

# Future Business Leaders of America (FBLA) Personal Finance Practice Test (Sample)

## Study Guide



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**SAMPLE**

## **Questions**

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- 1. What does a diversified investment portfolio aim to achieve?**
  - A. Maximize risk through concentrated investments**
  - B. Minimize risk through asset variety**
  - C. Eliminate all market risk**
  - D. Focus solely on high-risk stocks**
- 2. What is one effect of budgeting?**
  - A. It allows you to increase your income**
  - B. It helps track spending and manage expenses**
  - C. It guarantees investment growth**
  - D. It eliminates all debt**
- 3. What is the principal in the context of a savings account?**
  - A. The fees charged for maintaining the account**
  - B. The amount of money you deposit**
  - C. The interest earned on the account**
  - D. The monthly withdrawal limit**
- 4. Why is setting long-term financial goals significant?**
  - A. It helps prioritize spending and motivates saving**
  - B. It offers immediate financial returns**
  - C. It eliminates all forms of debt**
  - D. It guarantees financial success without planning**
- 5. What is a likely effect of high unemployment on the economy?**
  - A. Increased consumer spending**
  - B. Lower production costs**
  - C. Decreased confidence in the job market**
  - D. Higher wages for the unemployed**

- 6. Which type of financial account typically yields interest on deposits?**
- A. Checking account**
  - B. Investment account**
  - C. Savings account**
  - D. Credit account**
- 7. Which of the following statements about life insurance is accurate?**
- A. It is only necessary for those with families**
  - B. It can serve as an investment tool**
  - C. Term life insurance is the same as whole life insurance**
  - D. Life insurance is required by law**
- 8. What is a 401(k) plan?**
- A. A type of savings account with no tax benefits**
  - B. A retirement savings plan sponsored by an employer**
  - C. A form of government-subsidized income**
  - D. A loan program for education expenses**
- 9. What does diversification in investments help to achieve?**
- A. Stable income regardless of market conditions**
  - B. Higher returns with no risk**
  - C. Reduction of overall investment risk**
  - D. Immediate profit from all investments**
- 10. What is a key difference between a traditional IRA and a Roth IRA?**
- A. A traditional IRA offers tax-free withdrawals in retirement.**
  - B. A Roth IRA allows for tax-deductible contributions.**
  - C. A traditional IRA is taxed upon withdrawal.**
  - D. A Roth IRA requires taxes to be paid before contributions.**

## **Answers**

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1. B
2. B
3. B
4. A
5. C
6. C
7. B
8. B
9. C
10. C

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## **Explanations**

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## **1. What does a diversified investment portfolio aim to achieve?**

- A. Maximize risk through concentrated investments**
- B. Minimize risk through asset variety**
- C. Eliminate all market risk**
- D. Focus solely on high-risk stocks**

A diversified investment portfolio aims to minimize risk through asset variety. When investors diversify their portfolios, they spread their investments across a wide range of asset classes, such as stocks, bonds, real estate, and commodities. This strategy reduces the impact of poor performance from any single investment on the overall portfolio. By holding a variety of investments, the negative performance of one asset can potentially be offset by the positive performance of others, thereby providing more stability and reducing volatility. Diversity in an investment portfolio also allows investors to capture different market opportunities and provides a cushion against market fluctuations. It's important to note that while diversification can significantly lower risk, it does not completely eliminate all market risk. Thus, a diversified portfolio aims for a balanced approach, seeking to achieve a reasonable return while managing risk effectively.

## **2. What is one effect of budgeting?**

- A. It allows you to increase your income**
- B. It helps track spending and manage expenses**
- C. It guarantees investment growth**
- D. It eliminates all debt**

The practice of budgeting plays a crucial role in personal finance management by helping individuals understand and monitor their financial health. One of the primary effects of budgeting is that it aids in tracking spending and managing expenses. By creating a budget, individuals can categorize their income and expenses, which enables them to see where their money is going each month. This visibility is essential for making informed decisions, allowing individuals to adjust their spending habits if necessary, plan for future expenses, and prioritize savings. When budgeting is effectively implemented, it creates a clear picture of financial inflows and outflows, making it easier to identify areas where costs can be cut or adjusted. This proactive approach can lead to better financial discipline, improve savings rates, and ensure that essential expenses are covered without overspending. In contrast, simply increasing income, guaranteeing investment growth, or eliminating all debt are outcomes that may not directly result from budgeting alone. While budgeting can help manage and reduce debt over time, it does not guarantee any specific financial outcomes such as income increases or growth in investments. Instead, it serves as a foundational tool for achieving better financial management and planning.

### 3. What is the principal in the context of a savings account?

- A. The fees charged for maintaining the account
- B. The amount of money you deposit**
- C. The interest earned on the account
- D. The monthly withdrawal limit

In the context of a savings account, the principal refers to the initial amount of money that you deposit into the account. This is the base amount on which interest is calculated. Understanding the principal is crucial because it directly impacts the growth of your savings through interest accumulation. When you deposit money into a savings account, you are increasing the principal, and as the bank pays you interest, it is calculated as a percentage of this principal amount. The larger the principal, the more interest you can earn over time, which is fundamental in building savings and managing personal finances effectively.

### 4. Why is setting long-term financial goals significant?

- A. It helps prioritize spending and motivates saving**
- B. It offers immediate financial returns
- C. It eliminates all forms of debt
- D. It guarantees financial success without planning

Setting long-term financial goals is significant because it provides a roadmap for individuals to prioritize their spending and motivates them to engage in saving behaviors. By having clear objectives, individuals can make informed decisions about where to allocate their resources, ensuring that their daily expenditures align with their broader financial aspirations. This strategic approach fosters discipline and encourages consistent saving habits, as people are more likely to set aside money when they have defined goals to work towards, such as purchasing a home, funding education, or preparing for retirement. Long-term financial goals also serve as a source of motivation, inspiring individuals to remain committed to their financial plans despite short-term distractions or setbacks. This focused mindset helps people to resist impulsive purchases and stay on track, ultimately leading to improved financial wellbeing over time.

**5. What is a likely effect of high unemployment on the economy?**

- A. Increased consumer spending**
- B. Lower production costs**
- C. Decreased confidence in the job market**
- D. Higher wages for the unemployed**

High unemployment typically leads to decreased confidence in the job market. When unemployment rates rise, individuals who are currently unemployed may feel uncertain about their ability to find new jobs. This lack of confidence can stifle job-seeking behavior, lead to reduced spending, and generally create a more pessimistic economic outlook. Additionally, consumers may be hesitant to spend money if they fear losing their job or are dealing with the hardships that come with unemployment. This drop in consumer confidence can further exacerbate economic slowdowns, as less consumer spending means lower overall demand for goods and services. In contrast, increased consumer spending would be unlikely during high unemployment due to the financial strains faced by those out of work. Lower production costs may not be directly linked to unemployment, as companies might still face high operational costs regardless of unemployment rates. While higher wages for the unemployed might seem beneficial, in reality, employers may not have incentive to raise wages if there is a surplus of labor in the market.

**6. Which type of financial account typically yields interest on deposits?**

- A. Checking account**
- B. Investment account**
- C. Savings account**
- D. Credit account**

A savings account typically yields interest on deposits because it is specifically designed to encourage saving. When funds are deposited into a savings account, they earn interest, which is a percentage of the account balance paid by the bank as a return for allowing the bank to use that money for lending and other activities. Savings accounts generally offer a higher interest rate compared to checking accounts, as they are intended for funds that are not intended for frequent withdrawals. In contrast, checking accounts usually provide easy access to funds for daily transactions and generally do not accrue significant interest. Investment accounts are used for trading stocks, bonds, mutual funds, and other securities with the potential for higher returns but also come with greater risk. Credit accounts, such as credit cards, allow borrowing but do not yield interest on deposits; instead, they typically charge interest on any borrowed funds. Thus, the nature of a savings account makes it the correct choice for yielding interest on deposits.

**7. Which of the following statements about life insurance is accurate?**

- A. It is only necessary for those with families**
- B. It can serve as an investment tool**
- C. Term life insurance is the same as whole life insurance**
- D. Life insurance is required by law**

The statement indicating that life insurance can serve as an investment tool is accurate. Certain types of life insurance, particularly whole life insurance and universal life insurance, not only provide a death benefit but also accumulate cash value over time. This cash value component can grow at a guaranteed rate and can be used during the policyholder's lifetime. Policyholders may borrow against the cash value, withdraw funds, or even use it to pay premiums. This dual function makes life insurance not just a safety net for beneficiaries but also a potential financial asset for the policyholder. In contrast, term life insurance is strictly focused on providing coverage for a specific term, with no cash value accumulation. The idea that life insurance is only necessary for those with families is too narrow because individuals without dependents might still require life insurance for debts, business partnerships, or legacy planning. Moreover, life insurance is not required by law, although certain situations, like having a mortgage or business loans, may encourage individuals to consider obtaining it.

**8. What is a 401(k) plan?**

- A. A type of savings account with no tax benefits**
- B. A retirement savings plan sponsored by an employer**
- C. A form of government-subsidized income**
- D. A loan program for education expenses**

A 401(k) plan is a retirement savings plan sponsored by an employer, allowing employees to save for retirement while benefiting from tax advantages. Through this plan, employees can contribute a portion of their paycheck to their retirement savings before taxes are deducted, which can lower their taxable income. Additionally, many employers offer matching contributions, further enhancing the benefits of participating in a 401(k). This makes it an effective strategy for building wealth in preparation for retirement. The other choices do not accurately represent what a 401(k) is. It is not merely a savings account without tax benefits, nor is it a government-subsidized income or a loan program for education expenses. These mischaracterizations highlight the importance of understanding the specific nature and benefits of a 401(k) as a key tool in retirement planning.

## 9. What does diversification in investments help to achieve?

- A. Stable income regardless of market conditions
- B. Higher returns with no risk
- C. Reduction of overall investment risk**
- D. Immediate profit from all investments

Diversification in investments primarily helps to achieve the reduction of overall investment risk. By spreading investments across various asset classes, sectors, or geographical regions, an investor can minimize the impact of any single investment's poor performance on the overall portfolio. This strategy takes advantage of the fact that different assets often react differently to market conditions; for instance, when stocks may be underperforming, bonds or real estate might provide stability or growth. Embracing diversification helps mitigate risks associated with specific investments. It is particularly effective during fluctuating market conditions since not all asset classes will perform poorly at the same time. Hence, while a diversified portfolio may experience some losses, the gains in other areas can offset these dips, thereby contributing to a more stable and balanced investment strategy over time. The other choices present misconceptions related to investment principles. While stability in income and potential profits are certainly goals for many investors, diversification does not guarantee income stability in all market conditions, nor does it promise immediate profits from every investment. Additionally, claiming higher returns with no risk is misleading since all investments come with some level of risk, and diversification primarily seeks to manage that risk rather than eliminate it entirely.

## 10. What is a key difference between a traditional IRA and a Roth IRA?

- A. A traditional IRA offers tax-free withdrawals in retirement.
- B. A Roth IRA allows for tax-deductible contributions.
- C. A traditional IRA is taxed upon withdrawal.**
- D. A Roth IRA requires taxes to be paid before contributions.

The distinction between a traditional IRA and a Roth IRA fundamentally revolves around when taxes are paid in relation to contributions and withdrawals. In the case of a traditional IRA, contributions made may not be taxed when the money is deposited, allowing individuals to potentially lower their taxable income during the year of contribution. However, the key aspect is that withdrawals in retirement are subject to income taxes. Therefore, when individuals take money out of a traditional IRA during retirement, they will have to pay taxes on those distributions. This framework contrasts with a Roth IRA, where contributions are made with after-tax dollars. Consequently, the money grows tax-free, and qualified withdrawals during retirement are tax-free as well. This allows individuals to enjoy their savings without worrying about taxes on those funds later. Understanding this difference is crucial for strategic retirement planning, as it affects an individual's tax situation both now and during retirement.