

EXAM FM QUESTIONS OF THE WEEK

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Question 15 - Week of October 31

Smith sells short 1000 shares of stock at a current price of \$2 per share. The stock pays a dividend of \$.20 per share per year. Smith is required to put up 40% margin on the short sale, the margin account earns 5% interest for one year. What is the upper bound on the stock price per share at the end of one year that will allow Smith to cover the short sale and still at least break even?

The solution can be found below.

Question 15 Solution

Smith's margin is $2 \cdot (1000) \cdot (.4) = 800$. With a price per share of x after one year, Smith's profit is $2000 + 800(.05) - 1000(.2) - 1000x$. In order for this to be ≥ 0 , we must have $x \leq 1.84$.