MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

1) The payoffs for financial derivatives are linked to
   A) the volatility of interest rates.
   B) securities that will be issued in the future.
   C) previously issued securities.
   D) government regulations specifying allowable rates of return.
   E) none of the above.

2) Which of the following is a reason to hedge a portfolio?
   A) To limit exposure to risk.
   B) To increase the probability of gains.
   C) To profit from capital gains when interest rates fall.
   D) All of the above.
   E) Both A and C of the above.

3) A person who agrees to buy an asset at a future date has gone

4) The advantage of forward contracts over future contracts is that they
   A) are standardized.  B) are more liquid.
   C) have lower default risk.  D) none of the above.

5) By selling short a futures contract of $100,000 at a price of 115 you are agreeing to deliver
   A) $115,000 face value securities for $115,000.
   B) $115,000 face value securities for $110,000.
   C) $100,000 face value securities for $115,000.
   D) $100,000 face value securities for $100,000.

6) If you bought a long contract on financial futures you hope that interest rates
   A) rise.  B) fall.  C) are stable.  D) fluctuate.

7) If a firm is due to be paid in deutsche marks in two months, to hedge against exchange rate risk the firm should
   A) sell foreign exchange futures short.  B) stay out of the exchange futures market.
   C) buy foreign exchange futures long.  D) none of the above.
8) To hedge the interest rate risk on $4 million of Treasury bonds with $100,000 futures contracts, you would need to purchase
   A) 25 contracts.
   B) 40 contracts.
   C) 400 contracts.
   D) 4 contracts.
   E) 20 contracts.

9) Options on individual stocks are referred to as
   A) individual options.  
   B) stock options.
   C) futures options.
   D) American options.

10) If you buy a call option on treasury futures at 115, and at expiration the market price is 110,
    A) the call will be exercised.  
    B) the put will be exercised.
    C) the call will not be exercised.
    D) the put will not be exercised.

11) A tool for managing interest rate risk that requires exchange of payment streams is a
    A) futures contract.
    B) macro hedge.
    C) forward contract.
    D) swap.
    E) micro hedge.

12) The most common type of interest rate swap is
    A) the ordinary swap.
    B) the basic swap.
    C) the plain vanilla swap.
    D) the notional swap.
    E) the swaption.

13) One advantage of using swaps to eliminate interest rate risk is that swaps
    A) are less costly than futures.
    B) are more liquid than futures.
    C) are less costly than rearranging balance sheets.
    D) have better accounting treatment than options.
14) The problems of default risk and finding counterparties for interest rate swaps has been reduced by

   A) writing complex contracts.
   B) commercial and investment banks serving as intermediaries.
   C) government regulation.
   D) all of the above.
   E) both B and C of the above.

15) If, for a $1000 premium, you buy a $100,000 put option on bond futures with a strike price of 110, and at the expiration date the price is 114

   A) your profit is $4000.
   B) your loss is $4000.
   C) your profit is $3000.
   D) your loss is $3000.
   E) your loss is $1000.
Answer Key
Testname: PRACTICE_CH13

1) C
2) A
3) A
4) D
5) C
6) B
7) A
8) B
9) B
10) C
11) D
12) C
13) C
14) B
15) E