

## Question 1

L2PM-EP0011-1908

LOS: LOS-10811

Lesson Reference: Lesson 1: Trading Costs and Electronic Markets

Difficulty: medium

Identify which of the following is *not* an implicit trading cost.

- ☐ Market impact
- ☐ Opportunity costs
- ☒ Exchange fees

### Rationale

#### **Market impact**

Incorrect. Market impact is an implicit cost.

### Rationale

#### **Opportunity costs**

Incorrect. Opportunity costs are implicit costs.

### Rationale

#### **Exchange fees**

Correct. Exchange fees are explicit costs.

## Question 2

L2PM-EP0013-1908

LOS: LOS-10812

Lesson Reference: Lesson 1: Trading Costs and Electronic Markets

Difficulty: medium

Identify which of the following correctly states the calculation for effective spread transaction cost estimates.

☐ Trade size  $\times \left\{ \frac{\text{Trade price} - \frac{(\text{Bid} + \text{Ask})}{2} \text{ for buy orders}}{\text{Trade price} + \frac{(\text{Bid} + \text{Ask})}{2} \text{ for sell orders}} \right\}$

☐ Trade size  $\times \left\{ \frac{\text{Trade price} - \frac{(\text{Bid} - \text{Ask})}{2} \text{ for buy orders}}{\text{Trade price} - \frac{(\text{Bid} + \text{Ask})}{2} \text{ for sell orders}} \right\}$

☒ Trade size  $\times \left\{ \frac{\text{Trade price} - \frac{(\text{Bid} + \text{Ask})}{2} \text{ for buy orders}}{\frac{(\text{Bid} + \text{Ask})}{2} - \text{Trade price} \text{ for sell orders}} \right\}$

### Rationale



$$\text{Trade size} \times \left\{ \frac{\text{Trade price} - \frac{(\text{Bid} + \text{Ask})}{2} \text{ for buy orders}}{\text{Trade price} + \frac{(\text{Bid} + \text{Ask})}{2} \text{ for sell orders}} \right\}$$

Incorrect. Trade price + (Bid + Ask/2) for sell orders is incorrect; it should be (Bid + Ask/2) – Trade price.

### Rationale



$$\text{Trade size} \times \left\{ \frac{\text{Trade price} - \frac{(\text{Bid} - \text{Ask})}{2} \text{ for buy orders}}{\text{Trade price} - \frac{(\text{Bid} + \text{Ask})}{2} \text{ for sell orders}} \right\}$$

Incorrect. Trade price – (Bid – Ask/2) for buy orders is incorrect; it should be (Bid + Ask/2) – Trade price.

### Rationale



$$\text{Trade size} \times \left\{ \frac{\text{Trade price} - \frac{(\text{Bid} + \text{Ask})}{2} \text{ for buy orders}}{\frac{(\text{Bid} + \text{Ask})}{2} - \text{Trade price for sell orders}} \right\}$$

Correct. This is the correct formula to estimate effective spread transaction costs.

### Question 3

L2PM-EP0015-1908

LOS: LOS-10812

Lesson Reference: Lesson 1: Trading Costs and Electronic Markets

Difficulty: medium

Based on the following information, identify which of the following statements is *correct*.

Trade size: 1,000 shares

Buy VWAP: 56

Sell VWAP: 52

VWAP benchmark for buy orders: 55

VWAP benchmark for sell orders: 54

- ☐ The trader received better sell prices than the average market player.
- ☒ The trader received worse sell prices than the average market player.
- ☐ The trader received better buy prices than the average market player.

#### Rationale

 **The trader received better sell prices than the average market player.**

Incorrect. The trader sold for a VWAP of 52, whereas benchmark sell orders executed at 54.

#### Rationale

 **The trader received worse sell prices than the average market player.**

Correct. The trader sold for a VWAP of 52, whereas benchmark sell orders executed at 54.

#### Rationale

 **The trader received better buy prices than the average market player.**

Incorrect. The trader sold for a VWAP of 52, whereas benchmark sell orders executed at 54.

#### Question 4

L2PM-EP0018-1908

LOS: LOS-10817


Lesson Reference: Lesson 1: Trading Costs and Electronic Markets

Difficulty: medium

Identify which of the following statements regarding the effect of corporate news and market events is true.

- ☐ News and market events produce trading opportunities, but not liquidity opportunities.
- ☐ News and market events produce liquidity opportunities, but not trading opportunities.
- ☒ News and market events produce both trading opportunities and liquidity opportunities.

#### Rationale

 **News and market events produce trading opportunities, but not liquidity opportunities.**


Incorrect. News and market events create liquidity opportunities.

#### Rationale

 **News and market events produce liquidity opportunities, but not trading opportunities.**

Incorrect. News and market events produce trading opportunities.

#### Rationale

 **News and market events produce both trading opportunities and liquidity opportunities.**

Correct. News and market events produce both trading opportunities and liquidity opportunities.

### Question 5

L2PM-EP0016-1908

LOS: LOS-10814

Lesson Reference: Lesson 1: Trading Costs and Electronic Markets

Difficulty: easy

Identify which of the following is *not* a factor driving the development of new information technologies for trading.

- ☐ Electronic exchanges
- ☒ Floor exchanges
- ☐ Alternative trading systems

#### Rationale

##### **Electronic exchanges**

Incorrect. Electronic exchanges have driven new trading technologies.

#### Rationale

##### **Floor exchanges**

Correct. Floor exchanges have not driven the development of new trading technologies.

#### Rationale

##### **Alternative trading systems**

Incorrect. Alternative trading systems have driven new trading technologies.

## Question 6

L2PM-EP0021-1908

LOS: LOS-10819

Lesson Reference: Lesson 1: Trading Costs and Electronic Markets

Difficulty: medium

Identify which of the following is *not* considered a solution to the risks associated with electronic trading systems.

- ☐ Mock trading sessions on exchanges
- ☒ Exchanges surveilling trading activity after every trading day
- ☐ Exchanges adopting price shift limits and trading halts

### Rationale

#### **Mock trading sessions on exchanges**

Incorrect. Extensively testing software before it is used for live trading can include mock trading sessions on exchanges.

### Rationale

#### **Exchanges surveilling trading activity after every trading day**

Correct. Exchanges surveil trading activity in real time.

### Rationale

#### **Exchanges adopting price shift limits and trading halts**

Incorrect. Exchanges adopt price shift limits and trading halts to prevent large price changes.

### Question 7

L2PM-EP0020-1908

LOS: LOS-10819

Lesson Reference: Lesson 1: Trading Costs and Electronic Markets

Difficulty: medium

Identify which of the following is *not* a risk associated with electronic trading systems.

- ☒ Algorithms
- ☐ Oversized orders
- ☐ Malevolent order streams

#### Rationale

##### **Algorithms**

Correct. Algorithms in themselves are not a risk; runaway algorithms are a risk.

#### Rationale

##### **Oversized orders**

Incorrect. Oversized orders are a risk associated with electronic trading systems.

#### Rationale

##### **Malevolent order streams**

Incorrect. Malevolent order streams are a risk associated with electronic trading systems.



### Question 8

L2PM-EP0019-1908

LOS: LOS-10818

Lesson Reference: Lesson 1: Trading Costs and Electronic Markets

Difficulty: easy

Identify which of the following about trading algorithms is *not* true.

- ☒ Algorithms maximize market impact.
- ☐ Algorithms minimize market impact.
- ☐ Algorithms conceal trading intentions.

#### Rationale

☒ **Algorithms maximize market impact.**

Correct. Algorithms are used to minimize transaction costs.

#### Rationale

☒ **Algorithms minimize market impact.**

Incorrect. Algorithms are used to minimize transaction costs.

#### Rationale

☒ **Algorithms conceal trading intentions.**

Incorrect. Algorithms are used to conceal trading intentions to others.