Question #1 of 9

Question ID: 1574432

Which of the following statements regarding exchange-traded derivatives is *least* accurate? Exchange-traded derivatives:

A) are backed by a central clearinghouse.

B) are illiquid.

C) often trade in a physical location.

Explanation

Derivatives that trade on exchanges have good liquidity in most cases. They have the other characteristics listed.

(Module 68.1, LOS 68.b)

Question #2 of 9

Question ID: 1577417

An investor hedges her long position in her shares of Jaffrey Ltd. (Jaffrey) by taking a position in a forward contract where she agrees to sell the shares of Jaffrey. Which of the following statements best describes the investor's position regarding the forward contract?

A) The investor will have a gain on the forward contract when the price of the shares of Jaffrey falls.

B) The investor will have a gain on the forward contract when the price of the shares of Jaffrey rises.

C) The investor will have neither a gain nor a loss on the forward contract because her position is hedged.

Explanation

The investor is a forward seller and therefore, has a short exposure to the Jaffrey shares with respect to the forward contract. When the price of Jaffrey falls (rises), the investor gains (loses) on the forward contract.

(Module 68.1, LOS 68.a)

Question #3 of 9

Question ID: 1577420

Josh Amie purchases a one-year interest rate forward contract based on the market reference rate (MRR). At settlement, the MRR has risen and Amie will have:

A) a loss on the forward contract.

B) a gain on the forward contract.

C) neither a loss nor a gain on the forward contract.

Explanation

For an *interest rate* forward contract, a higher interest rate means gains for the buyer. In contrast, higher interest rates mean lower bond prices and losses for the buyer of a *bond* forward contract.

(Module 68.1, LOS 68.a)

Question #4 of 9

Question ID: 1577416

Party A takes a position in a forward contract to purchase 200 shares of Squealer Inc. (Squealer) for $40 per share three months from now. Party B takes the opposite position to sell 200 shares of Squealer for $40 per share three months from now. The relevant discount rate is 5%.

The value of the forward contract to Party A at the initiation of the contract is *closest to*:

A) $7,900.

B) $0.

C) $8,000.

Explanation

The forward price is set so that the forward contract has zero value to both parties at contract initiation; neither party pays at the initiation of the contract.

(Module 68.1, LOS 68.a)

Question #5 of 9

Question ID: 1574433

A derivative is defined as a security that has a value:

A) based on another security, commodity, or index.

B) established outside an organized exchange.

C) stated in a contract between two counterparties.

Explanation

A derivative is a security the value of which is derived from the value of some other underlying asset. Some derivatives trade on organized exchanges. The *price* at which a transaction will (or may) take place in the future is stated in a derivatives contract.

(Module 68.1, LOS 68.b)

Question #6 of 9

Question ID: 1577418

A forward contract specifying that only the gains and losses are exchanged at settlement is called a:

A) deliverable contract.

B) cash-settled contract.

C) netted contract.

Explanation

A cash-settled contract specifies that only the net gain or loss from the forward contract is exchanged at settlement.

Although the amount is netted, the contract is not called a "netted contract". A deliverable contract requires that the payment and shares be exchanged at the settlement date.

(Module 68.1, LOS 68.a)

Question #7 of 9

Question ID: 1577419

Which of the following statements regarding derivatives and/or cash market transactions is *most accurate*?

A) Investors can easily gain exposure to risk through derivatives but at a relatively high cost.

B) Initiating a derivatives position is most likely to have a greater impact on market prices of the underlying, relative to initiating an equivalent position in the underlying through a cash market transaction.

C) Transaction costs for a derivatives position are often lower than for the equivalent cash market trade.

Explanation

Investors can gain exposure to risk at relatively low cost, effectively creating a highly leveraged investment in the underlying. Initiating a derivatives position is most likely to have a lesser impact on market prices of the underlying, relative to initiating an equivalent position in the underlying through a cash market transaction.

(Module 68.1, LOS 68.a)

Question #8 of 9

Question ID: 1574431

For exchange-traded derivatives, the role of the central clearinghouse is to:

A) maintain private insurance that can be used to provide funds if a trader defaults.

B) stabilize the market price fluctuations of the underlying commodity.

C) guarantee that all obligations by traders will be honored.

Explanation

The central clearinghouse does not originate trades, it acts as the opposite party to all trades. In other words, it is the buyer to every seller and the seller to every buyer. This action guarantees that all obligations under the terms of the contract will be fulfilled.

(Module 68.1, LOS 68.b)

Question #9 of 9

Question ID: 1574434

In futures markets, the primary role of the clearinghouse is to:

A) reduce transaction costs by making contract prices public.

B) act as guarantor to both sides of a futures trade.

C) prevent arbitrage and enforce federal regulations.

Explanation

Acting as the counterparty for all buyers and sellers is the primary role of the clearinghouse. By providing liquidity, the clearinghouse may also help lower transaction costs indirectly.

(Module 68.1, LOS 68.b)