Example FL.2

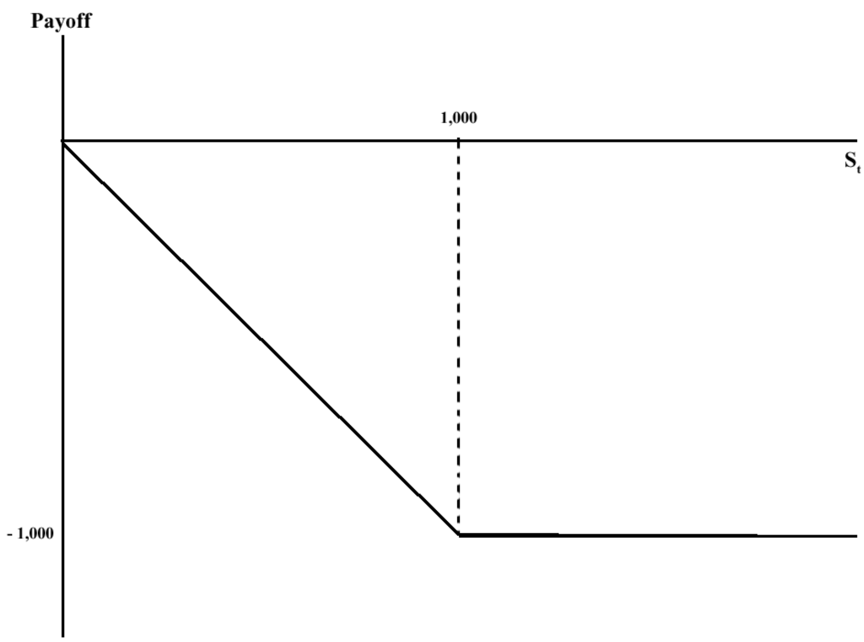
Suppose you short an asset valued $1,000. To insure the asset from value increase you buy a 1000 - strike 6 - month call option. The risk - free 6 - month rate is 2 % and the premium for the call option is $ 93.81.

Solution

The table looks like this:

Asset's market price in 6 months	Shortened	Put Option Payoff	Total Payoff	Profit
850	-850	0	-850	74.21
900	-900	0	-900	24.21
950	-950	0	-950	-25.79
1,000	-1,000	0	-1,000	-75.79
1,050	-1,050	50	-1,000	-75.79
1,100	-1,100	100	-1,000	-75.79
1,150	-1,150	150	-1,000	-75.79
1,200	-1,200	200	-1,000	-75.79

and the diagrams are:



And