Quiz A for 1:00 Class: 2/18/13 Name ____________________________

Note: Answer parts a, c, and e on the same graph. Be sure to clearly label which parts of your graph answer each part of the question.

Assume you have $100,000 and are considering buying and/or short-selling shares of Amazon (AMZN) and Morgan Stanley (MS). According to your calculations, the expected return on Amazon equals 6% and on Morgan Stanley equals 14%. And according to your calculations, the standard deviation of returns (volatility) is expected to equal 19% for Amazon and 50% for Morgan Stanley. The correlation between Amazon and Morgan Stanley equals 0.2.

a. Sketch a graph of the portfolios it would be possible for you to construct and label your best portfolio if you want an expected return of 15%.
b. What is the approximate dollar investment in each asset?
c. Assume the expected returns on both stocks drop by 3% (Amazon drops to 3% and Morgan Stanley drops to 11%). <u>On the same graph you used to answer part a</u>, show your new set of possible portfolios and your best portfolio (if you still want an expected return of 15%).
d. What types of changes will you need to make to your investments?
e. Are you better or worse off in c) than in a)? <u>On the same graphs you used to answer parts a) and c)</u>, demonstrate how the change in c) has made you better or worse off.

Wall Street Journal Questions are on the back of this page.