

Mini-Case Study

Melissa Sanders, a recent MBA graduate in finance and accounting from Regis University, is an analyst at a local hedge fund. The fund wishes to sell (write) European calls on 2-year, 4.5% coupon Treasury notes. The notes currently sell for \$98.90. The one-year forward rate (r_0) is 4.65 percent. The assumed one-year forward rate one year from now ($r_{1,L}$) is 5.0 percent. The standard deviation is 10 percent. Fill in the seven boxes of the following binomial tree. ASSUME EACH STATE HAS A PROBABILITY OF 50% AND INTEREST IS PAID ANNUALLY. Show your work.

