

Finance and accounting

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Finance and Accounting [Supervisor Firm AABC Currency Analyst (XYZ firm)]

Future Interest Rate Your company has borrowed 25 million Euros for two years therefore we are giving the details of the interest rate and future price rates that will help you to pay back the amount that you have borrowed. The overall interest rate that you firm will pay the 3-month Interbank Offered Rate that varies on the daily basis plus 2% per quarter. The amount of interest that your company will pay is $25,000,000 * 2\% * 89/360 = 123,611$ Euros per quarter plus the amount that is determine by Interbank Offer Rate. As on 19 January 2012, the interest rate that is offered is 1.195%. Therefore, the overall interest rate that your firm has to pay is 3.195%. The total amount for the next three month is calculated as $25,000,000 * (1.195\% + 2\%) * 89/360 = €197,468.75$. It is highly recommended for your firm to make a fixed future contract because the economic conditions of some of the EU states are worsening and it is likely that one or two countries will default upon their payments and the EU will have to step in to save these economies. If this happens, the interest rate will jump very high as central borrowing will sharply increase to support these economies and your firm can end up paying higher interest on variable interest bearing loan.. The future contracts are consistent and the features of the contract are established. The variable price in future contract is negotiable and it is determined in open and regulated markets (Euronext 2012). If your company decides not to take fixed future contracts then your company has other two options as well. You can also do either swap contract or forward contract with any other company. The swap is an agreement of contract that is between the two companies. In this type contract, each company makes payment to the other company for an agreed period of time that is based on <https://assignbuster.com/finance-and-accountting/>

speculative amount of principal. The principal amount is estimated because in a single currency, there is no need to exchange in the actual amount. Nevertheless, this estimated amount is required to calculate the real cash amount that will be exchanged periodically. Another option for your company is forward contract. It is contract between the two parties to buy or sell an asset at a specified time and the price is fixed today. The party that is buying an asset in this contract assumes a long position and the party that is selling the asset assumes the short position (Investopedia 2011). Therefore, it is your choice to take any contract but it is recommended for your company by us to take a fixed future contract as in the coming months there is more chance of the interest rate to increase.

Long straddle strategy: The long straddle strategy is neutral in trading and it involves the buying of a stock, striking price and date of expiration. The options in a long straddle strategy involve the unlimited profit and limited risk in which the trader thinks that the share or stock will have a major volatility in the upcoming time period. The investor can achieve a huge profit because he has position for long term in both the options of call and put (Kaepfel 2011). The formula for calculating the profit is: a Maximum Profit = Unlimited Profit Achieved When Price of Underlying > Strike Price of Long Call + Net Premium Profit = Price of Underlying - Strike Price of Long Call - Net Premium Paid (Optionsguide 2009) The risk involved in long straddle strategy is limited and the highest loss take place when the original price of stock is trading on the date of expiry and at the price of strike options that is brought. Both options expire at this price and traders lose the whole primary debt that was taken to enter in the trade. The formula for maximum loss is: Max Loss = Net Premium Paid + Commissions Paid Max Loss Occurs When Price of Underlying = Strike

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Price of Long Call/Put (Optionsguide 2009) Diagram: (Optionsguide 2009)

Short straddle strategy: The short straddle is a neutral strategy in which put and call of the same stock is sold at the same time, striking price and the date of expiration. Limited profit and unlimited risk is involved in this strategy. The profit that is maximum in this strategy is accomplished when the primary price of stock is traded on the price of strike of the options that are sold. The formula for maximum profit in this strategy is: $\text{Max Profit} = \text{Net Premium Received} - \text{Commissions Paid}$ Max Profit Achieved When Price of Underlying = Strike Price of Short Call/Put (Optionsguide 2009) The losses in short straddle can be huge when the basic price of stock moves strongly in the upward or downward at the date of expiration that affect the short put to finish the money deeply. The unlimited risk of short straddle strategy is calculated as: $\text{Maximum Loss} = \text{Unlimited Loss Occurs When Price of Underlying} > \text{Strike Price of Short Call} + \text{Net Premium Loss} = \text{Price of Underlying} - \text{Strike Price of Short Call} - \text{Net Premium Received}$ (Optionsguide 2009) (Optionsguide 2009) List of References Euronext. 2012. Three month Euro (Euribor) Futures. [Online] Available from <http://www.euronext.com>: [Accessed January 20, 2011] Investopedia. 2011. Interest Rate Swap. [Online] Available from <http://www.investopedia.com>: [Accessed January 20, 2011] Kaepfel, J. 2011 12-September. Profit On Any Price Change With Long Straddles. [Online] Available from [Accessed January 20, 2011] Optionsguide. 2009. Option Straddle (Long Straddle). [Online] Available ffrom [Accessed January 20, 2011] Optionsguide. 2009. Short Straddle (Sell Straddle). [Online] Available from <http://www.theoptionsguide.com>: [Accessed January 20, 2011]