Investing Knowledge Quiz

A helpful guide to learning more about investing.
FINRA and Investor Education

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The FINRA Investor Education Foundation helps to empower underserved Americans with the knowledge, skills and tools to make sound financial decisions throughout life. Through a combination of research and educational programming, the FINRA Foundation helps Americans build financial stability, invest for life goals, and guard against fraud and financial exploitation.

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1. **If you buy a company's stock:**
   a) You own a part of the company.
   b) You have lent money to the company.
   c) You are liable for the company's debts.
   d) The company will return your original investment to you with interest.
   e) Don't know

2. **If you buy a company's bond:**
   a) You own a part of the company.
   b) You have lent money to the company.
   c) You are liable for the company's debts.
   d) You can vote on shareholder resolutions.
   e) Don't know

3. **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

4. **If a company files for bankruptcy, which of the following securities is most at risk of becoming virtually worthless?**
   a) The company's preferred stock
   b) The company's common stock
   c) The company's bonds
   d) Don't know
5. Which of the following best explains why many municipal bonds pay lower yields than other government bonds?
   a) Municipal bonds are lower risk.
   b) There is a greater demand for municipal bonds.
   c) Municipal bonds can be tax-free.
   d) Don't know

6. You invest $500 to buy $1,000 worth of stock on margin. The value of the stock drops by 50%. You sell it. Approximately how much of your original $500 investment are you left with in the end?
   a) $500
   b) $250
   c) $0
   d) Don't know

7. Which is the best definition of “selling short”?
   a) Selling shares of a stock shortly after buying it
   b) Selling shares of a stock before it has reached its peak
   c) Selling shares of a stock at a loss
   d) Selling borrowed shares of a stock
   e) Don't know

8. In the 20-year period between 2002-2022, the best average returns were generated by:
   a) Stocks
   b) Bonds
   c) CDs
   d) Money market accounts
   e) Precious metals
   f) Don't know
9. What is the main advantage that index funds have when compared to actively managed funds?
   a) Index funds are generally less risky in the short term.
   b) Index funds generally have lower fees and expenses.
   c) Index funds are generally less likely to decline in value.
   d) Don't know

10. Past performance of an investment is a good indicator of future results.
    a) True
    b) False
    c) Don't know

11. If you own a call option with a strike price of $50 on a security that is priced at $40, and the option is expiring today, which of the following is closest to the value of that option?
    a) $10
    b) $0
    c) -$10
    d) Don't know

Check your answers on the following pages to see how you did.
See how you did! Check the correct answers below and give yourself one point for each question you answered correctly. Your score will equal the total number of questions you answered right. Make sure to review the explanations for each answer to learn more about investing.

1. If you buy a company’s stock:
   a) You own a part of the company. 
   Stocks are known as “equities” because each stock share represents a small percentage of ownership in the company, usually entitling the shareholder to vote in the election of directors and on other matters taken up at shareholder meetings or by proxy.

2. If you buy a company’s bond:
   b) You have lent money to the company. 
   Bonds are loans that investors make to a corporation or a government body in exchange for regular interest payments and the return of principal at a future date. Companies issue corporate bonds to raise money for capital expenditures, operations and acquisitions. But unlike stockholders, bondholders don’t receive ownership rights in the corporation.

3. In general, investments that are riskier tend to provide higher returns over time than investments with less risk.
   a) True 
   The stock and bond markets tend to reward risk-taking over the long term. This is called the risk-reward tradeoff. Over the short term, however, high-risk investments such as small-company stocks can be extremely volatile. The less willing you are to take that risk, the more you might want to emphasize investments that provide a regular return with less volatility, such as high-quality short-term bonds.

Answer Key
4. If a company files for bankruptcy, which of the following securities is most at risk of becoming virtually worthless?

b) The company’s common stock.
Among those with claims to a bankrupt company’s assets, shareholders of common stock have the last claim on any assets, falling in line behind secured creditors, bondholders and owners of preferred shares. Common shareholders may not receive anything if the secured and unsecured creditors’ claims aren’t fully repaid.

5. Which of the following best explains why many municipal bonds pay lower yields than other government bonds?

c) Municipal bonds can be tax-free.
Dividend payments from municipal bonds are usually exempt from federal income tax because they are issued by local authorities—such as cities, states and counties. Even though municipal bonds often pay lower yields than other government bonds, their after-tax rates of return can be attractive to investors in higher tax brackets.

6. You invest $500 to buy $1,000 worth of stock on margin. The value of the stock drops by 50%. You sell it. Approximately how much of your original $500 investment are you left with in the end?

c) $0
When you buy stock on margin—with borrowed money—you risk losing your entire investment or much more. In this example, an investor used $500 to buy $1,000 worth of stock, borrowing the additional $500 from a brokerage firm to make the purchase. When the stock was sold after dropping 50% in value, its remaining worth was only $500—the same amount the investor still owed to the brokerage firm for the margin loan.
7. Which is the best definition of “selling short”?

d) Selling borrowed shares of a stock

Short selling involves borrowing stock from a brokerage firm through a margin account and selling it, with the understanding that it must later be bought back and returned to the firm. A short seller hopes the stock will decline in value so they can return the stock to their firm at a lower price than what was initially paid, thus profiting off the difference. However, if the stock rises in value, the investor must pay the difference to make good on the stock owed to the firm.

8. In the 20-year period between 2002–2022, the best average returns were generated by:

a) Stocks

Historical data shows that, during this time period, a portfolio of stocks generated an average annual return that outpaced returns on bonds, CDs, money market accounts or precious metals. Even so, stocks’ performance edge has come with more uncertainty and some dramatic ups and downs along the way.

9. What is the main advantage that index funds have when compared to actively managed funds?

b) Index funds generally have lower fees and expenses.

Index funds, also known as passive funds, refer to mutual funds that intend to mimic the trend and return of a certain market index. They’re structured to invest in the same securities that make up a given index and seek to match the performance of the index they track, whether positive or negative. As the name implies, no manager or management team actively picks stocks or makes buy and sell decisions.
Active funds, in contrast, attempt to outperform whichever index serves as the fund’s benchmark, although—and this is important—there’s no guarantee they will do so. Active managers conduct research, closely monitor market trends and employ a variety of trading strategies to achieve return. But this active involvement comes at a price. Actively managed funds typically have significantly higher fees and expenses.

10. Past performance of an investment is a good indicator of future results.

b) False

In their marketing materials for a mutual fund or exchange-traded fund, fund companies are required by regulators to disclose to potential investors that past performance does not guarantee future results. This disclosure is designed to prevent investment companies from marketing their funds based on high returns the fund may have had in the past because it’s possible that the fund will not generate those high returns again and may even lose money.

11. If you own a call option with a strike price of $50 on a security that is priced at $40, and the option is expiring today, which of the following is closest to the value of that option?

b) $0

A call is a contract between a holder and a seller to purchase a certain security for a certain price—known as the strike price—with a set expiration date. A call is only valuable to the holder if the price of the security is higher than the strike price. When that happens, the holder of the call could purchase the security from the seller of the call at the strike price, then immediately sell the security at the current price. However, in this question, the strike price is higher than the current price. So there is no benefit to exercise it since the call has no value.
Interpreting Your Score

0 – 3
You’re still learning the ins and outs of investing, and you’re not alone: 33 percent of investors in the 2021 National Financial Capability Study (NFCS) scored in this category. Investing can be complex, but it doesn’t have to be confusing. Check out the resources listed here to start building your knowledge.

4 – 7
You likely know the investing basics, but you might need to brush up on some of the more complex topics. This category is where 50 percent of investors in the 2021 NFCS scored. When it comes to finances, there’s a lot of information to sort through. Our list of resources can help you fill in the gaps in your financial savvy.

8+
You’ve done your homework and have a strong investing knowledge base. In the 2021 NFCS, 16 percent of investors got eight or more correct responses. But the investing landscape can evolve quickly, and there’s always more to learn. Consult the resources provided to keep growing as an investor.

These questions are based on questions from the Investor Survey component of the FINRA Foundation’s 2021 National Financial Capability Study (NFCS). The survey provides an in-depth exploration of investors across the United States. Learn more about the NFCS at www.finrafoundation.org/nfcs.
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Resources to Learn More

FINRA Investing Content
Browse investor-focused content ranging from introductory investing concepts to in-depth information on investment products and more. Investing courses, tools and calculators are also available.
www.finra.org/investors

FINRA Investor Insights
Read our Investor Insights for updates on topics like complex products, financial fraud awareness and market trends.
www.finra.org/investors/insights

FINRA BrokerCheck
Investigate the background and experience of investment professionals and firms using this free tool.
www.finra.org/brokercheck

FINRA Fixed Income Data
Find free, comprehensive fixed income security and trade information compiled from multiple sources.
www.finra.org/finra-data/fixed-income

FINRA Market Data
Find free, comprehensive data on equities, options and mutual funds compiled from multiple sources.
https://finra-markets.morningstar.com

FINRA Help Center
File a complaint against a brokerage firm or financial professional, and find options for dispute resolution or asset recovery.
www.finra.org/investors/need-help

FINRA Foundation
Learn more about the FINRA Foundation’s financial inclusion initiatives and its industry-leading research.
www.finrafoundation.org

SEC Investor Education
Find essential investing information, including product overviews, tips for getting started, and investor tools and alerts.
www.investor.gov

NASAA Investor Education
The North American Securities Administrators Association provides investor advisories, fraud prevention tips and multimedia educational material.
www.nasaa.org/investor-education

Options Clearing Corp
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