

Update

Update for Licensing Examination for Securities and Futures Intermediaries Sample Questions - Paper 9: Futures

On pages 19, 42 and 43 of the English version, question 31 and its explanation are to be replaced by the following:

Question 31

Jason believes that he has a thorough understanding of derivative investment. In order to fully hedge his current holding of Bang Inc. shares, he decides to long Bang Inc.'s futures contracts. The transaction details of Jason's hedging strategy are summarised below:

Number of Bang Inc.'s shares on hand:	100,000 shares
Spot price of Bang Inc.'s shares:	HKD15.50 per share
Number of shares per futures contract:	10 shares
Current price of Bang Inc.'s futures:	HKD15.80 per share

Two days later, the price of Bang Inc.'s shares drops to HKD14.50 per share while [the futures contracts are trading at HKD14.25 per share](#). Which of the following statements CORRECTLY illustrates the mark-to-market situation of Jason's portfolio?

- A There is no gain or loss in Jason's portfolio since the futures contracts perfectly hedge the positions in Bang Inc.'s shares.
- B A gain of HKD55,000 in Jason's portfolio due to an over-hedge in futures contracts.
- C A loss of HKD255,000 in Jason's portfolio due to an incorrect hedging strategy with the futures contracts.
- D A loss of HKD55,000 in Jason's portfolio due to an under-hedge in futures contracts.

Question 31 The performance of Jason's portfolio can be evaluated by comparing the portfolio value on each of the 2 days.

Day 0:

- i) Share value = HKD(100,000 × 15.50) = HKD1,550,000
- ii) Number of futures contracts required = $\frac{100,000}{10} = 10,000$ contracts
- iii) Value of the bought (long) futures contracts (10 shares per futures contracts):
HKD(10,000 × 15.80 × 10) = HKD1,580,000

Day 2:

- iv) Share value = HKD(100,000 × 14.50) = HKD1,450,000
- v) Value of the bought (long) futures contracts (10 shares per futures contracts):
HKD(10,000 × 14.25 × 10) = HKD1,425,000
- vi) Profit(loss) on shares = HKD(1,450,000 – 1,550,000) = –HKD100,000
- vii) Profit(loss) from futures contracts = HKD(1,425,000 – 1,580,000)
= –HKD155,000
- viii) Total profit(loss) of portfolio = –HKD100,000 – HKD155,000 = –HK255,000

Since the value of the futures contracts decreases when the share price decreases, the futures contracts are obviously not performing their hedging function, i.e. Jason has implemented an incorrect hedging strategy. In fact, for a long shares position, Jason should short futures contracts. The reader is encouraged to calculate the net profit (loss) if Jason does short the futures contracts. (Ans.: a profit of HKD55,000)

The answer to the question remains to be C.

June 2005