# FIN 366: INVESTMENTS
# CRITICAL THINKING & CONCEPTUAL QUESTIONS

## Chapter 5:

1. What is the key difference between the geometric and arithmetic averages, and when is each appropriate to use?
2. How do you interpret the geometric average?
3. Is the APR or EAR a better measure of what an investment actually yields?
4. Where do the probabilities for economic states and the associated asset returns come from when we do scenario analysis?
5. How do you interpret the standard deviation, and what are its units? What is the range of standard deviations that we might expect a return to fall in most of the time?
6. Is a 30% *expected* return better than a 20% *expected* return?
7. If we only know the expected return of the risky portfolio, the standard deviation of the risky portfolio, and the risk-free rate of return, can we find the Sharpe ratio of the *complete* portfolio without knowing the weight we put in the risk-free asset?
8. What determines the $y$, or how much we invest in the risky vs. the risk-free asset on the CAL?
9. How many portfolios can there be on the CAL?
10. What might we use as the “risky asset” in the complete portfolio?
11. What is commonly used as the “risk-free” component of the complete portfolio?
12. Is there a “best” portfolio to hold on the CAL?
13. Can you draw and label the CAL and CML? What is the distinction between these two lines?
14. What might cause the CAL’s slope to increase? What might cause the CAL’s slope to decrease?
15. What can cause the entire CAL to shift upward? What can “stretch” the CAL in the horizontal direction and make it “longer”?
16. What measure represents the slope of the CAL?

17. What could we use to proxy for the market portfolio on the CML, and why do we need to “proxy” for the market portfolio?
18. Why do we care about market history given it cannot predict the future?
19. How are T-bills risk-free if they have a historical standard deviation?
20. Do we typically see nominal or real rates of return presented in the financial press for stock market movements and mutual fund performance?