EASY INTERMEDIATE HARD

CFA® SAMPLE QUESTION – LEVEL I

Corporate Finance

Q: The risk-free rate is 3% and the expected market return is 11%. An investor find a stock with a beta of 1.3 selling for $33 that will pay a $2 dividend next year. If he thinks the stock will be selling for $40 at year end, he thinks the stock should be:

CORRECT ANSWER:

ⓑ **underpriced, so buy it.**

Required rate of return by CAPM = 3% + 1.3 (11%-3%) =13.4%
Expected return on the stock = (40-33+2)/33 = 27.3%

Based on above calculation, the stock will plot above the SML and thus it is underpriced, so buy it!

CFA Society Hong Kong
Candidate Services

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