Question #1 of 85

Question ID: 439248

What are the two components of domestic and foreign nominal interest rates?

A) Compound interest rate plus real inflation-adjusted interest rate.

B) Compound nominal interest rate and expected exchange rate risk.

C) Inflation adjusted interest rate plus foreign currency adjustment.

D) Real interest rate and expected inflation rate.

Question #2 of 85

Question ID: 439227

A hedge fund specializing in commodity related derivatives is considering a crush spread position using soybean and soybean oil futures contracts. Using the information in the table below, determine which of the following statements is correct.

	Soybeans	Soybean Oil
Spot Price	$5.83/bushel	$0.27/pound
Storage Cost*	63%	3%
Convenience Yield*	6%	6%
Interest rate*	11%	11%
Time to expiration	3 months	6 months

*Continuously compounded annual rates

A) The hedge fund should establish a long position in the soybean futures contract for no more than $6.91 and a short position in the soybean oil contract for no less than $0.29.

B) The hedge fund should establish a long position in the soybean futures contract for no more than $7.01 and a long position in the soybean oil contract for no more than $0.29.

C) The hedge fund should establish a short position in the soybean futures contract for no less than $7.01 and a long position in the soybean oil contract for no less than $0.28.

D) The hedge fund should establish a long position in the soybean futures contract for no more than $7.01 and a short position in the soybean oil contract for no less than $0.28.

Question #3 of 85

Question ID: 459979

American put option values increase as a result of increases in which of the following factors?

I. Volatility.

II. Dividends.

III. Stock Price.

IV. Time to expiration.

A) I, II, and IV only.

B) I and III only.

C) II and IV only.

D) I, III, and IV only.

Question #4 of 85

Which of the following commodities is an example of seasonal production and constant demand?

A) Corn.

B) Natural gas.

C) Gold.

D) Oil.

Question #5 of 85

Why is there basis risk in a hedged commodity transaction, and what effect does having a situation in which a financial futures contract must be rolled over before delivery date have on basis risk?

A) Basis risk occurs because the values of spot and futures contracts do not move together perfectly, and basis risk is lessened when a financial futures contract must be rolled over before delivery date.

B) Basis risk occurs because of changes in interest rates and supply/demand for the commodity, and basis risk increases when a financial futures contract must be rolled over before delivery date.

C) Basis risk occurs because the values of spot and futures contracts do not move together perfectly, and basis risk increases when a financial futures contract must be rolled over before delivery date.

D) Basis risk occurs because of changes in interest rates and supply/demand for the commodity, and basis risk is lessened when a financial futures contract must be rolled over before delivery date.

Question #6 of 85

Assume that the current price of a stock is $100. A call option on that stock with an exercise price of $97 costs $7. A call option on the stock with the same expiration and an exercise price of $103 costs $3. Using these options what is the cost of entering into a long bull spread on this stock?

A) $0.

B) $4.

C) $7.

D) $1.

Question #7 of 85

Referring to put-call parity, which one of the following alternatives would allow you to create a synthetic European call option?

- A) Sell the stock; sell a European put option on the same stock with the same exercise price and the same maturity; invest an amount equal to the present value of the exercise price in a pure-discount riskless bond.
- B) Buy the stock; buy a European put option on the same stock with the same exercise price and the same maturity; short an amount equal to the present value of the exercise price worth of a pure-discount riskless bond.
- C) Buy the stock; sell a European put option on the same stock with the same exercise price and the same maturity; short an amount equal to the present value of the exercise price worth of a pure-discount riskless bond.
- D) Sell the stock; buy a European put option on the same stock with the same exercise price and the same maturity; invest an amount equal to the present value of the exercise price in a pure-discount riskless bond.

Question #8 of 85

A chooser option allows the owner to:

- A) choose the option's strike price.
- B) pay the minimum price over a period chosen by the owner.
- C) receive the intrinsic value either at expiration or at a time chosen by the owner.
- D) choose whether the option is a call or a put at a specified period of time.

Question #9 of 85

What effect does the fact that electricity is a non-storable commodity have on overall electricity pricing?

- A) Price is set according to supply and electricity production source, and daily price fluctuations are lower compared to financial futures.
- B) Short-term arbitrages are possible, but daily price fluctuations are higher compared to financial futures.
- C) Price is set by supply and demand at a given point in time, and futures prices fluctuate more during the day compared to financial futures.
- D) Arbitrage opportunities are only available long-term, and price fluctuations are much higher compared to all other commodities.

Question #10 of 85

Assume that the value of a call option with a strike price of $100 and six months remaining to maturity is $5. For a stock price of $100 and an interest rate of 6 percent, what is the value of the corresponding put option with the same strike price and expiration

as the call option?

A) $2.87.

B) $1.78.

C) $5.00.

D) $2.13.

Question #11 of 85

ABEX Corporation common stock is selling for $50.00 per share. Both an American call option and a European call option are available on ABEX common, and each have identical strike prices and expiration dates. Which of the following statements concerning these two options is **TRUE**?

A) Because the American and European options have identical terms and are written against the same common stock, they will have identical option premiums.

B) The European option will normally have a higher option premium because of their relative scarcity compared to American options.

C) The greater flexibility allowed in exercising the American option will normally result in a higher market value relative to an otherwise identical European option.

D) The American option will have a higher option premium, because the American security markets are larger than the European markets.

Question #12 of 85

An option wherein the payoff is based on the highest or lowest price experienced over some period of time, whichever is *most advantageous* to the option holder, is called what?

A) An outside barrier option.

B) A lookback option.

C) A fixed-quanto option.

D) A rainbow option.

Question #13 of 85

Which of the following is a *difference* between a strip and a stack hedge? A stack hedge uses:

A) futures contracts on assets that are related to, but different, from the hedged asset.

B) futures contracts that are concentrated in a single futures expiration.

C) a combination of long and short positions in different futures expirations.

D) out-of-the money put options.

Question #14 of 85

A security sells for $40. A 3-month call with a strike of $42 has a premium of $2.49. The risk-free rate is 3 percent. What is the value of the put according to put-call parity?

A) $4.18.

B) $6.03.

C) $3.45.

D) $1.89.

Question #15 of 85

Which of the following combinations resemble(s) the payoff of a covered call position?
 I. Long stock plus a long put.
 II. Short put plus cash.
 III. Short stock plus long call.
 IV. Short call plus cash.

A) III only.

B) III and IV only.

C) I and II only.

D) II only.

Question #16 of 85

A bank's investment portfolio derives income from the difference between revenue and costs. What has been achieved when, in addition, the bank has a matched maturity and currency foreign asset-liability book?

A) On-balance sheet hedging has been achieved.

B) All earnings risk has been eliminated.

C) Off-balance sheet hedging has been achieved.

D) Earnings declines have been neutralized.

Questions #17-18 of 85

Ronald Franklin, CFA, has recently been promoted to junior portfolio manager for a large equity portfolio at Davidson-Sherman (DS), a large multinational investment-banking firm. He is specifically responsible for the development of a new investment strategy that DS wants all equity portfolio managers to implement. Upper management at DS has instructed its portfolio managers to begin overlaying option strategies on all equity portfolios. The relatively poor performance of many of their equity portfolios has been the main factor behind this decision. Prior to this new mandate, DS portfolio managers had been allowed to use options at their own discretion, and the results were somewhat inconsistent. Some portfolio managers were not comfortable with the most basic concepts of option valuation and their expected return profiles, and simply did not utilize options at all. Upper management

of DS wants Franklin to develop an option strategy that would be applicable to all DS portfolios regardless of their underlying investment composition. Management views this new implementation of option strategies as an opportunity to either add value or reduce the risk of the portfolio.

Franklin gained experience with basic options strategies at his previous job. As an exercise, he decides to review the fundamentals of option valuation using a simple example. Franklin recognizes that the behavior of an option's value is dependent on many variables and decides to spend some time closely analyzing this behavior. His analysis has resulted in the information shown in Exhibits 1 and 2 for European style options.

Exhibit 1: Input for European Options	
Stock Price (S)	100
Strike Price (X)	100
Interest Rate (r)	0.07
Dividend Yield (q)	0.00
Time to Maturity (years) (t)	1.00
Volatility (Std. Dev.)(Sigma)	0.20
Black-Scholes Put Option Value	$4.7809

Exhibit 2: European Option Sensitivities		
Sensitivity	Call	Put
Delta	0.6736	-0.3264
Gamma	0.0180	0.0180
Theta	-3.9797	2.5470
Vega	36.0527	36.0527
Rho	55.8230	-37.4164

Question #17 of 85

Using the information in Exhibit 1, Franklin wants to compute the value of the corresponding European call option. Which of the following is the *closest* to Franklin's answer?

A) $12.07.

B) $4.78.

C) $5.55.

D) $11.54.

Question #18 of 85

Franklin is interested in the sensitivity of the European call option to changes in the volatility of the underlying equity's returns. What happens to the value of the call option if the volatility of the underlying equity's returns *decreases*?
The call option value:

A) stays the same.

B) increases or decreases.

C) increases.

D) decreases.

Question #19 of 85

Which of the following statements regarding the lease rate in commodity futures contracts is incorrect?

I. The lease rate is the return required by the lender in exchange for lending a commodity.

II. Assuming it is positive, as the lease rate increases, the futures price for a commodity increases.

III. In a cash-and-carry arbitrage, the lease rate is earned whether or not the underlying commodity is actually loaned.

IV. Lease rates are similar to dividends paid to the lender of a share of common stock.

V. If the lease rate is less than the risk-free rate, the forward market is said to be in contango.

A) II and III.

B) I, III, and V.

C) III and V.

D) II and IV.

Question #20 of 85

A shout option allows the owner to:

A) pay the average price over the option period from shout time.

B) choose whether the option is a call or a put at shout time.

C) cancel the option if it falls below a specified price barrier.

D) receive either the intrinsic value at shout time or at expiration.

Question #21 of 85

A covered call position is equivalent to:

A) a short call.

B) a short put.

C) owning the stock and a long put.

D) owning the stock and a long call.

Question #22 of 85

All of the following statements describing the formulation of synthetic forward commodity are correct **EXCEPT**:

I. A synthetic commodity forward price can be derived by combining a long position on a commodity forward, $F_{0,T}$, and a long zero-coupon bond that pays $F_{0,T}$ at time T.

II. The total cost at time 0 is equivalent to the cost of the bond, or $e^{-rT}F_{0,T}$.

III. The payoff at time T is $S_T - F_{0,T} + F_{0,T} = S_T$.

A) All of the statements are correct.

B) II only.

C) III only.

D) I only.

Question #23 of 85

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

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

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

C) American and European options always have different strike prices when written on the same underlying asset.

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

Question #24 of 85

Which of the following options is *best* described as follows: "A six month call option may only be exercised early on the first day of each month"?

A) Binary option.

B) American option.

C) Bermudan option.

D) Chooser option.

Question #25 of 85

It may be attractive to exercise an American put option prior to expiration when the underlying stock price is:

A) much lower than the exercise price and risk-free rates are positive.

B) close to the strike price and risk-free rates are close to zero.

C) above the strike price and risk-free rates are close to zero.

D) close to the strike price and risk-free rates are positive.

Question #26 of 85

Assume that Swiss interest rates remain ahead of U.S. rates, and thus banks are focusing their activities more on making hedged Swiss loans, and are correspondingly buying more Swiss francs. What will be the likely eventual result?

A) Forward rate spread will increase and spot exchange rate for buying Swiss francs will decline.

B) Forward rate spread will decline and spot exchange rate for buying Swiss francs will rise.

C) Forward rate spread will decline and spot exchange rate for buying Swiss francs will decline.

D) Forward rate spread will increase and spot exchange rate for buying Swiss francs will rise.

Question #27 of 85

Which of the following is the *main* motivation behind using a strip hedge instead of using a stack hedge? A strip hedge is:

A) Able to hedge against both interest rate risk and volatility risk.

B) more suitable for a single large cash flow.

C) cheaper.

D) a more effective interest rate risk hedging strategy for multiple cash flows.

Questions #28-30 of 85

Dennis Austin works for O'Reilly Capital Management and manages endowments and trusts for large clients. The fund invests most of its portfolio in S&P 500 stocks, keeping some cash to facilitate purchases and withdrawals. The fund's performance has been quite volatile, losing over 20 percent last year but reporting gains ranging from 5 percent to 35 percent over the previous five years. O'Reilly's clients have many needs, goals, and objectives, and Austin is called upon to design investment strategies for their clients. Austin is convinced that the best way to deliver performance is to, whenever possible, combine the fund's stock portfolio with option positions on equity.

Question #28 of 85

Given the following scenario:

- Performance to Date: Up 3%
- Client Objective: Stay positive
- Austin's scenario: Low stock price volatility between now and end of year.

Which is the *best* option strategy to meet the client's objective?

A) Bull call.

B) 2:1 Ratio Spread.

C) Protective put.

D) Long butterfly.

Question #29 of 85

Given the following scenario:

- Performance to Date: Up 16%
- Client Objective: Earn at least 15%
- Austin's scenario: Good chance of large gains or large losses between now and end of year.

Which is the *best* option strategy to meet the client's objective?

A) Long straddle.

B) Short straddle.

C) Condor.

D) Long butterfly.

Question #30 of 85

Given the following scenario:

- Performance to Date: Up 16%
- Client Objective: Earn at least 15%
- Austin's scenario: Good chance of large losses between now and end of year.

Which is the *best* option strategy to meet the client's objective?

A) Long put options.

B) Short put options.

C) Long call options.

D) Short call options.

Question #31 of 85

Which of the following is **TRUE** in normal backwardation? Futures prices tend to:

A) fall over the life of the contract because speculators are net short and have to receive compensation for bearing risk.

B) fall over the life of the contract because hedgers are net short and have to receive compensation for bearing risk.

C) rise over the life of the contract because hedgers are net long and have to receive compensation for bearing risk.

D) rise over the life of the contract because speculators are net long and have to receive compensation for bearing risk.

Question #32 of 85

Referring to put-call parity, which one of the following alternatives would allow you to create a synthetic riskless pure-discount bond?

A) Sell a European put option; buy the same stock; buy a European call option.

B) Buy a European put option; sell the same stock; sell a European call option.

C) Buy a European put option; buy the same stock; sell a European call option.

D) Sell a European put option; sell the same stock; buy a European call option.

A down-and-out call option is an option that:

A) ceases to exist when the underlying asset price falls to a designated barrier price.

B) comes into existence when the underlying asset price rises to a designated barrier price.

C) ceases to exist when the underlying asset price rises to a designated barrier price.

D) comes into existence when the underlying asset price falls to a designated barrier price.

How could an oil refiner hedge the risk of an agreement to supply 50,000 barrels of oil each month for a year at a fixed price? The oil refiner could enter a:

I. long futures contract position for every month for 50,000 barrels.

II. short futures contract position for every month for 50,000 barrels.

III. long near-term futures contract for 600,000 barrels.

IV. short near-term futures contract for 50,000 barrels.

A) II and IV only.

B) I only.

C) II only.

D) I and III only.

An investor owns a stock and believes that the stock's price will remain relatively unchanged for the short term but is bullish in the long term. Which of the following strategies will be the *best* for this investor?

A) An at-the money strap.

B) A protective put.

C) An at-the-money strip.

D) A covered call.

Assume that the current price of a stock is $100. A call option on that stock with an exercise price of $97 costs $7. A call option on the stock with the same expiration and an exercise price of $103 costs $3. Using these options what is the expiration profit of a bear call spread if the stock price is equal to $110?

A) $2.

B) -$6.

C) -$2.

D) $6.

Question #37 of 85

An option that allows its holder to purchase or sell an asset based on its average price over some time period is an example of a(n):

A) barrier option.

B) contagion option.

C) lookback option.

D) Asian option.

Question #38 of 85

Which of the following describes a compound option?

A) Selling a forward contract on a put option.

B) Buying a call option on another call option.

C) Buying a call and put at the same strike price.

D) Selling a call and put at the same strike price.

Question #39 of 85

Gold is currently selling for $1,600 and the one-year futures price is $1,680. Assume an investor can borrow and lend funds at 6.25%, and there are no transaction costs. According to the no-arbitrage principle, the one-year futures price should be $1,710. How would profit be made in this situation?

A) Establish a cash-and-carry arbitrage.

B) Establish a reverse cash-and-carry arbitrage.

C) Go long gold, borrow funds at the 6.25%, and sell the futures contract.

D) Short the futures contract and go long gold.

Question #40 of 85

Which of the following statements regarding controlling risk with derivatives is **FALSE**?

A) To calculate the dollar duration of a portfolio, the manager multiplies the effective duration times the basis point movement times the value of the position.

B) Credit spread risk refers to the risk that the difference between the yield on a risky asset and the yield on a risk-free asset increases.

C) In a strip hedge, the portfolio manager buys more of the nearest-term futures contract than the amount the manager is hedging.

D) To reduce the duration of a current portfolio to a target duration, a portfolio manager can sell T-bond futures contracts.

Question #41 of 85

Assume that the current price of a stock is $100. A call option on that stock with an exercise price of $97 costs $7. A call option on the stock with the same expiration and an exercise price of $103 costs $3. Using these options what is the profit for a long bull spread if the stock price at expiration of the options is equal to $110?

A) $2.

B) $0.

C) -$2.

D) $6.

Question #42 of 85

Jimmy Deininger, FRM can invest in USD at 4%, or he can invest in Swiss francs (CHF) at 4.25%. Deininger is a U.S. resident, and the current spot rate is 1.03 USD/CHF. Using the interest rate parity theorem, calculate the 1-year forward rate expressed in USD/CHF:

A) 1.0158.

B) 1.0267.

C) 0.9956.

D) 1.0275.

Question #43 of 85

Which of the following *best* explains put-call parity?

A) A stock can be replicated using any at the money call and put options and a bond.

B) No arbitrage requires that only the underlying stock can be synthetically replicated using at the money call and put options and a zero coupon bond with a face value equal to the strike price of the options.

C) A stock can be replicated using any call option, put option and bond.

D) No arbitrage requires that using any three of the four instruments (stock, call, put, bond) the fourth can be synthetically replicated.

Question #44 of 85

If a domestic bank is assisting a customer in the buying and selling of foreign currencies in conjunction with that customer's particular business transaction, how would the bank's role be best described?

A) The bank would not assume any foreign exchange rate risk itself, and would serve as an agent for the customer.

B) The bank would share in the foreign exchange rate risk along with serving as an agent for the customer.

C) The bank would assume the entire foreign exchange rate risk, as well as serve as agent for the customer.

D) The bank would offset the foreign currency exposure for hedging purposes.

Question #45 of 85

The buyer of a straddle on a stock is *most likely* to benefit:

A) under all conditions because the straddle is guaranteed a risk-free rate of return.

B) if the volatility of the underlying asset's price increases.

C) if the volatility of the underlying asset's price decreases.

D) if the position expires worthless.

Question #46 of 85

A call option where early exercise is restricted to certain dates is an example of a(n):

A) chooser option.

B) Asian option.

C) lookback option.

D) Bermudan option.

Question #47 of 85

Which of the following commodities is an example of constant production and seasonal demand?

A) Natural gas.

B) Wheat.

C) Corn.

D) Gold.

Question #48 of 85

Suppose the owner of a commodity decides to lend out the commodity. If the commodity has a continuously compounded convenience yield of c, proportional to the value of the commodity, which of the following *best represents* the lowest forward price?

A) $S_0 e^{(r+\lambda)T}$

B) $S_0 e^{(r+\lambda-c)T}$

C) $E(S_0)e^{(r+\lambda+c)T}$

D) $S_0 e^{(r-\delta_1-c)T}$

Question #49 of 85

How can a bank control the scale of its foreign exchange exposure?

A) Matching duration of assets and liabilities.

B) Trading foreign currencies and acting as an agent for customers.

C) On-balance-sheet hedging and off-balance sheet hedging.

D) Limits on foreign currencies speculation.

Question #50 of 85

A Bermudan option is one where the:

A) strike price is chosen to be the average between the maximum and minimum stock price over the life of the option.

B) volatility is assumed to increase by.

C) strike price is changed to one-half the initial stock price.

D) exercise is restricted to certain dates.

Question #51 of 85

Which of the following results from a commodity that is an input in the production process of other commodities?

A) Commodity spread.

B) Implied forward rate.

C) Implied lease rate.

D) Convenience yield.

Question #52 of 85

If the October 2005 spot price for natural gas is 5.171, the annual risk-free rate of interest is 5 percent, and the November

forward price is 5.253. What is the natural gas implied storage cost for the month of October?

A) 0.057.

B) 0.043.

C) 0.075.

D) 0.060.

Question #53 of 85

Which of the following barrier put options is *best* described as a standard put option that ceases to exist if the underlying asset price hits a barrier level, which is set above the current stock value?

A) Down-and-out put.

B) Up-and-in put.

C) Up-and-out put.

D) Down-and-in put.

Question #54 of 85

The current spot rate for a commodity is $24. The annual lease rate is 6 percent for the commodity. The appropriate continuously compounding annual risk-free rate for the commodity is equivalent to 7 percent. What is the 6-month commodity forward rate?

A) $24.22.

B) $23.91.

C) $24.12.

D) $24.00.

Question #55 of 85

Calculate the 3-month forward price for a barrel of crude oil if the current spot price is $92/barrel, the effective monthly interest rate is 0.75%, and the monthly storage costs in a floating tanker are $0.50/barrel.

A) 94.50.

B) 93.40.

C) 96.40.

D) 95.60.

Question #56 of 85

Referring to put-call parity, which one of the following alternatives would allow you to create a synthetic stock position?

A) Sell a European call option; sell a European put option; invest the present value of the exercise price in a riskless pure-discount bond.

B) Buy a European call option; short a European put option; invest the present value of the exercise price in a riskless pure-discount bond.

C) Buy a European call option; buy a European put option; invest the present value of the exercise price in a riskless pure-discount bond.

D) Sell a European call option; buy a European put option; short the present value of the exercise price worth of a riskless pure-discount bond.

Question #57 of 85

A shout option allows the owner to:

A) receive the greater of the intrinsic value at shout time or the intrinsic value at expiration.

B) choose whether the option is a call or a put at shout time.

C) pay the average price over the option period from shout time.

D) cancel the option if it falls below a specified price barrier.

Question #58 of 85

A down-and-in call option is an option that:

A) ceases to exist when the underlying asset price rises to a designated barrier price.

B) ceases to exist when the underlying asset price falls to a designated barrier price.

C) comes into existence when the underlying asset price rises to a designated barrier price.

D) comes into existence when the underlying asset price falls to a designated barrier price.

Question #59 of 85

A put option on DCY stock matures six months from today and sells for $0.49. A call option on DCY stock with the same strike price sells for $4.52. Both the put and the call are European options. DCY stock is priced at $55 and the risk-free rate of interest is 4 percent. The strike price of the put and call options is *closest* to:

A) $50.

B) $53.

C) $52.

D) $51.

Question #60 of 85

Consider the factors that affect the price of futures contracts on various commodities. Which of the following statements does not accurately describe the relationship between a commodity's futures price and its underlying factors?

A) Natural gas is produced relatively consistently but has seasonal demand, causing the futures price to rise steadily in the fall months, since natural gas is too expensive to store.

B) Gold futures have an implicit lease rate which, because it is not actually paid by commodity borrowers, creates incentive to hold physical rather than synthetic gold as ideal strategy to gain gold exposure.

C) The cost of storing corn, which has relatively constant demand, causes the futures price to rise until the next harvest at which point the price falls.

D) Relatively constant worldwide demand for oil and its ability to be cheaply transported keep oil prices relatively stable in the absence of short-run supply and demand.

Question #61 of 85

Which of the following commodities is very difficult to store and transport?

A) Gold.

B) Oil.

C) Natural gas.

D) Corn.

Question #62 of 85

A down-and-out call option is an option that:

A) comes into existence when the underlying asset price rises to a designated barrier price.

B) ceases to exist when the underlying asset price rises to a designated barrier price.

C) comes into existence when the underlying asset price falls to a designated barrier price.

D) ceases to exist when the underlying asset price falls to a designated barrier price.

Question #63 of 85

In assessing foreign exchange risk, a negative net exposure in a given currency occurs when:

A) the value of the currency is more likely to fall than rise.

B) more liabilities than assets are held in a given currency.

C) a net long position in the currency is held.

D) more assets than liabilities are held in a given currency.

What is the expiration payoff of a long straddle, with an exercise price $100, if the underlying stock price is $125?

A) -$25.

B) $0.

C) $50.

D) $25.

A short straddle comprises a trading combination of options that:

A) purchases a put and call option at the same strike price.

B) purchases a low strike call option and sells a higher strike call option.

C) sells a put and call option at the same strike price.

D) sells a low strike call option and buys a higher strike call option.

A European bank exchanges euros for USD, lends them at the U.S. risk-free rate, and simultaneously enters into a forward contract to sell the loan proceeds for euros at loan maturity. If the net effect of these transactions is to earn the risk-free euro rate, it is an example of:

A) arbitrage.

B) interest rate parity.

C) spot-forward equality.

D) the law of one price.

Which of the following statements regarding options is (are) CORRECT?

I. Chooser options allow the seller to determine if the option is a put or a call.

II. Vega may be negative for a barrier option but is always positive for a standard option.

III. Restricting the early exercise of an American Option to specific dates results in an Asian option.

A) I only.

B) II and III.

C) I and II.

D) II only.

A bear call spread is an option strategy in which the option trader:

A) purchases a high strike call option and sells a lower strike call option.

B) purchases a low strike put option and sells a higher strike call option.

C) sells a low strike call option and sells a higher strike put option.

D) sells a low strike put option and buys a higher strike call option.

Which of the following has the same impact on both American call and put option prices?

I. An increase in volatility.

II. An increase in the stock price.

III. An increase in the risk-free rate.

IV. A decrease in time to expiration.

A) I only.

B) I and III.

C) I and II.

D) I and IV.

Which of the following is the expression for put-call parity (c_t = call price, p_t = put price, S_t = stock price (all at time t), X = exercise price of call and put, r = interest rate, T = time at expiration of the options)?

A) $S_t + c_t = p_t + Xe^{-r(T-t)}$

B) $S_t + p_t = c_t - Xe^{-r(T-t)}$

C) $S_t - p_t = c_t + Xe^{-r(T-t)}$

D) $S_t + p_t = c_t + Xe^{-r(T-t)}$

A commodities analyst is studying storage costs, lease rates and convenience yield. In determining a forward price in a non-arbitrage forward pricing formula, what is the convenience yield, and how would it be related to inventory levels?

A) Convenience yield is the reverse cost-of-carry adjustment which quantifies the benefit of going forward the asset, and is directly related to levels of inventory.

B) Convenience yield is the cost-of-carry adjustment, and is directly related to levels of inventory.

C) Convenience yield is equal to storage costs minus the lease rate, and is inversely related to levels of inventory.

D) Convenience yield is the benefit of holding the physical asset, and is inversely related to levels of inventory.

Question #72 of 85

An investor takes a position in two different markets with essentially equal positions in each, in an attempt to effectively counterbalance risk and to manage volatility. What is this strategy?

A) Swap spread.

B) Interest hedge.

C) Cross hedge.

D) Cross spread.

Question #73 of 85

A European put option on a stock can be replicated with which of the following combined postions?

A) Short a European call, long a zero-coupon bond, and short the stock.

B) Short a European call, short a zero-coupon bond, and long the stock.

C) Long a European call, short a zero-coupon bond, and long the stock.

D) Long a European call, long a zero-coupon bond, and short the stock.

Question #74 of 85

For American options prior to maturity, the difference between the price of a call option and the price of a put option with the same underlying stock, strike price, and maturity must be less than or equal to the:

A) stock price minus the exercise price.

B) exercise price minus stock price.

C) present value of exercise price minus stock price.

D) stock price minus the present value of the exercise price.

Question #75 of 85

Consider a call option on a stock currently priced at $50 with a strike price of $55. Which of the following **CANNOT** be the price of the call option?

A) $10.

B) $15.

C) $55.

D) $50.

Question #76 of 85

Banks generally have matched and mismatched asset-liability portfolios spread across many foreign currencies. How can risks from mismatching one-currency positions be alleviated?

A) Use of floating rate bonds can minimize interest rate risk.

B) Effective currency rate forecasts can reduce single currency positions.

C) Risks can be offset by an effective hedging program.

D) Risks can be offset by possible gains from asset-liability portfolio diversification.

Question #77 of 85

A knock-in barrier option is harder to hedge when it is:

A) at the inception of the trade.

B) at the barrier and near maturity.

C) out-of-the-money.

D) in-the-money.

Question #78 of 85

A positive net exposure position applies when:

A) the financial institution is net short in a currency.

B) more assets than liabilities are held in a given currency.

C) the financial institution faces the risk that the FX will rise in value against the dollar.

D) fewer assets than liabilities are held in a given currency.

Question #79 of 85

Which of the following is (are) reason(s) to hedge with over-the-counter (OTC) options rather than exchange-traded options?
 I. Superior liquidity.
 II. Better customization.
 III. Less credit risk.
 IV. Lower transactions costs.

A) I only.

B) II and IV.

C) III and IV.

D) II only.

Question #80 of 85

Assume that the current spot exchange rate between the U.S. dollar and the euro is $1.2500 per . In the U.S., the 3-year nominal continuously compounded risk-free interest rate is 5%. In Europe, the 3-year nominal continuously compounded risk-free interest rate is 6.5%. The 3-year forward exchange rate is *closest* to:

A) $1.195.

B) $1.308.

C) $1.213.

D) $1.288.

Question #81 of 85

A bank can create an on-balance-sheet hedged position by matching:

A) domestic and foreign cash rate exposure on its balance sheet.

B) domestic and foreign market value positions on its balance sheet.

C) maturity and currency positions on its balance sheet.

D) domestic and foreign inflation rate exposure on its balance sheet.

Question #82 of 85

A bear spread is an option strategy in which the option trader:

A) sells a high strike put option and buys a lower strike call option.

B) sells a high strike call option and buys a lower strike call option.

C) purchases a high strike call option and sells a lower strike call option.

D) purchases a high strike put option and sells a lower strike call option.

Question #83 of 85

Glacier Bank is a U.S. bank with some Euro assets and liabilities. Glacier also does a limited amount of Euro trading. At quarter end, here is a summary of the bank's Euro positions:

$1,367,450 Euro assets

$1,500,325 Euro liabilities

$580,368 Euro bought

> $250,200 Euro sold

What is Glacier Bank's net Euro exposure?

A) 197,293.

B) 1,750,525.

C) 330,168.

D) (132,875).

Question #84 of 85

A covered call position is:

A) the purchase of a share of stock with a simultaneous sale of a put on that stock.

B) the short sale of a stock with a simultaneous sale of a call on that stock.

C) the purchase of a share of stock with a simultaneous sale of a call on that stock.

D) the simultaneous purchase of the call and the underlying asset.

Question #85 of 85

Burton Riviera, FRM does not know the forward price of a commodity and wants to derive it by establishing a synthetic commodity forward price. How would this strategy be implemented?

A) Establish a straddle on the commodity.

B) Combine a short position on the commodity forward, and a long zero-coupon bond.

C) Combine a long position on the commodity forward, and a long zero-coupon bond.

D) Establish a straddle on the commodity, and simultaneously purchase a short-term Treasury bond.