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*Problem Set #3*

1. Bookmakers organize betting on football games in the following way: First, they determine a "point spread" that one team is expected to beat with 50-50 probability. Then bettors are allowed to bet on whether the team will beat the spread. They may take either side of the bet and are offered slightly unfavorable odds either way. Show the budget line faced by the bettors. What will a risk-averse bettor do in these circumstances? What will a risk-preferring bettor do? Can you think of any reasons why the risk averter might still bet?
2. Herman has a choice between two jobs. One pays very little now, but promises high raises in the future. The other has a high starting salary, but less potential for future raises. *True or False (and explain)* Herman's choice should depend on his tastes. It's all a matter of whether he'd rather consume a lot when he's old or when he's young.
3. Why do economists insist on assuming that people behave rationally, when such an assumption is usually false?
4. *True or False (and explain)* Nobody would ever hold a stock that was below the efficient set, since there is always an alternative with less risk or greater expected return.