Name: _____   Date: _____

Answer Key: Prudent Portfolios: Personal Finance Problems for Prospering Pros

Imagine managing a $50,000 portfolio while navigating 10 complex scenarios covering tax-advantaged accounts, inflation hedging, and risk-adjusted returns.

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1. A 25-year-old investor chooses a Target Date Fund (TDF) with a 'glide path' for retirement. What is the primary analytical justification for this strategy?

Answer: B) It automates the shift from capital appreciation to capital preservation over time.

> A glide path refers to the automated asset allocation shift in a TDF, moving from riskier assets (stocks) to more stable assets (bonds) as the target date approaches to preserve wealth.

2. The _____ Ratio is a common metric used by investors to measure the risk-adjusted return of an investment portfolio by subtracting the risk-free rate from the return.

Answer: B) Sharpe

> The Sharpe Ratio is a fundamental concept in finance that helps individuals understand if their portfolio's excess returns are due to smart investment decisions or excessive risk.

3. True or False: In a high-inflation environment, holding large amounts of cash in a standard checking account results in a 'negative real interest rate.'

Answer: A) True

> If the inflation rate exceeds the nominal interest rate earned on a bank account, the purchasing power of that money decreases, resulting in a negative real return.

4. Which of the following describes the 'Time Value of Money' (TVM) principle when comparing a lump sum today versus a series of future payments?

Answer: B) Money today is worth more due to its potential earning capacity.

> TVM posits that money available now is worth more than the same amount in the future because it can be invested to earn interest or dividends.

5. When an individual utilizes a 'Backdoor Roth,' they are typically trying to bypass _____, which would otherwise prevent them from contributing to a Roth IRA.

Answer: B) Income limits

> High-income earners who exceed the IRS limits for direct Roth IRA contributions use the 'backdoor' method by contributing to a traditional IRA and then converting it.

6. True or False: Tax Loss Harvesting involves selling securities at a loss to offset capital gains liabilities, thereby improving the net after-tax return.

Answer: A) True

> Tax loss harvesting is a common sophisticated strategy used to minimize the amount of taxes paid on investment gains by realizing losses elsewhere in the portfolio.

7. Consider the 'Efficient Market Hypothesis' (EMH). If a college student believes they can consistently 'beat the market' by picking individual stocks based on public news, they are challenging which form of EMH?

Answer: B) Semi-strong form

> The semi-strong form of EMH suggests that all publicly available information is already reflected in stock prices, meaning fundamental analysis cannot produce consistent excess returns.

8. A standard 'Debt Avalanche' method of repayment focuses on paying off the balance with the _____ first to minimize total interest paid over time.

Answer: B) Highest interest rate

> Unlike the Debt Snowball (which focuses on the smallest balance), the Debt Avalanche is mathematically superior for saving money because it targets high-interest debt first.

9. Which document is essential for evaluating the internal fees, management strategy, and historical performance of a Mutual Fund or ETF?

Answer: B) Prospectus

> A prospectus is a legal document required by the SEC that provides detailed information about an investment offering to the public.

10. True or False: A 'Fiduciary' standard of care requires a financial advisor to act solely in the client's best interest, rather than just providing 'suitable' advice.

Answer: A) True

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The fiduciary standard is the highest legal duty one party can have to another, being much stricter than the 'suitability' standard often used by brokers.