Financial Literacy Quiz

Take the following quiz to test your financial knowledge. The answer key is below.

- 1 Suppose you put \$1,000 in an account that earns 5% interest per year, every year. You never invest additional money and you never withdraw money or interest payments. So in the first year, you earn \$50 in interest. In Year 4, how much will this account earn?
 - a. 1 Less than \$50
 - b. 2 \$50
 - c. More than \$50
 - d. 4 Don't know
- 2 Suppose you invest \$2,500 and earn 7% per year on this investment. How many years will it take for your total investment to be worth \$5,000?
 - a. Between 0 and 5 years
 - b. Between 5 and 15 years
 - c. Between 15 and 45 years
 - d. More than 45 years
 - e. Don't know
- 3 Consider the following scenario: Jack and Jill are twins. At the age of 20, Jack started contributing \$20 a month to a savings account. After 20 years, at the age of 40, he stopped adding to his savings, but he left the money in the account. Jill didn't start to save until she was 40. Then, she saved \$20 a month until she retired 20 years later at age 60. Suppose both Jack and Jill earned 6% interest per year on their savings. When they both retired at age 60, who had more money?
 - a. Jack
 - b. Jill
 - c. They had the same amount
 - d. Don't know

- 4 Pam is deciding between 2 options: Option A: Invest \$1,000 in a certificate of deposit that earns 5% interest. Pam would not add or remove any money from this investment for the next 30 years. Option B: Invest \$1,000 in a savings account that earns 5% interest. Move the interest earned on this account every year into a safe at home. Pam would not add or remove any other money from the savings account or the safe for the next 30 years. At the end of 30 years, which of these options would provide the most money?
 - a. Option A
 - b. Option B
 - c. Pam will have the same amount of money at the end of 30 years regardless of whether she chooses Option A or Option B.
 - d. Don't know
- 5 Suppose that by the year 2020 your income has doubled and prices of all goods have doubled too. In 2020, how much will you be able to buy with your 2020 income?
 - a. More than today
 - b. The same amount as today
 - c. Less than today
 - d. Don't know
- 6 Rita must choose between two job offers. She wants to select the job with a salary that will afford her the higher standard of living for the next few years. Job A offers a 3% raise every year, while Job B will not provide a raise for the next few years. If Rita chooses Job A, she will live in City A. If Rita chooses Job B, she will live in City B. Rita finds that the price of goods and services today are about the same in both areas. Prices are expected to rise, however, by 4% in City A every year, and stay the same in City B. Based on her concerns about standard of living, what should Rita do?
 - a. Take Job A
 - b. Take Job B
 - c. Take either one: she will be able to afford the same future standard of living in both places
 - d. Don't know

7 - In general, investments that are riskier tend to provide higher returns over time than investments with less risk.

- a. True
- b. False
- c. Don't know

8 - Which of the following is an accurate statement about investment returns?

- a. Usually, investing \$5,000 in shares of a single company is safer than investing \$5,000 in a fund which invests in shares of many companies in multiple industries.
- b. Usually, investing \$5,000 in shares of a single company is less safe than investing \$5,000 in a fund which invests in shares of many companies in different industries.
- c. Usually, investing \$5,000 in shares of a single company is equally as safe as investing \$5,000 in a fund which invests in shares of many companies in different industries.
- d. Don't know

9 - Suppose you are a member of a stock investment club. This year, the club has about \$200,000 to invest in stocks and the members prefer not to take a lot of risk. Which of the following strategies would you recommend to your fellow members?

- a. Put all of the money in one stock
- b. Put all of the money in two stocks
- c. Put all of the money in a stock indexed fund that tracks the behavior of 500 large firms in the United States
- d. Don't know

10 - When you invest in an employer's retirement savings plan such as a 401(k), your contributions are taxed:

- a. Either before you invest them or when you withdraw them during retirement, but not both times.
- b. Both before you invest them and when you withdraw them during retirement.
- c. Once a year on or before April 15.
- d. When you reach age 65.
- e. Don't know

11 - Both Irene and her employer contribute every year to her employer-sponsored 401(k) plan. Irene has worked at the company for twenty years, and is fully vested in her plan. Suppose Irene leaves her job or gets fired. Which of the following statements is true?

- a. If she is no longer working for the company, the whole plan balance is forfeited, because her benefits are tied to her job.
- b. If she gets fired, the company has the right to decide how much of her total plan balance she will get.
- c. If she voluntarily leaves her job, she forfeits all of her employer's contributions.
- d. Even if she leaves her job or gets fired, she is still entitled to the entire plan balance.
- e. Don't know

12 - Which of the following statements are true?

a. In any type of IRA or 401(k) account, all of the money in your account grows tax-free.

- b. If you have a traditional IRA or 401(k), you make contributions out of pre-tax income and pay income tax at your future tax rate when you withdraw the funds.
- c. Both are true
- d. Don't know
- 13 This year, Marge's salary is \$100,000 and she contributes \$10,000 of her salary to a traditional 401(k) offered by her employer. Her current tax rate is 28%. In 40 years, when Marge retires, the money will have grown to \$160,000. Her tax rate during retirement will fall to 20%. Which of the following is true?
 - a. This year, Marge should pay income taxes on her entire salary. During retirement, she will pay 20% tax on whatever she withdraws from her plan.
 - b. This year, Marge should pay income taxes on only \$90,000. During retirement, she will pay the same deferred 28% tax rate on whatever she withdraws from her plan.
 - c. This year, Marge should pay income taxes on only \$90,000. During retirement, she will pay 20% tax on whatever she withdraws from her plan.
 - d. This year, Marge should pay income taxes on only \$90,000. During retirement, she will pay no tax on whatever she withdraws from her plan.
 - e. Don't know

14 - Which of the following is a true statement?

- a. You will lose money that you personally invested in your 401(k) if you switch jobs.
- b. You will be charged income tax as well as tax on dividends and increases in the value of your stock if you invest through a 401(k).
- c. Unless you are undergoing significant hardship, you cannot withdraw money from a 401(k) without penalty until you reach a certain age.
- d. All of the above
- e. Don't know
- 15 Alice wants to invest \$1,000 for retirement this year. Her new employer will fully match her 401(k) contributions, up to \$10,000 per year. All else being equal, which of the following options will give Alice the highest total amount at the end of the year?
 - a. Alice contributes \$1,000 to her 401(k) plan and invests that money in mutual fund A. At the end of the year, mutual fund A has earned a 5% return.
 - b. Alice does not contribute to her 401(k) plan but she invests \$1,000 in mutual fund B outside of her 401(k) plan. At the end of the year, mutual fund B has earned a 20% return.
 - c. Alice does not contribute to her 401(k) plan, but she invests \$1,000 in mutual fund A outside of her 401(k) plan. At the end of the year, mutual fund A has earned a 5% return.
 - d. Don't know
- 16 David's new job offers a 401(k). His employer provides a 50% match up to \$2,000. How much should David invest at least in order to obtain the maximum amount of money from the employer match?
 - a. 1\$0
 - b. \$500
 - c. \$1,000
 - d. \$2,000
 - e. \$4,000
 - f. Don't know

17 - You have decided to set aside 15% of your salary for retirement. You work at a firm where your employer matches your contribution to the 401(k) plan, dollar by dollar, up to 5% of your salary. Which of these statements is correct?

- a. If you contribute up to 5% of your salary, the employer match is equivalent to a 100% return on your contribution.
- b. What the employer contributes should not play any role in your decision.
- c. It is always a good idea to contribute less than what the employer contributes.
- d. Don't know

Answer key:

1 c

2 b

3 a

4 a

5 b

6 b

7 a

8 b

9 c

10 a

11 d

12 b

13 c

14 c 15 a

16 e

17 a

Source: FIVE STEPS TO PLANNING SUCCESS. EXPERIMENTAL EVIDENCE FROM U.S. HOUSEHOLDS

Annamarie Lusardi, a professor at George Washington University, and one of the researchers who created the Five Steps educational program, says that answering approximately 11 out of 17 questions correctly indicates financial literacy.

Robert Powell is editor of <u>Retirement Weekly</u>, published by MarketWatch. <u>Follow his tweets at</u> RJPIII . Got questions about retirement? Get answers. <u>Send Bob an email here</u>.