QUESTION

Calculate the initial premium and the trading strategy for the asset/bond replicating portfolio for a European call option on the following data:

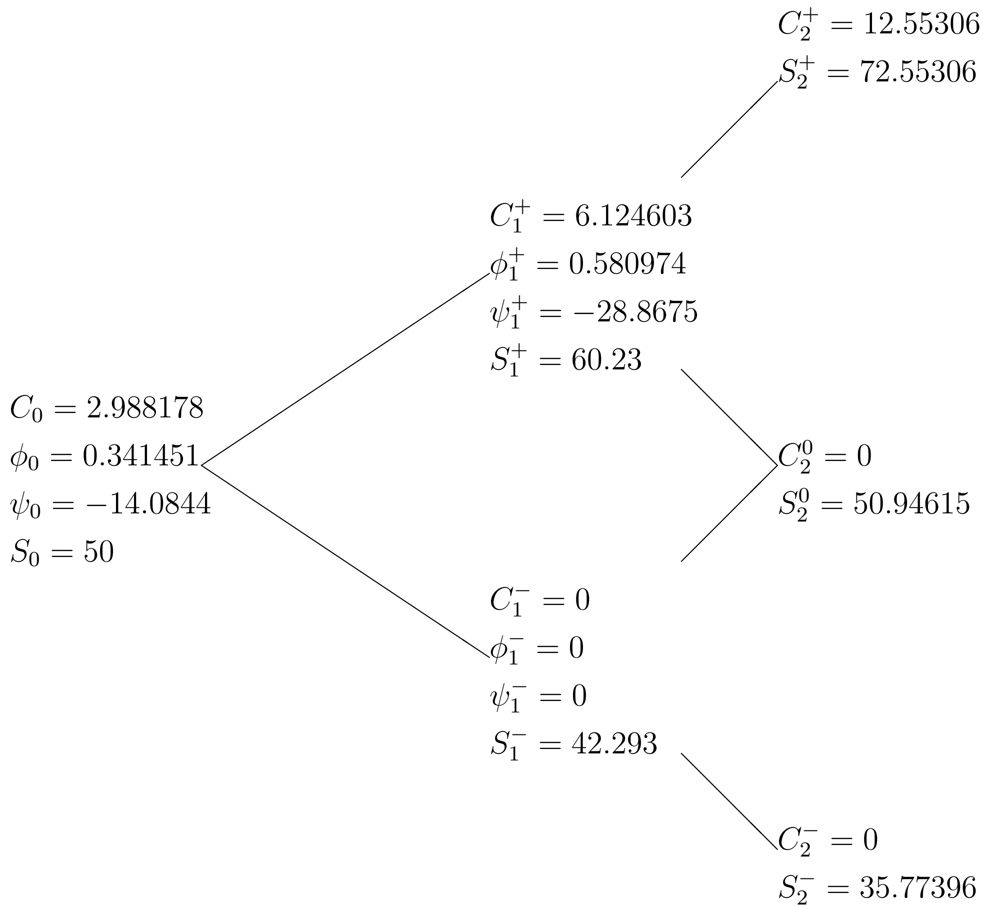
Strike \$60; Maturity 1 year, two intervals;
Continuously compounded annual risk-free rate 5%;
Volatility 25%; Current price \$50.

What do you notice about the way the premium behaves with strike price for a call option?

ANSWER

$k = \$60,\ r = 0.05,\ \sigma = 0.25,\ S_0 = \$50,\ U = 1.20460,\ D = 0.84586$

Eurocall Summary:



C_0 decreases with k increasing.