Quiz

1. Which one of the following definitions is correct?

A. Speculating is the use of derivatives to reduce a firm's risk exposure.
B. Hedging is the reduction of risk exposure through the use of derivatives.
C. A forward contract is the payment for a good today with the delivery of the good occurring sometime in the future.
D. A derivative is a financial instrument whose value becomes the basis for the value of another financial instrument.
E. A cash transaction is a forward contract wherein the buyer promises to pay cash upon delivery of a good in the future.

2. Which one of the following statements concerning a forward contract is correct?

A. The seller of a forward contract only agrees to make delivery sometime in the future.
B. The cash payment that will be made when the item being purchased is delivered is referred to as the deliverable instrument.
C. The buyer of a forward contract only agrees to pay a stated amount sometime in the future.
D. The payment for the item being purchased occurs at the time the parties engage in the forward contract.
E. If you order a wedding cake today to be delivered and paid for on your wedding day six months from now, you have agreed to a forward contract.

3. On April 15 you go to your local furniture store. The sofa you want is not in stock but the store agrees to order it for you and tells you that the price will be $1,200. No deposit is required for this order. Which one of the following statements correctly describes some aspect of this forward contract?

A. The $1,200 is the deliverable instrument.
B. You pay the $1,200 when you agree to the forward contract.
C. The store is the buyer of the forward contract.
D. This transaction is a cash transaction.
E. You are the buyer of the forward contract.

4. A forward contract:

A. is a type of option.
B. grants the buyer a choice as to whether or not the exchange will occur once the specified future date arrives.
C. is a type of cash transaction.
D. can be either an oral or a written agreement.
E. is an arrangement solely between two business entities.

5. Which of the following represent differences between a forward contract and a futures contract?

I. A futures contract only specifies the month of delivery whereas a forward contract specifies the date of delivery.
II. A forward contract is traded on an exchange while a futures contract is not.
III. With a futures contract, but not with a forward contract, the party which takes delivery may not be the original party which entered the contract with the seller.
IV. Forward contracts are marked to the market daily whereas futures contracts are not.

A. III only
B. I and III only
C. II and IV only
D. III and IV only

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E. I and II only

6. Which of the following represent advantages that futures contracts have that forward contracts may not have?
I. predetermined set of cash flows
II. ability to net out a position
III. individually customized contract terms
IV. liquidity

A. I only
B. I and III only
C. II and IV only
D. I and II only
E. III and IV only

7. Tom buys a futures contract on 5,000 bushels of corn at a price of $5.03 a bushel. The contract expires in two months. Tom will:

A. most likely both submit and receive cash payments during the two month period.
B. pay an unknown total amount for the corn due to the daily marking to the market.
C. pay an unknown total amount for the corn but the total price cannot exceed $5.03 a bushel.
D. pay $25,150 for the corn on the date the corn is delivered.
E. pay $25,150 to the seller at the time the contract is entered.

8. On Monday, Jennie purchased a 3-month futures contract on corn at a price of $4.96 a bushel. On Tuesday, the price of corn rose to $4.98 a bushel and on Wednesday the price fell back to $4.96. Which one of the following statements reflects the effects of these price changes?

A. Jennie can ignore any price movements as she purchased the corn at an agreed upon price of $4.96 a bushel.
B. Jennie can ignore the price movement on Tuesday because the price returned to her contracted amount of $4.96 a bushel on Wednesday.
C. Jennie will pay $0.02 a bushel to her broker on Wednesday for the price movement on Tuesday.
D. Jennie will receive $0.02 a bushel from her broker on Thursday for the price movement on Wednesday.
E. Jennie will receive $0.02 a bushel for the price movement on Tuesday.

9. Assume you sell a futures contract on Monday for one bushel of wheat which is to be delivered on Friday. The contract price per bushel is $4.98. As a result of the marking to market process, you receive $0.01 a bushel for Tuesday, receive $0.04 a bushel for Wednesday, and pay $0.03 a bushel for Thursday. How much will you receive per bushel when you take delivery on Friday?

A. $4.95
B. $4.96
C. $4.98
D. $5.00
E. $5.01

10. Sue entered a forward contract to buy wheat at a price of $5.10 a bushel. Ted purchased a futures contract on wheat at a price of $5.10 a bushel. Which one of the following statements is correct?

A. Sue will pay $5.10 a bushel whereas Ted may pay less than that amount for his wheat.
B. Both Sue and Ted have predetermined cash flows.
C. Sue must be prepared to pay cash to her broker if the price of wheat falls prior to the time of delivery.

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D. Sue must be prepared for payment on any day of the delivery month whereas Ted knows the exact day of delivery.
E. Both Sue and Ted will pay a total of $5.10 a bushel for their wheat.

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