

MFE Review Notes Errata – 3/28/07 Update

Chapter 9

Page 9-26. The fourth line of the lower, right portion of the box at the top of the page should be, “Buy $(1 - \lambda)$ of the K_3 -strike options.” The corrected version refers to a strike price of K_3 instead of K_1 .

Page Q9-3, Question 5. The American call option should have a strike price of \$70 instead of \$80.

Page Q9-16, Question 32. The strike price of the 9-month European put option should be \$206.60 instead of \$206.50.

Chapter 10

Page 10-19. The second equation in the Key Concept at the top of the page should be $d_F = e^{-\sigma\sqrt{h}}$.

Chapter 11

Page 11-15. In the second equation from the bottom of the page, -0.3014 should be replaced by -0.0314 .

Chapter 12

Page 12-3. There is a “+” missing from the numerator in the second line of the derivation in Section 12.2. Furthermore, T should not be in the exponent in the subsequent 3 lines. The corrected version is:

$$\begin{aligned}d_1 &= \frac{\ln(S/K) + (r - \delta + 0.5\sigma^2)T}{\sigma\sqrt{T}} \\&= \frac{\ln(S/K) + \ln(e^{rT}) - \ln(e^{\delta T}) + 0.5\sigma^2 T}{\sigma\sqrt{T}} \\&= \frac{\ln\left(\frac{Se^{rT}}{Ke^{\delta T}}\right) + 0.5\sigma^2 T}{\sigma\sqrt{T}} \\&= \frac{\ln\left(\frac{Se^{-\delta T}}{Ke^{-rT}}\right) + 0.5\sigma^2 T}{\sigma\sqrt{T}} \\&= \frac{\ln\left(\frac{F_{0,T}^P(S)}{F_{0,T}^P(K)}\right) + 0.5\sigma^2 T}{\sigma\sqrt{T}}\end{aligned}$$

*** New *** Page 12-7. The third equation is missing some negative signs that should appear in front of the values of δ . The corrected equation is:

$$\Delta_{Put} = -e^{-\delta T} N(-d_1) = -e^{-\delta T} [1 - N(d_1)] = e^{-\delta T} N(d_1) - e^{-\delta T} = \Delta_{Call} - e^{-\delta T}$$

Page 12-8. There should be a minus sign in front of δ in the last line of the Key Concept at the top of the page. The corrected expression is:

$$\Delta_{Put} = -e^{-\delta T} N(-d_1) = \Delta_{Call} - e^{-\delta T}$$

Chapter 13

Page 13-15. In the Key Concept a negative sign should appear in the first formula. The correct formula is:

$$R_{h,i} = -\frac{1}{2} S^2 \sigma^2 \Gamma(x_i^2 - 1)h$$

Page Q13-3. Question 5. Just after the sentence describing the call ratio spread, the following sentence should appear: “The market-maker delta-hedges the position.”

Page Q13-3. Question 6. This question requires 3 corrections:

1. The fourth sentence should be, “The delta of the **put** option is -0.2377 .”
2. The sentence describing the put ratio spread should say that “the market-maker buys 100 of the **55**-strike puts.”
3. Just after the sentence describing the put ratio spread, the following sentence should appear: “The market-maker delta-hedges the position.”

Page 13-11. Question 22. Choice B should be 51.2% instead of 50.1%.

Chapter 14

Page 14-13. The formulas in the Key Concept for the gap call price and the gap put price should have $e^{-\delta T}$ in place of $e^{-\delta t}$.

Page Q14-20. Question 35. This question requires 3 corrections:

1. Stock M is mixed up with Stock N in the first sentence. The corrected sentence is, “An exchange option gives its owner the right to exchange 0.5 shares of Stock **N** for 1 share of Stock **M** at the end of 6 months.”
2. The words “value of” should be deleted from the second sentence.
3. Stock M is mixed up with Stock N in the last sentence. The corrected sentence is, “Calculate the value of an exchange option giving its owner the right to exchange 2 shares of Stock **M** for 1 share of Stock **N** at the end of 6 months.”

Page Q14-23. Question 40. The second-to-last sentence should be, “An Asian geometric average strike **put** expires in 1 year.”

Chapter 20

Page 20-15. In the fourth equation from the bottom of the page, there is a C that should not appear. The corrected version is:

$$V_S = \frac{\partial V}{\partial S}$$

Chapter 24

- * **New** * Page 24-3. In the middle of the page, just above the formula for the duration of a portfolio, the sentence should refer to buying rather than selling N zero-coupon bonds. The first part of the corrected sentence is, “If we buy a zero-coupon bond maturing at time T_2 and **buy** N zero-coupon bonds that mature at time T_1 ...”
- * **New** * Page 24-6. In the first line, the sentence should refer to buying rather than selling N zero-coupon bonds. The first part of the corrected sentence is, “If we buy a zero-coupon bond maturing at time T_2 and **buy** N zero-coupon bonds that mature at time T_1 ...”

MFE Solutions Errata

The on-line solutions are updated for these errata as the errata are discovered.

Chapter 9

Page S9-6, Solution 14. The second to last sentence in the solution should reference 11 months instead of 8 months. The corrected version is: “Two coupons occur prior to the expiration of the option, the first of which occurs in 5 months and the second of which occurs in 11 months.”

Page S9-11, Solution 24. In the first line, “Swiss franc” should be replaced with “British pound.”

Page S9-15, Solution 32. About halfway down the page, the second sentence in the section describing the 6-month option, should read as follows: “The arbitrageur borrows **\$198** and uses it to buy the stock.”

Chapter 12

Page S12-11, Solution 13. There should be a minus sign in front of δ in the expression describing the delta of the put option. The corrected expression is:

$$\Delta_{Put} = \Delta_{Call} - e^{-\delta T} = 0.55198 - e^{-0.03(0.75)} = -0.42578$$

Chapter 13

Page S13-13, Solution 22. The correct answer is Choice B, 51.2% (see errata for Question 22 above). For a full updated solution, see the current file on our web site.

Chapter 14

Page S14-23, Solution 34. In the second paragraph from the top of the page, every reference to choice A should be a reference to choice B.

Page S14-23, Solution 35. Every reference to Stock M should actually be a reference to Stock N, and every reference to Stock N should actually be a reference to Stock M. For example, the corrected version of the first sentence is, "Let's define 0.5 shares of Stock **N** as the strike asset and 1 share of Stock **M** as the underlying asset."