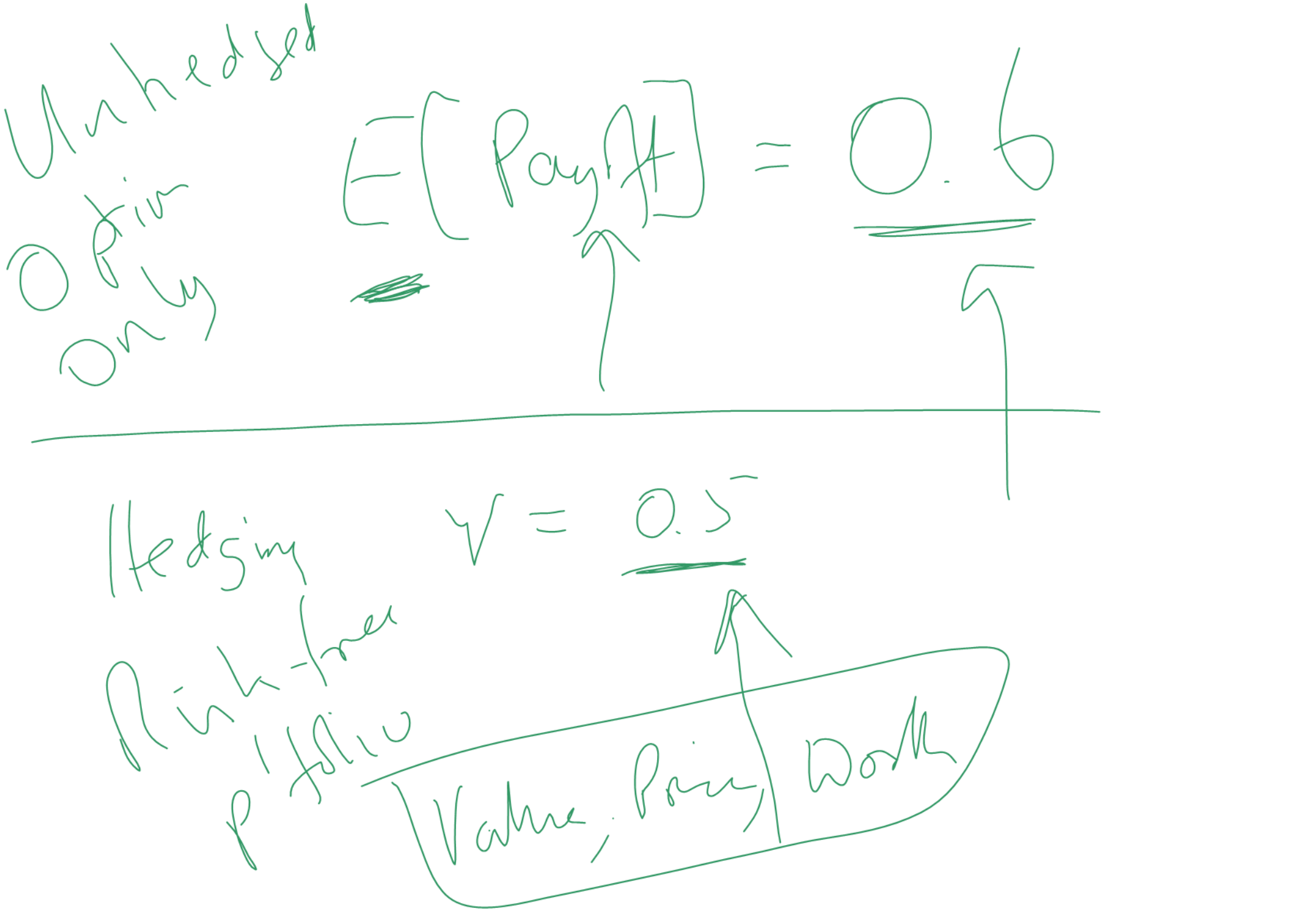
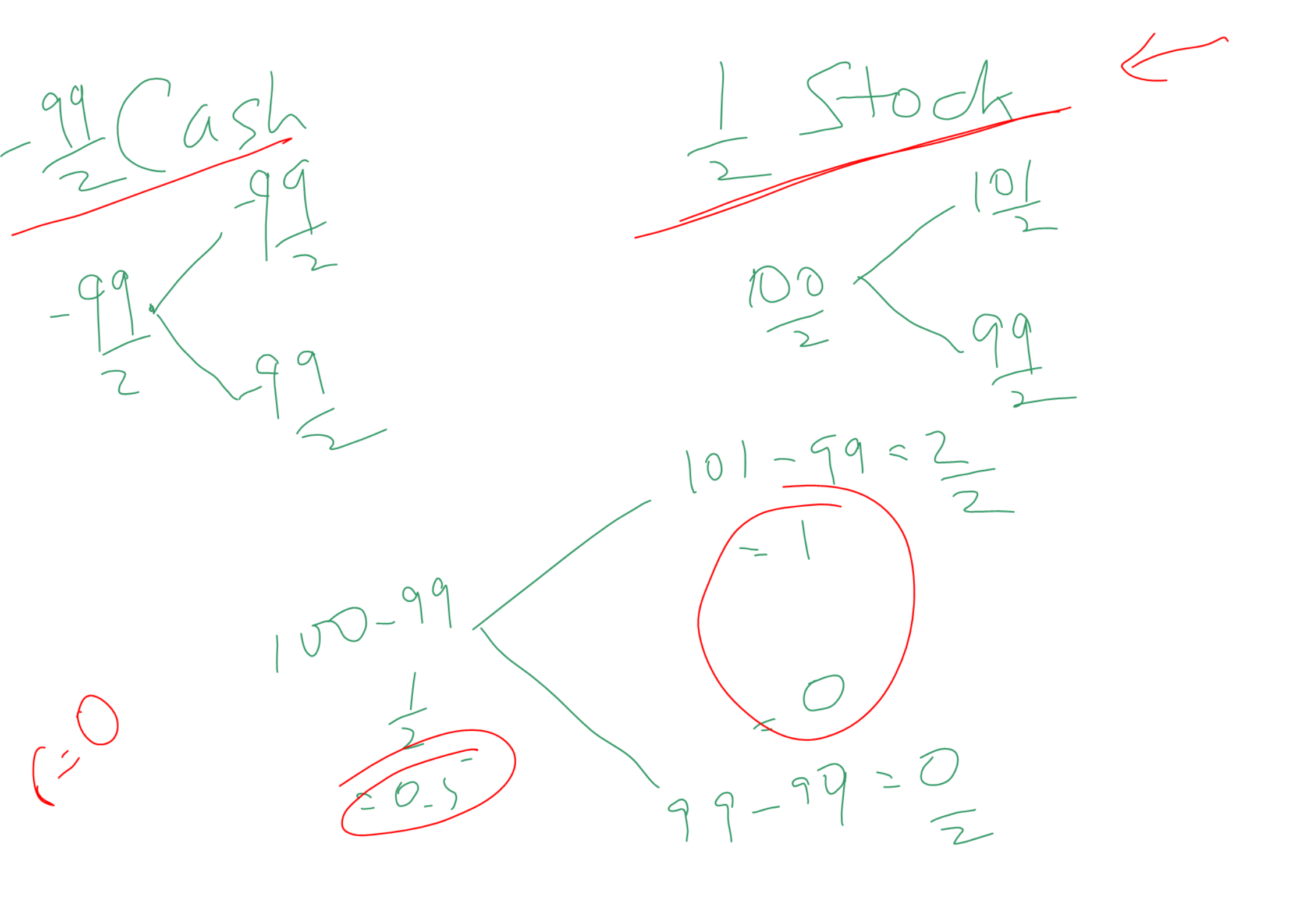
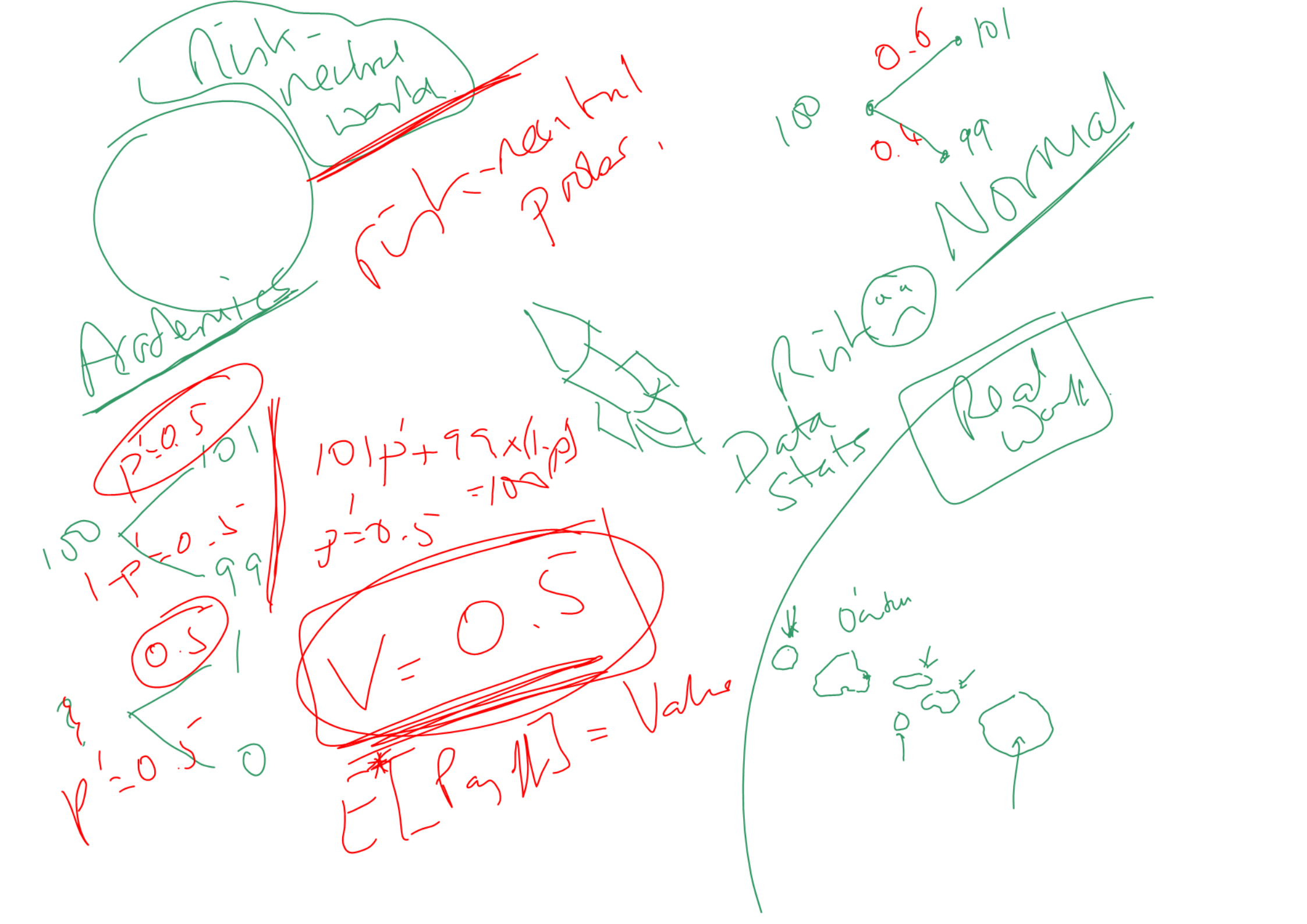
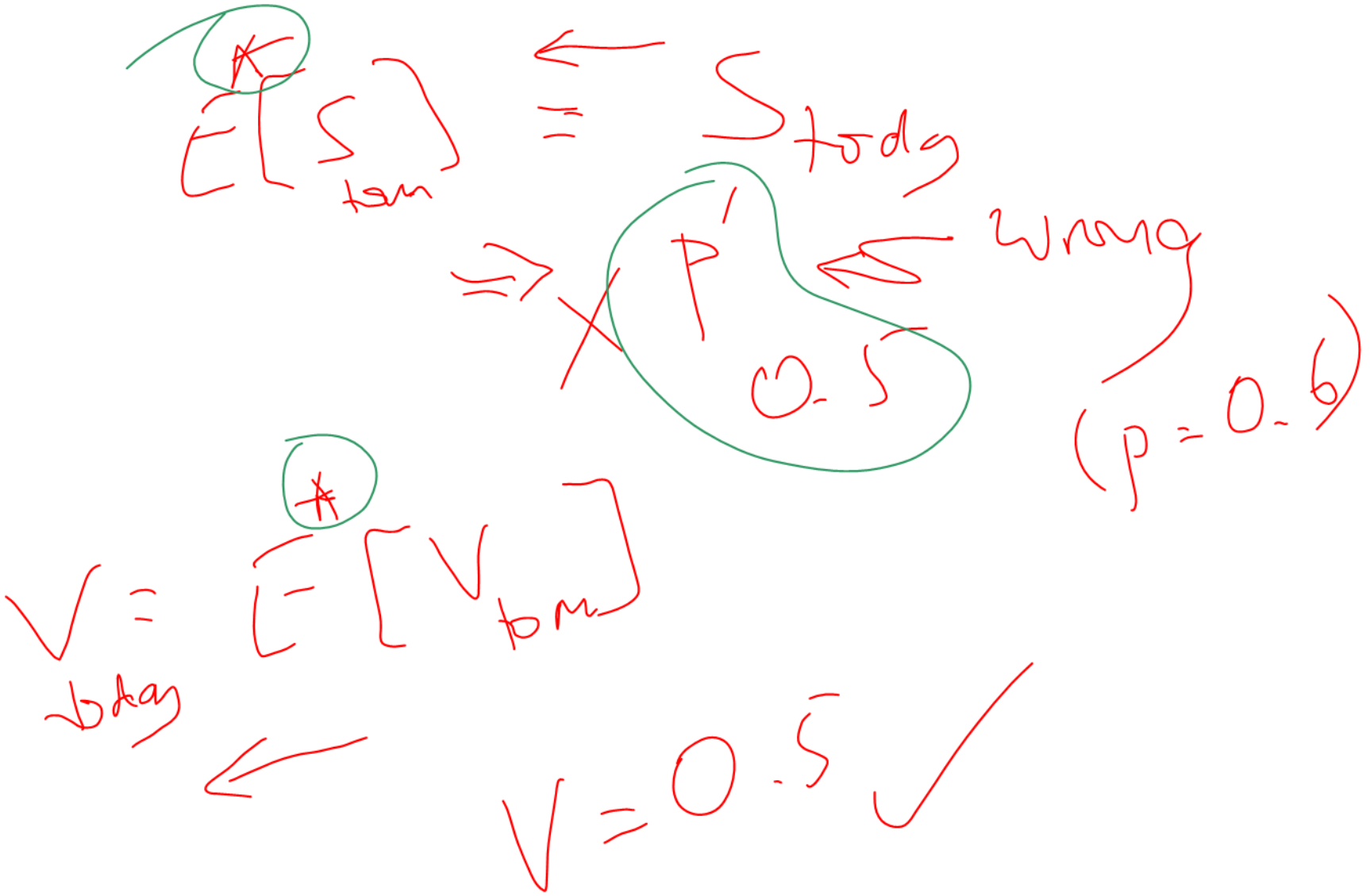

Unhedged
Option
Only
E[Payoff] = 0.6
Hedging
Risk-free
Portfolio
V = 0.5
Value, Price, Work


-99/2 Cash
-99/2
-99/2
-99/2
1/2 Stock
101/2
100/2
99/2
101 - 99 = 2/2
= 1
0
100 - 99
1/2
= 0.5
99 - 99 = 0/2
= 0


Risk-neutral world
Academics
Risk-neutral probs.
100
0.6
101
0.4
99
Normal
Risk
Data
Stats
Real world
p=0.5
101
100
1-p=0.5
99
0.5
1
p=0.5
0
101p+99x(1-p)
=100
p=0.5
V = 0.5
E[Payoff] = Value
Orders


E[S tom] = S today
wrong
p
0.5
(p = 0.6)
V = E[V tom]
today
V = 0.5