**Portfolio Management – 1**

**September 2023 Examination**

**1. The CAPM is a widely used framework for estimating the expected return of an asset or a portfolio based on its systematic risk or beta. However, critics argue that the CAPM has limitations and may not accurately capture the complexities of real-world financial markets. Consider a group of finance professionals discussing the relevance of the CAPM in a real-life investment scenario. They have different viewpoints and engage in a lively debate. Present arguments supporting or criticizing the relevance of the CAPM in real-life investment decisions. (10 marks)**

**Ans :**

**Introduction:**

The Capital Asset Pricing Model (CAPM) is a fundamental tool in finance that pursues to estimate the anticipated return of an asset or a portfolio based on its systematic hazard, as measured through beta. Developed independently by William Sharpe, John Lintner, and Jan Mossin in the 1960s, monetary professionals have extensively used the CAPM for many years to make investment selections. Its simplicity and elegance have made it an attractive preference for valuing property and figuring out required rates of return.

In its middle, the CAPM assumes that traders are rational and chance-averse, seeking to

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**2. For the three securities A, B and C, following information is provided. It is given that the risk-free rate is 6% while market’s return and standard deviation are 10% and 15%, respectively. Compute the expected and required return on each stock and determine whether each stock is undervalued, overvalued or properly valued and outline an appropriate trading strategy. (10 marks)**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Stock** | **Price****Today** | **E(Price) in 1  year** | **E(dividend)  in 1 year** | **Standard  Deviation** | **Cov(Ri, Rm)** |
| **A** | **100** | **108** | **2.5** | **20%** | **0.02** |
| **B** | **200** | **225** | **5** | **35%** | **0.055** |

**Ans :**

**Introduction:**

Investing in the monetary markets involves reading different securities' risk and return characteristics. In this context, three securities - A, B, and C, are supplied with their respective fee these days, predicted rate and dividend in one year, trendy deviation, and covariance with the marketplace's go back. To assess the beauty of those stocks, we can calculate their expected and required returns. Additionally, we are able to decide whether every inventory is undervalued, overvalued, or accurately valued primarily based on these calculations and the marketplace conditions. An appropriate trading method may be outlined

**3. According to a news article on Mint:**

***"Mutual funds offer value to investors by way of efficient portfolio diversification and professional fund management. Hence the emphasis on mutual funds as the ideal way for retail investors to enter securities markets. The basic premise of mutual investing is diversification. The benefits of diversification were known, even before a mathematical formulation in the ‘modern portfolio theory’ of Harry Markowitz (1952). It is based on the old axiom of not keeping all eggs in one basket." Source: Mint***

**A) In addition to the above statement, one of your friends mentioned that the diversification could be achieved at the investor’s level. Hence, there is no need for the diversification at the fund level. Comment whether your friend is correct. (5 marks)**

**Ans ;**

**Introduction:**

Diversification is a fundamental precept in investment management that aims to lessen the risk by spreading investments across diverse assets. The number one intention of Diversification is to mitigate the impact of any character investment's terrible overall performance on the broad portfolio. This approach is based on the concept that one-of-a-kind

**B) Further, in the context of above statement, how diversification helps in the reduction of risk. (5 marks)**

**Ans :**

**Introduction:**

Diversification is a fundamental principle in investing, and it performs a critical position in reducing danger for traders. Diversification is rooted in no longer placing all of 1's investment capital into a single or few assets. Instead, it includes spreading investments across diverse properties to create a well-balanced portfolio. The number one goal of