

- 2.) Suppose r_f is 5% and r_M is 10%. According to the SML and the CAPM, an asset with a beta of -2.0 has a required return of *negative* 5% [= $5 - 2(10 - 5)$]. Can this be possible? Does this mean that the asset has negative risk? Why would anyone ever invest in an asset that has an expected and required return that is negative? Explain

The return on the stock moves in an opposite manner to the returns on the market. In my organization within the banking industry, we pull up the Daily Market Report each morning to see the trends in the market and determine if our interest rates will decrease, remain the same or increase. We also observe the market prices to determine if our own stocks in our company have changed. Whenever the market rises, this stock will decline and when the market declines, the stock will rise. There is still risk in the stock since the returns vary. The negative return is due to the negative beta which implies that this stock is similar to an insurance policy; it helps in reducing risk but in itself does not provide any return. I think that Investors would be really interested in such a stock since it would reduce the beta of a portfolio and therefore, reduce the risk of a portfolio. The stock return is opposite to the market returns and so both together will have a stabilizing effect on the return and therefore lower the risk involved.