8-7

Suppose you are the money manager of a 4 million investment fund. The fund consists of four stocks with the following investments and betas:

Stock Investment Beta

A 400,000 1.50

B 600,000 (0.50)

C 1 million 1.25

D 2 million 0.75

If the market’s required rate of return is 14% and the risk free rate is 6%, what is the funds required rate of return?

8-10

Bradford Manufacturing has a beta of 1.45, while Farley Industries has a beta of 0.85. The required return on an index fund that holds the entire stock market is 12.0%. The risk free rate of interest is 5%. By now how much does Bradford’s required return exceed Farleys required return?

8-12

r(RF) = risk free rate of return; r(M) = required rate of return on a portfolio

b(i)= beta coffecient of the ith stock

Required Rate of Return : suppose r(RF) = 9%, r(M) = 14% and b(i)= 1.3

1. What is r(i) , the required rate of return on Stock i?
2. Now suppose r(RF) 1 increases to 10% or (2) decreases to 8%. The slope of the SML remains constant. How would this affect r(M) and r(i)?
3. Now assume r(RF) remains at 9% but r(M)(1) increases to 16% or (2) falls to 13%. The slope of the SML does not remain constant. How would these changes affect r(i)?