Quiz On The Day After Lecture # 9

Arbitrage Pricing Theory

Suppose that there are two independent economic factors F1 and F2. The risk-free rate is 6%, and all stocks have independent firm-specific components with a standard deviation of 45%. The following are well-diversified portfolios:

Portfolio	Beta on F_1	Beta on F_2	Expected Return
A	1.5	2.0	31
B	2.2	-0.2	27

Table 1: Scenarios for 2 stocks with 2 Factors

What is the expected return-beta relationship in this economy?