Cfa Level 1 Sample Test Papers

VIX term structure: In contango generally, and nearest future price > VIX actual as they converge → long futures loss typically (UNLESS VIX increases)

losses ≈ insurance premiums paid by policy holders.

30.4 Demonstrate knowledge of volatility products.

For example:

- Describe the economic rationale for the existence of volatility products efficient to transfer risks as vol.

4) vol sellers > must be compensated — higher price for implied vol > realized
bond buyers — credit spread

factors of VIX premium

- List and describe four features common to both volatility products and bonds
  1) Quoted in similar manner: yields and implied vol
  2) Bonds driven by interest rates / Vol. products by vols > Both mean revert.
  3) rates & vols have term structure no underlying traded asset.

- Describe the characteristics of variance swaps, including their link to realized volatility Buyer receives realized variance, pays predetermined variance (Strike) × Notional

  by implied option vol.

- Describe the Chicago Board Options Exchange (CBOE) Volatility Index (VIX), and recognize the steps for calculating the VIX

• 30-day implied vol of S&P 500 w exactly 30 days expiration (weighted average of actual options)

crisis • exact formula uses variance swap valuation. all strikes

@ two dates: prior 30 days > interpolate and $\sqrt{\text{sqr}}$ fewer sect

after 30 days except options w/o bids

payoff VIX↑ = asset prices↓

- Describe futures contracts and options based on the VIX, recognize how the VIX term structure can serve as a proxy for portfolio insurance, and describe VIX-related options and ETFs or deltas & deltas w/o bids.

• Long: $1,000 × VIX point above contract price. 30 day options all days

• monthly settlement: up to 1 yr.

• weekly: up to 6 weeks

futures settlement

Long futures VIX used to hedge long positions in Equity

VIX based on implied vol. of the next 30 days

- Calculate the price of a given 30-day hypothetical contract

→ insurance. 30-day hypothetical contract price

$$= \frac{P_S \times T_S}{T_1 - T_S} + P_1 \frac{30 - T_S}{T_1 - T_S}$$

P_S: price short-term contract

T_S: Time short-term

P_1: Price long-term

T_1:

"simulate roll down" changing weights

dispersion trade

corr swap ≈ short index options long options in components

→ gain if ↓

short corr swap can be adjusted to be proportional to countours

- Describe the mechanics of, price modeling of, and motivations for correlation swaps; calculate the net payment on a given correlation swap; and describe dispersion trades

Correlation swap: transfer risk from buyer to seller that actual correlation of set of individual stocks will differ from strike correlation.

• correlation ↑ in crises.
→ swaps profitable

swap | buyer pays Notional × strike weighted correlation
| seller pays notional × realized weighted correlation

swap price typically > realized vol
→ selling swap is profitable

- Identify the common theme found in the pricing and trading of volatility and volatility products

• investors are willing to pay for exposure to vol., variance, corr because all have negative correlation to equity mkt.
(passive long exposures produce negative returns)

all options delta hedged neutral

dispersion trade: long volatility in index component options, sell vol. index options all delta neutral

30.5 Demonstrate knowledge of option-based volatility strategies.

For example:

implied corr in index options > realized corr index components

- Describe the characteristics and mechanics of vertical intra-asset (skew) option spreads, describe how vertical spreads take advantage of volatility skew, and discuss how to use vertical spreads in equities while hedging delta risk

Vertical spread is a type of skew spread

implied vol

Selling OTM options: higher implied vol > buying ATM options

strike

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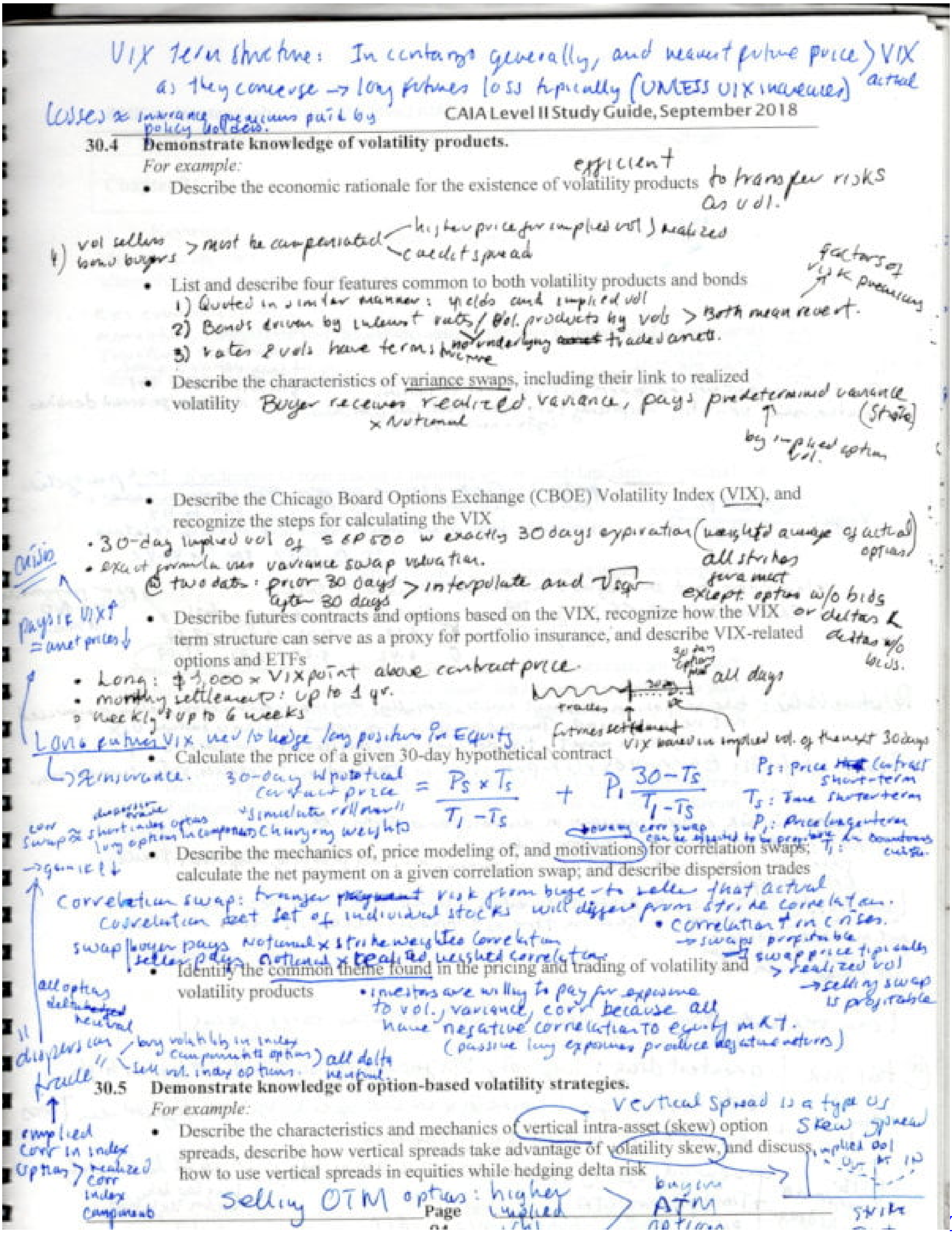

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