Concordia University
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TEST ANSWERS

COMM 220 B • FALL 2011

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About this document

Here are the answers to the test and brief, but hopefully not too cryptic, explanations of selected questions. Still not clear? Carry on the discussion on our message board, or let me know, and I'll try to set time aside in class.

Your grade

You can find your grade in Grades folder in our FirstClass conference.

Help and helping

Ask questions, throw in your two cents, and compare answers on the message board in our FirstClass forum.

Viewing and printing

This document is optimized so you can view entire pages on screen at scales of at least 120% on most monitors. Save paper: print two-sided.

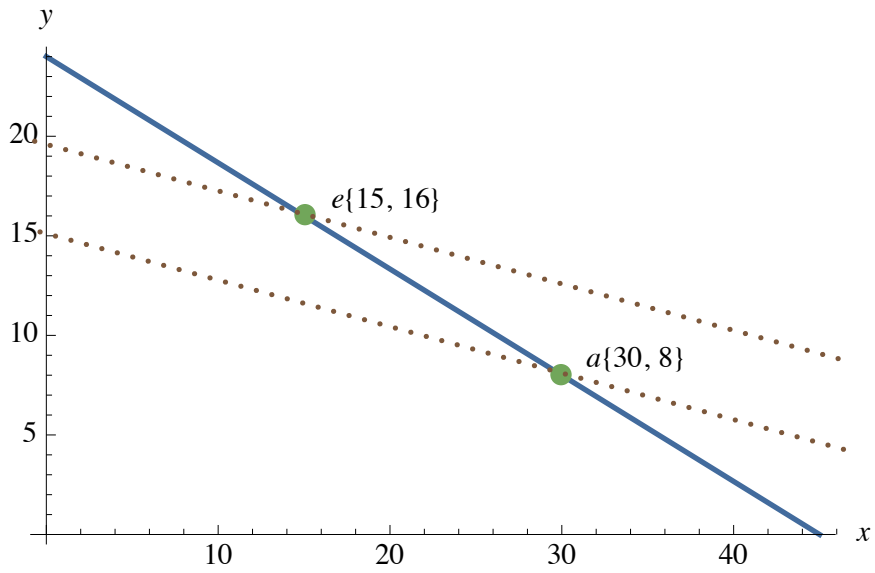
ANSWERS

Q	A	Q	A	Q	A	Q	A
1	D	11	A	21	C	31	D
2	B	12	B	22	C	32	A
3	A	13	B	23	A	33	B
4	C	14	B	24	D	34	E
5	B	15	A	25	B	35	E
6	A	16	C	26	B	36	C
7	B	17	E	27	D	37	A
8	B	18	E	28	B	38	B
9	B	19	C	29	C	39	E
10	B	20	C	30	C	40	D

Details for Selected Questions

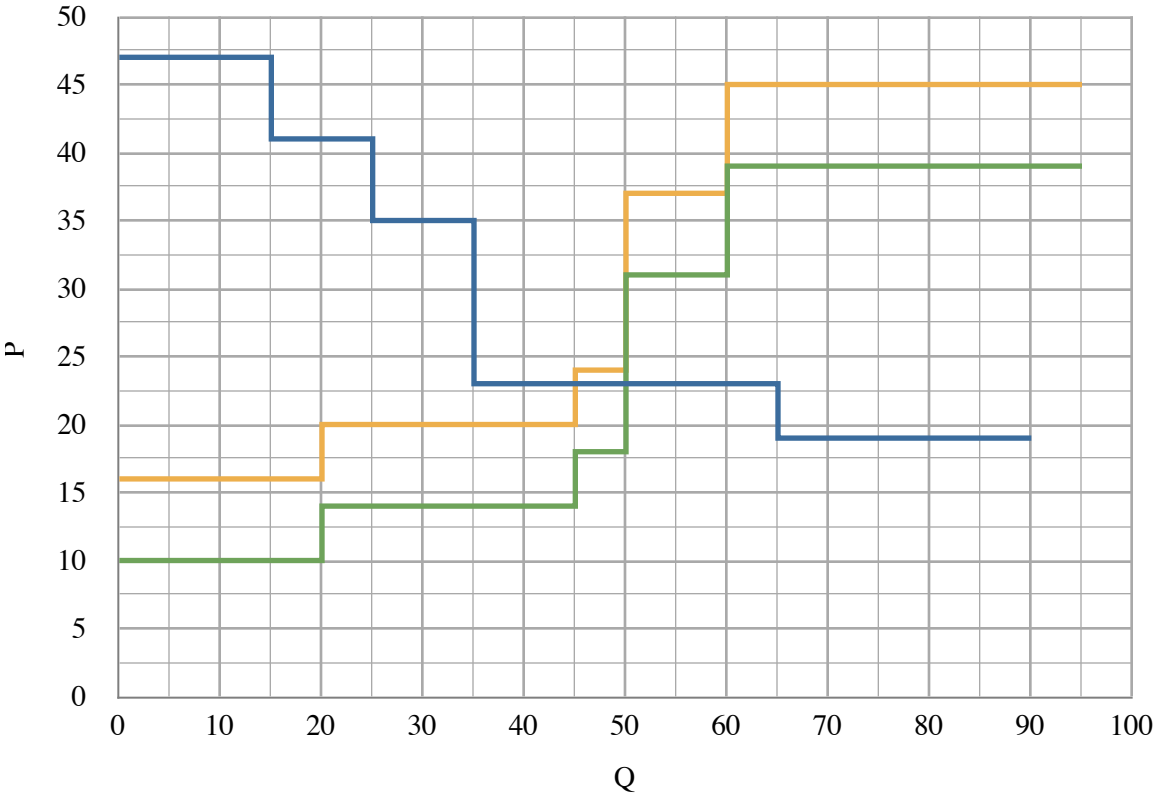
Questions 8

False because she owns *more* x at a than she does at e.



Questions 16 through 20

It's all in the graph. The original supply curve is green.



Question 16

50 units at $20.50

Question 17

CS(B3) = ($35 - $20.50) x 10 units = $145

Question 19

See the graph. Quantity falls to 45 and price rises to $21.50. Check out the version of this question that Section B was given.

Part 4 – Questions 20 to 23

Question 20

Z because a risk neutral investor sees that great big $85 and nothing else.

Question 21

Z for risk averters too because it has biggest expected payoff and is safest.

Question 22

As a risk averter, you'd never choose a portfolio of Y & Z because X & Z has the same expected payoff yet is safer.

Question 23

Get a load of the difference in risk between the two portfolios that contain X and the one that doesn't! X is attractive because it has a positive payoff when the others have a negative payoff and vice versa. In other words, X's payoff is perfectly negatively correlated with the other two. Combine X with either Y or Z, and your payoff will be the weighted sum of the two, but the risk, measured as the spread here, will be very small. It's called *diversification*. Try it and see.

	Heads	Tails	E(P)	Spread
X	-$700	$850	$75	$1,550
Y	$690	-$540	$75	$1,230
Z	$670	-$500	$85	$1,170
	Portfolios of two			
X & Y	-$10	$310	$150	$320
X & Z	-$30	$350	$160	$380
Y & Z	$1,360	-$1,040	$160	$2,400

This means that you always want some X in a portfolio, and you'd never choose one without it. In real life, the expected return on X will be relatively low because of the diversification benefit it gives you.

Question 28

If investors face the same tax rate each period, then they all get the same after-tax dividend, and everyone knows it. Wouldn't that get us to an equilibrium faster?

Question 32

Risk declines, expected payoff stays the same, more valuable to risk averters!

Question 33

	t = 1	t = 2	t = 3	t = 4
X	$50	$80	$100	$70
Y	$50	$80	$100	$75
Z	$50	$100	$80	$70

Throw X out. It can't be the most valuable because it has the same cash flow as Y in every period except period 4, where Y's is bigger. That leaves Y and Z. Z beats Y up to period 3 because it gives you the same cash flow only sooner. The question is whether the extra five dollars Y gives in period 4 is enough to undo Z's advantage. The long way to do this would be to calculate the present value of both Y and Z and choose the biggest. A faster way is to calculate the present value of the difference because, as we discussed in class, present values "add up".

$$PV(Z-Y) = \frac{\$20}{1.045^2} + \frac{-\$20}{1.045^3} + \frac{-\$5}{1.045^4} = -\$\text{-}3.40414$$

Y wins.

Question 34

That whole thing about going from before-tax to after-tax and vice versa. In this question, we're going from after to before, so we need to divide by *(1 - T)*.

$$\frac{\$400{,}000}{1-.06} = \$425{,}532$$

Part 8

Question 35

The status quo bias and endowment effect are all about loss aversion.

Question 36

De Bondt and Thaler's study is about weak-form efficiency, and they use a strategy of selling winners and buying losers to illustrate that it is violated.