

Question #1 of 222

Question ID: 605654

In early September, a customer buys 100 shares of MCS stock for \$83 per share and simultaneously writes 1 MCS Mar 90 call for \$4 per share. The customer will break even when MCS stock is at:

- X A) 86
- X B) 94
- ✓ C) 79
- X D) 87

Explanation

This is a covered call writer. If the stock rises above \$90, the writer will be exercised and will make \$700 on the stock (buy at \$83, deliver at \$90) and keep the \$400 received in premiums. If the stock declines, the call expires unexercised. The writer can lose \$400 on the stock (the premiums earned) and still break even. This occurs at \$79 (\$83 - \$4). Breakeven is cost of stock purchased less premiums.

**Reference:** 4.3.2 in the License Exam Manual

Question #2 of 222

Question ID: 605738

A customer buys 1 LMB Aug 70 put for 4 and 1 LMB Aug 70 call for 4. If the price of LMB stock is \$70, at what prices would the customer break even?

- I. \$62.
  - II. \$66.
  - III. \$74.
  - IV. \$78.
- X A) I or III.
  - ✓ B) I or IV.
  - X C) II or III.
  - X D) II or IV.

Explanation

To break even, the customer must recover \$800 paid in premiums. On the long 70 call, this occurs if the market price rises to 78. On the long 70 put, this occurs if the market price falls to 62.

**Reference:** 4.4.2.1 in the License Exam Manual

Question #3 of 222

Question ID: 605530

An investor with no other positions sells 1 DEF Jan 95 put at 5.50. If the put is exercised when the stock is trading at 79 and the investor immediately sells the stock in the market, what is the investor's profit or loss?

- X A) \$550 profit.
- X B) \$1,050 profit.
- X C) \$550 loss.
- ✓ D) \$1,050 loss.

Explanation

The investor has the obligation to buy the stock for 95 while the stock is currently worth 79, for a loss of 16. The loss of 16 minus the 5.50 premium received gives the customer a loss of 10.50 ( $10.50 \times 100 = \$1,050$ ).

**Reference:** 4.1.1.2 in the License Exam Manual

### Question #4 of 222

Question ID: 605549

If a customer is long 10 ABC Jul 50 calls at 4.50, the contracts give the holder the:

- ☐ A) right to sell stock.
- ☐ B) obligation to sell stock.
- ☐ C) obligation to buy stock.
- ☒ D) right to buy stock.

#### Explanation

A long call gives the holder the right to buy stock.

**Reference:** 4.1.1.1 in the License Exam Manual

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### Question #5 of 222

Question ID: 605639

An investor owns 100 shares of IBM. Which of the following would make a long hedge?

- ☐ A) Writing a put.
- ☐ B) Writing a call.
- ☒ C) Buying a put on IBM.
- ☐ D) Buying a call on IBM.

#### Explanation

If you own the stock, you want the market value to rise. To hedge the position against a decrease in value, you would buy a put option.

**Reference:** 4.3.3 in the License Exam Manual

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### Question #6 of 222

Question ID: 605706

If a customer buys 1 OEX Feb 350 call at 5 and sells 1 OEX Feb 335 call at 16 when the underlying index is at 344, he will profit if the

- I. spread narrows.
- II. spread widens.
- III. underlying index does not change.
- IV. underlying index rises in value.

- ☐ A) II and IV.
- ☒ B) I and III.
- ☐ C) I and IV.
- ☐ D) III and IV.

#### Explanation

This is a credit spread because the investor received more premium than was paid. Sellers profit if both contracts expire or the spread narrows. The breakeven point is 346 (335 + 11, the net premium) and because the spread is bearish, the customer profits if the index is below 346.

**Reference:** 4.4.1.3 in the License Exam Manual

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### Question #7 of 222

Question ID: 605757

Which of the following statements regarding straddles are TRUE?

- I. An investor who expects no change in a stock's price and wishes to generate income sells a straddle.
- II. An investor who expects no change in a stock's price buys a straddle.
- III. An investor who expects a substantial decline in a stock's price sells a straddle.
- IV. An investor who expects substantial fluctuations in a stock's price and is unsure as to direction buys a straddle.

- ☒ A) I and IV.

- X **B)** II and III.
- X **C)** I and II.
- X **D)** II and IV.

#### Explanation

A long straddle is the purchase of a put and a call on the same stock when both options have the same terms. The long call is profitable if the market rises, while the long put is profitable if the market falls. An investor purchases a straddle if sharp market movement is expected but the direction is uncertain. A short straddle is the sale of a put and a call on the same stock with both options having the same terms. If the market value remains stable, the options expire and the seller keeps the premium, thereby generating income.

**Reference:** 4.4.2 in the License Exam Manual

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### Question #8 of 222

Question ID: 605621

If a customer buys 100 shares of stock and writes one out-of-the-money call against his long position, the breakeven point is the:

- ✓ **A)** cost of stock purchased less premium.
- X **B)** strike price less premium.
- X **C)** cost of stock purchased plus premium.
- X **D)** strike price plus premium.

#### Explanation

When the investor owns stock and sells a call, the call is covered. Breakeven is computed by subtracting the premium from the stock's purchase price.

**Reference:** 4.3.2 in the License Exam Manual

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### Question #9 of 222

Question ID: 605684

An investor who owns XYZ stock is optimistic about the long-term growth potential of the company. However, the stock, currently priced at \$58, has made a sharp advance in the last week and the investor wants to lock in a minimum price in case the share price drops. Which of the following option transactions will help meet the investor's objective?

- X **A)** Sell \$55 call options.
- X **B)** Sell \$55 put options.
- X **C)** Buy \$55 call options.
- ✓ **D)** Buy \$55 put options.

#### Explanation

Buying the puts creates a long stock, long put hedge position. The exercise price for a put is the price at which the owner of the put can sell the stock when the put is exercised. With this position, if the stock falls, the investor will exercise the put and sell the stock at \$55. Thus, a sale price of \$55 will be assured in the event that the stock price falls.

**Reference:** 4.3.1 in the License Exam Manual

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### Question #10 of 222

Question ID: 605701

A customer buys 1 XYZ Dec 30 call at 7 and sells 1 XYZ Dec 40 call at 1. Two months later, if the customer closes the positions when the spread is trading at 9 points, the customer has

- ✓ **A)** a gain of \$300
- X **B)** a gain of \$100
- X **C)** a loss of \$100
- X **D)** a loss of \$300

#### Explanation

The investor established a debit spread and paid a net premium of \$600 (7 – 1). The spread widened to 9, giving the investor a profit of \$300 (9 – 6). Debit spreads are profitable if the spread between the premiums widens.

**Reference:** 4.4.1.2 in the License Exam Manual

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### Question #11 of 222

Question ID: 605708

The premium on the XYZ Jan 30 calls is 3 - 3.15, while the premium on the XYZ Jan 30 puts is quoted at 2.25 - 2.35. A customer establishing a short straddle receives total premiums of:

- ☐ A) 537.
- ☒ B) 525.
- ☐ C) 550.
- ☐ D) 545.

#### Explanation

To establish a short straddle, the customer sells a call and a put at the bid price. The premiums received are \$300 for the call and \$225 for the put, for a total of \$525.

**Reference:** 4.4.2.2 in the License Exam Manual

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### Question #12 of 222

Question ID: 605759

An investor buys 2 LMN 40 calls and pays a premium of 4 each, and also buys two LMN 40 puts and pays a premium of 2.50 each. At the time of purchase, LMN is trading at \$40.75. On the expiration date, LMN is trading at \$32.50. If the investor closes his position for its intrinsic value. Excluding commissions, the investor realizes a:

- ☐ A) \$200 loss.
- ☐ B) \$100 profit.
- ☒ C) \$200 profit.
- ☐ D) \$100 loss.

#### Explanation

Closing out a position is the opposite of the opening transaction. In this situation, the investor opened by buying 2 calls for a total of \$800, and closed them out by selling for their intrinsic value (calls have intrinsic value when the market value is above the strike price; in this situation there is no intrinsic value). The investor also bought 2 puts for a total of \$500 and closed them out by selling for their intrinsic value of \$1,500 (puts have intrinsic value when the market value is below the strike price; in this situation the intrinsic value is \$7.50 per contract) or  $40 - 32.50 = 7.5 \times 2 = 15 \times 100 \text{ shares} = \$1,500$ ). The resulting profit on the position is \$200 ( $\$1,500 - \$1,300$ ), the total of the premiums paid for all of the options.

**Reference:** 4.4.2.1 in the License Exam Manual

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### Question #13 of 222

Question ID: 605763

If a customer is long 1 ABC Oct 50 call at 11 and short 2 ABC Oct 60 calls at 5, the maximum loss potential is:

- ☐ A) 100
- ☐ B) 1000
- ☐ C) 1100
- ☒ D) unlimited.

#### Explanation

The customer is short two calls and long one call, leaving one of the short calls uncovered. The loss potential for a naked call writer is unlimited on the upside. If exercised, the writer must buy the stock at the current market price so it will be delivered at the strike price.

**Reference:** 4.4.1.2 in the License Exam Manual

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### Question #14 of 222

Question ID: 605686

Covered put writing is a strategy where an investor:

- ☐ A) sells a put and sells a call on the same stock.
- ☒ B) sells a put on a stock he has sold short.

- X **C)** sells a put on a stock that he owns.
- X **D)** sells a put and buys a call on the same stock.

Explanation

The customer sells the put to generate income. The short stock position provides the necessary cash should his short put be exercised, forcing him to buy the stock.

**Reference:** 4.3.4 in the License Exam Manual

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**Question #15 of 222**

Question ID: 605685

What has a customer established who buys 5 XYZ Jan 40 calls at 6 and writes 10 XYZ Jan 50 calls at 1 when XYZ is trading at 43?

- X **A)** Short combination.
- X **B)** Ratio straddle.
- X **C)** Long combination.
- ✓ **D)** Ratio spread.

Explanation

In theory this position is just like ratio call writing where more calls are written (sold) than stock is owned. When a ratio spread is established a customer writes (sells) more contracts than are being purchased. In this case, the customer is buying 5 calls and selling 10 calls. In a ratio call spread, potential loss is unlimited because the additional calls sold are uncovered (naked).

**Reference:** 4.3.4.2 in the License Exam Manual

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**Question #16 of 222**

Question ID: 605739

If a customer is long 1 GGZ Oct 50 call at 11 and short 2 GGZ Oct 60 calls at 5, the maximum loss potential is:

- X **A)** 100.
- ✓ **B)** unlimited.
- X **C)** 1100.
- X **D)** 1000.

Explanation

Because the customer is short 2 calls and long 1 call, one of the short calls is uncovered. The loss potential for a naked call writer is unlimited on the upside.

**Reference:** 4.4.1.2 in the License Exam Manual

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**Question #17 of 222**

Question ID: 605645

All of the following positions have limited loss potential EXCEPT:

- X **A)** short stock/long call.
- ✓ **B)** short stock/short put.
- X **C)** long stock/short call.
- X **D)** long stock/long put.

Explanation

If the stock rises the put will expire leaving the customer short stock with an unlimited loss potential.

**Reference:** 4.3.4 in the License Exam Manual

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**Question #18 of 222**

Question ID: 605753

If an investor buys a Jan 30 XYZ call for 4 and sells a Jan 35 call for 2, to become profitable, the spread between the prices of the two options must:

- X **A)** narrow.
- ✓ **B)** widen.
- X **C)** fluctuate.
- X **D)** remain the same.

Explanation

This is a debit spread. A debit spread is profitable when the difference between the premiums widens. A debit spread is closed as a credit and, to be profitable, the credit must be larger than the opening debit.

**Reference:** 4.4.1.2 in the License Exam Manual

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**Question #19 of 222**

Question ID: 605636

All of the following will cover a short call EXCEPT:

- ✓ **A)** cash equal to the aggregate exercise value.
- X **B)** an escrow receipt for the stock.
- X **C)** a long call with a lower strike price and later expiration.
- X **D)** a long position in the underlying stock.

Explanation

Cash never covers a short call because the cost to purchase the stock in the market for delivery at the strike price is unknown. If assigned, the customer must sell (deliver) at the strike price.

**Reference:** 4.3 in the License Exam Manual

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**Question #20 of 222**

Question ID: 605622

A customer buys 200 XYZ at 39 and writes 2 XYZ Feb 40 calls at 3. When the stock rises to 44 the customer is exercised for a gain of:

- X **A)** 200.
- X **B)** 1600.
- X **C)** 400.
- ✓ **D)** 800.

Explanation

The customer bought 200 shares at 39 and was forced to sell them at 40 for a \$200 gain. In addition, the customer received \$600 in premium income so the overall gain is \$800. Alternatively, the breakeven point for covered call writing is cost of shares purchased less premium received ( $39 - 3 = 36$ ). As the customer is bullish, gain occurs above 36. However, for this customer, the stock can go no higher than 40 because she will be exercised ( $40 - 36 = 4$  points  $\times$  200 shares = \$800).

**Reference:** 4.3.2 in the License Exam Manual

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**Question #21 of 222**

Question ID: 605736

A customer who buys 1 CDE Oct 60 call at 4 and sells 1 CDE Dec 60 call at 6 has created a:

- X **A)** price spread.
- X **B)** long straddle.
- X **C)** combination.
- ✓ **D)** calendar spread.

Explanation

Long a call and short a call is known as a call spread. If the strike prices are the same and the expiration months are different (Oct and Dec), it is a calendar spread. Calendar spreads are sometimes called time spreads or horizontal spreads.

**Reference:** 4.4.1.1 in the License Exam Manual

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**Question #22 of 222**

Question ID: 605629

Your client writes 2 ABC November 220 calls at 5, and buys 200 shares of ABC common stock at \$220 in his margin account. What is the breakeven point for each covered call position?

- ☐ A) 210.
- ☒ B) 215.
- ☐ C) 230.
- ☐ D) 225.

**Explanation**

The breakeven point for covered call writing is the cost of stock purchased less the premium ( $220 - 5$ ).

**Reference:** 4.3.2 in the License Exam Manual

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**Question #23 of 222**

Question ID: 605679

A customer is short 100 XYZ shares at 26 and long 1 XYZ 30 call at 1. What is the maximum potential loss on the positions?

- ☒ A) 500.
- ☐ B) Unlimited.
- ☐ C) 2500.
- ☐ D) 400.

**Explanation**

The customer has protected his short stock position from loss by purchasing a call. If the market rises, the call is exercised, allowing the customer to buy his stock at the option strike price of 30 to cover the short position. The most the customer can lose is \$400 on the stock position (the difference between the option strike price and the stock price) plus the premium paid for the option ( $\$400 + \$100 = \$500$ ).

**Reference:** 4.3.3 in the License Exam Manual

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**Question #24 of 222**

Question ID: 605524

If the Swiss franc closes at 56, 1 SF 59 put is:

- ☐ A) at the money.
- ☒ B) 3 points in-the-money.
- ☐ C) without intrinsic value.
- ☐ D) 3 points out-of-the-money.

**Explanation**

The put is in-the-money when the underlying instrument's market price is below the put's strike price.

**Reference:** 4.1.5.1 in the License Exam Manual

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**Question #25 of 222**

Question ID: 605516

If XYZ is currently trading at 32.50, which of the following is 2.50 points in the money?

- ☐ A) Long 1 XYZ 25 call.
- ☒ B) Long 1 XYZ 30 call.
- ☐ C) Long 1 XYZ 30 put.
- ☐ D) Long 1 XYZ 25 put.

**Explanation**

An option is in-the-money when it has intrinsic value. A call option is in-the-money when the underlying security's price is higher than the option's exercise price.

**Reference:** 4.1.4.1 in the License Exam Manual

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### Question #26 of 222

Question ID: 605707

A customer is short 10 ABC Dec 50 calls at 2.50 and short 10 ABC Dec 50 puts at 3.50. Prior to expiration, ABC declines to 40.50 and the customer is assigned on his put position while his short calls expire worthless. A month later, he liquidates his long position at 45 for a:

- X **A)** loss of \$1,500.
- ✓ **B)** gain of \$1,000.
- X **C)** loss of \$7,500.
- X **D)** gain of \$7,500.

#### Explanation

The customer opens two short positions on 10 contracts each, so his account is credited with premiums of \$2,500 for the calls and \$3,500 for the puts. The calls expire worthless, but the short puts are exercised, so the investor is required to buy the stock at the strike price. This results in a debit of \$50,000 (\$5,000 per contract × 10 contracts), and the stock is then sold at a credit of \$45,000.

**Reference:** 4.4.2.2 in the License Exam Manual

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### Question #27 of 222

Question ID: 605522

A call option premium increases in price by .85. What is the dollar amount of that increase?

- X **A)** 8.5.
- X **B)** 850.
- ✓ **C)** 85.
- X **D)** 0.85.

#### Explanation

A single point on an option is \$100; therefore, .85 is \$85.

**Reference:** 4.1.6.1 in the License Exam Manual

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### Question #28 of 222

Question ID: 605562

XYZ closed at 41 and the XYZ Mar 45 puts closed at 5.25. The puts are:

- X **A)** at the money.
- ✓ **B)** in-the-money.
- X **C)** at parity.
- X **D)** out-of-the-money.

#### Explanation

Put options are in-the-money when the market price is below the strike price. In this case, the puts are in-the-money by 4.

**Reference:** 4.1.5.1 in the License Exam Manual

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### Question #29 of 222

Question ID: 605517

An investor writes 1 XYZ 280 put at 16.65. If the investor makes a closing purchase at the put's intrinsic value when the stock is at 265.25, he realizes a gain of:

- X **A)** 147.5.
- ✓ **B)** 190.
- X **C)** 265.25.



X **D)** 166.5.

#### Explanation

The investor's opening sale at 16.65 and closing purchase at 14.75 resulted in a difference of 1.90 for a total gain of \$190.

**Reference:** 4.1.5.4 in the License Exam Manual

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### Question #30 of 222

Question ID: 605740

In March, a customer sells 1 ABC Oct 50 put for 3 and buys 1 ABC Oct 60 put for 11. The customer will experience a pretax profit from these positions if:

- I. the difference between the premiums narrows to less than \$8
- II. the difference between the premiums widens to more than \$8
- III. both puts are exercised at the same time
- IV. both puts expire unexercised.

- X **A)** I and III.
- ✓ **B)** II and III.
- X **C)** II and IV.
- X **D)** I and IV.

#### Explanation

This debit spread becomes profitable if the spread widens between the premiums. Credit spreads are profitable if the spread narrows between the premiums. If both puts are exercised, the spread is profitable. If the short 50 put is exercised, the customer buys the stock and sells it for 60 by exercising the long 60 put (\$1,000 profit – \$800 premiums = net \$200 profit).

**Reference:** 4.4.1.5 in the License Exam Manual

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### Question #31 of 222

Question ID: 605735

An investor buys 2 RST 40 calls and pays a premium of 4 each. He also buys 2 RST 40 puts and pays a premium of 2.50 each. When purchased, RST is trading at \$40.75. On the expiration date, RST is trading at \$32.50 and the investor closes his positions for intrinsic value. Excluding commission, the investor realizes a:

- ✓ **A)** \$200 profit.
- X **B)** \$200 loss.
- X **C)** \$100 loss.
- X **D)** \$100 profit.

#### Explanation

The cost of opening these two straddles is \$1,300. On the expiration date, the puts are worth \$750 each, for a total of \$1,500, giving the investor a \$200 profit. The calls will expire worthless. Alternatively, the breakeven points for this long straddle are 33.50 and 46.50 (add the combined premiums of 6.50 to the call strike and subtract combined premiums from the put strike). The investor profits in a long straddle when the stock moves outside the breakeven points. As the stock is at 32.50, the customer makes 1 point (33.50 – 32.50) on each straddle, resulting in a \$200 profit.

**Reference:** 4.4.2.1 in the License Exam Manual

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### Question #32 of 222

Question ID: 605658

If a customer with no other position sells 1 KLP Jul 80 call for 10 and buys 100 shares of KLP stock for \$85 per share, he will break even when KLP stock is trading at:

- ✓ **A)** 75.
- X **B)** 90.
- X **C)** 70.
- X **D)** 95.

#### Explanation

Breakeven for a covered call writer is the purchase price less premiums received. In this case, breakeven is 85 minus 10, or \$75 per share; below \$75, the customer loses money.

### Question #33 of 222

Question ID: 605537

When XYZ stock trades at 40 and an XYZ Oct 35 call trades at 5, which of the following is TRUE?

- ✓ **A)** The time value is zero.
- X **B)** The option is at-the-money.
- X **C)** The option's time value equals its intrinsic value.
- X **D)** The option is out-of-the-money.

#### Explanation

An option's premium consists of time value and intrinsic value. In this situation, the call is in-the-money by 5 (intrinsic value is 5), because the market value of 40 exceeds the strike price of 35 by 5. If the total premium is 5 and the intrinsic value is 5, the time value must be 0. The option is at parity, which means the premium equals the intrinsic value.

Reference: 4.1.6.2 in the License Exam Manual

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### Question #34 of 222

Question ID: 605761

If an investor sells 1 AMF Apr 50 put for 2.50 and buys 1 AMF May 60 put for 7.75, the investor has profit when

- I. the spread narrows.
- II. the spread widens.
- III. both puts are exercised.
- IV. both puts expire.

- X **A)** II and IV.
- X **B)** I and IV.
- ✓ **C)** II and III.
- X **D)** I and III.

#### Explanation

The investor created a debit spread, which is profitable when both sides are exercised or the spread widens. Conversely, credit spreads are profitable when both sides expire or the spread narrows.

Reference: 4.4.1.4 in the License Exam Manual

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### Question #35 of 222

Question ID: 605527

If the S&P 500 Index closed at 350 on the day your customer purchased a 355 put on the Index for \$500, which of the following would *best* describe your customer's position?

- X **A)** Even money.
- X **B)** Out-of-the-money.
- X **C)** At-the-money.
- ✓ **D)** Breakeven.

#### Explanation

Remember that for a put option, subtract the premium from the strike price to find the breakeven point.  $355 - 5 = 350$ . Since the S&P Index closed at 350 on the day, the customer's position is at breakeven.

Reference: 4.1.5.5 in the License Exam Manual

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### Question #36 of 222

Question ID: 605643

Covered call writing normally occurs in a

- ✓ **A)** stable market.
- X **B)** rising market.
- X **C)** falling market.
- X **D)** volatile market.

Explanation

Covered call writing normally occurs in a stable market. In a rising market, writing calls against a long stock position limits upside potential. In a falling market, the calls only provide downside protection to the extent of the premium received.

**Reference:** 4.3.2 in the License Exam Manual

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**Question #37 of 222**

Question ID: 605732

Which of the following listed option orders can be combined to form a spread order?

- I. Buy 1 XYZ Jul 30 put.
- II. Sell 1 XYZ Jul 35 call.
- III. Sell 1 XYZ Jul 35 put.
- IV. Buy 1 ABC Jul 30 call.

- ✓ **A)** I and III.
- X **B)** III and IV.
- X **C)** II and IV.
- X **D)** II and III.

Explanation

Spreads are deemed to be of the same class; class is defined as the same underlying security and the same type of option. Choices II and III would be a short straddle. The ABC call cannot be combined with anything, since you'd be combining ABC stock with XYZ stock.

**Reference:** 4.4.1.5 in the License Exam Manual

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**Question #38 of 222**

Question ID: 605508

The S&P 100 index closed on August 10 at 536.04. "The Wall Street Journal" quotes the closing premium for the OEX September 510 call at 28.90. The time value of the contract is:

- X **A)** 7.14.
- X **B)** 18.9.
- ✓ **C)** 2.86.
- X **D)** 26.04.

Explanation

To find time value, subtract the intrinsic value from the premium. The intrinsic value is the in-the-money amount. Calls are in the money if the market price exceeds the strike price. In this case, the intrinsic value of the 510 call is 26.04. If the premium is 28.90, the time value is 2.86.

**Reference:** 4.1.6.2 in the License Exam Manual

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**Question #39 of 222**

Question ID: 605664

Which of the following strategies would *most* effectively protect an investor with a short stock position?

- X **A)** Sell a call.
- ✓ **B)** Buy a call.
- X **C)** Sell a put.
- X **D)** Buy a put.

#### Explanation

Purchasing a call on the security protects the customer from a loss in excess of the strike price plus the cost of the call should the security rise in price.

**Reference:** 4.3.3 in the License Exam Manual

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### Question #40 of 222

Question ID: 605536

Which of the following terms is synonymous with an option's market value?

- ☐ A) Multiplier.
- ☒ B) Premium.
- ☐ C) Strike price.
- ☐ D) Exercise price.

#### Explanation

The premium is the cost or price at which the option can be bought or sold in the market. The strike price or exercise price is the cost to exercise the option, while the multiplier indicates contract size.

**Reference:** 4.1.6 in the License Exam Manual

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### Question #41 of 222

Question ID: 605520

Securities options may be *best* described as:

- ☐ A) roll ups.
- ☒ B) derivatives.
- ☐ C) forwards.
- ☐ D) futures.

#### Explanation

Options are a derivative because they get their values from the underlying instrument.

**Reference:** 4.1.0.5.1 in the License Exam Manual

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### Question #42 of 222

Question ID: 605545

The term that describes options of the same exercise price and expiration date for the same underlying security is:

- ☐ A) issue.
- ☐ B) type.
- ☐ C) class.
- ☒ D) series.

#### Explanation

Options at the same exercise price and expiration date for the same underlying security are known as a series of options.

**Reference:** 4.1.0.3 in the License Exam Manual

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### Question #43 of 222

Question ID: 605744

If an investor interested primarily in speculation does not expect the price of DWQ stock to change, he or she will:

- ☒ A) write an uncovered straddle.
- ☐ B) write a straddle and short the stock.
- ☐ C) write a straddle and buy stock.

X **D)** buy a straddle.

#### Explanation

An investor who expects prices to remain stable writes an uncovered straddle (short straddle). In selling the put and call at the same terms, the writer collects double premiums. Both expire if the price remains stable, but if the price moves, one side loses money. Short straddles carry unlimited loss potential because of the uncovered call.

**Reference:** 4.4.2.2 in the License Exam Manual

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### Question #44 of 222

Question ID: 605726

At expiration, if the market price of the underlying common stock and the strike price are the same, each of the following customer positions will show a profit EXCEPT:

- X **A)** short puts.
- ✓ **B)** long straddles.
- X **C)** short calls.
- X **D)** short straddles.

#### Explanation

The contracts will not be exercised if options expire at the money. Therefore, writers will show a profit but buyers will not.

**Reference:** 4.4.2.1 in the License Exam Manual

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### Question #45 of 222

Question ID: 605751

If your client writes a combination of a DWQ 45 call and a DWQ 50 put and the premiums total \$650, he breaks even when the price of the underlying stock is

- I. \$43.50
  - II. \$50.50
  - III. \$51.50
  - IV. \$56.50
- 
- X **A)** III and IV.
  - ✓ **B)** I and III.
  - X **C)** I and IV.
  - X **D)** II and IV.

#### Explanation

Combinations and straddles have two breakeven points. To calculate these breakeven points add the combined premiums to the call strike price and subtract the combined premiums from the put strike price.

**Reference:** 4.4.2.3 in the License Exam Manual

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### Question #46 of 222

Question ID: 605624

If a customer is long 300 shares of ABC, and writes 5 calls against the position, this is an example of a:

- ✓ **A)** ratio write.
- X **B)** spread.
- X **C)** straddle.
- X **D)** partial write.

#### Explanation

A ratio write involves writing more options than the customer has stock to cover.

**Reference:** 4.3.4.2 in the License Exam Manual

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### Question #47 of 222

Question ID: 605755

All of the following are credit spreads EXCEPT

- X **A)** buy 1 ABC Jan 50 put; write 1 ABC Jan 60 put
- X **B)** write 1 ABC Nov 35 put; buy 1 ABC Nov 30 put
- ✓ **C)** buy 1 ABC Jul 50 call; write 1 ABC Jul 60 call
- X **D)** buy 1 ABC Apr 40 call; write 1 ABC Apr 30 call

#### Explanation

The lower the strike price is, the more expensive the call premium for the option will be. The investor has purchased the option with the lower strike price so this is a debit spread. With puts, the higher the strike price is, the more expensive the option premium will be.

**Reference:** 4.4.1.6 in the License Exam Manual

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### Question #48 of 222

Question ID: 605722

If the Swiss franc is trading at .69, and a customer buys 1 Sep SF 70 put and writes 1 Sep SF 65 put, this position is a:

- X **A)** bull spread.
- X **B)** calendar spread.
- X **C)** diagonal spread.
- ✓ **D)** bear spread.

#### Explanation

The 70 put is dominant because it will have a higher premium than the 65 put. Buying puts is bearish; this is a debit put spread.

**Reference:** 4.4.1.4 in the License Exam Manual

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### Question #49 of 222

Question ID: 605767

If a customer buys 1 XYZ Aug 50 put at 1, and sells 1 XYZ Aug 65 put at 10 when XYZ is at 58, what is the maximum risk?

- X **A)** 900.
- X **B)** 1500.
- X **C)** 100.
- ✓ **D)** 600.

#### Explanation

This is a credit spread. The maximum loss is the difference between the strike prices and the net credit. In this example, the strike price difference is 15 (65 - 50) and the net premium is 9 (10 - 1) or  $15 - 9 = 6 \times \$100 = \$600$  maximum loss. Maximum gain is the net credit of \$900.

**Reference:** 4.4.1.5 in the License Exam Manual

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### Question #50 of 222

Question ID: 605623

The breakeven point for covered call writers is:

- ✓ **A)** cost of stock less premiums.
- X **B)** strike price less premiums.
- X **C)** cost of stock plus premiums .
- X **D)** strike price plus premiums.

#### Explanation

The breakeven point for an investor who owns the underlying stock and writes a call is the cost of that stock less the premium received from the sale of the call.

**Reference:** 4.3.2 in the License Exam Manual

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### Question #51 of 222

Question ID: 605632

A customer buys 100 ABC at 62.75 and simultaneously buys an ABC Jan 60 put at 1. If the stock rises to 66.25, then the put expires and the customer sells the stock at the current price for a:

- ☐ A) loss of \$100.
- ☒ B) gain of \$250.
- ☐ C) loss of \$250.
- ☐ D) gain of \$350.

#### Explanation

Looking at each trade separately, the customer buys 100 ABC at 62.75 and sells the shares at 66.25 for a \$350 gain. The customer pays \$100 for the put which expires worthless, resulting in a \$100 loss. Overall, the gain is \$250.

**Reference:** 4.3.1 in the License Exam Manual

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### Question #52 of 222

Question ID: 605514

Which of the following is inversely related to the length of time an investor holds an option?

- ☐ A) Intrinsic value.
- ☐ B) Volatility.
- ☐ C) Value of the underlying stock.
- ☒ D) Time value.

#### Explanation

An option's time value diminishes as the option nears expiration. The longer an option is held, the less time remains.

**Reference:** 4.1.6.2 in the License Exam Manual

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### Question #53 of 222

Question ID: 605689

A customer buys 1 XYZ Aug 50 put at 1 and sells 1 XYZ Aug 65 put at 10 when XYZ is at 58. If XYZ is at 52 at expiration, the customer has a:

- ☐ A) gain of \$400.
- ☐ B) loss of \$600.
- ☐ C) gain of \$600.
- ☒ D) loss of \$400.

#### Explanation

The 50 put expires because it is out of the money. The customer closes the position in the 65 put by purchasing it for its intrinsic value, \$1,300. Because the account was credited \$900 when the spread was established, there is a \$400 loss (\$1,300 – \$900). Alternately, breakeven is 56 (65 – 9) and the spread is bullish. Therefore, the customer makes money above 56 and loses below 56. Because the stock is at 52 at expiration, the customer has a \$400 loss (56 to 52).

**Reference:** 4.4.1.5 in the License Exam Manual

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### Question #54 of 222

Question ID: 605712

A customer is long 1 XYZ Jan 50 put. In order to create a bull put spread, the customer must sell a Jan:

- ☐ A) 50 call.
- ☐ B) 45 put.
- ☐ C) 50 put.
- ☒ D) 55 put.

#### Explanation

In any spread, put or call, if the customer is buying the lower strike price, the spread is bullish. Therefore, to create a bull put spread, the customer (who is long the 50 put) must sell a put with a higher strike price. A bull put spread is also termed a short put spread.

**Reference:** 4.4.1.6 in the License Exam Manual

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### Question #55 of 222

Question ID: 605533

An investor buys 6 DFI Feb 60 calls at 2.25 each. At the time of the purchase, DFI is trading at 59.50 per share. What price would DFI stock need to reach for the investor to break even?

- ☐ A) 61.75.
- ☐ B) 60.
- ☐ C) 57.75.
- ☒ D) 62.25.

#### Explanation

The breakeven point for a call, long or short, is strike price plus premium ( $60 + 2.25 = 62.25$ ).

**Reference:** 4.1.4.6 in the License Exam Manual

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### Question #56 of 222

Question ID: 605752

If a customer buys 5 ABC Sep 50 calls at 5 and 5 ABC Sep 50 puts at 3, this position is called a:

- ☐ A) ratio write.
- ☐ B) hedge.
- ☐ C) spread.
- ☒ D) straddle.

#### Explanation

A straddle is an option strategy in which the investor holds a position in both a call and a put with the same strike price, expiration, and underlying security.

**Reference:** 4.4.2.1 in the License Exam Manual

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### Question #57 of 222

Question ID: 605754

If a customer buys 1 XYZ Nov 70 put and sells 1 XYZ Nov 60 put when XYZ is selling for 65, this position is a:

- ☐ A) bull spread.
- ☐ B) straddle.
- ☒ C) bear spread.
- ☐ D) combination.

#### Explanation

This put spread is established at a debit because the customer pays more for the 70 put than she receives for the 60 put. A debit spread is a net buy, while a credit spread is a net sale. Therefore, a debit put spread is like buying a put, which is bearish.

**Reference:** 4.4.1.4 in the License Exam Manual

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### Question #58 of 222

Question ID: 605512

If an XYZ Aug 80 put is trading at 2, at which price would the option be at parity with the stock?

- ☐ A) Any of the above.
- ☐ B) 82.



✓ **C)** 78.

X **D)** 80.

Explanation

The term "at parity" means the premium equals the intrinsic value that occurs for an in-the-money option prior to expiration when the time value has eroded. An 80 put is in-the-money by 2 points (the premium) when the underlying stock is trading at 78.

**Reference:** 4.1.4.5 in the License Exam Manual

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**Question #59 of 222**

Question ID: 605532

An investor with no other positions buys 1 DWQ Jun 60 call at 3.50. If the investor exercises the call when the stock is trading at 68 and immediately sells the stock in the market, what is the investor's profit or loss?

X **A)** \$350 profit.

✓ **B)** \$450 profit.

X **C)** \$350 loss.

X **D)** \$450 loss.

Explanation

The investor exercised the right to buy the stock for 60 and can sell the stock in the market for 68 for an \$8 per-share gain. The gain of 8 minus the premium of 3.50 gives the investor a profit of 4.50 ( $4.50 \times 100 = \$450$ ).

**Reference:** 4.1.1.1 in the License Exam Manual

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**Question #60 of 222**

Question ID: 605715

Holders of long straddles would like the underlying stock to do all of the following EXCEPT:

X **A)** fluctuate.

✓ **B)** stay the same.

X **C)** go up.

X **D)** go down.

Explanation

In a long straddle, you are buying a put and a call. Holders can only profit if the stock moves farther away from the strike price than the total of the premiums paid.

**Reference:** 4.4.2.1 in the License Exam Manual

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**Question #61 of 222**

Question ID: 605698

Which of the following would protect a short May 50 put?

X **A)** Long June 45 put.

✓ **B)** Long June 55 put.

X **C)** Long April 55 put.

X **D)** Long April 45 put.

Explanation

For a long put to cover a short put, it must have the same or higher strike price and the same or longer expiration. This ensures the investor may sell the stock without financial loss if the short put is exercised and he is forced to buy.

**Reference:** 4.4.1.1 in the License Exam Manual

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**Question #62 of 222**

Question ID: 605731

Which of the following options strategies could be used by an investor who is bearish on a stock?

- I. Debit call spread.
- II. Debit put spread.
- III. Long call.
- IV. Long combination straddle.

- ✓ **A)** II and IV.
- X **B)** I and III.
- X **C)** II and III.
- X **D)** I and IV.

#### Explanation

A debit put spread is a bearish strategy that could realize a profit (the difference between the strike prices minus the premium paid for the spread) if the stock price fell. A long combination, which consists of both a long call and a long put, is both bullish and bearish and could also yield a profit if the stock price fell as the result of the long put. However, both a debit call spread and a long call are bullish strategies and would not be used if one is bearish on the stock.

**Reference:** 4.4.1.4 in the License Exam Manual

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### Question #63 of 222

Question ID: 605694

If a customer buys 1 XYZ Jan 40 call and 1 XYZ Jan 40 put, paying total premiums of \$650, and XYZ becomes worthless, the result is a:

- X **A)** loss of \$3,350.
- X **B)** gain of \$650.
- ✓ **C)** gain of \$3,350.
- X **D)** loss of \$650.

#### Explanation

This is a long straddle in which breakeven points are established by adding and subtracting the combined premiums (6-½ points) from strike (the breakeven points are 46-½ and 33-½). The customer makes money if the stock moves above 46-½ or below 33-½. As the stock becomes worthless, the customer earns a 33-½ point gain on 100 shares, or \$3,350.

**Reference:** 4.4.2.1 in the License Exam Manual

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### Question #64 of 222

Question ID: 605633

If a customer sells short 100 XYZ at 79 and simultaneously writes 1 XYZ Jan 80 put at 5, the maximum gain potential is:

- ✓ **A)** 400.
- X **B)** 600.
- X **C)** 500.
- X **D)** unlimited.

#### Explanation

Short stock combined with a short put is an income strategy that carries unlimited loss potential. Although gain will occur if the stock moves downward, the customer wrote an in-the-money put that will be exercised, forcing the customer to buy stock at 80 for a \$100 loss on the stock shorted at 79. However, the customer received \$500 in premiums, resulting in an overall gain of \$400. Breakeven for short stock-short put is short sale price plus premium. In this case, breakeven is 84 and maximum gain is 4 points, from 84 to 80.

**Reference:** 4.3.4 in the License Exam Manual

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### Question #65 of 222

Question ID: 605558

An investor with no other positions buys 1 DWQ May 75 call at 6.50. If the investor exercises the call when the stock is trading at 77 and immediately sells the stock in the market, what is the investor's profit or loss?

- ✓ **A)** \$450 loss.

- X **B)** \$450 profit.
- X **C)** \$350 loss.
- X **D)** \$350 profit.

Explanation

The investor exercised the right to buy the stock for 75 and can sell the stock in the market for 77, for a gain of 2. The investor paid a premium of 6.50 minus the gain of 2, which gives the investor a loss of 4.50 ( $4.50 \times 100 = \$450$ ).

**Reference:** 4.1.1.1 in the License Exam Manual

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**Question #66 of 222**

Question ID: 605509

All of the following are true about LEAPS EXCEPT they:

- ✓ **A)** are available only on index options.
- X **B)** may be exercised at any time after execution.
- X **C)** have a longer life than other listed options.
- X **D)** cease trading at 4:00 pm ET.

Explanation

LEAPS are available on both individual stocks as well as indexes.

**Reference:** 4.1.0.5.1 in the License Exam Manual

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**Question #67 of 222**

Question ID: 605552

As the underlying stock price increases, the premium of a call option generally:

- X **A)** decreases.
- X **B)** remains the same.
- X **C)** fluctuates.
- ✓ **D)** increases.

Explanation

The premium of an option changes as the market price of the underlying security moves; therefore, if the stock price increases, the premium of a call also increases.

**Reference:** 4.1.6.2 in the License Exam Manual

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**Question #68 of 222**

Question ID: 605651

An investor sells short 100 shares at 50 and sells a 50 put at 5. If the put is exercised when the stock is trading at 45, the investor realizes:

- X **A)** a gain of \$1,000.
- X **B)** a gain of \$1,500.
- ✓ **C)** a gain of \$500.
- X **D)** neither a gain nor a loss.

Explanation

When the short put is exercised, the investor buys stock at \$50 that she can use to cover the \$50 short sale. The investor realizes no gain or loss on the stock, but she collected \$500 in premiums for a gain of \$500.

**Reference:** 4.3 in the License Exam Manual

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**Question #69 of 222**

Question ID: 605525

Which of the following statements regarding investors who trade options that are American-style exercise is TRUE?

- ✓ **A)** They can exercise their options any time prior to expiration.
- X **B)** They can only be purchased or sold on the very first day they are issued.
- X **C)** They can only exercise their contracts on the last day of trading (the business day preceding expiration).
- X **D)** They can only close out long positions during a brief time prior to expiration.

Explanation

The American-style exercise contract allows investors to exercise their options any time before expiration. With European exercise style contracts, exercise is only permitted on the last trading day.

**Reference:** 4.1.0.4 in the License Exam Manual

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**Question #70 of 222**

Question ID: 605547

An investor writes 1 IBS 280 put for 16.60. The position is closed and the put is bought for its intrinsic value when IBS is trading at 265.25. The investor realizes a:

- ✓ **A)** \$185 profit.
- X **B)** \$185 loss.
- X **C)** \$145 profit.
- X **D)** \$235 loss.

Explanation

The opening sale of the IBS put was made for 16.60, and the closing purchase was made for the intrinsic value of 14.75. The put's intrinsic value is determined by how far the stock's market price is below the strike price. (In this case, 280 minus 265.25.)  $16.60 - 14.75 = 1.85 \times 100 \text{ shares} = \$185.00$ . The investor profits because the sale's proceeds exceed the purchase price.

**Reference:** 4.1.5.4 in the License Exam Manual

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**Question #71 of 222**

Question ID: 605667

If a customer buys 100 XYZ at 52.50 and buys 1 XYZ Aug 50 put at 1.50, what is the customer's maximum possible loss?

- X **A)** Unlimited.
- X **B)** 5400.
- ✓ **C)** 400.
- X **D)** 5250.

Explanation

Stockholders often buy puts to protect long positions. In this case, if the stock falls below 50, the investor will exercise the right to sell it at 50. The loss on the stock is limited to 2.50, which, combined with the premium paid of 1.50, results in a \$400 loss.

**Reference:** 4.3.1 in the License Exam Manual

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**Question #72 of 222**

Question ID: 605697

Which of the following would protect a short May 50 call?

- X **A)** Long April 55 call.
- X **B)** Long April 45 call.
- X **C)** Long June 55 call.
- ✓ **D)** Long June 45 call.

Explanation

For a long call to cover a short call, it must have the same or lower strike price and the same or longer expiration. This ensures the investor may purchase the stock without financial loss and deliver it at 50 if the short call is exercised.

### Question #73 of 222

Question ID: 605724

A registered representative would recommend a customer establish a short straddle on T-bonds when interest rates are expected to:

- ☐ A) be volatile.
- ☐ B) rise.
- ☒ C) remain unchanged.
- ☐ D) decline.

#### Explanation

Any straddle writer is always looking for a stable market. Volatility is the biggest enemy of the writer. Since this question is referring to debt options, their price movements are based upon changes in interest rates. No fluctuations in interest rates means no price changes.

Reference: 4.4.2.2 in the License Exam Manual

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### Question #74 of 222

Question ID: 605534

An investor bought 1 Apr KLP 40 call for 6 and 1 KLP Apr 50 put for 8 when KLP was at 45. If the stock declines to 44 and both the call and the put are sold at intrinsic value, the result would be a:

- ☒ A) \$400 loss.
- ☐ B) \$400 profit.
- ☐ C) \$100 profit.
- ☐ D) \$100 loss.

#### Explanation

The opening purchase of the Apr 40 call was made at 6 and the closing sale of that call was made at 4; the difference of 2 represents a \$200 loss. The opening purchase of the Apr 50 put was made at 8 and the closing sale of that put was made at 6; the difference of 2 represents a \$200 loss. The total loss for the account was \$400. The position is a long combination.

Reference: 4.1.6.2 in the License Exam Manual

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### Question #75 of 222

Question ID: 605737

An investor buys 1 XYZ Nov 50 call at 8 and sells 1 XYZ Nov 60 call at 3.50. At what stock price will the investor break even?

- ☐ A) 50.
- ☐ B) 63.5.
- ☒ C) 54.5.
- ☐ D) 60.

#### Explanation

To determine the breakeven point, net the option premiums ( $8 - 3.50 = 4.50$ ). For a call spread, add the netted premiums to the lower strike price ( $50 + 4.50 = 54.50$ ).

Reference: 4.4.1.2 in the License Exam Manual

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### Question #76 of 222

Question ID: 605746

Which of the following are spreads?

- I. Long 1 FLB May 40 call; short 1 FLB May 50 call.
- II. Long 1 FLB May 40 call; long 1 FLB May 50 call.
- III. Long 1 FLB Aug 40 call; short 1 FLB May 40 call.
- IV. Long 1 FLB Aug 40 call; short 1 FLB Aug 50 put.

- ☐ **A)** II and III.
- ☐ **B)** I and II.
- ☒ **C)** I and III.
- ☐ **D)** II and IV.

Explanation

Choices I and III fit the definition of a call spread because each includes one long and one short option of the same type with different strike prices (I, a price spread) or different expiration dates (III, a time spread). Choice II involves options of the same type, but both are long. Choice IV involves options of different types.

**Reference:** 4.4.1 in the License Exam Manual

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**Question #77 of 222**

Question ID: 605674

A client bought 100 XYZ at \$65 per share and sold an XYZ 65 call at 8. Closing the short call at 10 and selling XYZ at 68 would result in a:

- ☒ **A)** \$100 profit.
- ☐ **B)** \$500 loss.
- ☐ **C)** \$100 loss.
- ☐ **D)** \$500 profit.

Explanation

The client made \$300 on the stock and lost \$200 on the option for a \$100 profit.

**Reference:** 4.3.2 in the License Exam Manual

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**Question #78 of 222**

Question ID: 605703

A customer writes 1 XYZ Sept 45 put at 6 and 1 XYZ Sept 35 call at 6 when XYZ is at 40. Prior to expiration, if XYZ is at 43 and the customer closes his positions at intrinsic value, the customer has a:

- ☐ **A)** \$600 gain.
- ☒ **B)** \$200 gain.
- ☐ **C)** \$200 loss.
- ☐ **D)** \$600 loss.

Explanation

The customer collects \$1,200 in premiums for writing the options ( $6 + 6$ ), but later pays \$200 ( $45 - 43$ ) to close out the put, and \$800 to close out the call ( $43 - 35$ ). In this case, \$1,200 received minus \$1,000 paid leaves a gain of \$200.

**Reference:** 4.4.2.3 in the License Exam Manual

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**Question #79 of 222**

Question ID: 605644

A customer sells short 100 shares of XYZ at 58 and buys 1 XYZ Jan 60 call for 3. If the stock price falls to \$52, the customer buys back the stock and closes the option at 1 for a

- ☒ **A)** gain of \$400.
- ☐ **B)** gain of \$300.
- ☐ **C)** loss of \$400.
- ☐ **D)** loss of \$300.

Explanation

The customer made \$600 on the short stock position ( $\$58$  to  $\$52$ ) and lost \$200 on the call (bought for 3, sold at 1). Overall, the gain is \$400.

**Reference:** 4.3.3 in the License Exam Manual

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## Question #80 of 222

Question ID: 605756

In which of the following strategies would the investor want the spread to widen?

- I. Buy 1 RST May 30 put; write 1 RST May 25 put.
- II. Write 1 RST Apr 45 put; buy 1 RST Apr 55 put.
- III. Buy 1 RST Nov 65 put; write 1 RST Nov 75 put.
- IV. Buy 1 RST Jan 40 call; write 1 RST Jan 30 call.

- ✓ **A)** I and II.
- X **B)** III and IV.
- X **C)** I and IV.
- X **D)** II and III.

### Explanation

An investor wants a debit spread to widen (choices I and II). As the difference between premiums increases, so does potential profit because the investor may sell the option with the higher premium and buy back the option with the lower premium. With credit spreads, investors profit if the spread between the premiums narrows.

**Reference:** 4.4.1.6 in the License Exam Manual

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## Question #81 of 222

Question ID: 605773

What is the breakeven point on the following position?

Buy 1 QRS Jan 40 call at 2.35

Write 1 QRS Jan 45 call at .85

- X **A)** 43.5.
- ✓ **B)** 41.5.
- X **C)** 41.75.
- X **D)** 43.25.

### Explanation

Because this is a call spread, the breakeven point is calculated by adding the net premium of 1.50 to the lower strike price ( $40 + 1.50 = 41.50$ ).

**Reference:** 4.4.1.2 in the License Exam Manual

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## Question #82 of 222

Question ID: 605771

Which term describes the following position?

Write 1 DOH Jan 30 call.

Write 1 DOH Jan 40 put.

- X **A)** Short straddle.
- X **B)** Price spread.
- X **C)** Diagonal spread.
- ✓ **D)** Short combination.

### Explanation

A combination is composed of a long call and long put, or a short call and a short put each having different strike prices and/or expiration months on the same underlying security.

**Reference:** 4.4.2.3. in the License Exam Manual

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## Question #83 of 222

Question ID: 605680

If a customer is short 100 XYZ shares at 54 and long 1 XYZ 55 call at 2, what is the maximum potential loss?

- X **A)** 200.
- X **B)** Unlimited.
- ✓ **C)** 300.
- X **D)** 100.

Explanation

The customer has protected his short stock position from a market advance by purchasing the call. If the market rises, the call is exercised, allowing the customer to buy stock at the options strike price of 55 to cover the short position. Therefore, the most the customer can lose is \$100 on the stock position (the difference between the option strike price and short sale price), plus the premium paid for the option ( $\$100 + \$200 = \$300$ ).

**Reference:** 4.3.3 in the License Exam Manual

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**Question #84 of 222**

Question ID: 605544

On exercise of the option, the holder of a put will realize a profit if the price of the underlying stock:

- X **A)** falls below the exercise price.
- X **B)** exceeds the exercise price plus the premium paid.
- ✓ **C)** falls below the exercise price minus the premium paid.
- X **D)** exceeds the exercise price.

Explanation

Breakeven for the buyer of a put is the strike price of the option minus the premium paid for the option.

**Reference:** 4.1.5.1 in the License Exam Manual

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**Question #85 of 222**

Question ID: 60557

In April, a customer sold short 100 shares of QRS stock at \$50 and simultaneously wrote 1 QRS Jan 50 put for a premium of \$7. If the January put is exercised when the market value of QRS is 43 and the stock acquired is used to cover the short stock position, what is the customer's profit or loss per share?

- X **A)** \$14 loss.
- X **B)** 0.
- X **C)** \$7 loss.
- ✓ **D)** \$7 gain.

Explanation

Because the stock is purchased on exercise of the short put for \$50 and is used to cover the \$50 short sale, the investor incurs no gain or loss on the stock. The customer keeps the \$700 collected in premiums for a profit of \$7 per share.

**Reference:** 4.3.4 in the License Exam Manual

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**Question #86 of 222**

Question ID: 605523

If a March 80 Canadian dollar call option is trading at 6 and the Canadian dollar is at \$.85, which of the following statements is TRUE?

- ✓ **A)** The contract has intrinsic value.
- X **B)** The contract has no time value.
- X **C)** The contract is out-of-the-money.
- X **D)** The contract is at parity.

Explanation

A call is in-the-money whenever the market value of the underlying instrument is above the strike price. The Canadian dollar is currently at \$.85 (85 cents) which is above the strike price of \$.80 (80 cents), so this call is in-the-money and therefore has intrinsic value of .05 (5 cents). This contract is trading .01 greater than the intrinsic value of .05. Therefore, it also has a time value of .01 (1 cent).



**Reference:** 4.1.4.1 in the License Exam Manual

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### Question #87 of 222

Question ID: 605747

A customer sells an FLB Mar 35 call. To establish a straddle, she would:

- ☐ A) sell an FLB Mar 40 call.
- ☐ B) buy an FLB Mar 40 call.
- ☒ C) sell an FLB Mar 35 put.
- ☐ D) buy an FLB Mar 35 put.

#### Explanation

Straddles involve options of different types, but both options must be of the same series. An option series has the same strike price, expiration date, and underlying security.

**Reference:** 4.4.2.2 in the License Exam Manual

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### Question #88 of 222

Question ID: 605693

A customer buys 1 XYZ Aug 60 call at 4 and 1 XYZ Aug 60 put at 2 when XYZ is at 61.25. If the stock rises to 68 and the customer lets the put expire and closes out the call at intrinsic value, the result is a:

- ☒ A) gain of \$200.
- ☐ B) loss of \$600.
- ☐ C) gain of \$600.
- ☐ D) loss of \$200.

#### Explanation

The customer has established a long straddle. To determine profit or loss, compute the breakeven points by both adding and subtracting the combined premiums (6 points) from strike (the breakeven points are 54 and 66). Because the customer profits if the stock moves outside these points, at 68, the customer has a 2-point (\$200) gain.

**Reference:** 4.4.2.1 in the License Exam Manual

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### Question #89 of 222

Question ID: 605772

A customer purchases 2 QRS Jul 30 calls at 2 and 2 QRS Jul 30 puts at 2.50. She will break even when the price of the underlying stock is:

- I. 25.50.
- II. 27.50.
- III. 32.
- IV. 34.50.

- ☐ A) II and III.
- ☒ B) I and IV.
- ☐ C) I and II.
- ☐ D) III and IV.

#### Explanation

The customer has bought calls and puts with the same strike price and expiration date, so the position is a long straddle. Straddles have two breakeven points: the strike price plus, and minus, the sum of the two premiums. The customer profits in a long straddle when the stock price is outside the breakeven points (i.e., higher than 34.50 or lower than 25.50).

**Reference:** 4.4.2.1 in the License Exam Manual

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### Question #90 of 222

Question ID: 605683

Using listed options to reduce the market risk in a stock position by taking an opposing position in the options that represent an equivalent number of shares is known as

- X **A)** spreading.
- X **B)** market timing.
- X **C)** straddling.
- ✓ **D)** hedging.

Explanation

This describes hedging, a technique used to reduce the market risk or adverse price movement in a stock position using options. Each standardized listed equity option contract represents 100 shares so the number of contracts needed to hedge an existing stock position is determined by the number of shares the investor is currently long or short.

**Reference:** 4.3 in the License Exam Manual

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**Question #91 of 222**

Question ID: 605764

Which of the following strategies is intended to be profitable with either a significant upside or significant downside move in the underlying stock?

- X **A)** Horizontal spread.
- ✓ **B)** Long straddle.
- X **C)** Vertical spread.
- X **D)** Short straddle.

Explanation

If the stock moves sharply up or down, the customer will profit from owning a long straddle.

**Reference:** 4.4.2.1 in the License Exam Manual

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**Question #92 of 222**

Question ID: 605681

If a customer buys 100 shares of MTN at 60, buys an MTN 60 call at 3, and buys an MTN 60 put at 3, the investor's maximum gain would be:

- X **A)** 5400.
- X **B)** 600.
- ✓ **C)** unlimited.
- X **D)** 6000.

Explanation

There is no limit to how high a stock's price can rise. Since this investor owns both the stock and an option to buy, the potential for gain is theoretically unlimited.

**Reference:** 4.3 in the License Exam Manual

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**Question #93 of 222**

Question ID: 605635

A customer, long 100 shares of QRS at 62.50, writes 1 QRS Sep 65 call at 1.50. If the call is exercised, which two statements are TRUE?

- I. The gain is \$250.
- II. The gain is \$400.
- III. For tax purposes, cost basis per share is 62.50.
- IV. For tax purposes, cost basis per share is 61.

- X **A)** II and IV.
- X **B)** I and IV.
- ✓ **C)** II and III.
- X **D)** I and III.

Explanation

The customer has paid 62.50 for the stock and has received 1.50 for the call. If the Sep 65 call is exercised the customer will receive 65 for the sale of the stock. After exercise, total received is 66.50 (1.50 + 65). 66.50 received minus 62.50 paid equal's 4 points profit (\$400). If a covered call writer is exercised, the cost basis for tax purposes is the

purchase price of the stock. Sales proceeds for tax purposes are 66.50 per share (strike price plus premium).

**Reference:** 4.3.2 in the License Exam Manual

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### Question #94 of 222

Question ID: 640159

Options contracts known as mini-options

- I. overlay 50 shares of the underlying equity
- II. overlay 10 shares of the underlying equity
- III. have premium multipliers of \$100
- IV. have premium multipliers of \$10

- ☐ A) I and IV
- ☐ B) II and III
- ☒ C) II and IV
- ☐ D) I and III

#### Explanation

While each standard listed option contract represents 100 shares of the underlying equity and has a premium multiplier of \$100 (premium of 2 = \$200), a mini-option contract only represents 10 shares of the underlying equity and has a premium multiplier of \$10 (premium of 2 = \$20).

**Reference:** 4.1.0.5.1 in the License Exam Manual

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### Question #95 of 222

Question ID: 605748

A registered representative executes the following trades for an options account:

Buy 1 FLB Apr 40 call at 9  
Sell 1 FLB Apr 45 call at 4

Are these suitable trades?

- ☐ A) It is impossible to tell.
- ☒ B) No, because the customer cannot make a profit on these trades.
- ☐ C) It depends on the customer's investment objectives.
- ☐ D) Yes, because the trades will result in a small profit.

#### Explanation

These trades are not suitable because the customer will not make a profit. In any price spread, the net debit represents maximum loss; in this case, the net debit is 5 points, or \$500. Maximum loss added to maximum gain will always equal the difference between the strike prices. In this example, the difference between the strike price is 5 points, therefore maximum gain is 0.

**Reference:** 4.4.1.1 in the License Exam Manual

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### Question #96 of 222

Question ID: 605671

If a customer buys 200 XYZ at 58 and writes 5 XYZ Jan 60 calls at 2, maximum potential loss is:

- ☒ A) unlimited.
- ☐ B) 12600
- ☐ C) 1400
- ☐ D) 10600

#### Explanation

This is an example of ratio writing. Short calls are covered by long stock, but in this example it would take 500 shares of stock to cover the 5 calls written. Because there are actually 3 uncovered calls, the maximum loss is unlimited.

### Question #97 of 222

Question ID: 605655

In early September, a customer buys 100 shares of QRS stock for \$83 per share and simultaneously writes 1 QRS Mar 90 call for \$4 per share. If the QRS Mar 90 call were exercised and the QRS stock delivered, what would be the customer's per share profit?

- ☐ A) 7.
- ☐ B) 0.
- ☐ C) 4.
- ☒ D) 11.

#### Explanation

If the stock rises above \$90, the writer will be exercised and make \$700 on the stock (buy at \$83, deliver at \$90) and keep the \$400 received in premiums. Alternatively, the breakeven point is 79 ( $83 - 4$ ), and the stock was sold (delivered) at 90 for an 11-point gain.

Reference: 4.3.2 in the License Exam Manual

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### Question #98 of 222

Question ID: 605528

If assigned or closing the position, writers of puts might be required to

- I. sell the underlying stock.
- II. buy the underlying stock.
- III. sell the outstanding put.
- IV. buy the outstanding put.

- ☐ A) I and IV.
- ☒ B) II and IV.
- ☐ C) I and III.
- ☐ D) II and III.

#### Explanation

If you write a put, you are selling the option to someone else. You are giving them the right to sell the underlying stock to you at the strike price during the term of the option. To close that position, you have to buy back the same option you sold or, if assigned, buy the stock.

Reference: 4.1.1.2 in the License Exam Manual

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### Question #99 of 222

Question ID: 605711

To create a credit calendar spread, an investor should

- I. buy the near expiration.
- II. buy the distant expiration.
- III. sell the near expiration.
- IV. sell the distant expiration.

- ☐ A) II and III.
- ☒ B) I and IV.
- ☐ C) II and IV.
- ☐ D) I and III.

#### Explanation

A credit calendar spread occurs when premium received exceeds the amount paid out. An investor creates a credit spread by selling the distant expiration and buying the near expiration. The distant expiration has more time value, and therefore, a higher premium.

Reference: 4.4.1.1 in the License Exam Manual

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### Question #100 of 222

Question ID: 605538

What is the size of one LEAPS contract?

- ✓ **A)** 100 shares.
- X **B)** There is no standard LEAPS contract size.
- X **C)** 1,000 shares.
- X **D)** More than 1,000 shares.

#### Explanation

Like a standard options contract, the size of a LEAPs contract is 100 shares.

**Reference:** 4.1.0.5.1 in the License Exam Manual

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### Question #101 of 222

Question ID: 605648

Your client purchases 100 shares of XYZ common stock at \$50 and sells two XYZ Oct 55 calls for a premium of \$2 each. This investor's maximum potential loss is:

- X **A)** 4600.
- ✓ **B)** unlimited.
- X **C)** 4800.
- X **D)** 600.

#### Explanation

This is a ratio write. The client is writing more calls than he has stock to cover. The first call is covered by the 100 shares of stock owned, but the second call is uncovered, or naked. A short naked call has unlimited loss exposure.

**Reference:** 4.3.4.2 in the License Exam Manual

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### Question #102 of 222

Question ID: 605730

With XYZ trading at \$47.50, your customer writes 1 XYZ January 50 put and simultaneously writes 1 XYZ January 45 call receiving \$600 in combined premiums. Your customer's market attitude is:

- ✓ **A)** neutral.
- X **B)** speculative.
- X **C)** bullish.
- X **D)** bearish.

#### Explanation

This position is a short combination where both contracts are in the money. Breakeven points are 51 and 44. Above or below these points, the customer will lose money.

**Reference:** 4.4.2.3 in the License Exam Manual

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### Question #103 of 222

Question ID: 605626

A customer purchases 200 shares of XYZ at 17.50 and writes 2 XYZ Jan 20 calls at 1. At expiration, with the stock trading at 19, the options expire worthless. If the customer sells his long stock at the current market price, the gain is:

- X **A)** 350
- ✓ **B)** 500
- X **C)** 250
- X **D)** 700

#### Explanation

The customer buys stock at 17.50 and sells his shares at 19 for a gain of \$300. In addition, the customer keeps the \$200 in premiums for an overall gain of \$500.

### Question #104 of 222

Question ID: 605774

What is the breakeven point on the following position?

Buy 1 CDE Apr 30 put at 3.10.

Write 1 CDE Apr 35 put at 5.85.

- ☐ A) 33.1.
- ☒ B) 32.25.
- ☐ C) 30.1.
- ☐ D) 32.75.

#### Explanation

This is a put spread established at a credit of 2.75. To find the breakeven point on a put spread, subtract the net premium from the higher strike price (in this case,  $35 - 2.75 = 32.25$ ).

Reference: 4.4.1.5 in the License Exam Manual

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### Question #105 of 222

Question ID: 605543

Which of the following is NOT an advantage of buying listed call options as compared to buying the underlying stock?

- ☒ A) The call has a time value beyond an intrinsic value that gradually dissipates.
- ☐ B) Buying a call would require a smaller capital commitment.
- ☐ C) Buying a call allows greater leverage than buying the underlying stock.
- ☐ D) Buying a call has a lower dollar loss potential than buying the stock.

#### Explanation

Call options allow greater leverage than buying the underlying stock and the capital requirements are smaller, allowing for a smaller loss potential. The fact that options expire (i.e., have a time value that erodes as the option nears expiration) is a disadvantage of options. Stock purchases have no time value component-there is no expiration and no resulting value erosion.

Reference: 4.1.6.2 in the License Exam Manual

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### Question #106 of 222

Question ID: 605531

An investor with no other positions sells 1 ABC Dec 55 call at 4.50. If the call is exercised when the stock is trading at 57.25, what is the investor's profit or loss?

- ☐ A) \$225 loss.
- ☐ B) \$275 loss.
- ☐ C) \$275 profit.
- ☒ D) \$225 profit.

#### Explanation

When the call is exercised, the investor is forced to buy the stock in the market for 57.25 and sell it to the owner of the call for 55, for a 2.25-point loss. The investor's premium of 4.50 minus the loss of 2.25 gives the investor a profit of 2.25 ( $2.25 \times 100 = \$225$ ). If a call is exercised, a writer must sell (deliver) his shares at the strike price.

Reference: 4.1.1.1 in the License Exam Manual

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### Question #107 of 222

Question ID: 605668

If a customer buys 500 shares of ABC at 48 and writes 5 ABC 50 calls at 2, what is the maximum loss?

- ☐ A) Unlimited.

- X B) 4600.
- ✓ C) 23000.
- X D) 1000.

Explanation

The investor pays \$48 per share for the stock and receives \$2 for selling the calls. The maximum loss is \$48 per share minus the option premium collected, or  $(\$48 - \$2) \times 500$  shares = \$23,000.

**Reference:** 4.3.2 in the License Exam Manual

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**Question #108 of 222**

Question ID: 605559

An investor with no other positions sells 1 ABC Jun 25 put at 1.50. If the put is exercised when the stock is trading at 24 and the investor immediately sells the stock in the market, what is the investor's profit or loss?

- X A) \$150 loss.
- ✓ B) \$50 profit.
- X C) \$150 profit.
- X D) \$50 loss.

Explanation

The investor has the obligation to buy the stock at the strike price of 25. The stock is currently worth 24, which is a loss of 1. The investor's premium of 1.50 minus the loss of 1 leaves a net profit of .50 ( $.50 \times 100 = \$50$ ).

**Reference:** 4.1.1.2 in the License Exam Manual

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**Question #109 of 222**

Question ID: 605677

A customer is short 100 shares of DFI at 35 and the market price is 35.25. If he believes a near-term rally will occur, which of the following strategies would *best* hedge his position?

- X A) Write a DFI put with an exercise price of 40.
- X B) Buy a DFI call with an exercise price of 40.
- ✓ C) Buy a DFI call with an exercise price of 35.
- X D) Write a DFI call with an exercise price of 40.

Explanation

The best hedge for a short stock position is to buy a call, not sell a put. If the stock price rises, the investor has the right to exercise the call and use the stock to close out the short position. To obtain the most protection, the call's strike price should equal the short sale price.

**Reference:** 4.3.3 in the License Exam Manual

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**Question #110 of 222**

Question ID: 605725

An options trader goes long 1 XYZ Oct 60 put at 6 and purchases 1 XYZ Oct 60 call for 6. If XYZ is at 68 at expiration, what is the investor's gain or loss?

- X A) \$400 gain.
- ✓ B) \$400 loss.
- X C) \$200 gain.
- X D) \$1,200 loss.

Explanation

If the market price of XYZ is at \$68 per share, the put is out-of-the-money and will expire worthless. The call could be sold for the intrinsic value of 8. (There is no time value, since the option is at the expiration date.) Since the investor originally spent \$1,200 (a premium of \$600 was paid for each option), the net result is a loss of \$400.

**Reference:** 4.4.2.1 in the License Exam Manual

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**Question #111 of 222**

Question ID: 605546

An investor buys an ABC May 45 put at 4.25 when the stock is trading at \$43. The put is in-the-money when the stock is:

- ☐ A) below 40.75.
- ☒ B) below 45.
- ☐ C) below 38.75.
- ☐ D) above 47.25.

**Explanation**

A put is in-the-money when the underlying stock trades below the exercise price of the put. The put is in the money by 2 points.

**Reference:** 4.1.5.1 in the License Exam Manual

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**Question #112 of 222**

Question ID: 605760

An ABC 40 call is quoted at 4.25 - 4.50 and an ABC 45 call is quoted at 1.50 - 2.00. What is the cost of establishing a debit spread?

- ☐ A) 225.
- ☐ B) 275.
- ☒ C) 300.
- ☐ D) 250.

**Explanation**

To establish a debit spread, an investor buys a 40 call at the ask price of 4.50, and sells a 45 call at the bid price of 1.50. The net premium paid is  $(4.50 \text{ less } 1.50) \times 100 \text{ shares}$  which equals \$300.

**Reference:** 4.4.1.2 in the License Exam Manual

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**Question #113 of 222**

Question ID: 605775

What are the breakeven points on the following position?

Write 2 DWQ Apr 30 calls at 2.25.

Write 2 DWQ Apr 30 puts at 2.10.

- I. 25.65.
- II. 27.85.
- III. 32.25.
- IV. 34.35.

- ☐ A) II and IV.
- ☒ B) I and IV.
- ☐ C) II and III.
- ☐ D) I and III.

**Explanation**

A straddle, whether long or short, has two breakeven points: the strike price plus, and minus, the sum of the premiums paid or received. In this case, the sum of the premiums received for the two short options is 4.35 and the strike price is 30. If the stock price is greater than 34.35 or less than 25.65, the investor will lose money. With short straddles, the customer profits if the stock price stays inside the breakeven points. Maximum gain is the premium received, and maximum loss is unlimited because of the uncovered calls.

**Reference:** 4.4.2.2 in the License Exam Manual

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**Question #114 of 222**

Question ID: 605758

If an investor buys 1 TIP Jul 60 call at 4 and sells 1 TIP Jul 50 call at 8.50, what will be the investor's overall net profit or loss if both calls expire unexercised?



- ☐ **A)** \$1,250 loss.
- ☐ **B)** \$450 loss.
- ☒ **C)** \$450 profit.
- ☐ **D)** \$1,250 profit.

Explanation

This is a credit call spread because the larger premium of the two options is associated with the short call. The best possibility for this investor is expiration, when the maximum gain is realized. The maximum gain on a credit spread is the net credit. In this example, the investor paid 4 and received 8.50 for a net premium and maximum gain of 4.50.

**Reference:** 4.4.1.3 in the License Exam Manual

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**Question #115 of 222**

Question ID: 605507

When stock prices are below strike prices, which of the following statements are CORRECT?

- I. Puts are in-the-money.
- II. Puts are out-of-the-money.
- III. Calls are in-the-money.
- IV. Calls are out-of-the-money.

- ☒ **A)** I and IV.
- ☐ **B)** I and III.
- ☐ **C)** II and IV.
- ☐ **D)** II and III.

Explanation

When stock prices are below strike prices, puts are in-the-money and calls are out-of-the-money.

**Reference:** 4.1.5.1 in the License Exam Manual

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**Question #116 of 222**

Question ID: 605640

An investor establishes the following positions:

Long 200 XYZ shares  
Short 5 XYZ Jul 50 calls at 5

This strategy is known as a:

- ☐ **A)** diagonal spread.
- ☐ **B)** reverse spread.
- ☐ **C)** combination.
- ☒ **D)** ratio write.

Explanation

An investor establishes a ratio write by writing calls that represent more shares than he owns. The uncovered short calls represent unlimited maximum loss potential.

**Reference:** 4.3.4.2 in the License Exam Manual

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**Question #117 of 222**

Question ID: 605653

An investor is short stock at 70. If the stock's market price is 40 and the investor anticipates the price will continue to decline, to hedge against a rise in the price the investor should:

- ☐ **A)** buy a straddle.
- ☐ **B)** sell a call.

- X **C)** buy a put.
- ✓ **D)** buy a call.

Explanation

If the investor buys a call on the stock, he has the right to buy it back (cover his short) at a fixed price. The best way to hedge an unrealized gain on a short stock position is to buy a call.

**Reference:** 4.3.3 in the License Exam Manual

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**Question #118 of 222**

Question ID: 605670

In a rising market, all of the following strategies are appropriate EXCEPT:

- X **A)** short puts.
- X **B)** long calls.
- ✓ **C)** short stock/short put.
- X **D)** debit call spreads.

Explanation

Investors who short stock have sold borrowed shares, and profit when the market price declines.

**Reference:** 4.3.4 in the License Exam Manual

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**Question #119 of 222**

Question ID: 605675

An investor who buys a stock and wishes to limit the potential downside risk should:

- X **A)** enter a sell limit order.
- ✓ **B)** buy a put.
- X **C)** enter a buy stop order.
- X **D)** buy a call.

Explanation

The purchase of a put limits the downside risk to the difference between the stock price and the put's strike price.

**Reference:** 4.3.1 in the License Exam Manual

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**Question #120 of 222**

Question ID: 605515

The time value of an option that is at-the-money equals:

- X **A)** it's intrinsic value less premium.
- X **B)** its intrinsic value.
- X **C)** zero.
- ✓ **D)** its premium.

Explanation

The option has no intrinsic value if the strike price equals the market price (at the money). The only value an option has is its time value, which equals the premium.

**Reference:** 4.1.6.2 in the License Exam Manual

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**Question #121 of 222**

Question ID: 605682

If a client bought 100 shares of GM at 88.50, and the same day he went long a put at 90 for 4.25 on GM due to expire within the month, what is the breakeven point?

- X **A)** 90.25.

- ✓ **B)** 92.75.
- X **C)** 84.25.
- X **D)** 85.25.

Explanation

The stock is the dominant position. The breakeven point is calculated by adding the cost of the option to the cost of the stock. The stock must rise to 92.75 to break even.

**Reference:** 4.3.1 in the License Exam Manual

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**Question #122 of 222**

Question ID: 605551

Which of the following investors will purchase stock if an option is exercised?

- I. Owner of a call
- II. Owner of a put.
- III. Writer of a call.
- IV. Writer of a put.

- X **A)** I and II.
- ✓ **B)** I and IV.
- X **C)** III and IV.
- X **D)** II and III.

Explanation

An owner of a call and writer of a put will purchase stock if an option is exercised. Call buyers have the right to buy, and call sellers are obligated to sell; put buyers have the right to sell, and put sellers are obligated to buy.

**Reference:** 4.1.1.1 in the License Exam Manual

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**Question #123 of 222**

Question ID: 605702

A customer who is long 1 XYZ Sep 50 call could create a spread by combining it with which of the following positions?

- X **A)** Long 1 XYZ Sep 60 call.
- ✓ **B)** Short 1 XYZ Sep 60 call.
- X **C)** Long 1 XYZ Sep 50 put.
- X **D)** Short 1 XYZ Sep 50 put.

Explanation

A spread involves two simultaneous positions in related options of the same type-one long and the other short of the same underlying security.

**Reference:** 4.4.1.2 in the License Exam Manual

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**Question #124 of 222**

Question ID: 605776

An investor opens the following position:

Write 1 CDE Oct 30 call at 3.30  
Buy 1 CDE Oct 40 call at .10.

The maximum gain is:

- ✓ **A)** 320.
- X **B)** 680.
- X **C)** 1000.
- X **D)** unlimited.

#### Explanation

The maximum gain on a credit spread is the net credit received ( $3.30 - .10 = 3.20 \times 100 \text{ shares} = \$320$ ).

**Reference:** 4.4.1.3 in the License Exam Manual

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### Question #125 of 222

Question ID: 605511

A stock currently sells for \$75 per share. If a put option on the stock has an exercise price of \$70 and currently sells for \$0.50, the put option is:

- ☐ A) at breakeven.
- ☐ B) at-the-money.
- ☒ C) out-of-the-money.
- ☐ D) in-the-money.

#### Explanation

This put option has a zero intrinsic value and is therefore out-of-the-money by the \$5 difference by which the market price exceeds the strike price. A put option has intrinsic value or is in-the-money when the current market price of the underlying asset is less than the exercise price (in this example, \$70).

**Reference:** 4.1.5.3 in the License Exam Manual

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### Question #126 of 222

Question ID: 605727

If a customer writes 1 ABC Jan 35 call at 13.50 and 1 ABC Jan 55 put at 12.50 when ABC is trading at 45, excluding commissions, this position will be profitable if ABC is:

- I. above 29.
  - II. below 29.
  - III. above 61.
  - IV. below 61.
- 
- ☐ A) III and IV.
  - ☐ B) I and II.
  - ☒ C) I and IV.
  - ☐ D) II and III.

#### Explanation

This is a short in-the-money combination. To compute the breakeven points, add the combined premiums (26) to the strike price of the call and subtract the combined premiums from the strike price of the put. The breakeven points are 61 ( $35 + 26$ ) and 29 ( $55 - 26$ ). With a short combination like a short straddle, the customer makes money if the stock stays inside the breakeven points.

**Reference:** 4.4.2.3 in the License Exam Manual

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### Question #127 of 222

Question ID: 605749

An active options trader establishes the following position:

Long 10 ALF Apr 40 calls at 6  
Short 10 ALF Apr 50 calls at 2

What is the breakeven point?

- ☒ A) 44.
- ☐ B) 4.
- ☐ C) 40.
- ☐ D) 46.

#### Explanation

The breakeven on a call spread is determined by adding the difference in premiums ( $6 - 2 = 4$ ) to the lower strike price. In this case, the net debit is 4 points. Therefore,  $4 + 40 = 44$ .

**Reference:** 4.4.1.2 in the License Exam Manual

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### Question #128 of 222

Question ID: 605779

If a customer buys 1 XYZ Aug 50 put at 1, and sells 1 XYZ Aug 65 put at 10 when XYZ is at 58, the maximum potential gain is:

- ☐ A) 1500.
- ☒ B) 900.
- ☐ C) 1100.
- ☐ D) 600.

#### Explanation

The maximum gain on any credit spread is the net credit. In this case, \$1,000 was received and \$100 paid out, so the net credit is \$900.

**Reference:** 4.4.1.5 in the License Exam Manual

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### Question #129 of 222

Question ID: 605553

When XYZ stock trades at 40 and an XYZ Oct 35 call trades at 5, which of the following statements is TRUE?

- ☐ A) The option is out-of-the-money.
- ☐ B) The option is at the money.
- ☒ C) The option is at parity.
- ☐ D) The option's time value equals its intrinsic value.

#### Explanation

An option is at parity when its premium equals its intrinsic value. A call option has intrinsic value when the stock is trading above the call's strike price. In this example, the stock is at 40 and the call's strike price is 35, so the option is in the money by 5 points. The option is said to be trading at parity and there is no time value because the option's premium is 5.

**Reference:** 4.1.4.5 in the License Exam Manual

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### Question #130 of 222

Question ID: 605557

An investor with no other positions sells 1 KLP Jul 40 call at 3.50. If the call is exercised when the stock is trading at 47, what is the investor's profit or loss?

- ☒ A) \$350 loss.
- ☐ B) \$350 profit.
- ☐ C) \$450 profit.
- ☐ D) \$450 loss.

#### Explanation

When the call was exercised, the investor was forced to buy the stock in the market for 47 and sell it to the call holder for 40. The loss of 7, minus the 3.50 premium received, gives the investor a loss of 3.50 ( $3.50 \times 100 = \$350$ ). Writers of uncovered calls, if exercised, must sell (deliver) stock at the strike price.

**Reference:** 4.1.1.1 in the License Exam Manual

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### Question #131 of 222

Question ID: 605700

A customer wishes to buy 1 XYZ Jan 40 call and write 1 XYZ Jan 45 call. At the time the order is placed, the options are trading as follows:

Jan. 40 calls - 4.30 bid, 4.35 ask

Jan. 45 calls - 2.25 bid, 2.30 ask

If the transaction is effected at the market, the spread will be established at a:

- X **A)** 1.50 debit.
- X **B)** 1.85 debit.
- ✓ **C)** 2.10 debit.
- X **D)** 1.75 debit.

Explanation

The investor establishes a debit spread by purchasing the 40 call at the ask price of 4.35 and selling the 45 call at the bid price of 2.25; the difference is 2.10.

**Reference:** 4.4.1.2 in the License Exam Manual

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**Question #132 of 222**

Question ID: 605630

A customer buys 100 DEF at 70, but several months later, the stock is trading at 82.85. The customer, concerned about a possible pullback, buys 1 DEF Aug 80 put at 1.50. If the stock subsequently falls to 77.25 and the customer sells his stock by exercising the put, the result is:

- X **A)** gain of \$875.
- ✓ **B)** gain of \$850.
- X **C)** loss of \$150.
- X **D)** gain of \$575.

Explanation

The customer bought 100 shares at 70 and sold them at 80 by exercising the put for a gain of \$1,000. However, it cost \$150 to buy the put so the customer's gain is \$850. In other words, breakeven for long stock-long put is the cost of stock purchased (70) plus the premium paid (1.50). Breakeven is 71.50 and the customer sold stock at 80 ( $80 - 71.50 = 8.50$ -point gain).

**Reference:** 4.3.1 in the License Exam Manual

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**Question #133 of 222**

Question ID: 605518

An investor establishes the following positions:

Long 1 XYZ Apr 40 call for 6

Long 1 XYZ Apr 50 put for 8

If both options are sold for intrinsic value when XYZ trades at 44, the investor realizes a loss of:

- X **A)** 1000.
- X **B)** 200.
- X **C)** 100.
- ✓ **D)** 400.

Explanation

If the opening purchase of the XYZ Apr 40 call was made at 6, and the closing sale of that call was made at 4, the difference of 2 represents a \$200 loss. If the opening purchase of the XYZ Apr 50 put was made at 8, and the closing sale of that put was made at 6, the difference of 2 represents a \$200 loss. The total loss for the account is \$400.

**Reference:** 4.1.6.2 in the License Exam Manual

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**Question #134 of 222**

Question ID: 605529

Your client expects KLM Corporation stock to undergo a slight but long-term decrease in price. He is willing and able to take a risk to generate a small amount of income. Which of the following might be an effective strategy?

- X **A)** Buy near-term, in-the-money KLM calls.
- ✓ **B)** Sell KLM LEAPS calls.

- X **C)** Buy near-term, in-the-money KLM puts.
- X **D)** Sell KLM LEAPS puts.

Explanation

Your customer wishes to generate income, which means he must sell something, not buy it. Since he is in a position to take a risk, and expects KLM's stock price to decline long term, selling LEAPS calls would be a possible strategy.

**Reference:** 4.1.0.5.1 in the License Exam Manual

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**Question #135 of 222**

Question ID: 605688

With no other positions, a customer sells short 100 TIP at 40 and sells 1 TIP Oct 40 put at \$5. At what stock price will the customer break even?

- ✓ **A)** 45.
- X **B)** 50.
- X **C)** 40.
- X **D)** 35.

Explanation

On the downside, the short position fully covers the short put and the profit is the \$500 premium. On the upside above 40, the short put expires and the short stock position loses money. The first 5 points of loss (40 to 45) on the short stock position are offset by the premiums received. Above 45, losses begin and are potentially unlimited.

**Reference:** 4.3.4 in the License Exam Manual

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**Question #136 of 222**

Question ID: 605526

If the current OEX is valued at 487.95, which of the following option positions will be considered to be in the money?

- X **A)** Jan 495 Call.
- X **B)** Jan 485 Put.
- X **C)** Dec 490 Call.
- ✓ **D)** Dec 490 Put.

Explanation

A put is in the money if the current market value is below the strike price. A call is in the money if the current market value is above the strike price.

**Reference:** 4.1.5.1 in the License Exam Manual

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**Question #137 of 222**

Question ID: 605631

A customer buys 200 ABC at 76 and simultaneously writes 2 ABC MAR 80 calls at 2. If the stock rises to 83 and the customer is assigned on the short calls, the customer has a gain of:

- X **A)** 1400.
- X **B)** 1800.
- X **C)** 800.
- ✓ **D)** 1200.

Explanation

The customer bought 200 shares at 76 and was forced to sell those shares at 80 for a gain of \$800. In addition, the customer received \$400 for writing the calls, so the overall gain is \$1,200. The price of 83 is irrelevant. It only explains why the customer was exercised (the 80 calls are in-the-money). Breakeven for covered call writing is the cost of stock (76) less premiums (2). The breakeven point is 74, and the customer sold at 80 (6 points × 200 shares = \$1,200).

**Reference:** 4.3.2 in the License Exam Manual

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### Question #138 of 222

Question ID: 605566

American style options traded on the CBOE are priced higher than European style options on the same underlying stock, having the same expiration because:

- ☐ A) US investors cannot use European style options thus the demand is much less leading to lower premiums.
- ☐ B) European style options are not adjusted for stock splits and stock dividends.
- ☐ C) European style option positions cannot be traded out of.
- ☒ D) American style options can be exercised at any time until expiration, while European style options can be exercised only at expiration.

#### Explanation

American style options can be exercised at any time until expiration, while European options can be exercised only at expiration. With all other specifications the same, the American style option will have the higher premium because it allows the holder broader exercise rights.

**Reference:** 4.1.0.4 in the License Exam Manual

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### Question #139 of 222

Question ID: 605560

If ABC closed at 24 and the ABC Mar 20 puts closed at .75, the puts are:

- ☐ A) at parity.
- ☐ B) in-the-money.
- ☒ C) out-of-the-money.
- ☐ D) at the money.

#### Explanation

Put options are out-of-the-money when the market price is above the strike price.

**Reference:** 4.1.5.3 in the License Exam Manual

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### Question #140 of 222

Question ID: 605625

A customer buys 300 LMN at 45 and writes 3 LMN Aug 45 calls at 4. The customer will profit under all of the following circumstances EXCEPT if LMN:

- ☐ A) rises and the calls are exercised.
- ☐ B) remains at 45 through expiration.
- ☐ C) is between 41 and 45 at expiration.
- ☒ D) is below 41 at expiration.

#### Explanation

Breakeven is 41 ( $45 - 4$ ). If the stock is below 41 at expiration, the customer will incur a loss.

**Reference:** 4.3.2 in the License Exam Manual

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### Question #141 of 222

Question ID: 605729

If a customer believes that the market price of a stock will sharply rise or fall in the near future, which of the following strategies is *best*?

- ☐ A) Buy a call.
- ☒ B) Buy a straddle.
- ☐ C) Write a straddle.
- ☐ D) Write a call.

#### Explanation

If the stock goes either up or down sharply, the investor will profit from owning a straddle.

**Reference:** 4.4.2.1 in the License Exam Manual



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### Question #142 of 222

Question ID: 605521

A customer buys an Oct 76 put on the Swiss franc for a premium of 5. The franc closes at 74. Which of the following is TRUE?

- ☐ A) It has no time value.
- ☐ B) It is out-of-the-money.
- ☒ C) It has intrinsic value.
- ☐ D) It is at-the-money.

#### Explanation

When the CMV is below the strike price, puts are in-the-money. Therefore, they have intrinsic value.

**Reference:** 4.1.6.2 in the License Exam Manual

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### Question #143 of 222

Question ID: 605710

If a customer buys 1 ABC Jan 60 put at 6 and writes 1 ABC Jan 75 put at 13, the maximum loss is:

- ☐ A) 700.
- ☐ B) 900.
- ☐ C) 1500.
- ☒ D) 800.

#### Explanation

This is a credit spread (more premium was received than was paid). The maximum gain to a seller is the premium received (net credit of 7). In a spread, the maximum gain plus the maximum loss equal the difference in strike prices ( $75 - 60 = 15$ ). Therefore, 15 less the maximum gain of 7 equals the maximum loss of 8 multiplied by \$100, or \$800.

**Reference:** 4.4.1.5 in the License Exam Manual

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### Question #144 of 222

Question ID: 605565

A customer buys 10 ABC Jul 25 calls at 4.50. What is the total premium paid for the position?

- ☐ A) 450.
- ☐ B) 29500.
- ☒ C) 4500.
- ☐ D) 20500.

#### Explanation

A premium of 4.50 multiplied by 100 shares per contract, multiplied by 10 contracts equals \$4,500.

**Reference:** 4.1.2.1 in the License Exam Manual

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### Question #145 of 222

Question ID: 605716

A customer is long an ABC Apr 40 call and is also short an ABC Jul 40 call. Which of the following *best* describe his position?

- I. Bullish.
- II. Bearish.
- III. Calendar spread.
- IV. Vertical spread.

- ☒ A) II and III.
- ☐ B) I and III.
- ☐ C) I and IV.
- ☐ D) II and IV.

### Explanation

The July call will have a higher premium than the April call because it has more time value. Since the customer is selling the call with the higher premium, he is counting on the July call to go unexercised, which would allow him to keep the premium as a profit. That means the market value of the underlying security must either stay the same or decline. This customer's position is therefore bearish. Since the options expire in different months, the trade is a calendar spread.

**Reference:** 4.4.1.1 in the License Exam Manual

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## Question #146 of 222

Question ID: 605661

Which of the following positions has an unlimited dollar risk?

- X **A)** Short 100 shares of ABC; long 1 ABC call.
- X **B)** Short 1 ABC Jan 35 call; long 1 ABC Jan 40 call.
- X **C)** Short 1 ABC Jan 50 put.
- ✓ **D)** Short 1 ABC Jan 50 put; short 100 shares of ABC.

### Explanation

An investor faces unlimited dollar risk when short stock, short a naked call, or when a short stock position is combined with a short put. In this position, the unlimited risk of the stock is only protected on the upside by the premium received.

**Reference:** 4.3.4 in the License Exam Manual

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## Question #147 of 222

Question ID: 605656

A customer establishes the following positions:

Buy 100 JMB at 28  
Buy 1 JMB Dec 25 put at 2

What is the maximum potential loss?

- X **A)** 2800.
- X **B)** 3000.
- ✓ **C)** 500.
- X **D)** 200.

### Explanation

The investor loses money on the long stock position when the market value falls. With the purchase of the put, the investor can sell the stock for no less than the strike price, but also loses the premium. In this example, the investor loses a maximum of \$3 on the stock ( $28 - 25$ ) plus the premium of \$2, for a total loss of \$500 on 100 shares.

**Reference:** 4.3.1 in the License Exam Manual

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## Question #148 of 222

Question ID: 605666

If a customer sells short 100 ABC at 40 and sells 1 ABC June 40 put at 4, what is the maximum loss?

- ✓ **A)** Unlimited.
- X **B)** 3600.
- X **C)** 0.
- X **D)** 400.

### Explanation

A short stock position subjects an investor to unlimited risk. Writing a put against a short stock position only protects the investor to the extent of the premium received.

**Reference:** 4.3.4 in the License Exam Manual

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### Question #149 of 222

Question ID: 605718

John Chance purchased a DMF May 90 call and simultaneously sold a DMF Jun 80 call. Which of the following *best* describes John's position?

- ☐ A) A long spread.
- ☐ B) A bull spread.
- ☐ C) A short spread.
- ☒ D) A bear spread.

#### Explanation

This investor has established a net credit diagonal call spread. He bought the lower premium call (higher strike and earliest expiry) and sold the higher premium call (lower strike and longest expiry). He hopes the spread will narrow to zero (if the market falls below 80 and both calls expire worthless) so he can keep all of the premiums. He is a bear and so is the spread.

**Reference:** 4.4.1.3 in the License Exam Manual

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### Question #150 of 222

Question ID: 605513

An XYZ June 40 put trading at 4 would be considered in the money if XYZ is trading:

- ☒ A) below \$40 only.
- ☐ B) above \$44 only.
- ☐ C) above \$40 only.
- ☐ D) below \$36 only.

#### Explanation

A put is in-the-money, or has intrinsic value, whenever the price of the stock is below the strike price. The put would be in-the-money below \$40.

**Reference:** 4.1.5.1 in the License Exam Manual

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### Question #151 of 222

Question ID: 605721

If a customer buys 2 Canadian dollar 78 calls and writes 2 Canadian dollar 80 calls, this position is a

- ☐ A) diagonal call spread.
- ☒ B) bull call spread.
- ☐ C) credit call spread.
- ☐ D) horizontal call spread.

#### Explanation

Bull positions in options spreads are established by buying the option with the lower strike price.

**Reference:** 4.4.1.2 in the License Exam Manual

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### Question #152 of 222

Question ID: 605628

A customer is long 100 XYZ currently trading at \$40 per share. To generate income, the customer writes 2 XYZ Aug 40 calls at 4 for a maximum loss potential of:

- ☐ A) 3600.
- ☐ B) 3200.
- ☐ C) 4000.
- ☒ D) unlimited.

#### Explanation

This is an example of ratio writing where a customer writes more calls than he has stock to cover. Because only one of the calls is covered, the other is uncovered and loss potential is unlimited.

### Question #153 of 222

Question ID: 605506

Which of the following would not be a factor in determining the price of an options contract?

- ✓ **A)** The listing exchange
- X **B)** The time remaining to expiration
- X **C)** The volatility of the underlying stock
- X **D)** The price of the underlying stock

#### Explanation

Time remaining, volatility of the underlying stock, and price of the underlying stock all affect the price of an option contract. The exchange where the contract is listed should not impact pricing.

Reference: 4.1.6.2 in the License Exam Manual

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### Question #154 of 222

Question ID: 605510

A customer writes 3 XYZ Sep 55 puts at 5 when the stock is trading at 53.50. How much aggregate time value do these contracts have?

- X **A)** 450.
- ✓ **B)** 1050.
- X **C)** 150.
- X **D)** 350.

#### Explanation

Puts are in-the-money (have intrinsic value) when the market price of the underlying stock is below the strike price. In this case, the contracts are in the money by 1.50. Therefore, the time value of each contract is 3.50 or \$350 per contract. As there are 3 contracts, the aggregate time value is \$1,050.

Reference: 4.1.6.2 in the License Exam Manual

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### Question #155 of 222

Question ID: 605719

If a customer buys 1 OEX Feb 350 call at 5, then sells 1 OEX Feb 335 call at 16 when the underlying index is at 344, the breakeven point is:

- ✓ **A)** 346.
- X **B)** 340.
- X **C)** 339.
- X **D)** 342.

#### Explanation

To determine a call spread, add the net premium to the lower strike price to find the breakeven point. The net premium is the difference between the premium paid (5) and the premium received (16), or 11 (335 + 11 = a breakeven point of 346).

Reference: 4.4.1.3 in the License Exam Manual

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### Question #156 of 222

Question ID: 605765

An investor establishes the following positions:

Long 1 XYZ Apr 45 call at 3.50

Long 1 XYZ Apr 45 put at 2.75

The investor's strategy will realize a gain if XYZ trades above:

- X **A)** 47.75.
- X **B)** 45
- ✓ **C)** 51.25.
- X **D)** 48.5.

Explanation

A long straddle is profitable if the stock price moves sharply in either direction. In this example, the investor paid a premium of 6.25 to establish the straddle. To realize a gain, the stock must either fall below the strike price minus the combined premium ( $45 - 6.25 = 38.75$ ) or rise above the strike price plus the combined premium ( $45 + 6.25 = 51.25$ ).

**Reference:** 4.4.2.1 in the License Exam Manual

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**Question #157 of 222**

Question ID: 605769

A customer establishes the following positions:

Long 1 ABC Jun 25 call at 2  
Long 1 ABC Jun 25 put at 2

At expiration, the position is profitable if the stock price is

- I. above 21.
- II. below 21.
- III. above 29.
- IV. below 29.

- X **A)** I and III.
- ✓ **B)** II and III.
- X **C)** II and IV.
- X **D)** I and IV.

Explanation

The investor purchased a long straddle (both a call and put with the same strike prices and expiration months). While straddle investors are uncertain about the direction of the market, long straddles require substantial price movement (volatility) for profit because the two premiums paid must be recovered. In this example the breakeven of the call is found by adding the total premiums of 4 to the call strike price of 25 ( $25 + 4 = 29$ ). The breakeven of the put is found by subtracting the total premiums of 4 from the put strike price of 25 ( $25 - 4 = 21$ ). The market must either move up by 4 (total premiums paid) or down by 4 to be at breakeven. For profit, the market must be above or below the breakeven points.

**Reference:** 4.4.2.1 in the License Exam Manual

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**Question #158 of 222**

Question ID: 605699

A customer creates a long straddle by buying 5 ABC Nov 50 calls and 5 ABC Nov 50 puts paying premiums of \$3,750. If ABC is at 56.50 at expiration, the customer has a:

- X **A)** gain of \$1,000.
- ✓ **B)** loss of \$500.
- X **C)** gain of \$500.
- X **D)** loss of \$1,000.

Explanation

While the puts would expire, the customer may close out the calls by selling them at 6.50 ( $56.50 - 50$ ) for \$3,250 ( $6.50 \times 5 \times \$100$ ). The result is a loss of \$500 ( $\$3,750 - \$3,250$ ).

**Reference:** 4.4.2.1 in the License Exam Manual

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**Question #159 of 222**

Question ID: 605762

In a single day, a customer purchases 15 ACM Sep 50 puts at 6 and 15 ACM Sep 50 calls at 1. The customer would profit from the positions if ACM traded:

- X **A)** between \$43 and \$57.
- X **B)** either below \$38 or above \$52.
- ✓ **C)** either below \$43 or above \$57.
- X **D)** between \$38 and \$52.

Explanation

The customer paid \$6 for the Sep 50 puts and \$1 for the Sep 50 calls. A long straddle is profitable on the call side if the price rises above the strike price plus the combined premiums paid (\$57). On the put side, it is profitable if the price falls below the strike price minus the combined premiums paid (\$43).

**Reference:** 4.4.2.1 in the License Exam Manual

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**Question #160 of 222**

Question ID: 605649

A customer holds the following positions:

Short 100 XYZ shares at 40  
Short 1 XYZ Oct 40 put at 5

With XYZ trading at 35, the customer is assigned an exercise notice on the put and he uses the stock purchased to cover the short stock position, the customer has a

- ✓ **A)** \$500 gain.
- X **B)** \$1,000 gain.
- X **C)** \$1,000 loss.
- X **D)** \$500 loss.

Explanation

When exercised, the customer is forced to buy stock at 40 that is used to cover the short position for no gain or loss. Because the premium of \$500 was received, the investor has a gain of \$500 on this position.

**Reference:** 4.3.4 in the License Exam Manual

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**Question #161 of 222**

Question ID: 605704

If XYZ is trading at 39 and a customer sells 1 XYZ June 40 put and buys 1 XYZ June 35 put, he will profit if the:

- I. spread widens.
- II. spread narrows.
- III. contracts expire.
- IV. contracts are exercised.

- ✓ **A)** II and III.
- X **B)** II and IV.
- X **C)** I and IV.
- X **D)** I and II.

Explanation

When a spread's premiums are not available, the more valuable option is found by examining the strike price. A put with a higher strike price has a higher premium because a put represents the right to sell. Because the investor is selling the more valuable put (the one with the higher strike price), this is a credit spread, and profit occurs if the options expire worthless (in this case, the customer keeps the net credit) or the spread narrows between the premiums.

**Reference:** 4.4.1.5 in the License Exam Manual

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**Question #162 of 222**

Question ID: 605646

The derivative-based strategy known as portfolio insurance involves the:

- X **A)** sale of a call on the underlying security position.

- ✓ **B)** purchase of a put on the underlying security position.
- X **C)** purchase of a call on the underlying security position.
- X **D)** sale of a put on the underlying security position.

#### Explanation

The purchase of a put option to hedge the downside risk of an underlying security holding is called a protective put position one of many derivative-based strategies collectively known as portfolio insurance.

**Reference:** 4.3.1 in the License Exam Manual

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### Question #163 of 222

Question ID: 605647

Your client purchased 100 shares of ULA common stock at \$40 per share 2 years ago. Today, the client buys one ULA Apr 60 put at \$2, when the stock's price is \$65. At expiration, the ULA stock is selling for \$56, and the client exercises his put, delivering the long stock to cover the sale. The client has a gain of:

- ✓ **A)** 1800.
- X **B)** 2300.
- X **C)** 200.
- X **D)** 700.

#### Explanation

Exercise of the put enables the client to sell the stock at the strike price of \$60. The stock was originally purchased at \$40, so the result is a \$2,000 gain in the stock minus the \$200 premium paid for the put, for a net gain of \$1,800.

**Reference:** 4.3.1 in the License Exam Manual

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### Question #164 of 222

Question ID: 605743

If a ROP is asked to approve a discretionary order to buy 1 XYZ Oct 60 put and sell 1 XYZ Oct 55 put for a net debit of \$5, he should:

- ✓ **A)** not approve the order.
- X **B)** obtain the best execution for the order.
- X **C)** approve the order in writing.
- X **D)** approve the order if the customer has sufficient funds in his accounts.

#### Explanation

Because this is a debit spread, the maximum gain occurs if both sides are exercised. If this occurs, the investor earns \$5 (buy stock at 55 when the short put is exercised and sell stock at 60 by exercising the long put). Because the net premium paid for the spread is \$5, there can never be any gain. This spread is not economical.

**Reference:** 4.4.1.4 in the License Exam Manual

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### Question #165 of 222

Question ID: 605548

Which of the following is a derivative security?

- ✓ **A)** options.
- X **B)** REITs.
- X **C)** ADRs.
- X **D)** DPPs.

#### Explanation

Options are known as derivative securities because they derive their value from that of the underlying security.

**Reference:** 4.1.0.5.1 in the License Exam Manual

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### Question #166 of 222

Question ID: 605713

The writer of a combination expects the market to be:

- ☐ A) bearish.
- ☐ B) volatile.
- ☐ C) bullish.
- ☒ D) stable.

#### Explanation

The writer, or seller, of a combination expects the market to be stable. The buyer of a combination expects the market to be volatile. Combinations and straddles are never bullish or bearish, as there are always both calls and puts involved in the strategy, which are both bullish and bearish. Remember, the definition of a combination is a put and a call on the same underlying security with the strike prices and/or the expiration months being different.

**Reference:** 4.4.2.3 in the License Exam Manual

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### Question #167 of 222

Question ID: 605714

Which of the following would *best* describe, "Bought 1 Jan 55 call at 3 and sold 1 Jan 60 call at 1"?

- ☐ A) A bear vertical spread.
- ☒ B) A bull vertical spread.
- ☐ C) A bull horizontal spread.
- ☐ D) A bear time spread.

#### Explanation

The client paid 2 points out-of-pocket for a call spread. Break even here is 57. Your client wants the stock to go up; hence, a bull spread. Because the exercise prices are different, it is also a vertical spread.

**Reference:** 4.4.1.2 in the License Exam Manual

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### Question #168 of 222

Question ID: 605742

In a bull call spread, an investor:

- I. buys the lower exercise price and sells the higher exercise price.
- II. buys the higher exercise price and sells the lower exercise price.
- III. anticipates the spread will narrow.
- IV. anticipates the spread will widen.

- ☒ A) I and IV.
- ☐ B) I and III.
- ☐ C) II and III.
- ☐ D) II and IV.

#### Explanation

In a bull call spread (debit spread), a call with a lower strike price is purchased and a call with a higher strike price is sold. Because the long call has a lower strike price than the short call, it is more expensive, resulting in a net debit. In a bull call spread, the investor hopes the market prices rise. Maximum profit occurs if both calls are exercised, and because this is a debit spread, the spread is profitable if it widens.

**Reference:** 4.4.1.2 in the License Exam Manual

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### Question #169 of 222

Question ID: 605555

Which of the following investors are bearish?

- I. Buyer of a call.
- II. Writer of a call.
- III. Buyer of a put.



IV. Writer of a put.

- X **A)** III and IV.
- X **B)** I and IV.
- X **C)** I and II.
- ✓ **D)** II and III.

Explanation

Buyers of puts and writers of calls are bearish investors. Buyers of calls and writers of puts are bullish investors.

**Reference:** 4.1.5.6 in the License Exam Manual

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**Question #170 of 222**

Question ID: 605696

When comparing a short call to a credit call spread, all of the following are true EXCEPT:

- X **A)** maximum gain is limited in both positions.
- ✓ **B)** maximum loss is limited in both positions.
- X **C)** both positions are bearish.
- X **D)** both positions generate premium income.

Explanation

In any spread, both maximum gain and maximum loss are limited. In a short call, gain is limited to the premium received, but loss is unlimited. Short calls and credit call spreads are bearish, and both generate premium income. The investor who writes a call spread receives premium income (a short call spread is a credit spread).

**Reference:** 4.4.1.3 in the License Exam Manual

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**Question #171 of 222**

Question ID: 605564

If XYZ stock is trading at 25.75 and XYZ Jul 25 calls are trading at a premium of 2, what is the time value of the Jul 25 calls?

- X **A)** 200.
- X **B)** 0.
- ✓ **C)** 125.
- X **D)** 75.

Explanation

The time value is the premium minus the intrinsic value. The premium is 2 (or \$200), and the intrinsic value is \$75 ( $\$200 - \$75 = \$125$ ).

**Reference:** 4.1.6.2 in the License Exam Manual

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**Question #172 of 222**

Question ID: 605777

An investor opens the following position:

Buy 1 COD Jan 40 put at 6.50

Write 1 COD Jan 30 put at 2.10

His maximum loss is:

- X **A)** 2600.
- ✓ **B)** 440.
- X **C)** 560.
- X **D)** 2100.

Explanation

The maximum loss on a debit spread is the net debit.

**Reference:** 4.4.1.4 in the License Exam Manual

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### Question #173 of 222

Question ID: 605563

ALFA closed at 37.50, the ALFA Jan 35 calls closed at 3.50, and ALFA Feb 35 calls closed at 4.60. What is the difference in the time values between the two options?

- ☐ A) 35
- ☐ B) 2.5.
- ☒ C) 1.1.
- ☐ D) 37.5.

#### Explanation

The January premium is 3.50 and the February premium is 4.60 (the difference is 1.10). Each option is in the money by 2.50.

**Reference:** 4.1.6.2 in the License Exam Manual

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### Question #174 of 222

Question ID: 605678

A customer is short 100 XYZ shares at 26 and long 1 XYZ 30 call at 1. What is the maximum potential gain for the customer?

- ☒ A) 2500.
- ☐ B) 500.
- ☐ C) 2600.
- ☐ D) 5200.

#### Explanation

The customer has hedged his short stock position from a market advance by buying the call. If the market falls, the investor can make a maximum of \$26 per share if the stock price falls to zero, less the premium of 1 paid to buy the call, for a maximum gain of \$2,500 ( $26 - 1 = 25$ ).

**Reference:** 4.3.3 in the License Exam Manual

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### Question #175 of 222

Question ID: 605695

The market attitude of a customer who establishes a debit put spread is:

- ☐ A) speculative.
- ☐ B) neutral.
- ☐ C) bullish.
- ☒ D) bearish.

#### Explanation

In a put spread, a customer is buying one put and selling another with different strike prices and/or expirations. In any spread, one of the options is dominant. In a long put spread, the long put position is dominant because it has the higher premium; buying puts is bearish.

**Reference:** 4.4.1.6 in the License Exam Manual

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### Question #176 of 222

Question ID: 605690

A customer goes long an MMM Jan 40 put at 5 and writes an MMM Jan 50 put at 13. The customer will break even or profit when the market price is at all of the following EXCEPT:

- ☒ A) 35.
- ☐ B) 42.
- ☐ C) 48.

X **D)** 45.

Explanation

This is a bull spread; the investor wants the stock to rise. Breakeven for put spreads is computed by subtracting the net premium (8) from the higher strike price (50). If it stays above the breakeven price of 42, he will profit.

**Reference:** 4.4.1.5 in the License Exam Manual

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**Question #177 of 222**

Question ID: 605539

A call is in-the-money when the market price of the underlying stock is

- X **A)** equal to the strike price .
- X **B)** more than it was at the previous day's close.
- X **C)** less than the strike price.
- ✓ **D)** more than the strike price.

Explanation

Call options are in-the-money whenever the market price of the stock is greater than the strike price.

**Reference:** 4.1.4.1 in the License Exam Manual

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**Question #178 of 222**

Question ID: 605673

An option investor might do all of the following EXCEPT:

- X **A)** make a closing purchase.
- ✓ **B)** hedge a long stock position with a short put.
- X **C)** make an opening sale.
- X **D)** hedge a short stock position with a long call .

Explanation

Writing a put does not reduce the risk of a long stock position. The short put creates an obligation to purchase additional shares if the put is exercised (which will happen if the stock falls). A long call is an effective hedge against a short stock position.

**Reference:** 4.3 in the License Exam Manual

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**Question #179 of 222**

Question ID: 605667

Which of the following is TRUE regarding option contracts that expire weekly?

- X **A)** They expire on Mondays.
- X **B)** They can only be traded for a single day.
- ✓ **C)** They tend to have lower premiums than standard contracts or long-term equity anticipation (LEAP) contracts.
- X **D)** They are issued every week of every month.

Explanation

Weekly contracts or "weeklies" tend to have lower premiums than other types of contracts due to the short period of time between when they are issued and when they expire (1 week). They can be traded anytime during their week-long life cycle, expire on Fridays, and are issued each week of the month except the week that standardized contracts would be expiring.

**Reference:** 4.1.0.5.1 in the License Exam Manual

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**Question #180 of 222**

Question ID: 605709

If a customer buys 1 ABC Jan 50 call at 2 and 1 ABC Jan 50 put at 4 when ABC is at 49, the maximum potential gain is:

- ✓ **A)** unlimited.
- X **B)** 600.
- X **C)** 400.
- X **D)** 200.

Explanation

Maximum gain in a long straddle is unlimited if the market moves up. If the market moves to zero, the gain is \$4,400 ( $50 - 6 = 44$ ).

**Reference:** 4.4.2.1 in the License Exam Manual

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### Question #181 of 222

Question ID: 605642

What options trading program would be *most* appropriate for a retired customer with a portfolio of low cost basis blue-chip stocks who is seeking income from his portfolio?

- ✓ **A)** A covered call writing program.
- X **B)** An option purchasing program.
- X **C)** Selling straddles.
- X **D)** An uncovered call writing program.

Explanation

The most conservative option strategy is writing covered calls. In addition to the income from the call premium, this client could receive dividends on his stock if any were paid as well. Purchasing options brings no income to the account and uncovered call writing and short straddles have unlimited risk.

**Reference:** 4.3.1 in the License Exam Manual

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### Question #182 of 222

Question ID: 605660

All of the following subject an investor to unlimited risk EXCEPT:

- X **A)** 1 ABC uncovered (short) call.
- X **B)** short 100 shares ABC stock.
- X **C)** short 100 ABC; write 1 ABC put.
- ✓ **D)** short 100 ABC; buy 1 ABC call.

Explanation

Investors use long calls to protect short stock positions. If the market value of the stock needed to cover the short position begins to rise, the investor can exercise the long call position to buy the stock. Short stock positions, short uncovered calls, and short stock combined with short puts, all subject investors to unlimited risk.

**Reference:** 4.3 in the License Exam Manual

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### Question #183 of 222

Question ID: 605717

Long an ABC Apr 60 call and short an ABC Apr 70 call is a:

- X **A)** calendar spread.
- ✓ **B)** net debit spread.
- X **C)** straddle.
- X **D)** net credit spread.

Explanation

This is a vertical spread, not a calendar spread. To determine whether it is a net credit or debit, look at the strike prices. For call options with the same expiry month, the lower strike price will always have a higher value. In this case, the investor is long the higher valued option, which gives a net outflow of cash to enter the entire position (more money was spent on the lower strike price call than received for the higher strike price call). Therefore, the investor has a net debit for his account.

**Reference:** 4.4.1.6 in the License Exam Manual

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### Question #184 of 222

Question ID: 605768

A client writes 1 Jan 60 put and buys 1 Jan 50 put. This is a

- I. bull spread.
- II. bear spread.
- III. debit spread.
- IV. credit spread.

- ☐ A) II and III.
- ☐ B) II and IV.
- ☒ C) I and IV.
- ☐ D) I and III.

#### Explanation

This is a put credit spread, and bulls sell puts. The 60 put is worth more because it has a higher strike price. Long the lower put is bullish; short the lower put is bearish.

**Reference:** 4.4.1.6 in the License Exam Manual

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### Question #185 of 222

Question ID: 605780

A couple in retirement wants to add income to their account. Which of the following would be the least suitable?

- ☐ A) Writing covered calls
- ☐ B) Credit call spreads
- ☐ C) Credit put spreads
- ☒ D) Writing uncovered calls

#### Explanation

It should be noted that pending other factors, engaging in options transactions may not be suitable at all for someone in retirement. All of the selections would initially add income to the account but based only on the information given, writing uncovered calls would be deemed the least suitable as it is the only strategy listed with unlimited maximum loss potential. While the other strategies listed all have risk associated with them, the risk is limited to a defined amount.

**Reference:** 4.4.1.5 in the License Exam Manual

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### Question #186 of 222

Question ID: 605650

A customer buys 200 XYZ at 32, 2 XYZ June 35 calls at 3 and 1 XYZ June 35 put at 6.50. Two months later, the customer purchases 1 XYZ June 35 put at 4. Before expiration, with XYZ trading at 37, he sells his stock, and closes his calls at 2.10 and his puts at .25 for a:

- ☒ A) loss of \$180.
- ☐ B) gain of \$450.
- ☐ C) loss of \$450.
- ☐ D) gain of \$180.

#### Explanation

The customer opens 4 positions with debits to his account: 200 shares at \$32 per share = a debit of \$6,400; 2 calls at \$300 each = \$600; 1 put at \$650 = a debit of 650; and finally, an additional put at \$400. The stock position is sold for \$37 per share for a credit of \$7,400. The calls are closed for 2.10 each, a credit of \$420, and the puts are closed for a credit of \$25 each.

**Reference:** 4.3 in the License Exam Manual

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### Question #187 of 222

Question ID: 605750

An options trader establishes the following positions:

Long 10 ALF Apr 40 calls at 6  
Short 10 ALF Apr 50 calls at 2

What is the client's maximum gain and loss per share?

- ✓ **A)** Gain 6, loss 4.
- X **B)** Gain 2, loss 6.
- X **C)** Gain 4, loss 2.
- X **D)** Gain unlimited, loss 6.

Explanation

The gain is 6 (between 44 and 50). If the stock declines, both options will expire for a loss of 4 ( $6 - 2$ ).

**Reference:** 4.4.1.2 in the License Exam Manual

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### Question #188 of 222

Question ID: 605561

If XYZ closed at 41.10 and the XYZ Feb 50 calls closed at .35, the calls are:

- ✓ **A)** out-of-the-money.
- X **B)** at parity.
- X **C)** in-the-money.
- X **D)** at the money.

Explanation

Call options are out-of-the-money when the market price is below the strike price.

**Reference:** 4.1.4.3 in the License Exam Manual

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### Question #189 of 222

Question ID: 605519

Breakeven on a long put is the:

- X **A)** current price less the strike price.
- X **B)** current price less the premium.
- X **C)** strike price plus the premium.
- ✓ **D)** strike price less the premium.

Explanation

Breakeven for the buyer or seller of a put is the same: the option's strike price minus the premium.

**Reference:** 4.1.5.5 in the License Exam Manual

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### Question #190 of 222

Question ID: 605665

An investor is short stock at 60. The current market price of the stock is 35, and he anticipates it will continue to decline. If he thinks the price will rise temporarily and if he does not wish to close out his short position, his *best* strategy to prevent a loss would be to:

- I. Buy an XYZ 35 call.
- II. Sell an XYZ 35 call.
- III. Buy an XYZ 35 put.
- IV. Sell an XYZ 35 put.

- X **A)** I or III.
- X **B)** II or IV.
- ✓ **C)** I or IV.
- X **D)** II or III.

#### Explanation

This client is temporarily bullish on the stock, but, in the long term, feels that it will continue to decline so the short stock position is to be maintained. If the client is correct, a near-term rise in the price of XYZ will cause the long 35 call to be in the money and the investor can sell the call at a profit. Likewise, the short 35 put will be out of the money and will expire with the investor earning the premium.

**Reference:** 4.3.3 in the License Exam Manual

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### Question #191 of 222

Question ID: 605652

A customer sells short 1,000 ZOO at \$30 per share. If the ZOO stock declines to \$25 per share and the customer is worried the stock may reverse its trend, what should the customer do?

- X **A)** Buy 10 ZOO puts.
- X **B)** Write 10 ZOO puts.
- X **C)** Write 10 ZOO calls.
- ✓ **D)** Buy 10 ZOO calls.

#### Explanation

To protect the profit on the short stock position, the customer must be able to buy stock at the existing low price if the market moves up. By purchasing calls (say, at a \$25 strike price), the customer can capture existing profit by exercising and buying stock at \$25, regardless of how high the market moves.

**Reference:** 4.3.3 in the License Exam Manual

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### Question #192 of 222

Question ID: 605659

All of the following are suitable objectives for a covered call writer EXCEPT:

- ✓ **A)** profiting from an increase in the price of stock.
- X **B)** increasing return on a long stock position.
- X **C)** providing downside protection for a long stock position.
- X **D)** speculating that a stock will not rise in price.

#### Explanation

Covered call writers sell stock at the strike price if exercised. This strategy provides downside protection to the extent of the premium received, increases the rate of return on a long stock position (because of the premium collected).

**Reference:** 4.3 in the License Exam Manual

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### Question #193 of 222

Question ID: 605778

A client writes 1 Apr 30 call and buys 1 Apr 40 call. This is a:

- I. bull spread.
- II. bear spread.
- III. debit spread.
- IV. credit spread.

- X **A)** I and III.
- X **B)** I and IV.
- ✓ **C)** II and IV.
- X **D)** II and III.

#### Explanation

This is a call credit spread, and bears sell calls. The 30 call is worth more because it has a lower strike price. Long the lower is bullish; short the lower is bearish.

**Reference:** 4.4.1.6 in the License Exam Manual

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### Question #194 of 222

Question ID: 605542

If MCS is trading at 43 and the MCS Apr 40 call is trading at 4.50, what is the intrinsic value and the time value of the call premium?

- ☐ A) Intrinsic value 4.50; time value 0.
- ☐ B) Intrinsic value 1.50; time value 3.
- ☐ C) Intrinsic value 3; time value 4.50.
- ☒ D) Intrinsic value 3; time value 1.50.

#### Explanation

The option is in-the-money by 3 points (the strike price on the call is 40 and the market price is 43). This sets a minimum premium of \$3 per share. Since the actual premium is 4.50, the balance of 1.50 represents time value.

**Reference:** 4.1.6.2 in the License Exam Manual

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### Question #195 of 222

Question ID: 605638

Which of the following options positions would reduce the risk on a long position in the underlying stock?

- I. Buy a put.
  - II. Buy a call.
  - III. Sell a call.
  - IV. Sell a put.
- 
- ☐ A) I and IV.
  - ☒ B) I and III.
  - ☐ C) I and II.
  - ☐ D) II and III.

#### Explanation

Buying a put reduces risk on the stock's decline. Selling a call reduces the net cost of the long purchase. Both are hedging the stock position.

**Reference:** 4.3.1 in the License Exam Manual

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### Question #196 of 222

Question ID: 605770

What is the following position?

Buy 1 QRS May 40 call.  
Sell 1 QRS May 50 call.

- ☒ A) Price spread.
- ☐ B) Diagonal spread.
- ☐ C) Combination.
- ☐ D) Time spread.

#### Explanation

A price spread is composed of a long and short option of the same type with the same expiration, but different strike prices. A price spread is also termed a vertical spread.

**Reference:** 4.4.1.1 in the License Exam Manual

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### Question #197 of 222

Question ID: 605766

With ABC trading at 39, a customer buys 1 ABC March 40 call and sells 1 ABC March 35 call. A profit occurs if:

- I. the spread widens.
- II. the spread narrows.
- III. ABC declines sharply.



IV. both contracts are exercised.

- X **A)** III and IV.
- X **B)** II and IV.
- ✓ **C)** II and III.
- X **D)** I and III.

#### Explanation

This investor established a credit spread because the premium he received for the 35 call is more than he will pay for the 40 call; a call with a lower strike always carries a higher premium. As a general statement, credit spreads are bearish, and are profitable if the spread narrows between the premiums or the contracts expire unexercised (this will happen if the stock falls).

**Reference:** 4.4.1.3 in the License Exam Manual

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### Question #198 of 222

Question ID: 605672

After selling ABC short at 70, a customer holds the position as ABC gradually falls to \$53 per share. Which of the following strategies would *best* protect his gain?

- X **A)** Write 55 calls.
- X **B)** Buy 55 puts.
- ✓ **C)** Buy 55 calls.
- X **D)** Write 55 puts.

#### Explanation

If the investor buys the 55 calls, he has the right to purchase the stock at \$55 per share. If exercised, the investor has a 15-point gain, less the premium paid.

**Reference:** 4.3.3 in the License Exam Manual

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### Question #199 of 222

Question ID: 605556

If a customer believes the price of ABC is going to fall, which of the following option strategies would be appropriate?

- I. Buy calls on ABC.
- II. Write calls on ABC.
- III. Buy puts on ABC.
- IV. Write puts on ABC.

- ✓ **A)** II and III.
- X **B)** II and IV.
- X **C)** I and IV.
- X **D)** I and II.

#### Explanation

Buying puts and writing calls are bearish strategies.

**Reference:** 4.1.5.6 in the License Exam Manual

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### Question #200 of 222

Question ID: 605720

A customer writes 1 OEX (S&P 100) June 820 call at 13 and buys 1 OEX June 830 call at 6, when the index is trading at 826. The breakeven point is:

- X **A)** 826.
- ✓ **B)** 827.
- X **C)** 823.
- X **D)** 830.

#### Explanation

To compute the breakeven point for a call spread, add the net premium (debit or credit) to the lower strike price (a net credit of 7 plus 820 equals a breakeven point of 827). This is a bear spread. The customer will profit if the index is below 827 at expiration.

**Reference:** 4.4.1.3 in the License Exam Manual

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### Question #201 of 222

Question ID: 605541

If an investor with no other positions buys 2 DWQ Jun 45 calls at 3, and he exercises the calls when the stock is trading at 47.25 and immediately sells the stock in the market, what is the investor's profit or loss?

- ☐ A) \$150 profit.
- ☐ B) \$75 profit.
- ☒ C) \$150 loss.
- ☐ D) \$75 loss.

#### Explanation

The investor exercised the right to buy the stock for 45, and can sell the stock in the market for 47.25 for a gain of 2.25. The gain of 2.25 minus the premium of 3 gives the investor a loss of .75 per share. Multiplying the .75 loss by 200 (the number of shares), results in a loss of \$150.

**Reference:** 4.1.1.1 in the License Exam Manual

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### Question #202 of 222

Question ID: 605641

A foreign currency investor is long 40,000 Swiss francs at \$.81. If the investor buys 4 July 80 SF puts at 1.25 to hedge, the breakeven point is:

- ☐ A) 0.4875.
- ☐ B) 0.5125.
- ☒ C) 0.8225.
- ☐ D) 0.4975.

#### Explanation

When hedging with puts, the breakeven point is the cost of the underlying investment plus premium paid (\$.81 cents plus \$.0125 equals \$.8225, or 82¼ cents).

**Reference:** 4.3 in the License Exam Manual

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### Question #203 of 222

Question ID: 605741

In early April, a customer buys 1 XYZ Oct 60 call for 9 and sells 1 XYZ Jul 70 call for 4. Before the calls expire, the customer may realize a pretax profit if the:

- ☐ A) price of XYZ stays the same.
- ☐ B) spread narrows to less than \$5.
- ☐ C) price of XYZ decreases.
- ☒ D) spread widens to more than \$5.

#### Explanation

This is a debit spread of \$5 (net debit). Debit spreads are profitable if the spread widens between the premiums.

**Reference:** 4.4.1.2 in the License Exam Manual

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### Question #204 of 222

Question ID: 605663

Which of the following positions would create the *most* risk for an investor?

- ☐ A) Buy 100 shares of SSS and sell 1 SSS call.
- ☐ B) Buy 100 shares of SSS and buy 1 SSS put.
- ☐ C) Sell short 100 shares of SSS and buy 1 SSS call.

- ✓ **D)** Sell short 100 shares of SSS and sell 1 SSS put.

Explanation

A short sale of SSS stock has unlimited loss potential. Selling a put obligates the customer to buy the stock at the strike price in return for premium. A short sale coupled with a sale of a put is equivalent to selling an uncovered call and creates the most risk.

**Reference:** 4.3.4 in the License Exam Manual

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**Question #205 of 222**

Question ID: 605669

If a customer buys 100 XYZ at 49 and writes 1 XYZ Nov 50 call, receiving \$350 in premiums, the breakeven point is:

- X **A)** 53.5.  
X **B)** 52.5.  
X **C)** 46.5.  
✓ **D)** 45.5.

Explanation

This is a covered call, so the investor is protected against declining stock prices to the extent of the premium received, and the breakeven is 45.50 (49 – 3.50).

**Reference:** 4.3.2 in the License Exam Manual

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**Question #206 of 222**

Question ID: 605734

If a customer does not anticipate that a stock's price will change and he wants to take an option position, he would *most* likely:

- X **A)** buy a put.  
X **B)** buy a straddle.  
X **C)** buy a call.  
✓ **D)** write a straddle.

Explanation

The customer earns combined premiums when selling a straddle (sale of a call and put with same terms). He hopes the market price will not move, both positions will expire unexercised, and he will keep the premiums. This position has unlimited loss potential should the underlying stock rise (because of the short call).

**Reference:** 4.4.2.2 in the License Exam Manual

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**Question #207 of 222**

Question ID: 605637

The purchase of 200 shares of HGF at 45 and the subsequent sale of 2 HGF 50 calls at 3 could produce all of the following EXCEPT:

- X **A)** a loss of \$8,400.  
X **B)** a loss of \$6,000.  
✓ **C)** a profit of \$2,000.  
X **D)** a profit of \$1,600.

Explanation

This is covered call writing. The maximum loss that could be incurred is \$8,400 (\$9,000 paid for shares less premiums of \$600 received). If you can lose \$8,400 then you can certainly lose \$6,000 (if, for example the value of the stock drops to 12). The maximum profit that can be expected is \$1,600 (strike price of \$10,000 received when calls are exercised less the purchase price of \$9,000, plus \$600 in premiums received). Since the maximum profit possible is \$1,600, it is impossible to have a profit of \$2,000.

**Reference:** 4.3.2 in the License Exam Manual

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**Question #208 of 222**

Question ID: 605676

An investor with no other positions buys 1 CDE May 65 put at 3.50. If the investor buys the stock at 63.50 and exercises the put, what is the investor's profit or loss?

- ☐ A) \$350 loss.
- ☒ B) \$200 loss.
- ☐ C) \$200 profit.
- ☐ D) \$350 profit.

Explanation

The investor has the right to sell the stock for 65 when it is currently worth 63.50 for a gain of 1.50. The investor paid a premium of 3.50 minus the gain of 1.50 for a loss of 2 ( $2 \times 100 = \$200$ ).

**Reference:** 4.3.1 in the License Exam Manual

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**Question #209 of 222**

Question ID: 605745

An investor buys 100 shares of QRS stock at 60, and writes 1 QRS 60 call at 4 and 1 QRS 60 put at 5. If QRS stock is trading at \$74 on the expiration date, the investor realizes a profit of:

- ☐ A) 400.
- ☐ B) 500.
- ☐ C) 100.
- ☒ D) 900.

Explanation

With QRS trading at 74 on the expiration date, the QRS 60 call will be exercised while the QRS 60 put will expire. The investor originally bought the stock in the market at 60 and wrote the two options that generated a \$900 premium. Because the customer sells his stock at \$60, his \$900 premium is the profit.

**Reference:** 4.4.2.2 in the License Exam Manual

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**Question #210 of 222**

Question ID: 605550

Which of the following investors will sell stock if an option is exercised?

- I. Owner of a call.
- II. Owner of a put.
- III. Writer of a call.
- IV. Writer of a put.

- ☐ A) I and II.
- ☒ B) II and III.
- ☐ C) I and IV.
- ☐ D) III and IV.

Explanation

An owner of a put and writer of a call will sell stock if an option is exercised. Call buyers have the right to buy, and call writers are obligated to sell; put buyers have the right to sell, and put writers are obligated to buy.

**Reference:** 4.1.1.2 in the License Exam Manual

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**Question #211 of 222**

Question ID: 605705

If a customer buys 5 ABC Jan 40 puts and writes 5 ABC Jan 45 puts, which of the following statements are TRUE?

- I. The customer profits if the spread widens.
- II. The customer profits if the spread narrows.
- III. The customer is a bull.
- IV. The customer is a bear.

- ✓ **A)** II and III.
- X **B)** I and III.
- X **C)** II and IV.
- X **D)** I and IV.

Explanation

Because a put is a right to sell, the premium on the 45 puts is higher than that of the 40 puts. The customer is writing the put with the higher premium, so this is a credit spread and the bullish investor will profit at expiration if the difference between the two premiums narrows as the contracts lose value.

**Reference:** 4.4.1.5 in the License Exam Manual

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**Question #212 of 222**

Question ID: 605723

If a customer wishes to buy 1 XYZ option and sell another XYZ option, but he is not willing to spend more than \$300, which of the following orders should be entered?

- ✓ **A)** A spread order.
- X **B)** A straddle order.
- X **C)** 2 limit orders.
- X **D)** 2 stop orders.

Explanation

A spread involves the simultaneous purchase and sale of different option contracts of the same type. A spread incurs a gain or loss depending on what happens to the difference in the premiums between the two contracts. Because this investor wants to limit his risk to \$300, he would buy the spread at a net debit of \$300 or less (this is one order, not two).

**Reference:** 4.4 in the License Exam Manual

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**Question #213 of 222**

Question ID: 605627

A customer shorts 100 XYZ at 51 and buys 1 XYZ Aug 50 call at 4. The stock falls to 45, at which time the customer closes the options contract at 1 and covers his short position at the current market price for a:

- ✓ **A)** \$300 gain.
- X **B)** \$400 loss.
- X **C)** \$400 gain.
- X **D)** \$300 loss.

Explanation

The customer shorted stock at 51 and covered at 45 for a \$600 gain, and then he bought a call at 4 and sold it at 1 for a \$300 loss. Overall, the gain is \$300.

**Reference:** 4.3.3 in the License Exam Manual

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**Question #214 of 222**

Question ID: 605634

An investor, long 100 shares of XYZ at 23.50, writes 1 XYZ May 25 call at 2. At expiration, if XYZ is trading at \$20, the investor has a:

- ✓ **A)** loss of \$150.
- X **B)** gain of \$150.
- X **C)** loss of \$50.
- X **D)** gain of \$50.

Explanation

Breakeven is 21.50 ( $23.50 - 2$ ). If the stock is trading at 20, the customer has an unrealized loss of \$150.

**Reference:** 4.3.2 in the License Exam Manual

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### Question #215 of 222

Question ID: 605554

An investor with no other positions sells 1 ABC Jan 45 call at 2.50. If the option expires when the stock is trading at 44.50, what is the investor's profit or loss?

- ✓ **A)** \$250 profit.
- X **B)** \$50 loss.
- X **C)** \$50 profit.
- X **D)** \$250 loss.

#### Explanation

The option expired because it was out-of-the-money. When the option expires, the writer profits by the amount of the premium received from the sale.

**Reference:** 4.1.4.3 in the License Exam Manual

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### Question #216 of 222

Question ID: 605691

Your client's position is:

Long 1 CYR 120 call at 4  
Long 1 CYR 120 put at 3  
Long 100 CYR purchased at 120

If the current market price of CYR is 120, what is the client's maximum possible loss?

- X **A)** 300.
- X **B)** 487.5.
- X **C)** 100.
- ✓ **D)** 700.

#### Explanation

If the CYR stock drops to \$0, the customer loses \$12,000 on the long stock position, but retains the right to put the stock to someone at \$12,000, to prevent loss beyond the premium of \$300. The call would expire out of the money, for a total loss of \$700.

**Reference:** 4.4.2.1 in the License Exam Manual

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### Question #217 of 222

Question ID: 605687

Which of the following covers a short call?

- I. Long stock
  - II. Short stock
  - III. Long put
  - IV. Stock rights
- 
- X **A)** II and III
  - X **B)** I and III
  - ✓ **C)** I and IV
  - X **D)** II and IV

#### Explanation

Covering a short call requires taking action to eliminate the risk of being exercised. If the customer owns the stock or has the right to acquire it, the customer is covered. Stock rights (preemptive rights) give the holder the right to purchase the stock. Short stock and long puts both have the same market attitude as a short call (bearish) and therefore would not cover the risk associated with a short call.

**Reference:** 4.3 in the License Exam Manual

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### Question #218 of 222

Question ID: 605728

A customer writes 1 ABC Jan 65 put at 6 and 1 ABC Jan 55 call at 7 when ABC is trading at 60. This position will be profitable if, at expiration, ABC is

- I. above 68
- II. at 60
- III. below 52
- IV. between 52 and 68

- X **A)** I and III.
- X **B)** II and III.
- X **C)** I and II.
- ✓ **D)** II and IV.

#### Explanation

This is a short combination where both contracts are in-the-money. Short combinations are like short straddles, except the strike prices and/or the expirations are different. The breakeven points are computed by adding the combined premiums to the strike price of the call (strike price + premium) and subtracting the combined premiums from the strike price of the put (strike price – premium). The breakeven points, therefore, are 52 (65 – 13) and 68 (55 + 13). With a short combination, the investor makes money if the stock stays inside the breakeven points.

**Reference:** 4.4.2.3 in the License Exam Manual

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### Question #219 of 222

Question ID: 605540

An investor with no other positions sells 4 DWQ Jun 45 calls at 4. The calls are exercised when the stock is trading at 47.25. What is the investor's profit or loss?

- X **A)** \$700 loss.
- X **B)** \$175 loss.
- X **C)** \$175 profit.
- ✓ **D)** \$700 profit.

#### Explanation

When the calls were exercised, the investor had the obligation to sell the stock to the owner of the call at 45. Because the investor had no other positions we know that in order to fulfill the obligation to sell they will first need to purchase the stock in the open market for 47.25. 4 was received when the call was sold and 45 was received when the stock was sold to the owner of the call. Therefore a total of 49 was received. 47.25 had to be paid to purchase the stock in the open market. Therefore 47.25 paid and 49 received = 1.75 point profit (\$175) per contract.  $\$175 \times 4 \text{ contracts} = \$700 \text{ total profit}$ .

**Reference:** 4.1.1.1 in the License Exam Manual

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### Question #220 of 222

Question ID: 605662

An investor owns \$100,000 of convertible bonds with a conversion price of \$50. By depositing these bonds into his account, how many covered calls could he write?

- X **A)** 50.
- X **B)** 2000.
- X **C)** None.
- ✓ **D)** 20.

#### Explanation

These bonds are convertible into 20 shares for each \$1,000, making a total of 2,000 shares. That's enough stock to cover 20 calls.

**Reference:** 4.3.4.2 in the License Exam Manual

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### Question #221 of 222

Question ID: 605692

If a customer establishes a debit spread, the customer profits if the:

- I. spread widens.
- II. spread narrows.
- III. option expires.

IV. options are exercised.

- X **A)** I and III.
- X **B)** II and III.
- ✓ **C)** I and IV.
- X **D)** II and IV.

Explanation

Because debit spreads are closed as credits, the customer profits if the spread widens. In addition, to realize maximum profit, both contracts must be exercised. If they expire, the customer loses the net debit paid for a maximum loss.

**Reference:** 4.4.1.2 in the License Exam Manual

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**Question #222 of 222**

Question ID: 605733

Mr. Jones calls his registered representative and places an order to write an XYZ Oct 90 call and at the same time to write an XYZ Oct 80 put. The orders are executed at a premium of 5 for the call and 9 for the put. Which of the following *best* describes the customer's investment strategy?

- X **A)** Mixed strategy.
- X **B)** Bearish strategy.
- ✓ **C)** Neutral strategy.
- X **D)** Bullish strategy.

Explanation

A customer who writes both a call and a put on the same underlying security wishes for little or no market movement. This is referred to as a neutral strategy. Technically, the customer has created a short combination (an investment position very similar to a short straddle, with the same investment characteristics), and, in this case, a little less risk than a pure straddle because of the spread in the strike prices.

**Reference:** 4.4.2.3 in the License Exam Manual