TT TEXTBOOK TESTBANKS

Test Bank for Introduction to Derivatives and Risk Management 11th Chance

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Chapter 1 - Introduction

True / False

1. Options, forwards, swaps, and futures are financial assets.
   a. True
   b. False

ANSWER: False
POINTS: 1
DIFFICULTY: Easy
REFERENCES: 1.1 - Derivative Markets and Instruments
LEARNING OBJECTIVES: IDRM.CHANCE.27.01.01 - Explain the different types of derivatives: options, forward contracts, futures contracts, and swaps.
NATIONAL STANDARDS: United States - BUSPROG: Analytic
KEYWORDS: Bloom's: Remember

2. A risk premium is the additional return investors expect for assuming risk.
   a. True
   b. False

ANSWER: True
POINTS: 1
DIFFICULTY: Easy
REFERENCES: 1.3 - Important Concepts in Financial and Derivative Markets
LEARNING OBJECTIVES: IDRM.CHANCE.27.01.05 - Identify the role that derivative markets play through their four main advantages.
KEYWORDS: Bloom's: Remember

3. Derivatives permit investors to manage their risk more efficiently.
   a. True
   b. False

ANSWER: True
POINTS: 1
DIFFICULTY: Easy
REFERENCES: 1.1 - Derivative Markets and Instruments
LEARNING OBJECTIVES: IDRM.CHANCE.27.01.01 - Explain the different types of derivatives: options, forward contracts, futures contracts, and swaps.
KEYWORDS: Bloom's: Remember

4. The law of one price states that the price of an asset cannot change.
   a. True
   b. False

ANSWER: False
POINTS: 1
DIFFICULTY: Easy
REFERENCES: 1.4 - Fundamental Linkages Between Spot and Derivative Markets
LEARNING OBJECTIVES: IDRM.CHANCE.27.01.04 - Explain the relationship between spot and derivative markets through the mechanisms of arbitrage, storage, and delivery.

KEYWORDS: Bloom's: Remember

5. Derivative markets make stock and bond markets more efficient.
   a. True
   b. False

ANSWER: True
POINTS: 1
DIFFICULTY: Easy
REFERENCES: 1.3 - Important Concepts in Financial and Derivative Markets
LEARNING OBJECTIVES: IDRM.CHANCE.27.01.05 - Identify the role that derivative markets play through their four main advantages.
KEYWORDS: Bloom's: Understand

6. Swaps, like options, trade on organized exchanges.
   a. True
   b. False

ANSWER: False
POINTS: 1
DIFFICULTY: Easy
REFERENCES: 1.1 - Derivative Markets and Instruments
LEARNING OBJECTIVES: IDRM.CHANCE.27.01.01 - Explain the different types of derivatives: options, forward contracts, futures contracts, and swaps.
KEYWORDS: Bloom's: Remember

7. The theoretical fair value is the only value an asset can have.
   a. True
   b. False

ANSWER: False
POINTS: 1
DIFFICULTY: Easy
REFERENCES: 1.3 - Important Concepts in Financial and Derivative Markets
LEARNING OBJECTIVES: IDRM.CHANCE.27.01.03 - Define the important concept of theoretical fair value, which will be used throughout the book.
KEYWORDS: Bloom's: Understand

8. Short selling is a high risk activity.
   a. True
   b. False

ANSWER: True
POINTS: 1
DIFFICULTY: Easy
REFERENCES: 1.3 - Important Concepts in Financial and Derivative Markets
LEARNING OBJECTIVES: IDRM.CHANCE.27.01.02 - Review the concepts of risk preference, short selling, repurchase agreements, the risk–return relationship, and market efficiency.
KEYWORDS: Bloom's: Understand

9. Uncertainty of future sales and cost of inputs are examples of financial risks businesses may face.
   a. True
   b. False

ANSWER:	False
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.3 - Important Concepts in Financial and Derivative Markets
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.02 - Review the concepts of risk preference, short selling, repurchase agreements, the risk–return relationship, and market efficiency.
KEYWORDS:	Bloom’s: Understand

10. A call option on a futures contract gives the buyer the right to buy a futures contract.
   a. True
   b. False

ANSWER:	True
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.1 - Derivative Markets and Instruments
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.01 - Explain the different types of derivatives: options, forward contracts, futures contracts, and swaps.
KEYWORDS:	Bloom’s: Remember

Multiple Choice

11. Cash markets are also known as
   a. speculative markets.
   b. spot markets.
   c. derivative markets.
   d. dollar markets.
   e. equity markets.

ANSWER:	b
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.1 - Derivative Markets and Instruments
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.01 - Explain the different types of derivatives: options, forward contracts, futures contracts, and swaps.
KEYWORDS:	Bloom’s: Remember

12. A call option gives the holder
   a. the right to buy something.
   b. the right to sell something.
   c. the obligation to buy something.
   d. the obligation to sell something.
   e. the right to sell something and the obligation to buy something.

ANSWER:	a

POINTS: 1
DIFFICULTY: Easy
REFERENCES: 1.1 - Derivative Markets and Instruments
LEARNING OBJECTIVES: IDRM.CHANCE.27.01.01 - Explain the different types of derivatives: options, forward contracts, futures contracts, and swaps.
KEYWORDS: Bloom’s: Understand

13. Which of the following instruments are contracts but are not securities?
    a. Stocks
    b. Options
    c. Swaps
    d. Futures contracts
    e. Forward contracts

ANSWER: c
POINTS: 1
DIFFICULTY: Easy
REFERENCES: 1.1 - Derivative Markets and Instruments
LEARNING OBJECTIVES: IDRM.CHANCE.27.01.01 - Explain the different types of derivatives: options, forward contracts, futures contracts, and swaps.
KEYWORDS: Bloom’s: Understand

14. The positive relationship between risk and expected return is known as
    a. the risk–return tradeoff.
    b. diversification.
    c. market efficiency.
    d. arbitrage.
    e. the law of one price.

ANSWER: a
POINTS: 1
DIFFICULTY: Easy
REFERENCES: 1.3 - Important Concepts in Financial and Derivative Markets
LEARNING OBJECTIVES: IDRM.CHANCE.27.01.02 - Review the concepts of risk preference, short selling, repurchase agreements, the risk–return relationship, and market efficiency.
KEYWORDS: Bloom’s: Understand

15. A transaction in which an investor holds a position in the spot market and sells a futures contract or writes a call is
    a. a gamble.
    b. a speculative position.
    c. a hedge.
    d. a risk-free transaction.
    e. a short position..

ANSWER: c
POINTS: 1
DIFFICULTY: Moderate
REFERENCES: 1.3 - Important Concepts in Financial and Derivative Markets

LEARNING OBJECTIVES: IDRM.CHANCE.27.01.05 - Identify the role that derivative markets play through their four main advantages.
KEYWORDS: Bloom's: Remember

16. Which of the following is an advantage of derivatives?
    a. Lower transaction costs than securities and commodities
    b. Reveal information about expected prices and volatility
    c. Help control risk
    d. Make spot prices stay closer to their true values
    e. Lower transaction costs than securities and commodities, reveal information about expected prices and volatility, help control risk, and make spot prices stay closer to their true values

ANSWER: e
POINTS: 1
DIFFICULTY: Moderate
REFERENCES: 1.5 - Role of Derivative Markets
LEARNING OBJECTIVES: IDRM.CHANCE.27.01.05 - Identify the role that derivative markets play through their four main advantages.
KEYWORDS: Bloom's: Understand

17. A forward contract has which of the following characteristics?
    a. Has a buyer and a seller
    b. Trades on an organized exchange
    c. Has a daily settlement
    d. Gives the right but not the obligation to buy
    e. Has a buyer and a seller, trades on an organized exchange, has a daily settlement, and gives the right but not the obligation to buy

ANSWER: a
POINTS: 1
DIFFICULTY: Moderate
REFERENCES: 1.1 - Derivative Markets and Instruments
LEARNING OBJECTIVES: IDRM.CHANCE.27.01.01 - Explain the different types of derivatives: options, forward contracts, futures contracts, and swaps.
KEYWORDS: Bloom's: Understand

18. Which feature distinguishes futures contracts from forward contracts?
    a. Futures contracts are customized agreements negotiated privately.
    b. Futures contracts involve daily settlement of gains and losses (marking to market).
    c. Forward contracts require daily margin payments to an exchange.
    d. Futures contracts cannot be used to hedge risk.
    e. Forward contracts always trade on organized exchanges.

ANSWER: b
POINTS: 1
DIFFICULTY: Easy
REFERENCES: 1.1 - Derivative Markets and Instruments
LEARNING OBJECTIVES: IDRM.CHANCE.27.01.01 - Explain the different types of derivatives: options, forward

contracts, futures contracts, and swaps.

KEYWORDS: Bloom's: Remember

19. Investors who do not consider risk in their decisions are said to be
    a. speculating.
    b. short selling.
    c. risk neutral.
    d. traders.
    e. hedgers.

ANSWER: c
POINTS: 1
DIFFICULTY: Easy
REFERENCES: 1.3 - Important Concepts in Financial and Derivative Markets
LEARNING OBJECTIVES: IDRM.CHANCE.27.01.02 - Review the concepts of risk preference, short selling, repurchase agreements, the risk–return relationship, and market efficiency.
KEYWORDS: Bloom's: Remember

20. Which of the following statements is not true about the law of one price?
    a. Investors prefer more wealth to less.
    b. Investments that offer the same return in all states must pay the risk-free rate.
    c. If two investment opportunities offer equivalent outcomes, they must have the same price.
    d. Investors are risk neutral.
    e. Given two investments, investors prefer one that performs at least as well in all states and better in at least one state.

ANSWER: d
POINTS: 1
DIFFICULTY: Easy
REFERENCES: 1.4 - Fundamental Linkages Between Spot and Derivative Markets
LEARNING OBJECTIVES: IDRM.CHANCE.27.01.04 - Explain the relationship between spot and derivative markets through the mechanisms of arbitrage, storage, and delivery.
KEYWORDS: Bloom's: Remember

21. Which of the following contracts obligates a buyer to buy or sell something at a later date?
    a. Call
    b. Futures
    c. Cap
    d. Put
    e. Swaption

ANSWER: b
POINTS: 1
DIFFICULTY: Easy
REFERENCES: 1.1 - Derivative Markets and Instruments
LEARNING OBJECTIVES: IDRM.CHANCE.27.01.01 - Explain the different types of derivatives: options, forward contracts, futures contracts, and swaps.
KEYWORDS: Bloom's: Remember

22. The process of selling borrowed assets with the intention of buying them back at a later date and lower price is referred to as
    a. longing an asset.
    b. asset flipping.
    c. shorting.
    d. anticipated price fall arbitrage.
    e. longing an asset and also as asset flipping.

ANSWER:	c
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.3 - Important Concepts in Financial and Derivative Markets
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.02 - Review the concepts of risk preference, short selling, repurchase agreements, the risk–return relationship, and market efficiency.
KEYWORDS:	Bloom’s: Remember

23. In which one of the following types of contract between a seller and a buyer does the seller agree to sell a specified asset to the buyer today and then buy it back at a specified time in the future at an agreed future price?
    a. Repurchase agreement
    b. Short selling
    c. Swap
    d. Call
    e. Forward contract

ANSWER:	a
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.3 - Important Concepts in Financial and Derivative Markets
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.02 - Review the concepts of risk preference, short selling, repurchase agreements, the risk–return relationship, and market efficiency.
KEYWORDS:	Bloom’s: Understand

24. The expected return minus the risk-free rate is called
    a. the risk premium.
    b. the percentage return.
    c. the asset’s beta.
    d. the return premium.
    e. the discount rate

ANSWER:	a
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.3 - Important Concepts in Financial and Derivative Markets
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.02 - Review the concepts of risk preference, short selling, repurchase agreements, the risk–return relationship, and market efficiency.
KEYWORDS:	Bloom’s: Remember

25. When the law of one price is violated in that the same good is selling for two different prices, an opportunity for what type of transaction is created?
   a. Return-to-equilibrium transaction
   b. Risk-assuming transaction
   c. Speculative transaction
   d. Arbitrage transaction
   e. Hedging transaction

ANSWER:	d
POINTS:	1
DIFFICULTY:	Moderate
REFERENCES:	1.4 - Fundamental Linkages Between Spot and Derivative Markets
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.04 - Explain the relationship between spot and derivative markets through the mechanisms of arbitrage, storage, and delivery.
KEYWORDS:	Bloom’s: Analyze

26. Cash (spot) markets are characterized by
   a. delivery at a later date at a price agreed today
   b. no payment until expiration.
   c. immediate (or near-immediate) delivery and usually immediate payment.
   d. the right but not the obligation to transact.
   e. exchange of cash flows without exchanging the underlying.

ANSWER:	c
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.1 - Derivative Markets and Instruments
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.01 - Explain the different types of derivatives: options, forward contracts, futures contracts, and swaps.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom’s: Remember

27. Which of these best describes a derivative market?
   a. A market for ownership of real assets only
   b. A market for contractual instruments whose performance depends on another factor
   c. A market where securities create wealth directly
   d. A market where delivery must occur immediately
   e. A market limited to exchange-traded instruments only

ANSWER:	b
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.1 - Derivative Markets and Instruments
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.01 - Explain the different types of derivatives: options, forward contracts, futures contracts, and swaps.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom’s: Understand

28. An option is best described as
    a. an obligation to buy or sell later at a price set today.
    b. a right, but not an obligation, to buy or sell later at a price set today.
    c. a standardized exchange-traded forward with daily settlement.
    d. an agreement to exchange cash flows over time.
    e. a tradable claim on a group of assets.

ANSWER:	b
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.1 - Derivative Markets and Instruments
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.01 - Explain the different types of derivatives: options, forward contracts, futures contracts, and swaps.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom’s: Remember

29. A call option gives the buyer the right to
    a. sell the underlying at a fixed price.
    b. buy the underlying at a fixed price.
    c. exchange cash flows with a dealer.
    d. avoid paying any premium.
    e. settle daily based on price changes.

ANSWER:	b
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.1 - Derivative Markets and Instruments
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.01 - Explain the different types of derivatives: options, forward contracts, futures contracts, and swaps.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom’s: Remember

30. A put option gives the buyer the right to
    a. buy the underlying at a fixed price.
    b. sell the underlying at a fixed price.
    c. enter a forward contract with no obligation.
    d. swap interest-rate payments.
    e. trade only in spot markets.

ANSWER:	b
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.1 - Derivative Markets and Instruments
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.01 - Explain the different types of derivatives: options, forward contracts, futures contracts, and swaps.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom’s: Remember

31. Compared with options, a forward contract requires
    a. the buyer to have a right but no obligation.
    b. both parties to have an obligation to transact at the future date.
    c. standardization and exchange trading.
    d. daily settlement of gains and losses.
    e. payment of a premium to the seller.

ANSWER:	b
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.1 - Derivative Markets and Instruments
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.01 - Explain the different types of derivatives: options, forward contracts, futures contracts, and swaps.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom's: Remember

32. Which feature most clearly distinguishes futures from forwards?
    a. Futures give rights but not obligations.
    b. Futures are customized OTC contracts.
    c. Futures trade on organized exchanges and are subject to daily settlement.
    d. Futures always require physical delivery of the underlying.
    e. Futures are a claim on a group of assets.

ANSWER:	c
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.1 - Derivative Markets and Instruments
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.01 - Explain the different types of derivatives: options, forward contracts, futures contracts, and swaps.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom's: Remember

33. A swap is best described as a contract in which two parties
    a. agree to exchange cash flows.
    b. exchange ownership of a group of assets.
    c. buy and sell immediately in the spot market.
    d. obtain the right (but not obligation) to transact later.
    e. must settle gains and losses daily on an exchange.

ANSWER:	a
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.1 - Derivative Markets and Instruments
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.01 - Explain the different types of derivatives: options, forward contracts, futures contracts, and swaps.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom's: Remember

Chapter 1 - Introduction

34. In derivatives markets, the word "underlying" is used as a noun mainly because
   a. all derivatives are written on stocks and bonds.
   b. the underlying must always be a tradable security.
   c. it avoids implying the reference item is always an "asset."
   d. it makes derivatives legally enforceable contracts.
   e. it guarantees the derivative has intrinsic value.

ANSWER:	c
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.2 - The Underlying Asset
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.01 - Explain the different types of derivatives: options, forward contracts, futures contracts, and swaps.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom's: Remember

35. Which of the following is NOT necessarily an "asset" yet can still serve as the underlying of a derivative?
   a. Common stock
   b. Corporate bond
   c. Foreign currency
   d. Weather (e.g., temperature)
   e. Gold

ANSWER:	d
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.2 - The Underlying Asset
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.01 - Explain the different types of derivatives: options, forward contracts, futures contracts, and swaps.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom's: Remember

36. Which set of presuppositions is identified as necessary for well-functioning financial markets?
   a. Low inflation, balanced budgets, and free trade
   b. Clear rule of law, well-defined property rights, and a culture of trust
   c. High stock returns, deep capital markets, and flexible exchange rates
   d. Strong unions, government ownership, and strict price controls
   e. Low interest rates, high savings, and rapid population growth

ANSWER:	b
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.3 - Important Concepts in Financial and Derivative Markets
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.02 - Review the concepts of risk preference, short selling, repurchase agreements, the risk–return relationship, and market efficiency.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom's: Remember

37. A game pays $8 with probability 0.5 and $4 with probability 0.5. What is the expected payoff?
    a. $4.00
    b. $5.00
    c. $6.00
    d. $7.00
    e. $8.00

ANSWER:	c
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.3 - Important Concepts in Financial and Derivative Markets
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.02 - Review the concepts of risk preference, short selling, repurchase agreements, the risk–return relationship, and market efficiency.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom’s: Apply

38. If the expected payoff is $6.00 but you would only pay $5.60 to play, the risk premium is
    a. $0.00
    b. $0.40
    c. $0.60
    d. $1.40
    e. $5.60

ANSWER:	b
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.3 - Important Concepts in Financial and Derivative Markets
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.02 - Review the concepts of risk preference, short selling, repurchase agreements, the risk–return relationship, and market efficiency.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom’s: Apply

39. Which of these best describes short selling?
    a. Buying a stock and holding it for the long run
    b. Selling a stock you do not own by borrowing it, hoping to buy it back later at a lower price
    c. Buying a call option to profit from a price increase
    d. Selling stock only after you have received dividends
    e. Purchasing stock on margin to increase expected return

ANSWER:	b
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.3 - Important Concepts in Financial and Derivative Markets
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.02 - Review the concepts of risk preference, short selling, repurchase agreements, the risk–return relationship, and market efficiency.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom’s: Understand

40. Which of the following is an example of having the equivalent of a short sale, even if you did not borrow stock?
    a. Owning a stock outright (a long position)
    b. Buying a bond and holding it to maturity
    c. Having an obligation to purchase an asset at a later date at a set price
    d. Buying a put option
    e. Receiving dividends on a stock you own

ANSWER:	c
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.3 - Important Concepts in Financial and Derivative Markets
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.02 - Review the concepts of risk preference, short selling, repurchase agreements, the risk–return relationship, and market efficiency.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom’s: Remember

41. Which of these best describes a repurchase agreement (repo)?
    a. A contract where a buyer purchases an asset and the seller has no future obligation
    b. A contract where a seller sells an asset today and agrees to repurchase it later at a pre-agreed price
    c. A contract that gives the buyer the right, but not the obligation, to buy an asset later
    d. A permanent exchange of one asset for another with no cash involved
    e. A contract used only for high-risk securities like junk bonds

ANSWER:	b
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.3 - Important Concepts in Financial and Derivative Markets
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.02 - Review the concepts of risk preference, short selling, repurchase agreements, the risk–return relationship, and market efficiency.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom’s: Remember

42. In derivative pricing, the repo rate is important because it
    a. equals the stock’s expected return.
    b. measures the volatility of the underlying asset.
    c. approximates a dealer’s marginal cost of borrowing/lending and is often close to a government rate due to collateral.
    d. guarantees arbitrage profits for traders.
    e. replaces the need for risk-free rates in valuation models.

ANSWER:	c
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.3 - Important Concepts in Financial and Derivative Markets
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.02 - Review the concepts of risk preference, short selling, repurchase agreements, the risk–return relationship, and market efficiency.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom’s: Remember

43. A market is considered efficient when
    a. investors can consistently earn above-average returns with little effort.
    b. prices fully reflect instruments' true economic values, so abnormal risk-adjusted profits are not consistently possible.
    c. prices change slowly and predictably over time.
    d. only professional investors can trade successfully.
    e. government regulation sets prices near their intrinsic values.

ANSWER:	b
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.3 - Important Concepts in Financial and Derivative Markets
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.03 - Define the important concept of theoretical fair value, which will be used throughout the book.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom's: Remember

44. In this text, the term used for an asset's "true economic value" is
    a. book value.
    b. liquidation value.
    c. theoretical fair value.
    d. par value.
    e. face value.

ANSWER:	c
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.3 - Important Concepts in Financial and Derivative Markets
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.03 - Define the important concept of theoretical fair value, which will be used throughout the book.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom's: Remember

45. The effectiveness of valuation models (e.g., CAPM, APT, derivative pricing models) in producing "fair value" depends largely on the assumption that
    a. investors are always risk seeking.
    b. markets are inefficient and mispricing is common.
    c. the underlying market is efficient and information is quickly incorporated into prices.
    d. interest rates are constant over time.
    e. dividends are predictable.

ANSWER:	c
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.3 - Important Concepts in Financial and Derivative Markets
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.03 - Define the important concept of theoretical fair value, which will be used throughout the book.

NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom's: Remember

46. Arbitrage is best described as
    a. buying a risky asset and holding it for the long run.
    b. profiting from the same good selling at two different prices by buying low and selling high.
    c. earning a high return by taking on high risk.
    d. buying an asset because its price is expected to rise.
    e. reducing risk by holding many different assets.

ANSWER:	b
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.4 - Fundamental Linkages Between Spot and Derivative Markets
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.04 - Explain the relationship between spot and derivative markets through the mechanisms of arbitrage, storage, and delivery.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom's: Remember

47. Asset A1 pays $120 in state 1 and $90 in state 2. Asset A2 pays $40 in state 1 and $30 in state 2. Based on the law of one price, which statement is correct?
    a. A1 should be priced lower than A2 because it is riskier.
    b. A1 is equivalent to three shares of A2.
    c. A2 is equivalent to three shares of A1.
    d. A1 and A2 must have the same price.
    e. A1 and A2 are not comparable because states are uncertain.

ANSWER:	b
POINTS:	1
DIFFICULTY:	Moderate
REFERENCES:	1.4 - Fundamental Linkages Between Spot and Derivative Markets
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.04 - Explain the relationship between spot and derivative markets through the mechanisms of arbitrage, storage, and delivery.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom's: Apply

48. Suppose A1 sells for $95 and A2 sells for $31. Which trade is an arbitrage (risk-free profit) according to the passage?
    a. Buy 1 share of A1 and sell 3 shares of A2.
    b. Buy 3 shares of A2 and short-sell 1 share of A1.
    c. Buy 1 share of A1 and buy 1 share of A2.
    d. Short-sell 3 shares of A2 and buy 1 share of A1.
    e. Do nothing because the prices are close.

ANSWER:	b
POINTS:	1
DIFFICULTY:	Moderate
REFERENCES:	1.4 - Fundamental Linkages Between Spot and Derivative Markets
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.04 - Explain the relationship between spot and derivative markets

	through the mechanisms of arbitrage, storage, and delivery.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom's: Apply

49. Derivative market participants who use derivatives to reduce the risk of owning spot items are called
    a. arbitrageurs.
    b. dealers.
    c. hedgers.
    d. speculators.
    e. market makers.

ANSWER:	c
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.5 - Role of Derivative Markets
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.05 - Identify the role that derivative markets play through their four main advantages.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom's: Remember

50. Derivative markets often have greater liquidity than spot markets mainly because
    a. derivatives always trade on a single exchange.
    b. derivatives require less capital, so markets can absorb high-volume trades more easily.
    c. spot markets are illegal for large trades.
    d. liquidity is created by dividends paid on derivatives.
    e. liquidity is higher only when interest rates are falling.

ANSWER:	b
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.5 - Role of Derivative Markets
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.05 - Identify the role that derivative markets play through their four main advantages.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom's: Remember

51. One role of derivative markets is to facilitate short selling because
    a. short selling is banned in spot markets but allowed in derivatives.
    b. derivatives impose fewer restrictions than securities markets for taking short positions.
    c. short selling always produces risk-free profits.
    d. only hedgers are allowed to sell short.
    e. short selling is unnecessary when markets are efficient.

ANSWER:	b
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.5 - Role of Derivative Markets

LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.05 - Identify the role that derivative markets play through their four main advantages.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom’s: Remember

52. How do derivative markets support price discovery?
    a. Options prices directly forecast future spot prices.
    b. Spot markets use futures prices to set accounting values.
    c. Derivative prices are fixed by regulators to reduce volatility.
    d. Price discovery occurs only when markets are inefficient.
    e. Futures markets aggregate dispersed spot-market information into a consensus price, often using the nearby contract.

ANSWER:	e
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.5 - Role of Derivative Markets
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.05 - Identify the role that derivative markets play through their four main advantages.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom’s: Remember

53. Derivative markets can improve market efficiency by
    a. preventing arbitrage activity.
    b. raising transaction costs to deter trading.
    c. enabling low-cost arbitrage that quickly corrects temporary mispricing between spot and derivative prices.
    d. ensuring all investors hold identical beliefs.
    e. removing uncertainty about future spot prices.

ANSWER:	c
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.5 - Role of Derivative Markets
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.05 - Identify the role that derivative markets play through their four main advantages.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom’s: Remember

54. Derivative markets primarily allow the
    a. creation of new wealth through productive investment.
    b. transfer of risk from one party to another.
    c. elimination of risk from the economy.
    d. permanent increase of risk in the economy.
    e. replacement of financial markets.

ANSWER:	b
POINTS:	1
DIFFICULTY:	Easy

REFERENCES: 1.6 - Criticisms of Derivative Markets
LEARNING OBJECTIVES: IDRM.CHANCE.27.01.06 - Address some criticisms.
NATIONAL STANDARDS: United States - BUSPROG: Analytic
KEYWORDS: Bloom's: Remember

55. For hedgers to reduce risk in derivative markets, these markets typically require
    a. auditors willing to verify contracts.
    b. regulators willing to set prices.
    c. market makers who only hedge.
    d. speculators willing to assume risk.
    e. insurers who provide guarantees.

ANSWER: d
POINTS: 1
DIFFICULTY: Easy
REFERENCES: 1.6 - Criticisms of Derivative Markets
LEARNING OBJECTIVES: IDRM.CHANCE.27.01.06 - Address some criticisms.
NATIONAL STANDARDS: United States - BUSPROG: Analytic
KEYWORDS: Bloom's: Remember

56. Compared with stock markets, derivative markets generally
    a. create wealth by funding new business ideas.
    b. destroy wealth through negative-sum trading.
    c. neither create nor destroy wealth, but redistribute risk.
    d. always increase total risk in the economy.
    e. reduce the need for any underlying transactions.

ANSWER: c
POINTS: 1
DIFFICULTY: Easy
REFERENCES: 1.6 - Criticisms of Derivative Markets
LEARNING OBJECTIVES: IDRM.CHANCE.27.01.06 - Address some criticisms.
NATIONAL STANDARDS: United States - BUSPROG: Analytic
KEYWORDS: Bloom's: Remember

57. A key characteristic of derivative markets is that
    a. one party's gains are another's losses.
    b. everyone can gain at the same time.
    c. losses are always capped for both parties.
    d. they add new capital directly to firms.
    e. they function only when participants hold the underlying good.

ANSWER: a
POINTS: 1
DIFFICULTY: Easy
REFERENCES: 1.6 - Criticisms of Derivative Markets
LEARNING OBJECTIVES: IDRM.CHANCE.27.01.06 - Address some criticisms.

NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom’s: Understand

58. The text argues that derivatives differ from gambling because derivatives
    a. benefit only the participants who trade.
    b. have no effect on market efficiency.
    c. always guarantee profits to hedgers.
    d. primarily involve people who know nothing about the underlying.
    e. can improve market efficiency and expand risk-management opportunities that spill over to society.

ANSWER:	e
POINTS:	1
DIFFICULTY:	Moderate
REFERENCES:	1.6 - Criticisms of Derivative Markets
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.06 - Address some criticisms.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom’s: Understand

59. Derivatives are described as “powerful instruments” primarily because they
    a. eliminate risk from the economy.
    b. guarantee profits to hedgers.
    c. have high leverage, so small price changes can cause large gains or losses.
    d. require owning the underlying asset to trade.
    e. always increase market liquidity.

ANSWER:	c
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.7 - Misuses of Derivatives
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.06 - Address some criticisms.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom’s: Remember

60. Even knowledgeable users face risk because they may
    a. refuse to hedge and only diversify.
    b. confuse spot markets with futures markets.
    c. underestimate taxes on derivative gains.
    d. speculate when they should be hedging, often due to overconfidence in forecasts.
    e. avoid efficient-market assumptions entirely by holding cash.

ANSWER:	d
POINTS:	1
DIFFICULTY:	Easy
REFERENCES:	1.7 - Misuses of Derivatives
LEARNING OBJECTIVES:	IDRM.CHANCE.27.01.06 - Address some criticisms.
NATIONAL STANDARDS:	United States - BUSPROG: Analytic
KEYWORDS:	Bloom’s: Understand