

Quiz A for 4:00 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 a standard deviation of returns (volatility) of 20%.
- b. What is the approximate dollar investment in each asset?
- c. Assume the correlation between Amazon and Morgan Stanley rises to 0.8. On the same graph you used to answer part a, show your new set of possible portfolios and your best portfolio (if you still want a standard deviation of returns of 20%).
- 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)? On the same graphs you used to answer parts a) and c), demonstrate how the change in c) has made you better or worse off.

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