DERIVATIVES MOCK TEST

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1. An investor hedges her long position in her shares of Jaffrey Ltd. (Jaffrey) by taking a position in a forward contract where she agrees to sell the shares of Jaffrey. Which of the following statements best describes the investor's position regarding the forward contract?
   (A) The investor will have a gain on the forward contract when the price of the shares of Jaffrey falls.
   (B) The investor will have a gain on the forward contract when the price of the shares of Jaffrey rises.
   (C) The investor will have neither a gain nor a loss on the forward contract because her position is hedged.

2. Josh Amie purchases a one-year interest rate forward contract based on the market reference rate (MRR). At settlement, the MRR has risen and Amie will have:
   (A) a loss on the forward contract.
   (B) a gain on the forward contract.
   (C) neither a loss nor a gain on the forward contract.

3. Party A takes a position in a forward contract to purchase 200 shares of Squealer Inc. (Squealer) for $40 per share three months from now. Party B takes the opposite position to sell 200 shares of Squealer for $40 per share three months from now. The relevant discount rate is 5%. The value of the forward contract to Party A at the initiation of the contract is closest to:
   (A) $7,900.
   (B) $0.
   (C) $8,000.

4. A forward contract specifying that only the gains and losses are exchanged at settlement is called a:
   (A) deliverable contract.
   (B) cash-settled contract.
   (C) netted contract.

5. Which of the following statements regarding derivatives and/or cash market transactions is most accurate?
   (A) Investors can easily gain exposure to risk through derivatives but at a relatively high cost.
   (B) Initiating a derivatives position is most likely to have a greater impact on market prices of the underlying, relative to initiating an equivalent position in the underlying through a cash market transaction.
   (C) Transaction costs for a derivatives position are often lower than for the equivalent cash market trade.

6. For exchange-traded derivatives, the role of the central clearinghouse is to:
   (A) maintain private insurance that can be used to provide funds if a trader defaults.
   (B) stabilize the market price fluctuations of the underlying commodity.
   (C) guarantee that all obligations by traders will be honored.

7. Which of the following statements regarding a forward commitment is least accurate? A forward commitment:
   (A) is a contractual promise.
   (B) can involve a stock index.
   (C) is not legally binding.

8. A European call option on a stock has an exercise price of 42. On the expiration date, the stock price is 40. The value of the option at expiration is:
   (A) positive.
   (B) negative.
   (C) zero

9. If the margin balance in a futures account with a long position goes below the maintenance margin amount:
   (A) A deposit is required to return the account margin to the initial margin level.
   (B) A margin deposit equal to the maintenance margin is required within two business days.
   (C) A deposit is required which will bring the account to the maintenance margin level.

10. At expiration, the value of a call option is the greater of zero or the:
   (A) Underlying asset price minus the exercise value.
   (B) Exercise price minus the exercise value.
   (C) Underlying asset price minus the exercise price.

11. An agreement that gives the holder the right, but not the obligation, to sell an asset at a specified price on a specific future date is a:
   (A) call option.
   (B) put option.
   (C) swap.

12. The settlement price for a futures contract is:
   (A) the price of the last trade of a futures contract at the end of the trading day.
   (B) the price of the asset in the future for all trades made in the same day.
   (C) an average of the trade prices over a period at the end of a trading session.

13. Which of the following statements about options is most accurate?
   (A) The holder of a put option has the right to sell to the writer of the option.
   (B) The writer of a put option has the obligation to sell the asset to the holder of the put option.
   (C) The holder of a call option has the obligation to sell to the option writer if the stock's price rises above the strike price.

14. A financial instrument with a payoff that depends on a specified event occurring is most accurately described as:
   (A) a default swap.
   (B) a contingent claim.
   (C) an option.

15. An investor buys a call option that has an option premium of $5 and an exercise price of $22.50. The current market price of the stock is $25.75. At expiration, the value of the stock is $23.00. The net profit/loss of the call position is closest to:
   (A) −$4.50.
   (B) $4.50.
   (C) −$5.00.

16. On the expiration date of a put option, if the spot price of the underlying asset is less than the exercise price, the value of the option is:
   (A) positive.
   (B) zero.
   (C) negative.

17. Al Steadman receives a premium of $3.80 for writing a put option with an exercise price of $64. If the stock price at expiration is $84, Steadman's profit or loss from the options position is:
    (A) $3.80.
    (B) $16.20.
    (C) $23.80.

18. Jimmy Casteel pays a premium of $1.60 to buy a put option with an exercise price of $145. If the stock price at expiration is $128, Casteel's profit or loss from the options position is:
    (A) $1.60.
    (B) $18.40.
    (C) $15.40.

19. A corporation that employs hedge accounting and uses an interest rate swap to offset changes in the value of fixed rate bond liability is said to be employing a:
    (A) net investment hedge.
    (B) cash ow hedge.
    (C) fair value hedge.

20. A corporation that employs hedge accounting and uses derivatives to reduce the volatility of the value of its inventory is most likely using a:
    (A) cash ow hedge.
    (B) fair value hedge.
    (C) net investment hedge.

21. The most appropriate action an owner of common stock can take to hedge the stock's price risk while retaining its upside potential is to:
    (A) sell calls.
    (B) buy calls.
    (C) buy puts.

22. Which of the following statements regarding the use of derivatives is most accurate?
    (A) A portfolio manager can decrease exposure to the risk and return of a market index.
    (B) The issuer of a fixed-rate obligation can increase risk exposure by converting to a floating-rate obligation.
    (C) A manufacturer can hedge the exchange risk of anticipated receipts or payments.

23. The calculation of derivatives values is based on an assumption that:
    (A) Investors are risk neutral.
    (B) Arbitrage opportunities are exploited rapidly.
    (C) Arbitrage opportunities do not arise in real markets.

24. Costs of holding the underlying that are greater than benefits from holding the underlying will:
    (A) Decrease the no-arbitrage forward price.
    (B) Increase the no-arbitrage forward price.
    (C) Have no effect on the no-arbitrage forward price.

25. Other things equal, an increase in storage costs of the underlying asset will:
    (A) not affect the no-arbitrage forward price.
    (B) decrease the no-arbitrage forward price.
    (C) increase the no-arbitrage forward price.

26. The time value of an option is most accurately described as:
    (A) The amount by which the intrinsic value exceeds the option premium.
    (B) Equal to the entire premium for an out-of-the-money option.
    (C) Increasing as the option approaches its expiration date.

27. Which of the following statements about moneyness is most accurate? When the stock price is:
    (A) below the strike price, a call option is in-the-money.
    (B) above the strike price, a put option is in-the-money.
    (C) above the strike price, a put option is out-of-the-money.

28. An increase in the riskless rate of interest, other things equal, will:
    (A) decrease call option values and decrease put option values.
    (B) decrease call option values and increase put option values.
    (C) increase call option values and decrease put option values.

29. For a European style put option:
    (A) time value is equal to its market price minus its exercise value.
    (B) intrinsic value is equal to its market price plus its exercise value.
    (C) exercise value is equal to the underlying stock price minus its exercise price.

30. An investor holds two options on the same underlying stock, a call option with an exercise price of 25 and a put option with an exercise price of 30. If the market price of the stock is 27:
    (A) only one of the options is in the money.
    (B) both options are in the money.
    (C) neither option is in the money.