Session 4: Post class test solutions

1. **d. Risk may be easier to measure and to insure against than uncertainty, but investors should care about both, when investing.** Just because you cannot measure something does not mean that it does not affect you and that you will not try to protect yourself against it.
2. **c. Investors will take risk, but only if they feel that they get a sufficient reward for risk taking.** Risk averse does not imply that you avoid risk at all costs and it certainly does not imply that you will seek it out.
3. **c. Less than $50.** If you were risk neutral, you would pay $50. If you were risk seeking, you would pay more than $50.
4. **b. Investor B is more risk averse than investor A.** These cash flows are certainty equivalents, and the more risk averse you are, the less you will be willing to pay, relative to expected value, to take a gamble.
5. **d. Rejecting a $60 loss to take a bet where you have a 60% chance of losing $100.** The reason this is a behavioral quirk is that risk aversion, in general, should lead you to accept a guaranteed amount over an uncertain bet with the same expected value. That seems to work with gains but not with losses.