

CAPM Flashcards PDF

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What does CAPM stand for?

Capital Asset Pricing Model

What is the primary purpose of the CAPM?

To determine the expected return on an investment based on its systematic risk.

What is the formula for the CAPM?

Expected Return = Risk-Free Rate + Beta * (Market Return - Risk-Free Rate)

What does 'Beta' represent in the CAPM?

Beta measures the sensitivity of an asset's returns to the returns of the market.

What is the 'Risk-Free Rate' in the context of CAPM?

The return on an investment with zero risk, typically represented by government bonds.

How does CAPM relate to portfolio management?

CAPM helps investors understand the trade-off between risk and return when constructing a portfolio.

What is the 'Market Return' in the CAPM formula?

The expected return of the market portfolio, which includes all available risky assets.

What assumptions does the CAPM make about investors?

Investors are rational, risk-averse, and have access to the same information.

What is the significance of the Security Market Line (SML) in CAPM?

The SML represents the relationship between expected return and beta for all assets.

What is a limitation of the CAPM?

It assumes that markets are efficient and that all investors have the same expectations.