Test Bank for
Derivatives: Principles & Practice

Chapter 2: Futures Markets

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1. The most widely traded futures are of the following type:
   (a) Equity.
   (b) Interest rate.
   (c) Agricultural.
   (d) Commodity.
   Answer b.

2. Which of the following features distinguish futures markets from forwards markets?
   (a) Standardization of contracts.
   (b) The use of margin accounts to manage risk.
   (c) Ease in reversing positions.
   (d) All of the above.
   Answer d.

3. Which of the following types of orders does not involve specifying a price limit or trigger price as part of the order?
   (a) Stop order.
   (b) Market-if-touched order.
   (c) A fill-or-kill limit order.
   (d) A spread order.
   Answer d.

4. A price tick is
   (a) The maximum amount by which the price can move in a day.
   (b) The minimum amount by which the price can move.
   (c) The bid-ask spread on the price.
   (d) The minimum amount of trading required on the exchange per trade.
   Answer b.

5. Futures contracts are more likely to be cash-settled when
   (a) The asset underlying the contract is too costly to deliver physically.
   (b) There is no "underlying" for the futures contract.
   (c) There are more futures contracts in notional value than the physical stock of the underlying asset.
   (d) The maturity date of the futures is not the last day of the month.
   Answer a. (Note that c is also sometimes specified as a possible reason, but is not always valid.)

6. When a counterparty to a futures contract fails to perform under the contract,
   (a) The futures exchange informs the party on the other side of the amount of loss they will bear.
   (b) The futures exchange bears the loss,
   (c) The futures exchange sues the failed counterparty.
   (d) The futures exchange replaces the failed counterparty with a solvent one.
   Answer b.

7. Plutonium is trading at a one-year futures price of $5,000 per gram. A futures contract comprises 100 grams. The initial margin is $100,000 and the maintenance margin is $80,000. You are short one futures contract. There is a margin call when the price per gram of plutonium changes to
   (a) $4,750
   (b) $4,900
   (c) $5,100
   (d) $5,250
   Answer d.

8. A "stack-and-roll" strategy makes profits from the "roll" part when
   (a) The market is in backwardation.
   (b) The market is in contango.
   (c) There is a sharp fall in commodity prices.
   (d) The correlation between long- and short-term futures prices is less than 0.5.
   Answer a.

9. An investor enters into a long position in 10 gold futures contracts at a futures price of $1000/oz and closes out the position at a price of $1020/oz. If one gold futures contract is for 50 ounces, what are the investor's gains or losses?
   (a) $100
   (b) $1,000
   (c) $5,000
   (d) $10,000
   Answer d.

10. Ignoring convenience yields, the theoretical futures price for a commodity with a positive cost of carry should typically exhibit
   (a) Backwardation.
   (b) Contango.
   (c) Either backwardation or contango depending on the delivery month.
   (d) Either backwardation or contango depending on the initial level of the spot price.
   Answer b

11. For a futures contract on an asset to be successful compared to the alternative of forward contracts, which of the following features would help?
   (a) The most appropriate standardized grade for the contract is difficult to identify.
   (b) Counterparty credit risk is high.

(c) Bid-ask spreads in the spot market are high.
(d) The underlying spot asset is difficult to short.
Answer b.

12. March what futures are trading at $4.20 a bushel and May wheat futures are trading at $4.35 a bushel. You expect the spread between May and March futures prices to widen. To speculate on this view, you would
(a) Go long March futures and short May futures.
(b) Go long May futures and short March futures.
(c) Go long May futures.
(d) Go long March futures.
Answer b.

13. September corn futures are currently trading at $3.80 a bushel while the spot price of corn is $3.65 a bushel, so the "basis" (the futures price minus the spot price) is $0.15 a bushel. If you expect the basis to weaken (i.e., to fall) significantly in the next few days, you can speculate on your view by
(a) Going long the September futures contract.
(b) Going long spot corn.
(c) Going long spot corn and short September futures.
(d) Going long September futures and short spot corn.
Answer c.

14. You go short oil 10 futures contracts on NYMEX when the futures price of oil is $79 a barrel and close out your position three days later at a futures price of $83 a barrel. One futures contract is for 1,000 barrels. Ignoring interest on the margin account, the futures trading has resulted in a
(a) Gain of $790,000.
(b) Loss of $4,000
(c) Gain of $4,000
(d) Loss of $40,000
Answer d.

15. The cheapest-to-deliver option
(a) Hurts the holder of the long position in the futures contract.
(b) Improves the quality of the position hedged by the futures.
(c) Makes it easy to price the futures contract.
(d) Makes it easier for market players to implement short squeezes.
Answer a.

16. The level of margining in a futures contract takes as an important input
(a) The trading volume that underlies the contract.
(b) The credit quality of counterparties trading in the futures market.
(c) The volatility of the asset underlying the futures contract.
(d) The difference between the initial and maintenance margin in the futures.
Answer c.

17. In the absence of arbitrage, the futures price at maturity should equal
    (a) The price at inception plus interest on the margin account for the period of the contract.
    (b) The spot price of the underlying asset at that point.
    (c) The price at inception plus the storage cost for the asset over the contract period.
    (d) The price of the underlying asset minus a convenience yield.
    Answer b.

18. A calendar spread futures position comprises
    (a) A long position in a futures contract of one maturity and a short position in another futures contract of a different maturity.
    (b) A contract on the difference between two different-maturity futures prices.
    (c) A portfolio of long futures contracts of different maturities.
    (d) A portfolio of futures contracts spanning more than one year.
    Answer a.

19. If the market is in backwardation
    (a) Spot prices are less than forward prices.
    (b) Futures prices are less than forward prices.
    (c) Spot prices are less than futures prices.
    (d) None of the above.
    Answer d.

20. When the futures-spot basis weakens
    (a) The difference between futures and spot prices drops.
    (b) The correlation between changes in futures and spot prices drops.
    (c) A hedger experiences more risk.
    (d) A hedger loses money on the hedge.
    Answer a.