5. According to the Capital Asset Pricing Model (CAPM), under what circumstances should an investor expect to be paid for the total, or stand-alone, risk associated with a particular investment?

a. When the investment is held in isolation—that is, the investor holds a single-asset portfolio.

b. When the investment is held in a well-diversified portfolio.

c. When the total risk associated with the investment is comprised of firm-specific risk only.

d. When the total risk associated with the investment is comprised of market risk only.

e. Investors should always expect to be paid for the total risk associated with an investment.

According to the CAPM, investors should be paid only for the relevant risk associated with an investment—that is, its market risk—that cannot be diversified away. Total risk = Firm-specific risk + Market risk. As a result, according to the CAPM, total risk will be rewarded only when Total risk = Market risk—that is, firm-specific risk equals zero. Does such an investment exist? A mutual fund that invests in a broad base of stocks and bonds is close to such a situation.