# CHAPTER 1: INTRODUCTION

MULTIPLE CHOICE TEST QUESTIONS

1. The market value of the derivatives contracts worldwide totals

a. less than a trillion dollars

b. in the hundreds of trillion dollars

c. over a trillion dollars but less than a hundred trillion

d. over quadrillion dollars

e. none of the above

2. Cash markets are also known as

a. speculative markets

b. spot markets

c. derivative markets

d. dollar markets

e. none of the above

3. 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. none of the above

4. Which of the following instruments are contracts but are not securities

a. stocks

b. options

c. swaps

d. a and b

e. b and c

5. The positive relationship between risk and return is called

a. expected return

b. market efficiency

c. the law of one price

d. arbitrage

e. none of the above

6. 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. none of the above

7. Which of the following are advantages 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. all of the above

8. 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. all of the above

9. Options on futures are also known as

a. spot options

b. commodity options

c. exchange options

d. security options

e. none of the above

10. A market in which the price equals the true economic value

a. is risk-free

b. has high expected returns

c. is organized

d. is efficient

e. all of the above

11. Which of the following trade on organized exchanges?

a. caps

b. forwards

c. options

d. swaps

e. none of the above

12. Which of the following markets is/are said to provide price discovery?

a. futures

1. forwards
2. options
3. a and b

e. b and c

13. Investors who do not consider risk in their decisions are said to be

a. speculating

b. short selling

c. risk neutral

d. traders

e. none of the above

14. 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

1. none of the above
2. Which of the following contracts obligates a buyer to buy or sell something at a later date?
3. call
4. futures
5. cap
6. put
7. swaption
8. The process of creating new financial products is sometimes referred to as
9. financial frontiering
10. financial engineering
11. financial modeling
12. financial innovation
13. none of the above
14. The process of selling borrowed assets with the intention of buying them back at a later date and lower price is referred to as
15. longing an asset
16. asset flipping
17. shorting
18. anticipated price fall arbitrage
19. none of the above
20. 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.
21. repurchase agreement
22. short selling
23. swap
24. call
25. none of the above
26. The expected return minus the risk-free rate is called
27. the risk premium
28. the percentage return
29. the asset’s beta
30. the return premium
31. none of the above
32. 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?
33. return-to-equilibrium transaction
34. risk-assuming transaction
35. speculative transaction
36. arbitrage transaction
37. none of the above

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TRUE/FALSE TEST QUESTIONS

T F 1. Options, forwards, swaps, and futures are financial assets.

T F 2. The absence of a daily settlement is one of the factors distinguishing a forward contract from a futures contract.

T F 3. A risk premium is the additional return investors expect for assuming risk.

T F 4. Arbitrage is a transaction designed to capture profits resulting from market efficiency.

T F 5. Derivatives permit investors to manage their risk more efficiently.

T F 6. The law of one price states that the price of an asset cannot change.

T F 7. Lower transaction costs are one advantage of derivative markets.

T F 8. Derivative markets make stock and bond markets more efficient.

T F 9. Speculation is equivalent to gambling.

T F 10. Most derivative contracts terminate with delivery of the underlying asset.

T F 11. Swaps, like options, trade on organized exchanges.

T F 12. Storing an asset entails risk.

T F 13. The theoretical fair value is the only value an asset can have.

T F 14. Short selling is a high risk activity.

T F 15. Uncertainty of future sales and cost of inputs are examples of financial risks businesses may face.

T F 16. Exchange-traded derivatives volume is less than one billion according to the *Futures Industry* magazine in 2010.

T F 17. Derivatives are securities and not contracts.

T F 18. A call option on a futures contract gives the buyer the right to buy a futures contract.

T F 19. A seller of a put option on a futures contract obligates them to buy a futures contract should the put buyer exercise the option.

T F 20. Swaps obligate delivery of either bonds or stocks.