Chapter 10 - Secondary Markets - Stocks

Problems

10-7. Suppose that ZX Inc. is currently selling at $50 per share. You buy 200 shares, using $5,000 of your own money and borrowing the remainder of the purchase price from your broker. The rate on the margin loan is 5%.

a. What is the percentage increase in the net worth of your brokerage account if the price of ZX Inc. changes to (i) $54, (ii) $50, (iii) $46?

b. If the maintenance margin is 25%, how low can ZX Inc.'s price fall before you get a margin call?

c. How would your answer to (b) change if you had financed the initial purchase with only $2,000 of your own money?

d. What is the rate of return on your margined position (assuming again that you invest $5,000 of your own money) if ZX Inc. is selling after one year at (i) $54, (ii) $50, (iii) $46?

e. Continue to assume that a year has passed. How low can ZX Inc.'s price fall before you get a margin call?

f. Suppose that you sell short 400 shares of ZX Inc., currently selling for $50 per share, what will your rate of return be after one year if ZX Inc. stock is selling at (i) $54, (ii) $50, (iii) $46? Assume that ZX Inc. pays no dividends.