10.02 Put Option Practice Name ____

"Why would somebody do this? How does it work?" These are great questions. Picture this: Wells has read the forecast on his weather app and it told him the next two days will be sunny and clear. Lillian has read the forecast on her weather app and it told her it was going to rain. Lillian doesn't have an umbrella. She gives Wells $3 if Wells will agree to let her use his umbrella to walk home if rains.

Why would Wells be happy to make this agreement with Lillian?

That's why people agree to sell put options (meaning, agree to sign the contract). They don't think it's going to rain so they don't need an um-ba-rella, ella, ella, eh, eh, eh… (Sorry, Millina.)

Mithila purchased 1000 put options for Lehman Brothers stock on January 5th of 2007 at a time when the stock price was $70 per share. The premium was $2 each. The strike price was $70 per contract.

What does Mithila intend to happen to the share price of Lehman stock?

She decided to hold on to the puts in the wake of rumors on Wall Street. Word was out that Lehman was in trouble. She could cash in big! She finally exercised the options on April 6th of 2008 when Lehman was trading at $3 per share.

a) If Mithila is a speculator, explain what she would have to do in order to exercise her put options. What are the steps?

b) Determine her total profit on the exercise of these options, including the premium.

In terms of put options, what is the difference between an *investor* and a *speculator*?

What happens when you buy a put option for a stock and the stock price winds up going up instead of down?

Rebecca owns 50,000 shares of IBM stock valued at $50 per share. She's concerned IBM might take a dive, so she buys 50,000 one-year put contracts to cover herself on March 17th 2014. The strike price of the put is $50 per share and the premium is $3 per contract.

In this problem, what is the role of the $50? What does that mean?

Assume the price of the stock has fallen to $35. <u>Assume she did not have the puts.</u> How much total equity (value) would she have lost due to the fall in the market price from the date listed above?

Assume she exercises the puts on a day on which the stock price has fallen to $28 per share. Determine her profit on these puts.

Draw a diagram that shows Luis buying put options for a stock on January 10th when the market price is $60 per share with a strike price of $60 per share and also showing that three months later, the share price is $45 per share.

Assuming the premium was $3 per option, determine Luis' profit on these puts.

Kaitlyn is holding 10,000 six-month put options with a strike price of $42 on a day when the market price of the underlying stock is $35 per share. She has four months left on the options. One month later, the share price has moved to $37 per share. Has she lost value or gained value on the options? Explain.