

REVIEW

1. What effect might operating leverage be expected to have on a project's beta?

- a. Beta will increase.
- b. Beta will decrease.
- c. Beta will not be affected.
- d. The effect depends on the market risk premium

2. The slope of the security market line equals:

- a. one.
- b. beta.
- c. asset risk premium.
- d. the market risk premium.

3. The correct opportunity cost for a project is determined to be 15% and the project is expected to generate \$1 million in cash flows at the end of the next five years after an initial outlay of \$3 million. Based on this information, the project would plot:

- a. above the security market line.
- b. below the security market line.
- c. on the security market line.
- d. on the security market line, with a beta of 1.0.

4. A project is determined to have equal probability of generating \$1 million annually or \$250,000 annually for four years. The initial outlay is \$2 million. The expected return on Treasury bills is 5% and the market risk premium is 7%. What is the highest project beta that will justify acceptance of the project?

- a. 0.51
- b. 0.74
- c. 1.00
- d. 1.36

5. What return should be expected from investing in the market portfolio, which is expected to yield 16% if the investment includes all of the investor's funds plus 40% of additional funds borrowed at the risk-free rate of 6%?

- a. 18.4%
- b. 20.0%
- c. 22.4%
- d. 26.4%