2:30 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 an expected return of 8%.
b. If the correlations between the three stocks drop, how will the set of possible portfolios change, how would the standard deviation of returns on your portfolio change (assuming you still desire an expected return of 8%)?

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