SSEI
Sanjay Saraf Educational Institute Pvt. Ltd.
A positive NPV Training Center

ADVANCED FINANCIAL MANAGEMENT

CASE SCENARIO BASED MCQ QUESTIONS

CASE STUDY 1

Answer:

Question 1:

A is correct.

Question 2:

A is correct.

Question 3:

D is correct.

Question 4:

B is correct.

Question 5:

A is correct.

Question 6:

D is correct.

Question 7:

C is correct.

Question 8:

C is correct.

Question 9:

B is correct.

Question 10:

C is correct.

Question 11:

B is correct.

Question 12:

C is correct.

Explanation:

Discussed in Class.

CASE STUDY 2

Question 1:

D is correct.

The covered call writer participates in gains up to the exercise price, after which further appreciation is lost to the call buyer. That is, $X - S_0 = 30.00 - 25.00 = 5.00$. The call writer also keeps c_0, the option premium, which is 1.55. So, the total maximum gain is 5.00 + 1.55 = 6.55.

Question 2:

A is correct.

The call premium of 1.55 offsets a decline in the stock price by the amount of the premium received: 25.00 − 1.55 = 23.45.

Question 3:

A is correct.

The stock price can fall to zero, causing a loss of the entire investment, but the option writer still keeps the option premium received: 25.00 − 1.55 = 23.45

CASE STUDY 3

Question 1:

A is correct.

If the stock price is above the put exercise price at expiration, the put will expire worthless. The profit is the gain on the stock ($S_T - S_0$) minus the cost of the put. Note that the maximum profit with a protective put is theoretically unlimited, because the stock can rise to any level and the entire profit is earned by the stockholder.

Question 2:

B is correct.

Because the option buyer pays the put premium, she does not begin to make money until the stock rises by enough to recover the premium paid.

Question 3:

A is correct.

Once the stock falls to the put exercise price, further losses are eliminated. The investor paid the option premium, so the total loss is the “deductible” plus the cost of the insurance.

CASE STUDY 4

Question 1:

C is correct.

With a bull spread, the maximum gain occurs at the high exercise price. At an underlying price of 50 or higher, the spread is worth the difference in the strike prices, or 50 − 45 = 5. The cost of establishing the spread is the price paid for the lower-strike option minus the price received for the higher-strike option: 2.55 − 1.45 = 1.10. The maximum gain is 5.00 − 1.10 = 3.90.

Question 2:

D is correct.

With a bear spread, an investor buys the higher exercise price and writes the lower exercise price. When this strategy is done with puts, the higher exercise price option costs more than the lower exercise price option. Thus, the investor has a debit spread with an initial cash outlay, which is the most he can lose. The initial cash outlay is the cost of the OCT 50 put minus the premium received from writing the OCT 45 put: 6.80 − 2.92 = 3.88.

Question 3:

A is correct.

An investor buys the OCT 45 call for 2.55 and sells the OCT 50 call for 1.45, for a net cost of 1.10. She breaks even when the position is worth the price she paid. The long call is worth 1.10 at a stock price of 46.10, and the OCT 50 call will expire out of the money and thus be worthless. The breakeven price is the lower exercise price of 45 plus the 1.10 cost of the spread, or 46.10.