University of Central Florida (UCF) FIN2100 Personal Finance and Investments Final Practice Exam (Sample)

Study Guide

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Questions

1. What is the primary purpose of personal finance?

   A. To save for retirement

   B. To manage an individual's financial resources to achieve personal financial goals

   C. To invest in stocks and bonds

   D. To determine one's credit score

2. What are certificates of deposit (CDs)?

   A. Stocks issued by corporations

   B. Time deposits that yield interest over a fixed period

   C. Short-term loans to banks

   D. Government bonds with variable interest

3. An investor bought a stock for $40 per share. It now trades for $90 per share and pays an annual dividend of $1 per share. What is the current dividend yield on this stock?

   A. 0.28%

   B. 2.5%

   C. 4.4%

   D. 1.1%

4. What are stocks?

   A. Debt securities issued by entities to raise funds

   B. Shares that represent ownership in a company

   C. Cash equivalents that earn interest

   D. Fixed income securities with no ownership interest

5. How does a person's age typically influence their investment strategy?

   A. Younger investors often seek to preserve capital

   B. Older investors often take greater risks for higher returns

   C. Younger investors may take greater risks for higher returns, while older investors focus on preserving capital

   D. Age does not affect investment strategy

6. How does a budget surplus differ from a budget deficit?

   A. A budget surplus occurs when income exceeds expenses; a deficit occurs when expenses exceed income

   B. Both terms mean the same thing

   C. A surplus indicates debt while a deficit means savings

   D. A budget surplus is only possible for governments

7. How long can passive activity losses be carried forward for tax purposes?

   A. Indefinitely

   B. 5 years

   C. 10 years

   D. Until they are used

8. What are capital gains?

   A. Income from dividends

   B. Profits from asset sale

   C. Interest from bank savings

   D. Losses from investments

9. What is a certificate of deposit (CD)?

   A. A short-term bond investment

   B. A savings account with a fixed interest rate and maturity date

   C. An investment in real estate

   D. A variable interest loan to consumers

10. What characterizes a bear market?

   A. A decline of 10% or more in stock prices

   B. A period of rapid stock price increase

   C. A decline of 20% or more in stock prices

   D. A period of stable stock prices

Answers

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

Explanations

1. What is the primary purpose of personal finance?

A. To save for retirement

B. To manage an individual's financial resources to achieve personal financial goals

C. To invest in stocks and bonds

D. To determine one's credit score

The primary purpose of personal finance is to manage an individual's financial resources to achieve personal financial goals. This encompasses a broad range of financial activities, including budgeting, saving, investing, and planning for future expenses. A comprehensive understanding of personal finance allows individuals to assess their current financial situation, plan effectively for future needs, and make informed decisions about how to allocate their resources. While saving for retirement, investing in stocks and bonds, and determining one’s credit score are important components of personal finance, they are all subsets of the overall goal of managing finances effectively. Personal finance gives individuals the tools and strategies to reach a diverse set of objectives—be it paying off debt, saving for emergencies, affording a home, or planning for retirement. The ultimate focus is on aligning financial behavior with one's personal aspirations and needs.

2. What are certificates of deposit (CDs)?

A. Stocks issued by corporations

B. Time deposits that yield interest over a fixed period

C. Short-term loans to banks

D. Government bonds with variable interest

Certificates of deposit (CDs) are time deposits offered by banks and credit unions that allow individuals to invest a specific sum of money for a predetermined period, which can range from a few months to several years. When you invest in a CD, you agree to leave your money untouched for the length of the term in exchange for a higher interest rate compared to regular savings accounts. This fixed interest rate is agreed upon at the time of investment and will not change until the CD matures. At maturity, you receive your original investment plus any earned interest. This structure makes CDs a low-risk investment option, appealing to conservative investors looking for stable returns. They are insured up to certain limits by the FDIC in the United States, which adds a layer of financial security. The other types of financial instruments listed, such as stocks, loans, and bonds, operate under different mechanisms and risk profiles, which do not align with the characteristics of a CD.

3. An investor bought a stock for $40 per share. It now trades for $90 per share and pays an annual dividend of $1 per share. What is the current dividend yield on this stock?

A. 0.28%

B. 2.5%

C. 4.4%

D. 1.1%

To determine the current dividend yield on the stock, you need to use the formula for dividend yield, which is calculated as follows: Dividend Yield = (Annual Dividend per Share) / (Current Price per Share) In this case, the annual dividend is $1 per share, and the current price per share is $90. Plugging in these values gives us: Dividend Yield = $1 / $90 Calculating that, we find: Dividend Yield = 0.0111, or when converted to a percentage, this becomes approximately 1.11%. This indicates that an investor earns about 1.11% of the current stock price in dividends each year, which corresponds to the choice that suggests a dividend yield of 1.1%. This result accurately reflects the relationship between dividend income and stock price, demonstrating that the yield decreases as the price of the stock increases, a key principle in understanding stocks and dividends in finance.

4. What are stocks?

A. Debt securities issued by entities to raise funds

B. Shares that represent ownership in a company

C. Cash equivalents that earn interest

D. Fixed income securities with no ownership interest

Stocks are shares that represent ownership in a company, allowing shareholders to have a stake in the company's assets and earnings. When you purchase stocks, you are effectively buying a small piece of that company, which can increase in value if the company performs well. This ownership also often entitles shareholders to vote on key company decisions and receive dividends, which are distributions of profit. Other options describe different financial instruments that do not represent ownership. For example, debt securities, such as bonds, involve borrowing rather than ownership, as the investor is lending money to the issuer. Cash equivalents are generally low-risk investments that provide liquidity and interest but do not convey any ownership in a company. Fixed income securities, like certain bonds, provide regular income without giving investors any claim on the company's equity. Thus, understanding that stocks are directly related to ownership helps distinguish them from these other financial instruments.

5. How does a person's age typically influence their investment strategy?

A. Younger investors often seek to preserve capital

B. Older investors often take greater risks for higher returns

C. Younger investors may take greater risks for higher returns, while older investors focus on preserving capital

D. Age does not affect investment strategy

A person's age typically influences their investment strategy due to varying financial goals, risk tolerance, and time horizons associated with different life stages. Younger investors often have a longer time horizon until retirement, allowing them to take on more risk in pursuit of higher returns. This means they may invest in more volatile assets, such as stocks, which can offer potential for significant growth over time. On the other hand, older investors are usually closer to retirement and may prioritize capital preservation. As they approach retirement, the need for security in their investment portfolio increases, leading them to shift towards more stable and conservative investments, like bonds or cash equivalents, which offer lower risk and more predictable returns. Thus, the correct choice reflects this generational difference: younger investors might embrace higher risk for the potential of greater gains, while older investors generally focus on preserving the wealth they have accumulated. This not only aligns with their financial objectives but also mitigates the risk of large losses as they near retirement.

6. How does a budget surplus differ from a budget deficit?

A. A budget surplus occurs when income exceeds expenses; a deficit occurs when expenses exceed income

B. Both terms mean the same thing

C. A surplus indicates debt while a deficit means savings

D. A budget surplus is only possible for governments

A budget surplus occurs when income exceeds expenses, meaning that there is more money coming in than going out. This situation allows individuals, businesses, or governments to save money, invest in growth, pay down existing debt, or build up financial reserves. On the other hand, a budget deficit occurs when expenses exceed income, leading to a situation where expenditures surpass revenue. This typically results in borrowing or increased debt to cover the shortfall. Understanding this distinction is crucial in personal finance, as it highlights the importance of managing expenses relative to income. If someone consistently operates at a budget deficit, it can lead to financial instability and accumulated debt. In contrast, maintaining a budget surplus is a sign of good financial health and responsible management of finances. The other options either misinterpret these fundamental concepts or make incorrect associations. For example, suggesting that both terms mean the same thing overlooks their definitions, while implying that a surplus indicates debt and a deficit means savings is fundamentally incorrect. Lastly, stating that a budget surplus is only possible for governments does not acknowledge that individuals and businesses can also achieve budget surpluses.

7. How long can passive activity losses be carried forward for tax purposes?

A. Indefinitely

B. 5 years

C. 10 years

D. Until they are used

Passive activity losses can be carried forward until they are utilized to offset passive income or are recognized when the investment is sold. This means that as long as there are no passive income gains or the property is not disposed of, the losses can be carried forward indefinitely until they can be entered against future income. The idea is to allow taxpayers to take advantage of these losses when their passive income situation changes, ensuring that they are not permanently unable to benefit from losses incurred in passive activities. Understanding this concept is crucial for strategic tax planning, particularly for those engaged in real estate or other passive investments.

8. What are capital gains?

A. Income from dividends

B. Profits from asset sale

C. Interest from bank savings

D. Losses from investments

Capital gains refer to the increase in value that an asset has achieved when it is sold for more than its purchase price. This profit arises specifically from the sale of assets like stocks, real estate, and other investments. When an individual sells an asset, the difference between the selling price and the original purchase price is considered the capital gain.   For example, if an investor buys shares of stock for $50 and later sells them for $70, the capital gain would be $20. Capital gains can be classified as either short-term or long-term, depending on how long the asset was held before selling, which can affect the tax treatment of these gains. While income from dividends, interest from bank savings, and losses from investments represent other aspects of financial activities, they do not encompass the concept of capital gains. Dividends are payments made to shareholders from a corporation's earnings, interest relates to earnings from savings or fixed-income investments, and losses reflect a decline in the asset's value, which is contrary to the idea of capital gains.

9. What is a certificate of deposit (CD)?

A. A short-term bond investment

B. A savings account with a fixed interest rate and maturity date

C. An investment in real estate

D. A variable interest loan to consumers

A certificate of deposit, or CD, is indeed best described as a savings account that offers a fixed interest rate and has a predetermined maturity date. When individuals deposit money into a CD, they agree to leave their funds untouched for a specific period, which can range from a few months to several years. In return for this commitment, the bank typically provides a higher interest rate compared to regular savings accounts, making it an attractive option for those looking to save money with some degree of return. The other options don't accurately depict what a CD is. For example, a short-term bond investment refers to debt securities issued by corporations or governments, which do not have the same fixed interest and maturity characteristics as a CD. An investment in real estate involves purchasing property, which is a different asset class with its own risks and benefits. Lastly, a variable interest loan typically refers to loans where the interest rate can change over time, differing from the fixed interest rate structure of a certificate of deposit. Thus, option B encapsulates the essence of what a CD represents in personal finance.

10. What characterizes a bear market?

A. A decline of 10% or more in stock prices

B. A period of rapid stock price increase

C. A decline of 20% or more in stock prices

D. A period of stable stock prices

A bear market is characterized by a decline of 20% or more in stock prices. This significant drop indicates a prolonged period of reduced investor confidence and is often linked to adverse economic conditions. In a bear market, investors typically expect further declines, which can lead to decreased spending and investment, creating a cycle that prolongs the downturn. Recognizing this definition is crucial for investors and individuals in personal finance, as it can influence investment strategies, risk assessment, and market entry points. By understanding this term, one can better navigate their financial planning and investment decisions in reaction to broader market conditions.