BUFN402: Homework 2s

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1.   a. CAPM assumes that all investors face the same investment opportunities, and they borrow at the same equilibrium risk-free rate. Assuming this is not true, and that the risk-free saving rate r_s and risk-free borrowing rate are different such that $r_s < r_b, \cdots$

     b. This table does not satisfy the CAPM's results. An important result of the CAPM is that since every trader is a mean-variance optimizer. Even if traders have different risk-tolerances, they will hold the same risky tangent portfolio T with maximum Sharpe Ratio, just with different weight to the tangent portfolio's weights. The different risk aversion (tolerances) simply adjust the weight of the risk-free asset and the weight of the tangent portfolio. However, the ratio of bonds to stocks for all of the investors should be the same. Since they aren't, not all investors are holding the tangent portfolio, so this defies the CAPM.

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