

# Arbitrage Pricing Theory - Details and Rubric

Address the following question and problem in a Word document by listing the question or problem first and then your response.

- Complete Chapter 25 question, 25-1, p. 1010
- Complete Chapter 25 problem, 25-2, p. 1011

Unit 4 Assignment 2: Arbitrage Pricing Theory		
Criteria for Assignment Grades	Points Possible	Points Earned
Provides correct and complete answers for questions and problems.	20	
Clearly shows the reasoning and/or calculations used to arrive at the answer or conclusion.	20	
Demonstrates excellent college-level organization and style; presents work in Excel® or Microsoft Word, showing all necessary formulas and steps.	10	
<b>Total</b>	<b>50</b>	

Question 25-1

- (25-1) Define the following terms, using graphs or equations to illustrate your answers wherever feasible:
- Portfolio; feasible set; efficient portfolio; efficient frontier
  - Indifference curve; optimal portfolio
  - Capital Asset Pricing Model (CAPM); Capital Market Line (CML)
  - Characteristic line; beta coefficient,  $b$
  - Arbitrage Pricing Theory (APT)

Question 25-2

- (25-2) An analyst has modeled the stock of Crisp Trucking using a two-factor APT model. The risk-free rate is 6%, the expected return on the first factor ( $r_1$ ) is 12%, and the expected return on the second factor ( $r_2$ ) is 8%. If  $b_{11} = 0.7$  and  $b_{12} = 0.9$ , what is Crisp's required return?

Answer 25-2

25-2 12%.