1:25 Quiz: 2/22/12 Name ______________________________

Quiz: Assume you are considering creating a portfolio by purchasing and/or short-selling shares of Kellogg (K), Royal Dutch Shell (RDS), and Southwest Airlines (LUV). The correlations between these three stocks all fall between +0.2 and + 0.7. The expected return and standard deviation of returns (volatility) on the three stocks follow:

Stock	Expected Return	Standard Deviation
K	5%	16%
RDS	8%	27%
LUV	12%	44%

a. Sketch a set of portfolios it would be possible to build using these three stocks and identify the best portfolio you could build if you desire a standard deviation of returns of 27%.

b. If the correlations between the three stocks drop, how will the set of possible portfolios change, how would the expected return on your portfolio change (assuming you still desire a standard deviation of returns of 27%)?

Note: Answer both parts on the same graph. Just be sure to label which part of the graph answers which question.

Note: Bonus WSJ Questions on back of page