Homework 5

8.1

By definition, we have and

For , we have . Therefore, . As the face value is assumed to be 100, we have

8.2

Let Bond1 be the 6.5s August 15, 2004 and Bond2 be the 6s May 15, 2011.

We have

In order to hedge $10m long position in Bond­1, we have . Therefore, we have to short $3.5864m of bond2 to hedge $10m face value position of bond1.