

Homework: Lecture 2 How Securities are Traded

(Due: 13 Sep 2019)

9. You are bullish on Telecom stock. The current market price is \$50 per share, and you have \$5,000 of your own to invest. You borrow an additional \$5,000 from your broker at an interest rate of 8% per year and invest \$10,000 in the stock.
 - a. What will be your rate of return if the price of Telecom stock goes up by 10% during the next year? The stock currently pays no dividends.
 - b. How far does the price of Telecom stock have to fall for you to get a margin call if the maintenance margin is 30%? Assume the price fall happens immediately.

15. You've borrowed \$20,000 on margin to buy shares in Ixnay, which is now selling at \$40 per share. Your account starts at the initial margin requirement of 50%. The maintenance margin is 35%. Two days later, the stock price falls to \$35 per share.
- a.* Will you receive a margin call?
 - b.* How low can the price of Ixnay shares fall before you receive a margin call?

7. Old Economy Traders opened an account to short sell 1,000 shares of Internet Dreams from the previous problem. The initial margin requirement was 50%. (The margin account pays no interest.) A year later, the price of Internet Dreams has risen from \$40 to \$50, and the stock has paid a dividend of \$2 per share.
- What is the remaining margin in the account?
 - If the maintenance margin requirement is 30%, will Old Economy receive a margin call?
 - What is the rate of return on the investment?

16. On January 1, you sold short one round lot (i.e., 100 shares) of Four Sisters stock at \$21 per share. On March 1, a dividend of \$2 per share was paid. On April 1, you covered the short sale by buying the stock at a price of \$15 per share. You paid 50 cents per share in commissions for each transaction. What is the value of your account on April 1?