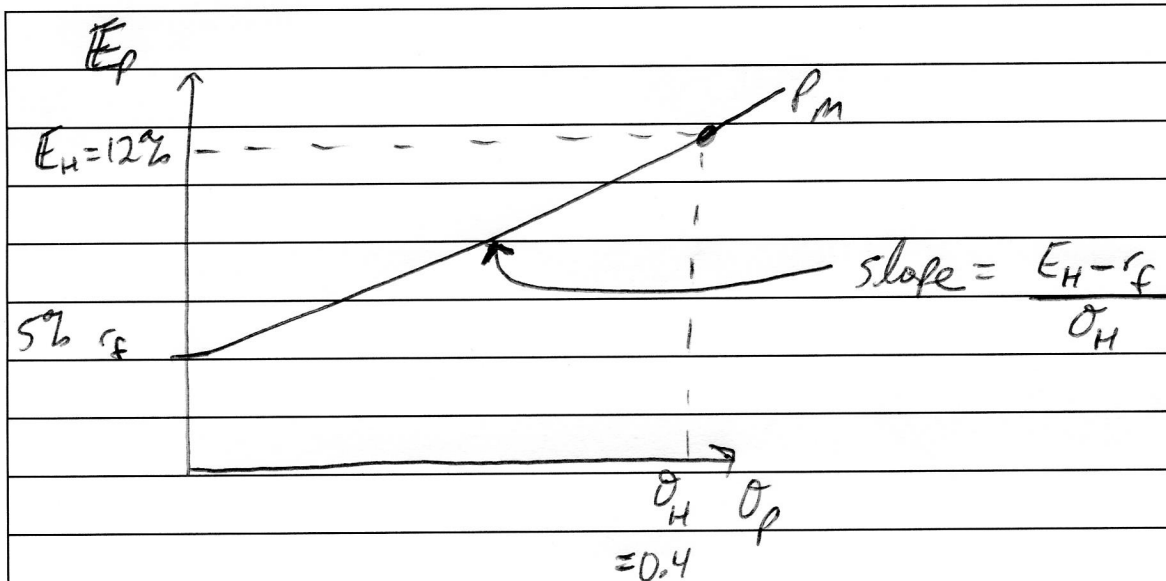




For H,

$$\frac{E_H - r_f}{\sigma_H} = \frac{12 - 5}{0.4} = \frac{7}{0.4} = 17.5$$

For M,

$$\frac{E_M - r_f}{\sigma_M} = \frac{10 - 5}{0.2} = \frac{5}{0.2} = 25$$

preview from Notesale.co.uk
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* PMs will want to choose the asset with the highest Sharpe Ratio.

• Capital Asset Pricing Model

→ Any relationship between the expected return and risk must be based on more than just the stand-alone risk of the asset σ_x .

→ CAPM captures the relationship using the incremental risk that the asset contributes to the risk of a portfolio

→ Assumptions

1) Investors are risk-averse, evaluate portfolios using mean and s.d.