

Homework 5 Comment and Q&A

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1 Regarding Question 1

For question 1 c), you need to show that in the case for risk-neutral ($\sigma = 0$), the expected return is $\frac{1}{R}$. In addition, the most important part of this question is to show what is the equity premium if agent is risk-neutral. (If you can say something about equity premium for risk-averse and/or risk-love agent, that would be great!)

2 Regarding Question 2

Question: Do we have to use implicit function theorem for $(e) - (g)$

Answer: No, you don't have to. You can simply use either graph or plain english to express the effect of τ, r and z on k_{t+1} based on the expression you derived in (d) .

However, your analysis should not only respect the math but also make sense to me.

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