Equity Forwards

Introduction

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A forward contract is an OTC derivative that obligates the seller to deliver the underlying asset to the buyer on some agreed future date for an agreed delivery price. The value of the forward contract is the economic benefit the buyer gets from holding the contract. The delivery price is analogous to the strike price of an option and the value is analogous to the price of an option. When a trade is entered into the forward price is set such that the contract has no value to neither seller nor buyer. After this point the contract will take on non-zero value as market data moves. The delivery price is often referred to as the forward level and it is this term I will use in this document.

S_t	The spot level at time t
T	The time to the delivery
r_t	The zero rate of a bond maturing at time t
D	The dividend stream
B	The borrow cost curve
K	The deliver price or forward level agreed at point of trade.
f_t	The value of the forward contract at time t.

The fair forward level is calculated as the cost of buying and holding the underlying asset to hedge a short forward position.