Name _____ Date _____

Investing Basics: Risk, Return and Diversification

Directions: The table describes two approaches to investing the same $1,000. Type each numerical answer as digits only, in the unit named beside the box.

1. Anyone learning about investing encounters these four terms early; match each term with the meaning that accurately describes it.

Write the letter of the matching answer on each line.

1. _____ Stock
2. _____ Bond
3. _____ Diversification
4. _____ Time horizon

Choices for question 1

A. A promise that an investment's value can only go up

B. A loan an investor makes to a government or company, which agrees to pay interest and return the money on a set date

C. A small slice of ownership in a company, with a price that can rise or fall over time

D. How long an investor expects to keep money invested before needing to use it

E. Owning many different investments so that one poor result can't sink the whole collection

2. Which statement about the relationship between risk and potential return is usually true?

A. The safest investments usually pay the highest returns.

B. An investment that might earn more usually also has a bigger chance of losing value.

C. Risk and return have no connection to each other.

D. A higher return is guaranteed to anyone who waits long enough.

3. Which statement about owning stock in a company is accurate?

A. A stock's price rises every single year.

B. A stock can never lose more than half its value.

C. A stock's value can fall, and its owner may lose part or even all of the money invested.

D. The government guarantees the value of every stock.

Two Portfolios

Two ways to invest $1,000. No return is guaranteed. Portfolio 1 puts all $1,000 into the stock of a single company, while Portfolio 2 splits the $1,000 equally among the stocks of 10 different companies in different industries.

Portfolio	Number of company stocks	Amount in each stock (dollars)
Portfolio 1	1	1,000

Portfolio	Number of company stocks	Amount in each stock (dollars)
Portfolio 2	10	100

4. In Portfolio 2, if one of the 10 stocks loses half its value while the other nine remain unchanged, how many dollars does the entire portfolio lose?

_____ dollars

5. Suppose the single company in Portfolio 1 fails and its stock loses all its value, and in Portfolio 2 one of the 10 companies fails the same way while the other nine remain unchanged; which portfolio loses less, and by how much?

A. Portfolio 2, by $100
B. Both portfolios lose the same amount
C. Portfolio 2, by $900
D. Portfolio 1, by $900

6. Since Portfolio 2 is diversified across 10 companies, which statement accurately describes what that diversification can and cannot accomplish?

A. It removes all risk once a portfolio holds 10 stocks.
B. It means Portfolio 2 will always earn more than Portfolio 1.
C. It guarantees that Portfolio 2 will never lose money.
D. It lowers the chance that one company's trouble does serious damage, but it does not get rid of risk.

7. If an economic downturn affects the entire economy, why might Portfolio 2 still lose value even though it holds stock in 10 different companies?

A. Each company's loss is counted 10 times in a diversified portfolio.
B. Diversified portfolios are not allowed to rise in value.
C. Events that affect the whole economy can push many companies' stocks down at the same time.
D. Portfolio 2 holds only bonds, which always fall in a downturn.

8. If a $500 investment is worth $560 exactly one year later, what was its return for that year, expressed as a percent?

_____ percent

9. A different investment begins the year at $800 and then loses 15% of its value; what is it worth at the end of the year?

_____ dollars

10. Why might someone saving for a goal one year away keep that money in lower-risk places than someone saving for a goal 30 years away?

A. Lower-risk choices always earn the most over one year.
B. Investments held for 30 years can't lose value.
C. People saving for short-term goals aren't allowed to own stocks.
D. Over one year, there may be no time to recover from a drop before the money is needed.