Quiz For Lecture # 7

You are consultant for a pension fund. The pension fund is allocating money and considers three institutional investors. The first is a stock investor, the second a long-term government and corporate bond investor, the third is a money market manager.

In your function as the consultant you have done your homework and figured out the following track records:

	expected return	standard deviation
Stock investor	20%	30%
Bond investor	12%	15%
Money market manager	8%	-

The pension fund requires 24% return to meet its asset/liability-objectives. The guidelines do not allow borrowing, however you can sell short. You wish to construct a portfolio of only stocks and bonds with an expected return of 24%

What are the appropriate portfolio proportions and the resulting standard deviations?

What reduction in standard deviation could you attain if you were allowed to borrow at the risk free rate of 8%.