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Research Article

On the exit value of a forward contract

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Abstract

Default risk associated with forward contracts can be substantial, yet these financial instruments are widely used to hedge price risk. An objectively priced exit option on the forward contract would help reduce the likelihood of litigation associated with contract default. A method is proposed to compute the exit option's value for an arbitrary forward contract, using Black's (1976) model and option premium data. The time series dynamics of the exit option value are confirmed to be, like its underlying, well described by a martingale with heavy-tailed (Student) GARCH residuals. Jrl Fut Mark 29: 179–196, 2009

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