

Early exercise of American put options: Investor rationality on the Swedish equity options market

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Abstract

Using Swedish equity option data, this study investigates how well the actual exercise behavior of American put options corresponds to the early exercise rules. The optimal exercise strategy is established in two ways. First, the critical exercise price, above which a put option should be exercised early, is computed and compared to the actual exercise price. Second, the exercise value of the option is compared to its market bid price. The results show that most early exercise decisions conform to rational exercise behavior, even though a large number of failures to exercise are found. Most of the faulty exercises can also be discarded after a sensitivity analysis, although several failures to exercise are considered irrational, even after taking transaction costs into account. © 2000 John Wiley & Sons, Inc. Jrl Fut Mark 20:167–188, 2000

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