Session 5: Post class test solutions

1. **b (Exp Return = 8% & Std Dev = 10%) is best and a (Exp Return = 3% & Std Dev = 20%) is the worst.** If you wanted to rank these investments, you could compute the ratio of Expected Return to Standard deviation and rank them from highest (best) to lowest (worst).
2. **c. The risk that a global economic slowdown will affect how much companies spend on advertising.** All the other risks are company-specific and can be diversified away.
3. **e. That you will get a better risk/return trade off than investors who are not diversified.** Diversifying will not cause risk to go away or even make your portfolio less risky than your neighbors, but it will improve your risk return trade off.
4. **c. That investors who hold large stakes in the company, and trade them, are diversified.** These marginal investors, by virtue of their large holdings and their trading, set prices and thus determine what is priced in. Everyone else is a price taker.
5. **e. All of the above.** All of these assumptions are necessary for the end result to be that investors hold the market portfolio.