

Past Midterm Exam

Question 1 (20 points)

(a) (5 points) What is the LIBOR rate and how is it determined? Are there any concerns with using it as a reference rate?

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(b) (5 points) What is one main drawback of a price weighted average approach in computing the stock index versus the value weighted index? Give an example of an index that is computed using the price weighted approach.

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(c) (7 points) Illustrate Portfolio A on a graph where you also plot the risk-free asset, the S&P 500 index fund, the capital allocation line and your indifference curve. Are you a relatively risk averse investor? Explain.

(d) (6 points) Now your employer adds an emerging-market fund to the two existing funds. The emerging-market fund offers an expected return of 10% per year, the same as the S&P 500 index fund, but with a standard deviation of 30%, higher than the S&P 500 index fund. Its correlation with the S&P500 index fund is 0. Would you consider including the emerging-market fund as part of your portfolio? Explain.

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