HW #3
Supplemental Problem

a) A forward discount of 3% means the forward E is 0.06683
b) If you sell Pesos forward, you are hedging because you will be paid Pesos in 6 months.
c) You are speculating that the Peso will appreciate by more than -3%.
d) An annual rate of 7.75% is an actual rate of 3.80%,

since $\sqrt{1.0775} = 1.0380$

You could borrow 9,633,661 Pesos now $\left(= \frac{10{,}000{,}000}{1.0380}\right)$

e) You are hedging.

On the spot, this is \$663,759 now.

If you buy a forward contract to sell Pesos, you would receive \$668,330 in 6 months, a gain of 0.69%.

Annualized, this is a yield of 1.38% $\left[= \left(\frac{668330}{663759}\right)^2 - 1 = 0.0138\right]$

f) You can speculate by waiting to sell Pesos on the spot, and if you are right you will receive \$695,890 instead, an increase of 4%. But you also hedge your bet by buying a put option on Pesos, and you are the holder. An ~~strike~~ option price for a put is cheaper when the strike price is lower, like 0.0660.

If the spot in 6 months is 0.0653, you bet wrong. You will strike to sell at 0.0660, as you are in the money. You will get \$660,000 from your 10 million pesos, a loss relative to (c) ~~[illegible]~~ in addition to the cost of the option.

But your boss may forgive you since you didn't reduce the amount to \$653,000 by leaving it uncovered.

Still \$8,000 or more is a lot to lose.