

**71****ARBITRAGE, REPLICATION, & THE  
COST OF CARRY IN PRICING  
DERIVATIVES**

1. The calculation of derivatives values is based on an assumption that:
  - (A) investors are risk neutral.
  - (B) arbitrage opportunities are exploited rapidly.
  - (C) arbitrage opportunities do not arise in real markets.
  
2. A net benefit from holding the underlying asset of a forward contract will:
  - (A) increase the value of the forward contract during its life.
  - (B) decrease the no-arbitrage forward price at initiation.
  - (C) decrease the value of the forward contract at expiration.
  
3. Costs of holding the underlying that are greater than benefits from holding the underlying will:
  - (A) decrease the no-arbitrage forward price.
  - (B) increase the no-arbitrage forward price.
  - (C) have no effect on the no-arbitrage forward price.
  
4. Other things equal, an increase in storage costs of the underlying asset will:
  - (A) not affect the no-arbitrage forward price.
  - (B) decrease the no-arbitrage forward price.
  - (C) increase the no-arbitrage forward price.
  
5. Which of the following is most likely to increase the no-arbitrage forward price of an asset?
  - (A) Lower storage costs for a commodity.
  - (B) Higher dividends from a stock.
  - (C) Lower convenience yield for a commodity.

6. It is possible to profit from arbitrage when there are no costs or benefits to holding the underlying asset and the forward contract price is:
- (A) equal to the future value of the spot price.
  - (B) greater than the present value of the spot price.
  - (C) less than the future value of the spot price.
7. Other things equal, the no-arbitrage forward price of an asset will be higher if the asset has:
- (A) storage costs.
  - (B) dividend payments.
  - (C) convenience yield.
8. For an underlying asset that has no holding costs or benefits, the no-arbitrage forward price at initiation of a forward contract is:
- (A) zero.
  - (B) the future value of the spot price.
  - (C) equal to the spot price.

