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Quantity-Adjusting Options and Forward Contracts

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Abstract

Quantity-adjusting option and forward contracts deliver a payoff on a variable quantity of underlying. This article explains the use, pricing, and hedging of such contracts. The pricing of product options is also derived. Product options include quantity-adjusting options as a special case and pay off as a function of the prices of four risky assets. The pricing formula for these options is reduced to an expression in a two-dimensional density from a four-dimensional one. Closed form solutions in terms of the bivariate normal are obtained. Similar formulae in terms of the univariate normal are obtained for quantity-adjusting options. The normal distribution is absent from the expression for quantity-adjusting forwards. Product options also include sequential switching, or guru options. These are options which guarantee optimal asset selection at present dates among a fixed set of traded assets.

Keywords: Quantos, foreign exchange, options, quantity-adjusting**JEL Classification:** G13[Suggested Citation](#) >[Show Contact Information](#) >[Download This Paper \(Delivery.cfm/SSRN_ID954174_code917445.pdf?abstractid=954174&mirid=1\)](https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID954174_code917445.pdf?abstractid=954174&mirid=1)[Open PDF in Browser \(Delivery.cfm/SSRN_ID954174_code917445.pdf?abstractid=954174&mirid=1&type=2\)](https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID954174_code917445.pdf?abstractid=954174&mirid=1&type=2)

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