#39

You are currently only invested in the Natasha Fund (aside from risk-free securities).It has an expected return of 14% with a volatility of 20%. Currently, the risk-free rate of interest is 3.8%. Your broker suggests that you add Hannah Corporation to your portfolio. Hannah Corporation has an expected return of 20%, a volatility of 60%, and a correlation of 0 with the Natasha Fund.

1. Is your broker right?
2. You follow your broker’s advice and make a substantial investment in Hannah stock so that, considering only your risky investment, 60% is in the Natasha Fund and 40% is in Hannah stock. When you tell your finance professor about your investment, he says that you made a mistake and should reduce your investment in Hannah. Is your finance professor right?
3. You decide to follow your finance professor’s advice, and reduce your exposure to Hannah. Now Hannah represents 15% of your risky portfolio, with the rest in the Natasha Fund. Is this the correct amount of Hannah stock to hold?