UNIVERSITY OF TEXAS AT AUSTIN

Quiz # 20

β. α. SML. Behavior of individual investors. EMH.

Please, provide your **final answers only** to the following problems:

Problem 20.1. (2 points) *Familiarity bias* can result in a systematic trading bias and result in a deviation of prices from their fundamental values. *True or false?*

Problem 20.2. (2 points) *Overconfidence bias* results from uninformed individuals overestimating the precision of their knowledge. *True or false?*

Problem 20.3. (2 points) The stocks **alpha** (α) measures the distance the stock's average return is away from the **security market line (SML)**. *True or false?*

Problem 20.4. (2 points) According to the weak formulation of the efficient market hypothesis, one cannot consistently make gains by trading based on the information contained in past prices. *True or false?*

Problem 20.5. (2 points) In the strong form of the efficient market theory, prices reflect all public information. *True or false?*

Please, provide your **complete solution** to the following problem:

Problem 20.6. (5 points) *Source: Course 2, May 2003, Problem #3.*
Assume the CAPM holds. The beta for QRS Life Insurance Company is 0.4, while the beta for the life insurance industry is X. The risk-free rate of interest is 4% and the market return is 14%. The expected return on QRS stock minus the expected return for the industry is 0.5%.
Calculate X.