SIMON FRASER UNIVERSITY
Department of Economics

Econ 482 | Prof. Kasa
Asset Pricing | Fall 2003

PRACTICE PROBLEMS

The following questions are True, False, or Uncertain. Briefly explain your answers.

1. Empirical evidence suggests that stock prices follow random walks.
2. Economic theory predicts that if markets are efficient then stock prices *should* follow random walks.
3. Increased uncertainty lowers stock prices.
4. All else equal, faster growth raises interest rates.
5. According to the consumption-based CAPM (ie, the CCAPM), the equity premium is higher when the correlation between consumption growth and stock returns is higher.
6. If investors are risk-neutral, then all assets should offer the same expected rate of return.
7. Someone with constant relative risk aversion has declining absolute risk aversion.
8. It is not possible for an asset with uncertain payoff to have an expected return below the risk-free rate.
9. If markets are complete then the expected rate of return is the same on all assets.
10. The CAPM provides a good description of the cross-section of expected stock returns.
11. A high price/earnings ratio indicates higher expected future earnings growth.
12. There is no benefit from diversification if asset returns are uncorrelated.
13. Stocks are safer in the long-run, i.e., if you can afford to hold on to them for a long time.

The following questions are short answer.

14. Briefly describe the relationship between stochastic discount factors and Arrow-Debreu state-contingent claims prices. Why is the concept of a contingent-claim useful?
15. Suppose your current wealth is $10,000 and you face a 50-50 risk of gaining or losing $1000. If you have a constant coefficient of relative risk aversion equal to 2, approximately how much would you pay to avoid this risk?