Finance 534 week 5 quiz 4

Question 1

Assume that in recent years both expected inflation and the market risk premium (rM − rRF) have declined. Assume also that all stocks have positive betas. Which of the following would be most likely to have occurred as a result of these changes?
Answer

Correct Answer: The required returns on all stocks have fallen, but the fall has been greater for stocks with higher betas.

Question 2

Assume that the risk-free rate is 5%. Which of the following statements is CORRECT?

Correct Answer: If a stock has a negative beta, its required return under the CAPM would be less than 5%.

Question 3

Which of the following statements is CORRECT?

Correct Answer: Diversifiable risk can be reduced by forming a large portfolio, but normally even highly-diversified portfolios are subject to market (or systematic) risk.

Question 4

A highly risk-averse investor is considering adding one additional stock to a 3-stock portfolio, to form a 4-stock portfolio. The three stocks currently held all have b = 1.0, and they are perfectly positively correlated with the market. Potential new Stocks A and B both have

expected returns of 15%, are in equilibrium, and are equally correlated with the market, with r = 0.75. However, Stock A's standard deviation of returns is 12% versus 8% for Stock B. Which stock should this investor add to his or her portfolio, or does the choice not matter?

Correct Answer: ✅
Stock B.

Question 5

Which of the following statements is CORRECT? (Assume that the risk-free rate is a constant.)

Correct Answer: ✅
If the market risk premium increases by 1%, then the required return will increase by 1% for a stock that has a beta of 1.0.

Question 6

During the coming year, the market risk premium (rM − rRF), is expected to fall, while the risk-free rate, rRF, is expected to remain the same. Given this forecast, which of the following statements is CORRECT?

Correct Answer: ✅
The required return will fall for all stocks, but it will fall more for stocks with higher betas.

Question 7
2 out of 2 points

Stock A's beta is 1.5 and Stock B's beta is 0.5. Which of the following statements must be true, assuming the CAPM is correct.

Correct Answer: ☑
In equilibrium, the expected return on Stock A will be greater than that on B.

Question 8

Bob has a $50,000 stock portfolio with a beta of 1.2, an expected return of 10.8%, and a standard deviation of 25%. Becky also has a $50,000 portfolio, but it has a beta of 0.8, an expected return of 9.2%, and a standard deviation that is also 25%. The correlation coefficient, r, between Bob's and Becky's portfolios is zero. If Bob and Becky marry and combine their portfolios, which of the following best describes their combined $100,000 portfolio?

Correct Answer: ☑
The combined portfolio's beta will be equal to a simple weighted average of the betas of the two individual portfolios, 1.0; its expected return will be equal to a simple weighted average of the expected returns of the two individual portfolios, 10.0%; and its standard deviation will be less than the simple average of the two portfolios' standard deviations, 25%.

Question 9

Stock A's beta is 1.5 and Stock B's beta is 0.5. Which of the following statements must be true about these securities? (Assume market equilibrium.)

Correct Answer: ☑
The expected return on Stock A should be greater than that on B.

Question 10

For a portfolio of 40 randomly selected stocks, which of the following is most likely to be true?

Correct Answer: ☑
The beta of the portfolio is equal to the average of the betas of the individual stocks.

Question 11