In-Class Exercise 1

Elizabeth forms an aggressive growth portfolio by investing 25% of her savings in Ford stock, 25% in GM stock, 20% in Chrysler stock, 15% in an index fund, and the last 15% is allocated on a bond fund. Assume for simplicity that the index fund is a good proxy to the market portfolio and has a beta equal to 1, whereas the bond fund is a good proxy to the riskless asset. The beta of Ford stock is 1.2, the beta of GM is 1.4, and the beta of Chrysler is 1.7.

If the expected return of the market index is 12% and the risk-free asset yields 5%, what are the beta and the expected return of Elizabeth's portfolio?

In-Class Exercise 2

Stock Y has a beta of 1.3 and an expected return of 18.5%.

Stock Z has a beta of 0.7 and an expected return of 12.1%.

If the risk-free rate is 8% and the market risk premium is 7.5%,

are these stocks correctly priced?