Example C.3

Bill purchases a $100 strike price put option with 6 months to expiration for a premium of $6.58. The risk-free rate is 6 % convertible semiannually-Calculate Bill's profit if the underlying asset in 6 months costs $90.

Solution

The payoff of Bill's put option is max{$100 – $90, 0} = $10.

The future value of the premium is 1.03 * $6.58 = $6.78

- ➔ Therefore Bill's profit is: $10 – $6.78 = $3.22