Series 3 Practice Test

1. What is excessive trading that results in increased commissions for the broker while providing no benefit to the customer called?

a. Arbitrage
b. Charting
c. Churning
d. Bidding

2. What is the tendency for prices of physical commodities and futures to approach one another, usually during the delivery month?

a. Divergence
b. Convergence
c. Arbitrage
d. Bucketing

3. What is an individual who solicits orders, customers, or customer funds on behalf of a futures commission merchant, an introducing broker, a commodity trading advisor, or a commodity pool operator and is registered with the Commodity Futures Trading Commission called?

a. Associated person
b. Floor broker
c. Floor trader
d. Scalper

4. Who is the individual who executes orders on the trading floor of an exchange for any other person?

a. Introducing broker
b. Scalper
c. Floor broker
d. Floor trader

5. What is a trader who trades for small, short-term profits during one trading session and rarely holds a position overnight?

a. Day trader
b. Position trader
c. Floor trader
d. Scalper

6. What is the smallest increment of a price movement for a futures contract called?

a. Spot
b. Spread
c. Short
d. Tick

7. An option writer can also be referred to as an option seller.

a. True
b. False

8. The strike price is the price that the holder of an option pays and the writer of an option receives for the rights conveyed by the option.

a. True
b. False

9. A call option is in the money if the current market value of the underlying security is above the exercise price of the option.

a. True
b. False

10. Intrinsic value is the amount, if any, that an option is in the money.

a. True
b. False

11. If the exercise price of a put is above the current market value of the underlying security, it is considered to be out of the money.

a. True
b. False

12. When computing margin calls, option values of all options contracts are not allowed to meet an account's total risk margin requirement.

a. True
b. False

13. What is a performance bond also referred to as?

a. Future
b. Option
c. Margin
d. Hedge

14. Which of the following is not specified in a futures contract?

a. The item being bought and sold
b. The strike price
c. The contract month
d. The manner of settlement

15. What is a feature of futures trading whose risks are the mirror image of its potential benefits?

a. Leverage
b. Hedging
c. Margin
d. Speculation

16. What is establishing a position in the futures market that is equal and opposite to a position in the cash market called?

a. Leveraging
b. Speculating
c. Bucketing
d. Hedging

17. How often are gains and losses credited or debited to the accounts of buyers and sellers of futures contracts?

a. Hourly
b. Daily
c. Weekly
d. Monthly

18. What is the minimum margin requirement for security futures set by law?

a. 20% of the contract value
b. 25% of the contract value
c. 30% of the contract value
d. 35% of the contract value

19. What is the initial margin requirement on the purchase of a futures contract worth $5,000?

a. $500
b. $750
c. $1,000
d. $1,500

20. What is it called when an investor takes a long position in a futures contract of one maturity and a short position in a contract on the same commodity with a different maturity?

a. Straddle
b. Option
c. Hedge
d. Spread

21. An investor purchased 5 September wheat futures contracts at 7.35. The contract is trending up in price, peaking at 9.85. The investor, going forward, would like to sell the contracts and maximize his profit but is concerned that the price will start trading lower, possibly reaching 7.50. Which of the following orders should he enter to protect and maximize profit?

a. Buy 5 September wheat futures at 7.00 stop.
b. Sell 5 September wheat futures at 7.25 stop.
c. Sell 5 September wheat futures at 8.25 stop.
d. Sell 5 September wheat futures at 9.25 stop.

22. An investor purchased 17 April corn futures contracts at 14.50. At which of the following prices will this investor be able to sell his 17 April corn futures contracts while maximizing the profit on the transaction?

a. 14.00
b. 15.25
c. 14.25
d. 15.75

23. In the futures industry, *margin* refers to a partial payment for the contract being purchased.

a. True
b. False

24. Buyers of futures contracts have the same ownership interests or voting rights and receive the same dividends as stock owners.

a. True
b. False

25. Failure to meet a margin call within the time period allowed may result in the broker liquidating a customer's open futures positions at the current market price without prior notice.

a. True
b. False

26. An investor establishes a short position by selling 9 May silver futures contracts at 57.25. At which of the following prices will this investor be able to purchase 9 May silver contracts to cover the short position while still maximizing profit?

a. 57.00
b. 57.75
c. 55.75
d. 58.25

27. What is a request for additional margin?

a. Margin call
b. Margin maintenance
c. Initial margin
d. Margin spread

28. If the initial margin required to buy or sell a futures contract is $5,000 and the maintenance margin requirement is $4,000, what is the amount of the margin call if losses on open positions reduce the funds remaining in the account to $3,000?

a. $1,000
b. $2,000
c. $4,000
d. $5,000

29. In what year did futures contracts begin trading in the United States?

a. 1965
b. 1892
c. 1982
d. 1865

Answer Key and Explanations

1. C: Churning is excessive trading that results in increased commissions for the broker while providing no benefit to the customer.

2. B: The tendency for prices of physical commodities and futures to approach one another, usually during the delivery month, is convergence.

3. A: An associated person is an individual who solicits orders, customers, or customer funds on behalf of a futures commission merchant, an introducing broker, a commodity trading advisor, or a commodity pool operator and is registered with the Commodity Futures Trading Commission.

4. C: A floor broker is an individual who executes orders on the trading floor of an exchange for any other person.

5. D: A scalper is a trader who trades for small, short-term profits during one trading session and rarely holds a position overnight.

6. D: A tick is the smallest increment of a price movement for a futures contract.

7. A: An option writer can also be referred to as an option seller.

8. B: The premium is the price that the holder of an option pays and the writer of an option receives for the rights conveyed by the option. The strike price is another name for the exercise price.

9. A: A call option is in the money if the current market value of the underlying security is above the exercise price of the option.

10. A: Intrinsic value is the amount, if any, that an option is in the money.

11. B: If the exercise price of a put is below the current market value of the underlying security, it is considered to be out of the money.

12. B: When computing margin calls, option values of all options contracts are allowed to meet an account's total risk margin requirement.

13. C: A performance bond is also referred to as margin.

14. B: A futures contract does not specify a strike price. It specifies the item being bought and sold, the contract month, the manner of settlement, and the standardized contract size.

15. A: A feature of futures trading whose risks are the mirror image of its potential benefits is leverage.

16. D: Establishing a position in the futures market that is equal and opposite to a position in the cash market is called hedging.

17. B: Gains and losses are credited or debited to the accounts of buyers and sellers of futures contracts daily.

18. A: The minimum margin requirement for security futures set by law is 20% of the contract value.

19. C: The initial margin requirement on the purchase of a futures contract worth $5,000 is $1,000 (20%).

20. D: A spread is when an investor takes a long position in a futures contract of one maturity and a short position in a contract on the same commodity with a different maturity.

21. D: An investor having purchased 5 September wheat futures contracts at 7.35 would like to protect and maximize the profit given his desire to sell sometime in the near future. The contracts are trading at a high of 9.85, but the investor believes that the price will begin to drop, possibly to as low as 7.50. The order he should enter to protect and maximize those profits is “sell 5 September wheat futures at 9.25 stop.” If these contracts trade down to or through 9.25, a market order will be triggered to sell at that price, thus providing a profit for that investor. A “sell 5 September wheat futures at 8.25 stop” order will provide profit but less than the order to sell at 9.25. A “sell 5 September wheat futures at 7.25 stop” will NOT provide any profit given the 7.25 sell price is below the purchase price of 7.35.

22. D: An investor who purchased 17 April corn futures contracts at 14.50 would maximize profits here by selling at 15.75. Selling at 15.25 would provide some profit but less than 15.75, and selling at either 14.00 or 14.25 would produce a loss, having purchased the contracts at 14.50.

23. B: In the futures industry, margin is a deposit of funds with the brokerage firm to provide a reserve to cover potential losses. When purchasing stocks, margin refers to a partial payment for the stock being purchased.

24. B: Buyers of futures contracts have no ownership interests or voting rights and receive no dividends.

25. A: Failure to meet a margin call within the time period allowed may result in the broker liquidating a customer’s open futures positions at the current market price without prior notice.

26. C: Purchasing 9 May silver futures contracts at 55.75 will allow this investor to cover the short position while additionally making a profit from buying at 55.75 and selling at 57.25. Purchasing at 57.00 is still below the sale price but barely and still less (if any) potential profit than the 55.75 option. Both 57.75 and 58.25 are purchase prices that are higher than this investor’s sale price, thus profit potential would be eliminated here.

27. A: The request for additional margin is a margin call.

28. B: The amount of the margin call is $2,000. Because the amount of funds fell below the maintenance requirement, deposit enough funds must be deposited to restore the account to the initial requirement of $5,000.

29. D: Futures contracts began trading in the United States in 1865.

30. D: If a Standard & Poor's (S&P) 500 index futures contract is currently trading at a price of 145-00, the intrinsic value of a call option conveying the right to purchase that futures contract at a strike price of 135-00 is $1,000. S&P 500 index options conventionally have a 100x contract multiplier, in which case a $10 difference between the currently traded price and the strike price ($145 - $135) would yield a $1,000 intrinsic value.