Corporate Investment Analysis - in FINANCE. Reilly, F., & Brown, K. (2012). *Investment analysis and portfolio management* (10th ed.). Mason, OH: South-Western/ Cengage Learning. Book used by Strayer University.

8). As an equity analyst, you have developed the following return forecasts and risk estimates for two different stock mutual funds (Fund T and Fund U):

|  |  |  |
| --- | --- | --- |
|  | Forecasted  Return | CAPM  Beta |
| Fund T | 9.0 | 1.20 |
| Fund U | 10.0 | .80 |

a). If the risk-free rate is 3.9% and the expected market risk premium (i.e., E(RM) – RFR) is 6.1%, calculate the expected return for each mutual fund according to the CAPM.

b). Using the estimated expected returns for Part a along with your own return forecasts, demonstrate whether Fund T and Fund U are currently priced to fall directly on the security market line (SML), above the SML, or below the SML.

c). According to your analysis, the Funds T and U overvalued, undervalued, or properly valued?

10). Draw the security market line for each of the following conditions:

a). (1) RFR = 0.08; RM(proxy) = 0.12

(2) Rz = 0.06; RM(true) = 0.15

b. Rader Tire has the following results for the last six periods. Calculate and compare the betas using each index.

RATES OF RETURN

|  |  |  |  |
| --- | --- | --- | --- |
| Period | Rader Tire  (%) | Proxy Specific Index (%) | True General Index (%) |
| 1 | 29 | 12 | 15 |
| 2 | 12 | 10 | 13 |
| 3 | -12 | -9 | -8 |
| 4 | 17 | 14 | 18 |
| 5 | 20 | 25 | 28 |
| 6 | -5 | -10 | 0 |
|  |  |  |  |

c). If the current period return for the market is 12% and for Rader Tire it is 11%, are superior results being obtained for either index beta?