Question #1 of 60

Which of the following statements about futures and the clearinghouse is *least* accurate? The clearinghouse:

A) requires the daily settlement of all margin accounts.

B) guarantees that traders in the futures market will honor their obligations.

C) has defaulted on one half of one percent of futures trades.

Question #2 of 60

Standardized futures contracts are an aid to increased market liquidity because:

A) standardization results in less trading activity.

B) uniformity of the contract terms broadens the market for the futures by appealing to a greater number of traders.

C) standardization of the futures contract stabilizes the market price of the underlying commodity.

Question #3 of 60

Which of the following statements about forward contracts is *least* accurate?

A) Both parties to a forward contract have potential default risk.

B) A forward contract can be exercised at any time.

C) The long promises to purchase the asset.

Question #4 of 60

Derivatives are often criticized by investors with limited knowledge of complex financial securities. A common criticism of derivatives is that they:

A) shift risk among market participants.

B) can be likened to gambling.

C) increase investor transactions costs.

Question #5 of 60

Which of the following statements about futures is *least* accurate?

A) Futures contracts have a maximum daily allowable price limit.

B) The futures exchange specifies the minimum price fluctuation of a futures contract.

C) The exchange-mandated uniformity of futures contracts reduces their liquidity.

Question #6 of 60

The clearinghouse, in U.S. futures markets is *least likely* to:

A) act as a counterparty in futures contracts.

B) guarantee performance of futures contract obligations.

C) choose which assets will have futures contracts.

Question #7 of 60

Which of the following is *most likely* an exchange-traded derivative?

A) Currency forward contract.

B) Equity index futures contract.

C) Bond option.

Question #8 of 60

Which of the following statements regarding exchange-traded derivatives is NOT correct? Exchange-traded derivatives:

A) are standardized contracts.

B) often trade in a physical location.

C) are illiquid.

Question #9 of 60

The short in a forward contract:

A) is obligated to deliver the asset upon expiration of the contract.

B) has the right to deliver the asset upon expiration of the contract.

C) is obligated to deliver the asset anytime prior to expiration of the contract.

Question #10 of 60

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) swap.

B) call option.

C) put option.

Question #11 of 60

Which of the following is a difference between futures and forward contracts? Futures contracts are:

A) standardized.

B) over-the-counter instruments.

C) larger than forward contracts.

Question #12 of 60

Which of the following relationships between arbitrage and market efficiency is *least* accurate?

A) The concept of rationally priced financial instruments preventing arbitrage opportunities is the basis behind the no-arbitrage principle.

B) Market efficiency refers to the low cost of trading derivatives because of the lower expense to traders.

C) Investors acting on arbitrage opportunities help keep markets efficient.

Question #13 of 60

Which of the following statements regarding plain-vanilla interest rate swaps is *least* accurate?

A) In a swap contract, the counterparties usually swap the notional principal.

B) The time frame covered by the swap is called the tenor of the swap.

C) The settlement dates are when the interest payments are to be made.

Question #14 of 60

An American option is:

A) an option on a U.S. stock or bond.

B) exercised only at expiration.

C) exercisable at any time up to its expiration date.

Question #15 of 60

In a credit default swap (CDS), the buyer of credit protection:

A) issues a security that is paid using the cash flows from an underlying bond.

B) exchanges the return on a bond for a fixed or floating rate return.

C) makes a series of payments to a credit protection seller.

Question #16 of 60

Which of the following is the *best* interpretation of the no-arbitrage principle?

A) There is no way you can find an opportunity to make a profit.

B) There is no free money.

C) The information flow is quick in the financial market.

Question #17 of 60

The process of arbitrage does all of the following EXCEPT:

A) promote pricing efficiency.

B) insure that risk-adjusted expected returns are equal.

C) produce *riskless* profits.

Question #18 of 60

All of the following are benefits of derivatives markets EXCEPT:

A) derivatives allow the shifting of risk to those who can most efficiently bear it.

B) transactions costs are usually smaller in derivatives markets, than for similar trades in the underlying asset.

C) derivatives markets help keep interest rates down.

Question #19 of 60

In a plain vanilla interest rate swap:

A) payments equal to the notional principal amount are exchanged at the initiation of the swap.

B) each party pays a fixed rate of interest on a notional amount.

C) one party pays a floating rate and the other pays a fixed rate, both based on the notional amount.

Question #20 of 60

Credit derivatives are *least accurately* characterized as:

A) forward commitments.

B) contingent claims.

C) insurance.

Question #21 of 60

Which of the following statements regarding futures and forward contracts is *least* accurate?

A) Futures contracts are highly standardized.

B) Both forward contracts and futures contracts trade on organized exchanges.

C) Forwards require no cash transactions until the delivery date, while futures require a margin deposit when the position is opened.

Question #22 of 60

Which of the following is a common criticism of derivatives?

A) Derivatives are too illiquid.

B) Derivatives are likened to gambling.

C) Fees for derivatives transactions are relatively high.

Question #23 of 60

The process that ensures that two securities positions with identical future payoffs, regardless of future events, will have the same price is called:

A) the law of one price.

B) arbitrage.

C) exchange parity.

Question #24 of 60

Sally Ferguson, CFA, is a hedge fund manager. Ferguson utilizes both futures and forward contracts in the fund she manages. Ferguson makes the following statements about futures and forward contracts:

> Statement 1: A futures contract is an exchange traded instrument with standardized features.
>
> Statement 2: Forward contracts are marked to market on a daily basis to reduce credit risk to both counterparties.

Are Ferguson's statements accurate?

A) Neither of these statements is accurate.

B) Only one of these statements is accurate.

C) Both of these statements are accurate.

Question #25 of 60

Which of the following statements about options is *most accurate*?

A) 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.

B) The holder of a put option has the right to sell to the writer of the option.

C) The writer of a put option has the obligation to sell the asset to the holder of the put option.

Question #26 of 60

Which of the following statements about arbitrage opportunities is *most accurate*?

A) The market prices of two assets or portfolios that have the same future payoffs cannot differ for protracted periods.

B) Engaging in arbitrage requires a large amount of capital.

C) Arbitrage is referred to as the law of one price.

Question #27 of 60

A European option can be exercised by:

A) either party, at contract expiration.

B) its owner, anytime during the term of the contract.

C) its owner, only at the expiration of the contract.

Question #28 of 60

A derivative security:

A) is one that is based on the value of another security.

B) has a value dependent on the shape of the yield curve.

C) is like a callable bond.

Question #29 of 60

A forward contract that must be settled by a sale of an asset by one party to the other party is termed a:

A) deliverable forward contract.

B) physicals-only contract.

C) take-and-pay contract.

Question #30 of 60

Which of the following is an example of an arbitrage opportunity?

A) A put option on a share of stock has the same price as a call option on an identical share.

B) A portfolio of two securities that will produce a certain return that is greater than the risk-free rate of interest.

C) A stock with the same price as another has a higher rate of return.

Question #31 of 60

Default risk in a forward contract:

A) only applies to the long, and is the probability that the short can not acquire the asset for delivery.

B) is the risk to either party that the other party will not fulfill their contractual obligation.

C) only applies to the short, who must make the cash payment at settlement.

Question #32 of 60

Which of the following statements regarding a forward commitment is NOT correct? A forward commitment:

A) can involve a stock index.

B) is not legally binding.

C) is a contractual promise.

Question #33 of 60

Typically, forward commitments are made with respect to all the following *EXCEPT*:

A) inflation.

B) equities.

C) bonds.

Question #34 of 60

MBT Corporation recently announced a 15% increase in earnings per share (EPS) over the previous period. The consensus expectation of financial analysts had been an increase in EPS of 10%. After the earnings announcement the value of MBT common stock increased each day for the next five trading days, as analysts and investors gradually reacted to the better than expected news. This gradual change in the value of the stock is an example of:

A) efficient markets.

B) inefficient markets.

C) speculation.

Question #35 of 60

A derivative security:

A) has a value based on another security or index.

B) has no default risk.

C) has a value based on stock prices.

Question #36 of 60

The party to a forward contract that is obligated to purchase the asset is called the:

A) short.

B) long.

C) receiver.

Question #37 of 60

Regarding buyers and sellers of put and call options, which of the following statements concerning the resulting option position is *most* accurate? The buyer of a:

A) call option is taking a long position while the seller of a put is taking a short position.

B) call option is taking a long position and the buyer of a put option is taking a short position.

C) put option is taking a short position and the seller of a call option is taking a short position.

Question #38 of 60

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) an average of the trade prices during the 'closing period'.

C) the price of the asset in the future for all trades made in the same day.

Question #39 of 60

Some forward contracts are termed *cash settlement* contracts. This means:

A) at settlement, the long purchases the asset from the short for cash.

B) at contract expiration, the long can buy the asset from the short or pay the difference between the market price of the asset and the contract price.

C) either the long or the short in the forward contract will make a cash payment at contract expiration and the asset is not delivered.

Question #40 of 60

One reason that criticism has been leveled at derivatives and derivatives markets is that:

A) they are complex instruments and sometimes hard to understand.

B) derivatives expire.

C) derivatives have too much default risk.

Question #41 of 60

Which of the following is *least likely* a characteristic of futures contracts? Futures contracts:

A) are traded in an active secondary market.

B) require weekly settlement of gains and losses.

C) are backed by the clearinghouse.

Question #42 of 60

Which of the following is *least likely* one of the conditions that must be met for a trade to be considered an arbitrage?

A) There is no risk.

B) There is no initial investment.

C) There are no commissions.

Question #43 of 60

Which of the following represents a long position in an option?

A) Writing a call option.

B) Writing a put option.

C) Buying a put option.

Question #44 of 60

An analyst determines that a portfolio with a 35% weight in Investment P and a 65% weight in Investment Q will have a standard deviation of returns equal to zero.

- Investment P has an expected return of 8%.
- Investment Q has a standard deviation of returns of 7.1% and a covariance with the market of 0.0029.
- The risk-free rate is 5% and the market risk premium is 7%.

If no arbitrage opportunities are available, the expected rate of return on the combined portfolio is *closest to*:

A) 5%.

B) 6%.

C) 7%.

Question #45 of 60

Which of the following statements about arbitrage is NOT correct

A) No investment is required when engaging in arbitrage.

B) If an arbitrage opportunity exists, making a profit without risk is possible.

C) Arbitrage can cause markets to be less efficient.

Question #46 of 60

Financial derivatives contribute to market completeness by allowing traders to do all of the following EXCEPT:

A) narrow the amount of trading opportunities to a more manageable range.

B) increase market efficiency through the use of arbitrage.

C) engage in high risk speculation.

Question #47 of 60

Over-the- counter derivatives:

A) are backed by the OTC Clearinghouse.

B) have good liquidity in the over-the-counter (OTC) market.

C) are customized contracts.

Question #48 of 60

What is the primary difference between an American and a European option?

A) The European option can only be traded on overseas markets.

B) American and European options are never written on the same underlying asset.

C) The American option can be exercised at anytime on or before its expiration date.

Question #49 of 60

A futures investor receives a margin call. If the investor wishes to maintain her futures position, she must make a deposit that restores her account to the:

A) initial margin.

B) maintenance margin.

C) daily margin.

Question #50 of 60

A financial instrument that has payoffs based on the price of an underlying physical or financial asset is a(n):

A) option.

B) future.

C) derivative security.

Question #51 of 60

If the margin balance in a futures account with a long position goes below the maintenance margin amount:

A) a margin deposit equal to the maintenance margin is required within two business days.

B) a deposit is required to return the account margin to the initial margin level.

C) a deposit is required which will bring the account to the maintenance margin level.

Question #52 of 60

Any rational quoted price for a financial instrument should:

A) be low enough for most investors to afford.

B) provide no opportunity for arbitrage.

C) provide an opportunity for investors to make a profit.

Question #53 of 60

Which of the following definitions involving derivatives is *least* accurate?

A) An arbitrage opportunity is the chance to make a riskless profit with no investment.

B) A call option gives the owner the right to sell the underlying good at a specific price for a specified time period.

C) An option writer is the seller of an option.

Question #54 of 60

Which of the following is NOT an over-the-counter (OTC) derivative?

A) A bond option.

B) A futures contract.

C) A forward contract.

Question #55 of 60

In the trading of futures contracts, the role of the clearinghouse is to:

A) guarantee that all obligations by traders, as set forth in the contract, will be honored.

B) stabilize the market price fluctuations of the underlying commodity.

C) maintain private insurance that can be used to provide funds if a trader defaults.

Question #56 of 60

A similarity of margin accounts for both equities and futures is that for both:

A) additional payment is required if margin falls below the maintenance margin.

B) the value of the security is the collateral for the loan.

C) interest is charged on the margin loan balance.

Question #57 of 60

Which of the following is *most* accurate regarding derivatives?

A) Derivative values are based on the value of another security, index, or rate.

B) Derivatives have no default risk.

C) Exchange-traded derivatives are created and traded by dealers in a market with no central location.

Question #58 of 60

A standardized and exchange-traded agreement to buy or sell a particular asset on a specific date is *best* described as a:

A) forward contract.

B) futures contract.

C) swap.

Question #59 of 60

Which of the following regarding a plain vanilla interest rate swap is *most* accurate?

A) Only the net interest payments are made.

B) The notional principal is returned at the end of the swap.

C) The notional principal is swapped.

Question #60 of 60

A legally binding promise to buy 140 oz. of gold two months from now at a price agreed upon today is *most likely* a:

A) futures contract.

B) forward commitment.

C) hedge.