

Example: David, a new graduate, is considering to invest in the stock market. Stocks he planned to invest have return patterns corresponding to economic conditions as the table below.

State of Economy	Probability of State of Economy	Rate of Return if State Occurs	
		Stock A	Stock B
Recession	0.15	6%	-20%
Normal	0.60	7%	13%
Boom	0.25	11%	33%
Expected Return		?	?
Variance		?	?
Standard Deviation		?	?

Which stock should you recommend David to invest? Why?

Answer:

	Stock A	Stock B
Expected Return	7.85%	13.05%
Variance	3.4275	263.3500
Standard Deviation	1.8514	16.2280
CV	0.2358	1.2435

Given risk-averse investor, David should invest in Stock A since its CV is lower, implying lower risk level of the security.