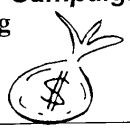
Test your Money $marts

Facts on Saving and Investing Campaign
www.investoreducation.org



☑ Check the correct answer. If you don't know the answer, check "don't know."

1. If you buy a company's stock,
   - ☐ A. you own a part of the company.
   - ☐ B. you have lent money to the company.
   - ☐ C. you are liable for the company's debts.
   - ☐ D. the company will return your original investment to you with interest.
   - ☐ E. don't know.

2. If you buy a company's bond,
   - ☐ A. you own a part of the company.
   - ☐ B. you have lent money to the company.
   - ☐ C. you are liable for the company's debts.
   - ☐ D. you can help manage the company.
   - ☐ E. don't know.

3. Over the past 70 years the type of investment that has earned the most money, or the highest rate of return, for investors has been
   - ☐ A. stocks.
   - ☐ B. corporate bonds.
   - ☐ C. savings accounts.
   - ☐ D. don't know.

4. If you buy the stock of a new company,
   - ☐ A. you cannot lose money.
   - ☐ B. you can lose all the money you used to buy the stock.
   - ☐ C. you can lose only a portion of the money used to buy the stock.
   - ☐ D. don't know.

5. Monique owns a wide variety of stocks, bonds, and mutual funds to lessen her risk of losing money. This is called
   - ☐ A. saving.
   - ☐ B. compounding.
   - ☐ C. diversifying.
   - ☐ D. don't know.

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6. Carlos has saved some cash and faces these choices. What would be the best thing for him to do?
   - ☐ A. put it in his savings account.
   - ☐ B. invest in a mutual fund.
   - ☐ C. buy a U.S. Savings bond.
   - ☐ D. pay off the balance on his credit card that charges 18% interest.
   - ☐ E. don't know.

7. Maria wants to have $100,000 in 20 years. The sooner she starts to save, the less she'll need to save because
   - ☐ A. the stock market will go up.
   - ☐ B. interest rates will go up.
   - ☐ C. interest on her savings will start compounding.
   - ☐ D. don't know.

8. Jennifer wants to take some of her savings and invest in a mutual fund because mutual funds are
   - ☐ A. guaranteed to earn more than savings accounts.
   - ☐ B. risk free.
   - ☐ C. managed by experts at picking investments.
   - ☐ D. don't know.

9. Bob is 22 years old and wants to start saving now for his retirement in 43 years. Of these choices, where should Bob put most of his money now for this long-term goal?
   - ☐ A. a savings account at the bank.
   - ☐ B. a checking account at the bank.
   - ☐ C. a mutual fund that invests in stocks.
   - ☐ D. the stock of one company.
   - ☐ E. don't know.

10. Federal and state laws protect investors by requiring companies to
    - ☐ A. show profits before they can sell stock.
    - ☐ B. give investors important information.
    - ☐ C. pay dividends.
    - ☐ D. repay investors who have lost money.
    - ☐ E. don't know.

Answers To Test Your Money Smarts

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1. If you buy a company's stock,

☑ A. you own a part of the company.

When you own stock, you own a part of the company. There are no guarantees of profits, or even that you will get your original investment back, but you might make money in two ways. First, the price of the stock can rise if the company does well and other investors want to buy the stock. If a stock's price rises from $10 to $12, the $2 increase is called a capital gain or appreciation. Second, a company sometimes pays out a part of its profits to stockholders—that's called a dividend. If the company doesn't do well, or falls out of favor with investors, your stock can fall in price, and the company can stop paying dividends, or make them smaller.

2. If you buy a company's bond,

☑ B. you have lent money to the company.

When you buy a bond, you are lending money to the company. The company promises to pay you interest and to return your money on a date in the future. This promise generally makes bonds safer than stocks, but bonds can be risky. To assess how risky a bond is you can check the bond's credit rating. Unlike stockholders, bond holders know how much money they will make, unless the company goes out of business. If the company goes out of business, bondholders may lose money, but if there is any money left in the company, they will get it before stockholders.

3. Over the past 70 years, the type of investment that has earned the most money, or the highest rate of return, for investors has been

☑ A. stocks.

If you had invested $1 in the stocks of large companies in 1925 and you reinvested all dividends, your dollar would be worth $2,350 at the end of 1998. If the same dollar had been invested in corporate bonds, it would be worth $61, and if it had been invested in U. S. Treasury bills, it would be worth $15. (This information came from Ibbotson Associates, Inc.)

4. If you buy the stock of a new company,

☑ B. you can lose all of the money you used to buy the stock.

One of the riskiest investments is buying stock in a new company. New companies go out of business more often than companies that have been in business for a long time. If you buy stock in small, new companies, you could lose it all. Or the company could turn out to be a success. You'll have to do your homework and learn as much as you can about small companies before you invest. If you decide to buy stock in a new or small company, only invest money that you can afford to lose.

5. Monique owns a wide variety of stocks, bonds, and mutual funds to lessen her risk of losing money. This is called

☑ C. diversifying

One of the most important ways to lessen the risk of losing money when you invest is to diversify your investments. It's common sense — don't put all your eggs in one basket. If you buy a mixture of different types of stocks, bonds, or mutual funds, your entire savings will not be wiped out if one of your investments fails. Since no one can accurately predict how our economy or one company will do, diversification helps you to protect your savings.

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6. Carlos has saved some cash and faces these choices. What would be the best thing for him to do?

☑ D. pay off the balance on his credit card that charges 18% interest.

Most advisers suggest that before you start to invest, you should save cash for emergencies and pay down any debt you have. If Carlos has money in a savings account or buys a U.S. savings bond, he'll earn 3 to 5% on his savings. Mutual funds are not guaranteed, and they may earn or lose money. But if Carlos pays off his credit card, it's like earning 18% because that's how much he's paying now to maintain the balance. If you owe money on your credit cards, you save money if you pay off the balance in full or as quickly as possible.

7. Maria wants to have $100,000 in 20 years. The sooner she starts to save, the less she'll have to save because

☑ C. interest on her savings will start compounding.

When you leave the interest in your account or reinvest the money you earn on your investments, the money you earn starts to earn money too. Over time, the magic of compounding works, allowing your money to grow with dramatic results. The more time you have to save, the less money you need to save because of compounding. And the longer you wait to start saving, the more you have to spend to reach your goal. For example, let's assume that Maria's savings grow by 5% a year. If she starts to save $243 a month now, it will cost her $58,320 to have $100,000 in twenty years. If she waits 10 years to start saving, she will have to save $644 a month for 10 years, and it will cost her $77,280 to reach $100,000 in twenty years.

8. Jennifer wants to take some of her savings and invest in a mutual fund because mutual funds are

☑ C. managed by experts at picking investments.

A diversified mutual fund invests in a wide variety of stocks, bonds, or other securities. The manager of the fund makes decisions about which stocks or bonds to buy, based on the objective of the fund. When you buy shares of a mutual fund, you share in the profits and losses of the portfolio, and pay your share of the expenses.

9. Bob is 22 years old and wants to start saving now for his retirement in 43 years. Of these choices, where should Bob put most of his money now for this long-term goal?

☑ C. a mutual fund that invests in stocks.

As you read in the answer to question three, over the long term, stocks have earned more money than any other investment. Since Bob doesn't need his money for a long time, he can afford to take on the risk of investing in stocks. Even if the stocks in his fund go up and down in value, chances are his savings will grow in value over the long term. He lessens the risk of losing money by choosing a diversified mutual fund rather than the stock of one company.

10. Federal and state laws protect investors by requiring companies to

☑ B. give investors important information.

Most businesses that raise money from the public must register with the SEC or the states and publicly report important information about their businesses on a regular basis. Federal and state laws protect you by requiring that

- the people who seek your investment dollars must tell you the truth about their businesses, and
- the people who sell securities must be licensed and treat you fairly and honestly, putting your interests first.

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