BS2551 Money Banking and Finance

Seminar 3

Suppose you have two stocks C and D, with the following probability distributions.

State	Prob	Return C	Return D
Boom	0.2	24%	5%
Growth	0.6	12%	30%
Slump	0.2	0%	-5%

a) Compute the expected return and the standard deviation of each stock.

b) Compute the covariance between stocks C and D.

c) Compute the expected return and standard deviation of a portfolio consisting of 50% investment in C and 50% investment in D.

d) Explain your investment strategy.