

If a question asks “why/explain”, you should give a full explanation that would convince a skeptic.

Name: _____
(also write your name on the back)

Finance 325: Quiz #4

December 2, 2010

1. You are looking into Yahoo.com as a potential investment. Below is a table with historical returns from the last 4 years. What is the expected return and standard deviation of Yahoo stock? Also give the 95% confidence interval of the expected stock return for Yahoo. (4 pts)

Yahoo.com	$\frac{1}{9\%}$	$\frac{2}{12\%}$	$\frac{3}{25\%}$	$\frac{4}{-15\%}$
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2. Total risk can be divided into two components. List and define each component. Which type of risk is compensated by the market, and why? (3 pts)
3. Southwest Airlines is looking to expand beyond transporting people. They are thinking about buying United Parcel Service (UPS). Southwest Airlines has an equity beta of 0.847, and it has 35% debt in its capital structure. UPS has an equity beta of 0.487, and 20% debt in its capital structure. What discount rate should Southwest use to value this acquisition? The market return is 13% and the risk-free rate is 5%. (3 pts)