8.03 Derivative Benefits, Risks, and Issuer and Investor Uses

Question 1
Which of the following statements *best* describes how derivatives markets influence risk? Derivatives markets:
A. facilitate more optimal allocation of risk.
B. reduce economy-wide risk by enabling hedging strategies.
C. increase economy-wide risk by facilitating financial speculation.

Question 2
Some believe that the use of derivatives by short-term speculators is just another form of gambling and increases the risk of financial market contagion. Which of the following statements *most likely* refutes this belief?
A. Short-term speculators allow hedgers to lay off risk.
B. Hedged positions make financial market contagion unlikely.
C. High capital and collateral requirements protect other investors from speculators.

Question 3
Arbitrage *most likely* contributes to market efficiency by reducing:
A. price differences from relative fair value.
B. the amount of speculative trading activity.
C. risk so expected profits converge with the risk-free rate.

Question 4
A farmer expects to harvest wheat in three months. If the farmer wants to protect against a decline in wheat prices between now and the harvest and to simultaneously participate in any increases in the price of wheat, the *most appropriate* transaction is to:
A. sell a three-month futures contract at the current futures price.
B. buy a three-month put option with a strike price equal to the current futures price.
C. sell a three-month futures contract for a price to be determined one month from now.

Question 5
Which of the following conditions would *most likely* prevent riskless arbitrage?
A. Markets are informationally inefficient.
B. It is illegal to sell short in some markets.
C. The investment's intrinsic value is unknown.

Question 6
Which of the following statements *best* describes the underlying basis of price discovery in the futures market?
A. The futures price is a forecasted value of the underlying.
B. The ability to hedge positions allows for the most efficient prices.
C. Lower capital requirements allow for information to flow into the market faster.