

**Solution**

The required rate of return

$$\begin{aligned} E(R) &= \lambda_0 + \lambda_1 b_{i1} + \lambda_2 b_{i2} \\ &= 4 + (3 \times -0.666) + (5 \times 1.6) \\ &= 10\% \end{aligned}$$

Present value of cash flow is

$$\begin{aligned} &= \frac{-5000}{(1.1)^1} + \frac{4000}{(1.1)^2} + \frac{5000}{(1.1)^3} + \frac{-2000}{(1.1)^4} + \frac{6000}{(1.1)^5} \\ &= -4545.5 + 3305.8 + 3756.6 - 1366.0 + 3725.5 \\ &= 10788 - 5911.5 \\ &= 4876.5 \end{aligned}$$

**Case: Choosing the Best Portfolio**

You are given the following information and asked to choose the best portfolio for your client.

Portfolio	Beta	Correlation of the return with index return
A	1.3	1.0
B	-0.7	-0.8
C	1.1	0.7

- (a) Advise him on which portfolio has unsystematic risk.
- (b) Suggest the highest yielding return portfolio in normal market conditions based on CAPM and explain your choice.