CAPM

1. Risk and return are directly proportional.
2. Higher the return expected, higher is the risk assumption should be.
3. Income risk is the focus point in this topic.
4. As greater number of securities added to portfolio, lesser will be the overall risk of the portfolio. This is referred to as risk diversification.
5. Risk diversification depends on the proportion of investment and the correlation co-efficient between the securities in the portfolio.
6. Risk is initially measured in terms of standard deviation and as the discussion graduates risk is fashioned into beta.
7. Beta is the relative sensitivity of a securities return for a given change in the market return.
8. Beta is otherwise referred to as Systematic risk.
9. Unsystematic risk can be diversified and systematic risk cannot be diversified.
10. The new approach to portfolio management is Markowitz approach to portfolio diversification under CAPM

The following are the important assumptions of CAPM

a. Efficient Market: Securities are bought and sold with fullest information of buyers and sellers. Price of the security will reflect the real or intrinsic value.

b. Rational investor's goal: Investors are rational i.e for higher return risk assumption will be higher

c. Risk aversion in efficient market is adhered to although at times risk-seeking behavior is adopted for gains.

d. CAPM assumes that all assets are divisible and liquid assets.

e. Investors are able to borrow without any difficulty at a risk-less rate of interest i.e risk free rate

f. There is no transaction cost in the market.

g. No bankruptcy or insolvency of firms assumed.