

National Financial Capability Study

Test Yourself

About the Study

Data and Downloads

National Findings

Investor Study

Press Room

NFCS Data in Use

You got 6 correct answers out of 6

Retake the Quiz

	Correct	Incorrect	Don't Know
Your Results	6	0	0
National Average	3.16	1.25	1.54
Alabama ▼	2.98	1.34	1.62

Suppose you have \$100 in a savings account earning 2 percent interest a year. After five years, how much would you have?



You'll have more than \$102 at the end of five years because your interest will compound over time. In other words, you earn interest on the money you save and on the interest your savings earned in prior years. Here's how the math works. A savings account with \$100 and a 2 percent annual interest rate would earn \$2 in interest for an ending balance of \$102 by the end of the first year. Applying the same 2 percent interest rate, the \$102 would earn \$2.04 in the second year for an ending balance of \$104.04 at the end of that year.

Continuing in this same pattern, the savings account would grow to \$110.41 by the end of the fifth year.

Imagine that the interest rate on your savings account is 1 percent a year and inflation is 2 percent a year. After one year, would the money in the account buy more than it does today, exactly the same or less than today?



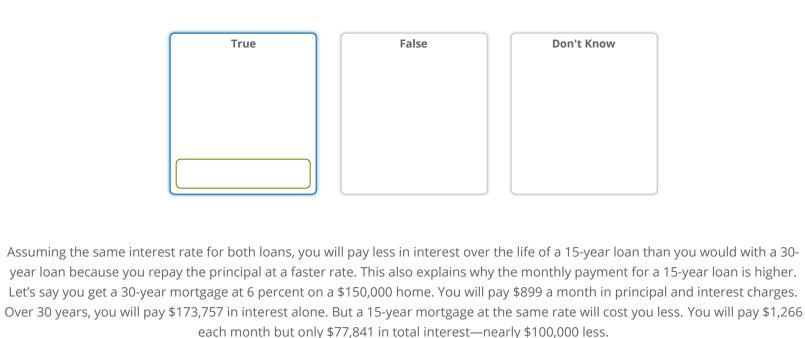
The reason you have less is inflation. Inflation is the rate at which the price of goods and services rises. If the annual inflation rate is 2 percent but the savings account only earns 1 percent, the cost of goods and services has outpaced the buying power of the money in the savings account that year. Put another way, your buying power has not kept up with inflation.

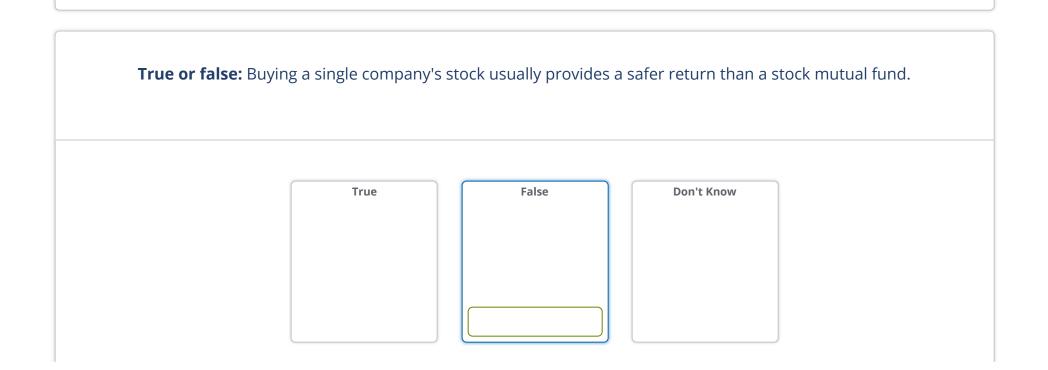
If interest rates rise, what will typically happen to bond prices? Rise, fall, stay the same, or is there no relationship?



When interest rates rise, bond prices fall. And when interest rates fall, bond prices rise. This is because as interest rates go up, newer bonds come to market paying higher interest yields than older bonds already in the hands of investors, making the older bonds worth less.

True or false: A 15-year mortgage typically requires higher monthly payments than a 30-year mortgage but the total interest over the life of the loan will be less.





In general, investing in a stock mutual fund is less risky than investing in a single stock because mutual funds offer a way to diversify. Diversification means spreading your risk by spreading your investments. With a single stock, all your eggs are in one basket. If the price falls when you sell, you lose money. With a mutual fund that invests in the stocks of dozens (or even hundreds) of companies, you lower the chances that a price decline for any single stock will impact your return. Diversification generally may result in a more consistent performance in different market conditions.

BONUS QUESTION: Suppose you owe \$1,000 on a loan and the interest rate you are charged is 20% per year compounded annually. If you didn't pay anything off, at this interest rate, how many years would it take for the amount you owe to double?



Ignoring interest compounding, borrowing at 20 percent per year would lead to doubling in five years; someone who knew about interest on interest might have selected a number less than five. Someone who knows the 'rule of 72' heuristic would know that it would be about 3.6 years, which makes the correct answer "2 to 4 years." In finance, the rule of 72 is a method for estimating an investment's doubling time. The rule number (i.e., 72) is divided by the interest percentage per period to obtain the approximate number of periods (usually years) required for doubling. The other responses reflect a misunderstanding of the concept of interest accrual.

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