

Introduction to Finance
Quiz 4 *November 13, 2018*

Show all work! For the purposes of this quiz you may assume that all 6-month periods are exactly one-half of a year.

1. Suppose that today is November 15, 2019. You observe the following quotes on Bloomberg.

Security	Bid Quote	Ask Quote
May 15 2020 STRIPS	96.25	96.35
10% May 15 2020 Bond	101.34	101.41

- (a) **(14 points)** Which one of these 2 securities is trading rich relative to the other one? Explain.

- (b) **(24 points)** Is there an arbitrage opportunity in this market? Explain.

- (c) Suppose that transactions costs were higher – the midpoint of both spreads is the same, but the bid ask spreads are wider:

Security	Bid Quote	Ask Quote
May 15 2020 STRIPS	96.10	96.50
10% May 15 2020 Bond	101.30	101.45

- (d) **(24 points)** How does this change in transaction costs affect your arb trade? Explain.

2. Suppose that today is August 15, 2019. You observe the following quotes on Bloomberg.

Security	Bid Quote	Ask Quote
3% February 15 2020 Note	98.44	98.56
7.5% February 15 2020 Bond	100.84	100.91

(a) (**14 points**) Which one of these 2 securities is trading rich relative to the other one? Explain.

(b) (**24 points**) Is there an arbitrage opportunity in this market? Explain.