

# FIN 6470 - Homework Chapter 5

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February 17, 2020

## Prepaid Forward Contracts

1. Assume that  $F_{0,T}^P > S_0$ . Choose values for these quantities that match this assumption and make a table like Table 5.2 in your book to calculate the arbitrage profit.
2. Now assume instead that the opposite is true, namely that  $F_{0,T} < S_0$ . Redo problem 1 in light of this information.
3. With these two problems as background, explain the thinking behind the no-arbitrage equation:  $F_{0,T}^P = S_0$ . Is this an economic law? Will it always hold? If not, when and why not? Under what conditions will it hold? If you were an arbitrageur, how would you use this equation?