

25 Lecture - MGT201

Important Subjective

- 1. Define stock beta and explain its relevance in risk analysis of individual stocks.**
Answer: Beta is a measure of a stock's volatility in relation to the overall market. It is used to analyze the risk of a stock and is a critical component of the Capital Asset Pricing Model (CAPM). A beta of 1.0 indicates that the stock's price will move with the market, while a beta greater than 1.0 means the stock will be more volatile than the market, and a beta less than 1.0 means it will be less volatile.
- 2. What is the Security Market Line (SML) and how is it used to determine the expected return of a stock?**
Answer: The Security Market Line (SML) is a graphical representation of the relationship between risk and expected return of stocks. The SML is used to determine the expected return of a stock by comparing its beta to the market risk premium. The SML is a line that connects the risk-free rate of return to the market rate of return and represents the minimum required return that investors should expect for a given level of risk.
- 3. How do efficient markets impact the pricing of stocks?**
Answer: Efficient markets are characterized by the rapid and accurate dissemination of information, leading to prices that quickly reflect all available information. In such markets, stock prices are determined by the fundamental values of the companies, and stocks are priced such that the expected return on a stock is equal to its risk-adjusted required return.
- 4. What is portfolio beta, and how is it calculated?**
Answer: Portfolio beta is the weighted average of the betas of the individual stocks held in a portfolio. It is calculated by multiplying the beta of each stock by its proportionate weight in the portfolio and adding up the results.
- 5. How does the SML relate to the Capital Asset Pricing Model (CAPM)?**
Answer: The SML is a key component of the Capital Asset Pricing Model (CAPM), which is a widely used model to estimate the expected return of an asset based on its risk. The CAPM uses the SML to determine the required rate of return for a given level of risk and the expected return of a stock.
- 6. What is the risk-free rate, and how is it used in the SML?**
Answer: The risk-free rate is the rate of return an investor can earn with certainty, such as from a government bond. It is used as the starting point for the SML, as it represents the minimum expected return an investor should receive for taking on any amount of risk.
- 7. What is the market risk premium, and how is it used in the SML?**
Answer: The market risk premium is the additional return investors require to invest in a risky asset over and above the risk-free rate. It is used in the SML to determine the required return for a given level of risk.
- 8. How do changes in market conditions, such as interest rates and inflation, impact the SML?**

Answer: Changes in market conditions, such as interest rates and inflation, can impact the SML by shifting the line up or down. An increase in interest rates or inflation will result in an increase in the risk-free rate, which will shift the SML up. Conversely, a decrease in interest rates or inflation will shift the SML down.

9. **How is the expected return of a stock determined using the SML?**

Answer: The expected return of a stock is determined by finding the point where the stock's beta intersects with the SML. The expected return is equal to the risk-free rate plus the stock's beta multiplied by the market risk premium.

10. **How does the SML relate to the concept of efficient portfolios?**

Answer: Efficient portfolios are those that offer the highest expected return for a given level of risk