

Lesson 7—Handout 1

Guided Notes

Vocabulary

Risk—The possibility of loss or injury.

Financial risk—The possibility that an asset will fail to produce a return or will lose value over time.

Asset—Anything you own that has commercial or exchange value.

Wealth-building assets—Possessions that generally increase in value over time.

Depreciating assets—Possessions that decrease in value over time.

Default risk—An interest-bearing investment that fails to pay the promised interest or return on the original investment.

Inflation—A sustained rise in the prices of goods and services.

Inflation risk—The rate of return on an investment that is less than the rate of inflation.

Liquidity risk—The inability to quickly sell an asset at an acceptable price.

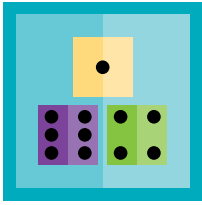
Return—The profit or loss from an investment.

Dividend—A share of profits paid to a stockholder.

Interest payment—The rate of return paid to the saver/investor.

Capital gain—The increase in value of an asset (such as stock or real estate) from the time it is bought to the time it is sold.

Brainstorm and write down answers to the question: What are the risks of playing a sport or driving a car?

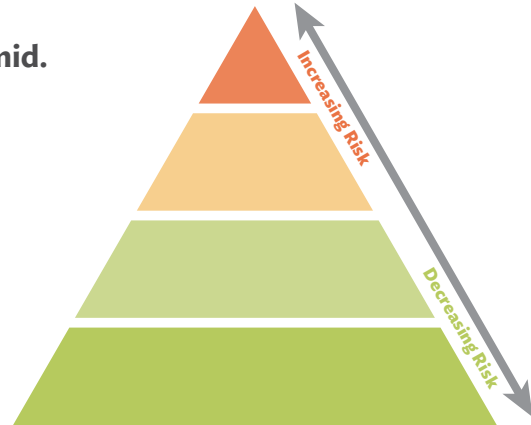


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Guided Notes (Cont.)

Sort the assets listed into the investment pyramid.

- Stock.
- Certificate of deposit.
- Mutual fund.
- Bond.
- Savings account.
- Real estate.



Use the formula below to solve for the real interest rate.

Nominal interest rate - **Inflation** = **Real interest rate**

If Darius earned 1% interest (nominal interest rate) on his certificate of deposit and inflation was 2%, what was the real interest rate Darius earned while keeping his money in a CD?

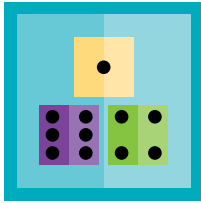
_____ %.

Extra practice: Solve for the real interest rate.

Savings account example: With a nominal return of .01% and inflation of 2.0%, the real interest rate is _____ %.

Bond example: With a nominal return of 2.0% and inflation of 2.0%, the real return is _____ %.

Mutual fund example: With a nominal return of 8.5% and inflation of 2.0%, the real return is _____ %.



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What is the risk–return relationship?

Do risk and return always move in the same direction? Explain.