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Q. Pg. 46 - Please explain whether your adjustments to the standard CAPM formula are supported by finance theory. If yes, please provide details.

A. Again there seems to be a serious misunderstanding in this question. Dr. Booth is using a standard CAPM formula; finance theory does not support any particular estimation method for the parameters that go into that formula. Finance theory for example, does not indicate the use of a Treasury Bill or long Canada bond yield as the risk free rate or how the market risk premium is determined or how to estimate future relative risk coefficients. Furthermore, there is no government in the standard CAPM model and debt is held in zero excess supply, whereas the reality is that we are dealing with the implications of a sovereign debt crisis.

The question seems to confuse an attempt to get better estimates of the parameters of the CAPM with the model itself.