Session 4: Post Class tests

1. Frank Knight drew a distinction between risk and uncertainty, based primarily upon measurability. Which of the following statements would you agree with, based upon that distinction?
    a. It is easier to insure against uncertainty than it is to insure against risk.
    b. Investors should avoid uncertainty but seek out risk
    c. Investors should seek out uncertainty but avoid risk
    d. Risk may be easier to measure and insure against than uncertainty, but investors should care about both, when investing.
2. In economics and investing, we assume that investors are risk averse. That implies that:
    a. Investors will not take risk
    b. Investors will seek out risk
    c. Investors will take risk, but only if they feel that they get a sufficient reward for risk taking
    d. Investors will take risk, but only if they are guaranteed that they will not lose money
    e. None of the above
3. Assume that you are risk averse and are offered a gamble, where there is a 50% chance you will make $100 and a 50% chance of making nothing. How much would you be willing to pay to partake?
    a. $50
    b. More than $50
    c. Less than $50
    d. I would not play. This is gambling.
4. Two investors are offered the gamble described in the previous question (50% chance you will make $100 and a 50% chance of making nothing). Investor A is willing to pay $40 to pay and Investor B is willing to pay only $35 to partake. Based upon this observation, which of the following is true?
    a. Investor A is more risk averse than investor B
    b. Investor B is more risk averse than investor A
    c. Investors A and B are equally risk averse
5. In behavioral finance, there is well documented evidence on "loss aversion". Which of the following is evidence of loss aversion?
    a. Accepting a $60 gain, instead of taking a bet where you have a 60% chance of making $100.
    b. Rejecting a $60 gain to take a bet where you have a 60% chance of making $100.
    c. Accepting a $60 loss, instead of taking a bet where you have a 60% chance of losing $100.
    d. Rejecting a $60 loss to take a bet where you have a 60% chance of losing $100.