OPTIONS PRACTICE EXAM

1. If a customer buys 1 FLB Oct 50 call at 3 and she exercises the option to buy 100 shares when the market is at 60, what is the cost basis of the 100 shares?

A) 5300.
B) 6000.
C) 6300.
D) 5000

2. An investor owning an option contract liquidates the position. The liquidation is

A) An opening sale.
B) An opening purchase.
C) A closing purchase.
D) A closing sale.

3. When must a new options customer return a signed option agreement?

A) Within 15 days of the account approval.
B) Before the account is approved by a registered options principal.
C) Before the first order is entered.
D) Within 15 days of the first trade

4. Which of the following investors are bearish?

I. Buyer of a call.
II. Writer of a call.
III. Buyer of a put.
IV. Writer of a put.

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

5. All of the following would affect option premiums EXCEPT the:

A) Price of the underlying security.
B) Volatility of the underlying security.
C) The number of contracts a client is long or short.
D) Time to expiration

6. To create a credit horizontal, calendar spread, the options should have

I. Different strike prices
II. Same expirations
III. Same strike prices
IV. Different expirations

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

7. A firm may assign option exercises using which of the following methods?

I. FIFO.
II. Random assignment.
III. LIFO.

A) I and II.
B) I only.
C) I, II and III.
D) II only.

8. With XYZ trading at $47.50, your customer writes 1 XYZ January 50 put and simultaneously writes 1 XYZ January 45 call receiving $600 in combined premiums. Your customer's market attitude is:

A) Neutral.
B) Speculative.
C) Bearish.
D) Bullish.

9. If an investor buys a Jan 30 XYZ call for 4 and sells a Jan 35 call for 2, to become profitable, the spread between the prices of the two options must:

A) Remain the same.
B) Narrow.
C) Fluctuate.
D) Widen

10. In a volatile market, which of the following option strategies carries the *most* risk?

A) Short straddle.
B) Credit spread.
C) Long straddle.
D) Debit spread

11. An investor with no other positions buys 1 CDE May 65 put at 3.50. If the investor buys the stock at 63.50 and exercises the put, what is the investor's profit or loss?

A) $200 profit.
B) $350 loss.
C) $350 profit.
D) $200 loss

12. A customer should receive a current option disclosure document before or at the date of:

A) The first trade.
B) Account approval.
C) The first monthly statement.
D) Settlement.

13. Your customer informs you that news is expected on Datatech that she believes will have a big impact on the stock. Unfortunately she is unsure if the news is good for the company or will be damaging. As her RR, you inform her that she could take advantage of this if she

A) Buys a call
B) Sells a put
C) Buys a spread
D) Buys a straddle

14. Your customer is short 100sh of xyz at $65 and simultaneously writes 1 xyz June 60 put for 2. The stock declines to $55 and the put is exercised. Before taxes, what is your customer's gain or loss?

A) $1200 gain
B) $700 gain
C) $200 loss
D) unlimited loss

15. A customer establishes the following positions: Buy 100 ABC at 28
Buy 1 ABC Dec 25 put at 2. At what price must ABC trade for the customer to breakeven?

A) $30
B) $27
C) $26
D) $23

16. An investor is long 1 OEX December 420 call for $1200. When the current market is at 445 the investor exercises is option. He would receive:

A) The difference between the strike price and the market value times a multiplier of 100
B) 100sh of stock in the underlying security for a cost of $420
C) The net difference between $1200 and $445
D) The difference between the strike price and the market value times a multiplier of 100 less the premium

17. An investor with no other positions buys 1 DWQ Jun 60 call at 3.50. If the investor exercises the call when the stock is trading at 68 and immediately sells the stock in the market, what is the investor's profit or loss?

A) $350 loss.

B) $450 profit.

C) $450 loss.

D) $350 profit

18. Your customer has noticed that her portfolio hasn't been performing well lately and would like to know how to increase the return in the short-term. As her RR, you may recommend she:

A) Buy long puts
B) Buy long calls
C) Write covered call
D) Write uncovered puts

19. As a RR, you would recommend a short straddle if you believed the market will:

A) Rise
B) Remain the same
C) Fall
D) Be volatile

20. A customer goes long an MMM Jan 40 put at 5 and writes an MMM Jan 50 put at 13. The customer will break even or profit when the market price is at all of the following EXCEPT:

A) $35/share
B) $50/share
C) $42/share
D) $45/share

21. A UK company exports sweaters to the U.S. and will be paid in U.S. dollars on delivery. To hedge foreign-exchange risk using listed currency options, the UK Company should:

A) Buy British pound calls
B) Sell British pound puts
C) Buy British pound puts
D) Sell British pound calls

22. A person who buys a put will lose most or all of his investment if, just before expiration, the price of the underlying stock is:

I. the same as the exercise price.
II. greater than the exercise price.
III. less than the exercise price.

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

23. Your customer is long 100sh of XYZ at $50. She fears a near term correction but overall she remains bullish. As her RR, you tell her if she would like to profit from this, she could:

A) Buy a 50 Put
B) Buy a 50 Call
C) Sell a 55 Call
D) Sell a 55 Put

24. On January 1, an investor buys 1 FLB Apr 50 call at 4 and 1 FLB Apr 50 put at 2.50. If both options expire unexercised, what are the tax consequences for the investor?

A) $150 net capital loss.
B) $400 gain on the call, $250 gain on the put.
C) $400 loss on the call, $250 loss on the put.
D) $150 net capital gain.

25. Your customer who is long a stock and wishes to limit the potential downside risk should:

A) Buy a put.
B) Enter a sell limit order.
C) Enter a buy stop order.
D) Buy a call

26. Data Tech imports raw material from their Tokyo supplier with payment in Yen expected in 30 days. However, Data Tech fears the value of the dollar will decline in the near future. To hedge their purchase they may:

A) Buy Yen Calls
B) Buy Yen Puts
C) Buy U.S. Dollar Calls
D) Buy U.S. Dollar Puts

27. Your customer writes a combination. She is:

A) Bullish
B) Bearish
C) Neutral
D) Consolidated

28. Your customer Bob buys 1 ABC Nov. 60 call for $300 when the market price of ABC is $56/sh. At expiration, with ABC now trading at $67/sh, he closes his position. For tax purposes, what is his gain or loss?

A) $300 capital gain
B) $400 capital gain
C) $700 capital gain
D) $300 capital loss

29. An investor is long 1XYZ Jan. 40 call and writes 1 XYZ Jan. 50 call. Which two statements are true?

I It is Bullish
II It is Bearish
III It is a Debit
IV It is a Credit

A) I and III
B) I and IV
C) II and III
D) II and IV

30. An investor is long 1 ABC May 40 call for $600 and is short 1 ABC May 50 call for $200. To maximize his profit, he would:

I Want the spread to widen
II Want the spread to narrow
III Exercise both options
IV Allow both options to expire

A) I and III
B) I and IV
C) II and III
D) Ii and IV

31. Your customer is long 1 XYZ Nov. 30 call when she learns that XYZ has announced a 3 for 2 split and wants to know how this will affect her option. As her RR, you tell her on the ex-dividend date she will own:

A) 1 XYZ 20 call (100 shares)
B) 2 XYZ 20 calls (100 shares)
C) 1 XYZ 20 call (150 shares)
D) 2 XYZ 20 calls (150 shares)

32. The VIX mimics the volatility of stocks that underlie options. Known as the “fear index”, the VIX tracks which index?

A) S&P 100
B) Wilshire 5000
C) Russell 2000
D) S&P 500

33. An investor is long 100 shares of XYZ at $50 and long 1 XYZ Jan 50 Put. This is known as

A) a married put
B) a straddle
C) a spread
D) a combination

34. Which of the following represents a spread?

A) Long April 50 call, long April 50 put
B) Long April 50 call, short May 50 call
C) Long May 50 put, long May 60 put
D) Long May 50 call, long April 60 call

35. An investor who is fairly conservative is seeking income and doesn’t think the market will rise. As a R.R., which would you recommend?

A) A credit call spread
B) A long straddle
C) Buy a put
D) covered calls

36. An investor is long 1 XYZ April 40 call and short 1 XYZ July 40 call. Which of the following best describes his position?

I Bullish
II Bearish
III Calendar spread
IV Vertical spread

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

37. Investor writes a call in July but it expires in January of next year. When is it taxed?
A) When the investor receives the money
B) When the option expires
C) When the option is sold
D) On the settlement date

38. An investor wished to generate maximum income from their portfolio. She is currently long 300sh of MNO ant $50/share and would like to place an order to sell 5 MNO 55 calls at 3. As the R.R., you would inform her that

A) This position has an unlimited potential risk
B) An excellent way to generate income from a stock portfolio
C) It is a bullish strategy
D) It would increase her cost basis on the stock

39. Your client bought 1 ABC 70 July put. What would you recommend to close her position?
A) Long 1 ABC 70 July Call
B) Short 1 ABC 70 July call
C) Short 1 ABC 70 July put
D) Long 1 ABC 70 July put

40. You have several clients that currently own option positions in DXY, Inc. The company has declared a $0.50 cash dividend to be paid in 3 months. What effect will this have on your customer's option positions?

A) It will only effect the number of contracts each customer owns
B) It will only effect the strike price of the option
C) It will effect both the number of contracts and the strike price
D) It will have no effect on the option contracts

41. In November, an investor wants to sell his shares now, but doesn't want to incur the tax consequences until next year. If he is only willing to hold the shares for another six months, writing which calls would be most profitable and achieve his objectives.

A) American style April call, out-the-money strike price
B) American style January call, at-the-money strike price
C) European style April call, out-the-money strike price
D) European style January call, at-the-money strike price

42. Which VIX Index option would be bearish in the market?

A) Long VIX call
B) Short VIX put
C) Debit VIX call spread
D) Debit VIX put spread

43. A customer buy 100 shares of ABC at 49 and buy 1 XYZ Jan 50 Put at $5. Just prior to expiration, the stock is trading at 49. The customer closes the option position at a premium of $2. One week later, the stock moves to 55 and the customer sells the stock position in the market. The net gain or loss on all transaction is:
A.$ 300 Gain
B.$ 300 Loss
C.$ 600 Gain
D. $600 Loss

44. An investor would like to take advantage of a rally in XYZ stock at the lowest possible cost. As the RR, which would you recommend?
A. A debit call spread
B. A credit call spread
C. A debit put spread
D. A credit put spread

ANSWER KEY

1. A. For tax purposes, add the premium to the cost of the stock to determine the cost basis
2. D. You had to have bought to own, therefore you must sell to close.
3. A. Be careful! It usually doesn't work like this in the real world. 15 days from account approval.
4. D. Look at your options chart. Don't you wish the real test was this easy!!
5. C. How many contracts an investor owns, has nothing to do with the value of the premium.
6. D. To create a calendar (or time) spread, the options must contain options of differing time value.
7. A. A B/D, unlike the O.C.C., has a choice between First in, first out or a random fair method.
8. A. A short straddle is neutral.
9. D. Debit spreads must widen.
10. A. Be careful! Our objective is NOT volatility. That is our RISK!
11. D. Do a T-chart. Out $350. Out $6350. In $6500 when they exercise their right to sell at the strike price.
12. B. The Options Disclosure Document is required to be delivered to the customer at or prior to the R.O.P. approval
13. D. When you anticipate volatility but are unsure of the direction – classic definition of a long straddle!
14. B. Do a T-chart. $65 in. $2 in. $60 is out when the put is exercised and you are obligated to buy at the strike price ($55 is a distracter).
15. A. Easy! For a hedge, do a T-chart to determine breakeven. $28 out, $2 out. Net $30.
16. A. When exercising an index option, the investor receives cash equal to the intrinsic value. Intrinsic value, of course, is simply when the market price is greater than the strike price and never involves the premium paid
17. B, Do a T-chart! Out $350 and $6000 from buying the initial option and then exercising and buying the stock at the strike price. In $6800 when you sell the stock at the current market price. $450 net profit.
18. C. If you're long stock and want to enhance the profit, you would sell or write calls.
19. B, We are anticipating a flat or neutral market when we sell a straddle.
20. A, This is a credit put spread. Since the short put is more dominant (higher strike price) it is bullish. The breakpoint for this spread is the net premium subtracted from the higher strike price (PSH) which would be 42. So any price of 42 or above would be profitable.
21. A. A foreign exporter (U.S. importer) buys calls on the risk the U.S. dollar declines (foreign currency increases) in value.
22. D. Buying puts are bearish and therefore will lose money if the stock is at, or, out of the money.
23. C. Look at your options chart. If you're long stock and want to profit, sell a call. Bullish is a distractor, the option matches the risk direction.
24. C. The maximum loss whenever you buy options are the premiums.
25. A. Look at your options chart. Whenever you're long stock and want to protect, buy a put.
26. A. Remember, there are no options on U.S. currency. Only on foreign currency. Our risk is that the yen will cost more.
27. C. Selling straddles/combinations we are neutral (stability).
28. B. There are many ways to look at this. The easiest is buy the call for $300 and trade it for its intrinsic value of $700 for a net profit of $400.
29. A. For spreads without premiums, the lower strike price has a higher premium and thus, more dominant. The long call being more dominant and is bullish. More money is going out, thus a debit.
30. A. "DEW". Debit spreads, exercise, widen.
31. C. For an uneven split, the number of contracts do not change. Only the number of shares in the contract (Ignore the strike price). There is only one answer that satisfies this.

32. D. The “VIX” attempts to mimic the volatility of the S&P 500 index.
33. A. A long stock position with a long put is known as a married put.
34. B. A spread is buying and selling the same type of option. This is a horizontal spread since the strike prices are the same and the expiration is different.
35. D. Writing covered calls is a low risk strategy to create income when the market is stable or slightly bearish.
36. C. Since the strike prices are the same but the expirations are different, this is a calendar (horizontal) spread. Since the short call has the longer expiration, it would have more time value and therefore a higher premium and thus make the short call more dominant. And short calls are bearish.
37. B. Capital gain or loss is realized when the option expires.
38. A. Known as a “ratio write”, it contains 2 calls that are uncovered and, therefore, has an unlimited risk.
39. C. To close an option position, you would use the same option, only opposite transaction.
40. D. Option contracts are only adjusted for stock dividends
41. C. European options cannot be exercised before expiration thus avoiding the possibility of being exercised and incurring a capital gain on the stock.
42. D. In a debit put spread, the long put is more dominant (higher premium) and long puts are bearish.
43. A. Buys the stock for $49 and buys the put for $5. Sells the put at $2 and sells the stock at $55.
44. D. Both the debit call spread and the credit put spread are bullish strategies. However, the credit put spread would bring premiums into the account where the debit call spread would cost premiums out of the account.