

Common Sense Economics

Part IV. Twelve Key Elements of Practical Personal Finance

Practice Test

Multiple Choice Questions

1. Your comparative advantage in a specific area is determined by
 - a. the market value of the skill relative to your opportunity cost of supplying it.
 - b. the absolute value of the skill in the performance of a specific job.
 - c. minimum wage laws, health and safety standards and marginal tax rates.
 - d. the comparative positions of the wealthy, the middle income individuals and low income individuals.

Answer: a

2. Financial insecurity in America is primarily the result of
 - a. the low incomes of Americans.
 - b. the huge amount of time and complex knowledge required for basic financial planning.
 - c. a low rate of personal saving and poor financial planning.
 - d. a shortage of financial planners and portfolio managers.

Answer: c

3. Economic analysis indicates that
 - a. single-minded pursuit of money and wealth is the key to happiness.
 - b. wealthy people are happier than those with lots of friends, satisfying marriages, and strong religious convictions.
 - c. the desire for more wealth is limited to those who are interested only in their personal welfare.
 - d. no matter what our objectives in life, they are easier to achieve if we have more wealth.

Answer: d

4. Compared to graduates, high school drop outs are
 - a. more valuable to employers.
 - b. more likely to be highly productive.
 - c. more likely to earn high incomes.
 - d. more likely to be poor.

Answer: d

5. Which of the following is true?
 - a. Most entrepreneurs work very few hours.
 - b. Entrepreneurs generally save less of their income than other Americans.

- c. Additional years of schooling will substantially increase your earnings even if it fails to increase your productivity and ability to provide others with things that they value.
- d. If you want to make a lot of money, you had better figure out how to provide others with substantial value and find ways to discover and act on valuable opportunities.

Answer: d

6. Which of the following is the best example of an item that a “real world” savings account is designed to cover?
- a. the monthly payment for the lease of your apartment
 - b. the purchase of the gasoline you use driving back and forth to work
 - c. an unexpected expenditure to repair the transmission of your car
 - d. funds you are setting aside for your retirement years

Answer: c

7. Deferred tax saving plans such as a Roth Individual Retirement Account (IRA) or 401k plan will
- a. reduce your current tax liability because funds paid into these plans are tax deductible.
 - b. make it more difficult for a young person to save and accumulate wealth.
 - c. increase your tax liability now, but you will pay lower taxes when you withdraw the funds.
 - d. help those with the lowest incomes, but will be of little value to those with higher incomes who want to save for retirement.

Answer: a

8. Which of the following is an advantage of an indexed equity mutual fund relative to a managed equity fund?
- a. Indexed funds generally have better stock pickers.
 - b. Indexed funds engage in more detailed research.
 - c. Indexed funds have lower operating costs because they engage in less stock trading.
 - d. Indexed funds earn a significantly higher rate of return than a broad portfolio that represents the entire stock market.

Answer: c

9. The random walk theory indicates that
- a. investors can make money by purchasing stocks that are widely expected to earn substantial profits in the future.

- b. while changes in the prices of specific stocks are difficult to predict, experts are able to forecast the future direction of broad stock market indexes with a high degree of accuracy.
- c. changes in stock prices are driven by surprise occurrences that are difficult to predict.
- d. managed mutual funds will persistently out-perform indexed funds.

Answer: c

10. The variation in the rate of return one can expect from ownership of stocks will generally be smaller
- a. if all of the funds are invested in a specific sector of the economy such as health care.
 - b. if a diverse set of stocks is held over a lengthy period of time such as 30 or 40 years.
 - c. if all of the funds are invested in a single stock.
 - d. if the funds are invested for a relatively short period of time.

Answer: b

11. Buying shares of corporate stock tends to be risky when
- a. the stock of a single corporation is purchased.
 - b. the stock may have to be sold within a few months.
 - c. all stocks bought are in the same industry.
 - d. all of the above are true.

Answer: d

12. If an investor's primary stock holding is currently Exxon Mobil, the purchase of which of the following stocks would provide the investor with the largest reduction in risk?
- a. BP / Amoco.
 - b. Shell Oil Corporation.
 - c. Wal-Mart.
 - d. Texaco.

Answer: c

13. Which of the following has enhanced the ability of investors, without any special business skills, to benefit from the ownership of corporate America?
- the increased availability of mutual funds, that make it possible for even small investors to purchase a diverse stock portfolio at a low cost
 - an increased tendency of small investors to buy and sell stock frequently
 - the virtual disappearance of business failures among corporations with publicly traded stock shares
 - all of the above

Answer: a

14. Which of the following is true?
- Managed equity funds that have yielded attractive returns during the last 5 or 10 years can generally be counted on to yield similar returns in the future.
 - Managed funds generally outperform indexed equity mutual funds.
 - An investment strategy that yielded a high rate of return in the past will often be disastrous in the future.
 - Indexed equity mutual funds are usually tied directly to either the Consumer Price Index or Producer Price Index.

Answer: c

15. Which of the following is the best analogy to describe the power of compound interest?
- throwing a baseball into a strong wind that slows the speed of the pitch
 - watering your lawn while it is raining because it doubles the volume of your output
 - a snowball rolling down a snow-covered mountain, growing in size as it descends
 - a penny dropped from the top of a very tall building, gathering speed as it falls

Answer: c

16. Which of the following is a risk associated with investing in bonds?
- Increases in interest rates can reduce the market value of a bond.
 - Unanticipated inflation lessens the value of both principal and fixed-interest income.
 - If the firm issuing the bond goes bankrupt, bondholders may lose all or most of their investment.
 - All of the above are risks associated with bond investments.

Answer: d

17. It is often substantially cheaper to own and operate a used car rather than a new one because
- the interest rate on a used car loan is generally lower.
 - the maintenance cost of a new car is generally higher.
 - the depreciation cost for a new car will almost always be substantially higher.
 - This is a trick question. All things considered, the cost per mile traveled is generally cheapest if you buy a new car every year.

Answer: c

18. Which of the following items would be most dangerous to purchase on credit
- an automobile
 - a house
 - a vacation
 - a college education

Answer: c

19. Which of the following financial strategies will help you increase your wealth and future level of income?
- regularly saving and investing a portion of your income
 - paying off the outstanding balance every month, if you use a credit card
 - getting by with a used economy car rather than buying a new one every couple of years
 - All of the above will help you build wealth.

Answer: d

20. Many Americans feel financially insecure primarily because
- the taxes of Americans are just about the highest in the world.
 - it is difficult for Americans to borrow funds to deal with emergencies.
 - the personal saving rate of Americans is low and many spend more than they earn.
 - the incomes of Americans are low and, therefore, it would be virtually impossible for them to spend less and save more.

Answer: c