70 DERIVATIVE BENEFITS, RISKS, AND ISSUER AND INVESTOR USES

1. Compared to cash markets, which factor is both an advantage and disadvantage of derivative instruments?
   (A) Market efficiency.
   (B) Short sales.
   (C) Liquidity.

2. A corporation that employs hedge accounting and uses an interest rate swap to offset changes in the value of fixed rate bond liability is said to be employing a:
   (A) net investment hedge.
   (B) cash flow hedge.
   (C) fair value hedge.

3. In the context of determining option prices, which factor is not directly observable?
   (A) Volatility of the underlying.
   (B) Exercise price.
   (C) Risk-free rate.

4. Hedge accounting with a net investment hedge most likely refers to a company that is using derivatives to reduce the volatility of:
   (A) the value of a foreign subsidiary.
   (B) its net working capital.
   (C) a balance sheet liability.

5. A corporation that employs hedge accounting and uses derivatives to reduce the volatility of the value of its inventory is most likely using a:
   (A) cash flow hedge.
   (B) fair value hedge.
   (C) net investment hedge.

6. The most appropriate action an owner of common stock can take to hedge the stock's price risk while retaining its upside potential is to:
   (A) sell calls.
   (B) buy calls.
   (C) buy puts.

7. Which of the following statements regarding the use of derivatives is most accurate?
   (A) A portfolio manager can decrease exposure to the risk and return of a market index.
   (B) The issuer of a fixed-rate obligation can increase risk exposure by converting to a floating-rate obligation.
   (C) A manufacturer can hedge the exchange risk of anticipated receipts or payments.

8. To acquire the upside potential of an asset's price movement while maintaining downside protection, without holding the underlying asset, an investor should buy:
   (A) a call option on the asset.
   (B) a put option on the asset.
   (C) both a call option and a put option on the asset.