Answer the questions

Finance

Finance and Accounting The capital asset pricing model breaks ‘ total risk’ into two components. The first component is systematic risk. Systematicrisk is market risk that cannot be eliminated through diversification. Specifically, it refers to large-scale economic downturns that span the entire financial sector. The other component is unsystematic risk. This is risk that is contingent in the specific investment, including sector or industry concerns.

2.

Diversification refers to the process of developing an investment portfolio that spans many industries and sectors (Moyer, et al. 2012, p. 295). The purpose behind diversification is that oftentimes a sector will witness decreases in equity value, while another sector will remain stable or even increase in price. The same is true of investments in gold or real estate. A diversified portfolio then allows the investors to shield themselves from unsystematic risk by spreading investment among various sectors of the economy.

3.

If one expects the stock market to increase in the upcoming year there are specific ways to structure the beta in their portfolio. Beta is a measure implemented in the capital asset pricing model that demonstrates the volatility of an asset in relation to the volatility of the benchmark the asset is compared to. Oftentimes then benchmark in investment portfolio is the S&P 500. A positive beta indicates that an assets value generally increases when the market increases. Therefore, if one believes that the stock market will increase in the upcoming year they should ensure that the assets in their portfolio have a strong positive correlation.

References

Moyer, C. McGuigan, J. Rao, R. (2012). Contemporary Financial Management,

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