

Name: \_\_\_\_\_ Date: \_\_\_\_\_

## Answer Key: Compounding Fortunes: 7th Grade Wealth Architecture Quiz

Can small choices create a financial empire? Analyze 10 complex scenarios regarding opportunity cost, compound interest, and speculative vs. stable growth.

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**1. Anish is deciding between a 0.5% savings account and a 3% Certificate of Deposit (CD) for his \$2,000 savings. If the inflation rate is currently 4%, what is the real economic outcome of his decision?**

**Answer:** B) Both options result in a loss of purchasing power over time.

If inflation (4%) is higher than the interest rate (3% or 0.5%), the 'real' value of the money decreases because prices are rising faster than the money is growing.

**2. Diversifying a portfolio by purchasing shares in different industries, such as technology and renewable energy, effectively eliminates all market risk for an investor.**

**Answer:** B) False

Diversification reduces 'unsystematic risk' (specific to one company), but it cannot eliminate 'systematic risk,' which affects the entire market regardless of the industry.

**3. When a person chooses to invest \$500 in a stock rather than keeping it in an emergency fund, the potential security they lose by not having cash available is known as \_\_\_\_\_.**

**Answer:** C) Opportunity cost

Opportunity cost is the value of the next best alternative given up when making a financial choice.

**4. Which of these scenarios best demonstrates the 'Rule of 72' to estimate how long it takes for an investment of \$1,000 to double at a 6% fixed annual return?**

**Answer:** B) The investment will double in approximately 12 years.

The Rule of 72 is a mental math shortcut: divide 72 by the annual interest rate ( $72 / 6 = 12$ ) to find the years to double.

**5. A financial strategy where an investor buys a fixed dollar amount of a particular investment on a regular schedule, regardless of the share price, is called \_\_\_\_\_.**

**Answer:** D) Dollar-cost averaging

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Dollar-cost averaging reduces the impact of volatility by buying more shares when prices are low and fewer when prices are high.

**6. A credit utilization ratio—the amount of credit you use compared to your total limit—is a significant factor in determining your credit score.**

**Answer:** A) True

Lenders prefer to see that you aren't maxing out your credit lines; keeping utilization low (typically under 30%) improves your creditworthiness.

**7. In the context of the 'time value of money,' why is \$100 today generally worth more than \$100 received one year from now?**

**Answer:** B) Because of its potential to earn interest and the impact of inflation.

Money available now can be invested to earn more money, and \$100 today typically has more purchasing power than it will in a future inflationary environment.

**8. Elena earns dividends from her stocks and immediately uses them to buy more shares of that same company. This process of earning 'interest on interest' is known as \_\_\_\_\_.**

**Answer:** B) Compound growth

Compounding occurs when your earnings are reinvested to generate their own earnings, leading to exponential growth over long periods.

**9. An 'Index Fund' is a type of mutual fund designed to mimic the performance of a specific market benchmark rather than being managed by a person picking individual stocks.**

**Answer:** A) True

Index funds provide broad market exposure, low operating expenses, and low portfolio turnover by tracking a list of stocks like the Dow Jones or Nasdaq.

**10. Which type of investment represents an 'IOU' where you act as the lender to a government or corporation in exchange for regular interest payments?**

**Answer:** C) Municipal bond

Bonds are debt instruments. When you buy a bond, you are lending money to the issuer for a set period at a fixed interest rate.