Introduction to Personal Finance Beginning Your Financial Journey 2nd edition Grable Solutions Manual

SKU: 9781119797067-SOLUTIONS

Chapter 1—Solutions Manual

Beginning Your Financial Journey: The Interior Finance Point of View

Introduction to Personal Finance: Beginning Your Financial Journey
By John Grable and Lance Palmer

Learning Objectives

1.1 Describe how your financial knowledge, experience, risk tolerance, and feelings of control influence the way you view the financial world.

1.2 Explain how your human and social capital relate to your financial well-being.

1.3 Discuss how financial risk tolerance relates to financial goal achievement.

1.4 Use your unique time perspective to create SMART financial goals.

1.5 Describe strategies to overcome mental biases and improve financial decision making and well-being.

Key to metadata for questions:

LO: Learning objective number

BT: Bloom's taxonomy [Knowledge (K), Comprehension (C), Application (Ap), Analysis (An), Synthesis (S), Evaluation (E)]

Diff: Difficulty level [Easy (E), Medium (M), Hard (H)]

TOT: Expected time for student to complete

AACSB: Knowledge (K), Communication (C), Ethics (E), Analytic (A), Technology (T), Diversity (D), Reflective Thinking (RT), Not Applicable (NA)

Sample rubric for writing questions:

Note: It is generally recommended that the rubric be shared with students, so it should be sufficiently general to not give away answers.

Notes for instructor:

Each writing question will have criteria which are specific to the question. The instructor may want to add or delete grading criteria (rows) depending on the topic and assignment. How each grading criterion will be assessed and the associated points for each level of performance are found in columns 2–5.

In the sample rubric, a total of 16 points are possible for this assignment. Each grading criterion (row) is worth up to 4 points (column 2).

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Rubric: (It is suggested that the rubric be shared with the students.)

Criteria	**Full points (4 out of 4)**	**75% of points (3 out of 4)**	**50% of points (2 out of 4)**	**25% of points (1 out of 4)**
Thoroughness of answer to the question	The question is answered thoroughly	The response is lacking a few details	The response is lacking significant details	The response is incomplete and limited
Answer is realistic/relevant	Amounts and information discussed are relevant and pertinent to the question	Some of the response is irrelevant to the question	Much of the response is irrelevant, unrealistic, or overly simplistic	The response does not represent realistic or relevant understanding of topic
Organization/clarity of thought (25% of score)	Well organized	Adequate organization	Limited organization	Poor organization
Appropriate recommendations and conclusions are reached (25% of score)	A clear conclusion or recommendation is presented that is appropriate given the content discussed	Conclusion or recommendation is mostly clear and appropriate given the content	Conclusion or recommendation is incomplete	No conclusion or recommendation is provided

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1.1 Describe how your financial knowledge, experience, risk tolerance, and feelings of control influence the way you view the financial world.

1.1 Multiple-Choice Questions

1. b. the combination of financial knowledge and skills.

   Answer: b; Section: 1.1; LO: 1.1; BT: K; Diff: E; TOT: 2 min; AACSB: K

2. c. I and II only.

   Answer: c; Section: 1.1; LO: 1.1; BT: C; Diff: E; TOT: 2 min; AACSB: RT

3. d. your financial knowledge, financial risk-taking, and feelings of control over your situation.

   Answer: d; Section: 1.1; LO: 1.1; BT: K; Diff: E; TOT: 2 min; AACSB: RT

4. c. believe strongly in luck and fate

   Answer: c; Section: 1.1; LO: 1.1; BT: C; Diff: E; TOT: 2 min; AACSB: RT

5. a. more knowledgeable about the financial marketplace over time and to increase his personal wealth.

   Answer: a; Section: 1.1; LO: 1.1; BT: C; Diff: E; TOT: 2 min; AACSB: RT

6. c. Having and raising a child.

   Answer: c; Section: 1.1; LO: 1.1; BT: C; Diff: E; TOT: 2 min; AACSB: RT

7. a. Consumer spending.

   Answer: a; Section: 1.1; LO: 1.1; BT: K; Diff: E; TOT: 2 min; AACSB: K

8. b. GDP would fall because consumers would spend less on goods and services.

   Answer: b; Section: 1.1; LO: 1.1; BT: C; Diff: E; TOT: 2 min; AACSB: RT

9. a. A willingness to save money on a regular basis.

   Answer: a; Section: 1.1; LO: 1.1; BT: C; Diff: E; TOT: 2 min; AACSB: RT

10. c. Michelle, who gives regularly to charity, reads about investing and is self-confident.

    Answer: c; Section: 1.1; LO: 1.1; BT: C; Diff: E; TOT: 2 min; AACSB: RT

1.1. Adventures in Personal Finance

Short Answer

1. Answer: High-quality responses should include a discussion of how the wealth was accumulated, work effort, and locus of control (chance versus work), and also include a

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discussion of the student's perception of his or her locus of control. Please refer to the sample writing assignment rubric in the solutions manual.

Section: 1.1; LO: 1.1; BT: C; Diff: E; TOT: 15 min; AACSB: RT, E

2. Answer**:** Risk tolerance describes your willingness to engage in financial activities that have uncertain outcomes. Individuals with low risk tolerance may be fearful of the financial markets and financial activities and avoid them. As your financial literacy increases and risk perceptions are properly understood, your willingness to engage in risks may increase.

   Section: 1.1; LO: 1.1; BT: Ap; Diff: M; TOT: 5 min; AACSB: RT, A

3. Answer: High-quality responses should include a discussion of how savings behavior may differ between generations. Please refer to the sample writing assignment rubric in the solutions manual.

   Section: 1.1; LO: 1.1; BT: Ap or An; Diff: M; TOT: 20 min; AACSB: RT, D

4. Answers will vary based on student experiences. The sample grading rubric found in the solutions manual can be adapted to grade this assignment.

   Section: 1.1; LO: 1.1; BT: Ap; Diff: M; TOT: 20 min; AACSB: RT

Explore

1. Answer: GDP decreased during this time period. A recession is a decrease in GDP.

   Section: 1.1; LO: 1.1; BT: An; Diff: E; TOT: 10 min; AACSB: A

2. Answer: High-quality responses should include a discussion of material that the student found as well as the student's assessment of that material. Please refer to the sample writing assignment rubric in the solutions manual.

   Section: 1.1; LO: 1.1; BT: C; Diff: E; TOT: 20 min; AACSB: T

3. Answer: High-quality responses should include a discussion of how well the student performed in the game and the student's assessment whether this type of learning platform is helpful for others. Students should justify their responses. Please refer to the sample writing assignment rubric in the solutions manual.

   Section: 1.1; LO: 1.1; BT: An; Diff: M; TOT: 20 min; AACSB: C

4. Answer: The F.I.R.E. movement may appeal to individuals studying personal finance. The notion of saving money early if life in order to exit the job market to pursue life dreams, community service, and work-life balance is something that appeals to Millennials and others who find working to be restrictive. There are no correct or incorrect answers to this question. After researching the movement, students may realize that the reality of filling 30 to 50 years of daily experience outside of the job market may not be match the dream, especially if the retirement budget is very tight. Please refer to the sample writing assignment rubric in the solutions manual.

   Section: 1.1; LO: 1.1; BT: An; Diff: M; TOT: 20 min; AACSB: C

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Expanded Learning Activity

Answer: High-quality responses should discuss the results of the research and how those results relate to financial planning. Please refer to the sample writing assignment rubric in the solutions manual.

Section: 1.1; LO: 1.1; BT: E; Diff: H; TOT: 120 min; AACSB: C

1.1 Practice Questions

(The Practice Questions do not appear in the printed textbook. Autogradable version is available in your Wiley course, with algorithmically changing values when applicable.)

1. Which of the following elements influence your view of the financial world?

   I. Your risk tolerance.

   II. How much you believe you control your financial future.

   III. Knowledge about personal finance topics.

   a. II only.

   b. II and III only.

   c. I and II only.

   d. I, II, and III.

   Answer: d; Section: 1.1; LO: 1.1; BT: C; Diff: E; TOT: 2 min; AACSB: RT

2. Someone who feels that investing is too difficult to understand likely

   a. has a lower level of financial literacy.

   b. is positioned to maximize lifetime wealth accumulation goals.

   c. has a high tolerance for financial risk.

   d. feels in control of his or her financial situation.

   Answer: a; Section: 1.1; LO: 1.1; BT: C; Diff: E; TOT: 2 min; AACSB: RT

3. Why might some people who are nearing retirement feel less confident about their financial future?

   a. They have too much debt.

   b. They have not saved enough over their lifetime.

   c. They live too frugally and cannot enjoy the joys of retirement.

   d. They have too much debt and they have not saved enough over their lifetime.

   Answer: d; Section: 1.1; LO: 1.1; BT: C; Diff: E; TOT: 2 min; AACSB: RT

4. Someone who reports that they strongly agree with (a) the thought of taking a risk is exciting to me, (b) in terms of investing, high returns are more important than safety, and (c) making money in stocks and bonds is based on knowledge is most likely

   a. willing to take more financial risk.

   b. willing to take no financial risk.

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c. believing in luck and fate.

d. feeling that he or she cannot control his or her financial future.

Answer: a; Section: 1.1; LO: 1.1; BT: C; Diff: M; TOT: 2 min; AACSB: RT

5. All of the following are pathways to wealth, except

a. saving money on a regular basis.

b. keeping good financial records.

c. spending less than income earned.

d. maximizing insurance expenditures.

Answer: d; Section: 1.1; LO: 1.1; BT: C; Diff: E; TOT: 2 min; AACSB: RT

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1.2 Explain how your human and social capital relate to your financial well-being.

1.2 Multiple-Choice Questions

1. b. human capital.

   Answer: b; Section: 1.2; LO: 1.2; BT: K; Diff: E; TOT: 2 min; AACSB: K

2. b. Michelle.

   Answer: b; Section: 1.2; LO: 1.2; BT: Ap; Diff: M; TOT: 2 min; AACSB: RT

   Solution: Human capital is your ability and willingness to work, learn, earn, and make wise decisions about how to save and invest money. Earnings are often closely associated with your level of formal education (see Illustration 1.2.1). Holding an advanced degree is often a pathway to higher income and human capital. Those with an advanced academic degree tend to do better when the economy turns downward. Michelle does not have an advanced degree.

3. a. Healthy people spend more money on food and exercise, which reduces their lifetime wealth accumulation.

   Answer: a; Section: 1.2; LO: 1.2; BT: C; Diff: E; TOT: 2 min; AACSB: RT

4. c. Tammy.

   Answer: c; Section: 1.2; LO: 1.2; BT: Ap; Diff: M; TOT: 2 min; AACSB: RT

   Solution: In addition to education, your health affects human capital in both the short run and the long run. Generally, healthy people work more hours and for a longer period of years over their life span compared to those with health problems. Thus, healthy people tend to earn more money on an annual basis, as well as over their lifetimes. Poor health may result in a lower standard of living across the life span. Actively managing your health by eating a healthy diet, avoiding substance abuse, and preventing and minimizing accidents (by wearing your seat belt and never texting while driving) all add up to a healthy lifestyle that will extend your life and increase your human capital. Lance is a smoker, and Rob regularly texts while driving.

5. a. Relocate to a place where his welding skills will be valued in the marketplace.

   Answer: a; Section: 1.2; LO: 1.2; BT: C; Diff: E; TOT: 2 min; AACSB: RT

6. a. Converting human capital to financial wealth depends on wise planning and management.

   Answer: a; Section: 1.2; LO: 1.2; BT: C; Diff: E; TOT: 2 min; AACSB: RT

7. b. Jorge.

   Answer: b; Section: 1.2; LO: 1.2; BT: Ap; Diff: M; TOT: 2 min; AACSB: RT

   Solution: Unlike human capital, social capital is not found in individuals themselves but rather in the space between individuals or the network of connections among people. Your social capital is shaped by informal and formal networks, like Jorge's fraternity.

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8. a. A formal network

   Answer: a; Section: 1.2; LO: 1.2; BT: C; Diff: E; TOT: 2 min; AACSB: K

9. b. Option 2.

   Answer: b; Section: 1.2; LO: 1.2; BT: Ap; Diff: M; TOT: 2 min; AACSB: A

   Solution: Option 2 has a $40,000/year payback, where Option 1 only has a $35,000/year payback. The higher payback amount will achieve a quicker breakeven.

10. d. only go back to school if the time and effort will result in an increase in personal satisfaction and fulfillment.

    Answer: d; Section: 1.2; LO: 1.2; BT: Ap; Diff: M; TOT: 2 min; AACSB: RT

    Solution: Regardless of the type of school or educational program you are interested in pursuing, you would be wise to compare the cost of the program to the additional annual income you'll earn once you have completed it. You can use the following formula to estimate how long it will take you to earn back your investment. This is called the investment payback period. The longer the payback period, the more you should question the economic value of your investment.

$$\text{Payback period} = \frac{\text{Total costs}}{\text{Increase in annual income}}$$

$$\text{Payback period} = \frac{\$75{,}000 \text{ cost of degree} + \$50{,}000 \text{ lost annual wages}}{\$55{,}000 \text{ new earnings} - \$50{,}000 \text{ past earnings}} = 25 \text{ years}$$

    It turns out that it is going to take Ruby about 25 years to break even on her investment, which is 8 years past her expected retirement at 67 years of age. The payback period is helpful in making education decisions, but it shouldn't be the only factor considered. For example, the investment payback period calculation doesn't account for the value of Ruby's human and social capital that she'll obtain by finishing school. There's also the personal feeling of satisfaction that is hard to value.

1.2 Adventures in Personal Finance

Short Answer

1. Answer: High-quality responses should address the specific questions. Please refer to the sample writing assignment rubric in the solutions manual.

   Section: 1.2; LO: 1.2; BT: Ap; Diff: M; TOT: 15 min; AACSB: RT

2. Answer: High-quality responses should include a discussion of protection measures such as seat belts, exercise/good health practices, safe driving, and stress management. Responses may also include health insurance, life insurance, disability insurance, and other forms of insurance on the individual (NOT property insurance). Please refer to the sample writing assignment rubric in the solutions manual.

   Section: 1.2; LO: 1.2; BT: Ap; Diff: M; TOT: 20 min; AACSB: RT

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3. Answer: High-quality responses should include a discussion of whom these relationships are with and how those relationships can be strengthened. Please refer to the sample writing assignment rubric in the solutions manual.

   Section: 1.2; LO: 1.2; BT: An; Diff: M; TOT: 30 min; AACSB: RT, C

4. Answer: e—1; b—2; h—3; a—4; g—5; j—6; f—7; i—8; d—9; c—10.

   Solution: (1) physician, (2) dentist, (3) lawyer, (4) personal financial advisor, (5) construction manager, (6) electrical engineer, (7) police officer, (8) kindergarten teacher, (9) social worker, (10) massage therapist.

   Section: 1.2; LO: 1.2; BT: Ap; Diff: M; TOT: 10 min; AACSB: RT

Explore

1. Answer: High-quality responses should include a discussion of the student's estimated human capital and how it compares with his or her other assets. Please refer to the sample writing assignment rubric in the solutions manual.

   Section: 1.2; LO: 1.2; BT: An; Diff: M; TOT: 40 min; AACSB: RT, C, A

2. Answer: High-quality responses should include a discussion of how the student perceives his or her online image and how it could be improved or maintained. Please refer to the sample writing assignment rubric in the solutions manual.

   Section: 1.2; LO: 1.2; BT: An; Diff: M; TOT: 20 min; AACSB: RT, T

Expanded Learning Activity

Answer: High-quality responses should include a discussion of the student's chosen career, estimated income, and estimated cost of education as well as thoughtful responses to questions (a), (b), and (c). Please refer to the sample writing assignment rubric in the solutions manual.

Section: 1.2; LO: 1.2; BT: S; Diff: H; TOT: 90 min; AACSB: RT, C, A, T

1.2 Practice Questions

(The Practice Questions do not appear in the printed textbook. Autogradable version is available in your Wiley course, with algorithmically changing values when applicable.)

1. Lifetime earnings and education are positively related. Select the ranking that represents the median lifetime earnings based on education achievement from lowest to highest.

   a. High School Diploma, Associate's Degree, Some College, Master's Degree.

   b. Professional Degree, Bachelor's Degree, Associate's Degree, High School Diploma.

   c. High School Diploma, Bachelor's Degree, Doctoral Degree, Professional Degree.

   d. Bachelor's Degree, Professional Degree, Master's Degree, Doctoral Degree.

   Answer: c; Section: 1.2; LO: 1.2; BT: Ap; Diff: M; TOT: 2 min; AACSB: K

   Solution: Your earnings are an indicator of the value of your human capital in the labor market. Earnings are often closely associated with your level of formal education. Illustration 1.2.1 shows how annual earnings increase with formal education.

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2. All of the following influence your human capital, except:

   a. your health.

   b. your financial investments.

   c. your educational level.

   d. your skill(s).

   Answer: b; Section: 1.2; LO: 1.2; BT: K; Diff: E; TOT: 2 min; AACSB: RT

3. As people age, their human capital can decline due to changes in the marketplace that demand different skills and abilities. One way to boost human capital is to

   a. enroll in a continuing education program.

   b. go back to school and learn a new skill.

   c. begin working out in order to look younger.

   d. both enroll in a continuing education program and go back to school and learn a new skill.

   Answer: d; Section: 1.2; LO: 1.2; BT: C; Diff: E; TOT: 2 min; AACSB: RT

4. Which of the following is most likely to reduce your social capital among those who may be likely to hire you for a job?

   a. Posting pictures of yourself with influential politicians in your community.

   b. Sending notes to business colleagues congratulating them on their accomplishment.

   c. “Liking” someone’s photo posted on a social media site.

   d. Posting pictures of yourself drinking at a bar.

   Answer: d; Section: 1.2; LO: 1.2; BT: C; Diff: E; TOT: 2 min; AACSB: RT

5. Which of the following occupations is likely to have the highest median salary?

   a. Kindergarten teacher.

   b. Massage therapist.

   c. Construction worker.

   d. Personal financial advisor.

   Answer: d; Section: 1.2; LO: 1.2; BT: C; Diff: E; TOT: 2 min; AACSB: RT

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1.3 Discuss how financial risk tolerance relates to financial goal achievement.

1.3 Multiple-Choice Questions

1. a. on a scale that can change over time.

   Answer: a; Section: 1.3; LO: 1.3; BT: K; Diff: E; TOT: 2 min; AACSB: K

2. d. not be worried because her risk tolerance will increase as her knowledge and experience increase.

   Answer: d; Section: 1.3; LO: 1.3; BT: C; Diff: E; TOT: 2 min; AACSB: RT

3. d. It is impossible to know what Terry's financial risk tolerance is given the information provided.

   Answer: d; Section: 1.3; LO: 1.3; BT: C; Diff: E; TOT: 2 min; AACSB: RT

4. c. The person who is willing to take risk after adequate research.

   Answer: c; Section: 1.3; LO: 1.3; BT: C; Diff: E; TOT: 2 min; AACSB: RT

5. c. generate the lowest returns.

   Answer: c; Section: 1.3; LO: 1.3; BT: C; Diff: E; TOT: 2 min; AACSB: K

6. a. The greater the return required, the greater the risk that must be taken.

   Answer: a; Section: 1.3; LO: 1.3; BT: C; Diff: E; TOT: 2 min; AACSB: K

7. d. They have a relatively low level of financial literacy, and they view playing the lottery as a form of entertainment.

   Answer: d; Section: 1.3; LO: 1.3; BT: C; Diff: E; TOT: 2 min; AACSB: RT

8. c. risk perception.

   Answer: c; Section: 1.3; LO: 1.3; BT: K; Diff: E; TOT: 2 min; AACSB: K

9. a. risk preference.

   Answer: a; Section: 1.3; LO: 1.3; BT: C; Diff: E; TOT: 2 min; AACSB: K

10. b. a general change in perceptions about the chain's quality of food.

    Answer: b; Section: 1.3; LO: 1.3; BT: C; Diff: E; TOT: 2 min; AACSB: RT

1.3 Adventures in Personal Finance

Short Answer

1. Answer: Uncertainty in financial decision refers to financial risk. Other behaviors also have risk or uncertain outcomes. Examples of risky behavior include texting while driving, drinking alcohol excessively, driving without a seat belt, chronic overeating, and sedentary lifestyle. Many activities in our daily life are inherently risky.

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Section: 1.3; LO: 1.3; BT: Ap or An; Diff: M; TOT: 20 min; AACSB: A

2. Answer**:** Risk perception is the cognitive evaluation of potential gains and losses. Risk preference is the amount of uncertainty individuals desire or seek. Risk tolerance is the willingness to engage in financial activities with uncertain outcomes.

   Section: 1.3; LO: 1.3; BT: Ap; Diff: M; TOT: 15 min; AACSB: A

3. Answer**:** Students should clearly state the activity and its rating for questions (a), (b), and (c).

   Section: 1.3; LO: 1.3; BT: Ap; Diff: M; TOT: 20 min; AACSB: RT

Explore

1. Answer: High-quality responses should include a discussion of whether the student agrees with the risk statement and provides evidence from his or her personal experience that supports his or her position, including research on this topic. Please refer to the sample writing assignment rubric in the solutions manual.

   Section: 1.3; LO: 1.3; BT: Ap; Diff: M; TOT: 30 min; AACSB: C, RT, A

2. Answer: High-quality responses should include a discussion of the student's perception of how accurate the risk score is. Please refer to the sample writing assignment rubric in the solutions manual.

   Section: 1.3; LO: 1.3; BT: Ap; Diff: M; TOT: 20 min; AACSB: RT

3. Answer: High-quality responses should clearly identify events and the odds or probabilities of those events occurring; additionally, students should also discuss their perceptions of those events occurring and whether they actually occur more or less frequently than what they thought. Please refer to the sample writing assignment rubric in the solutions manual.

   Section: 1.3; LO: 1.3; BT: S; Diff: H; TOT: 60 min; AACSB: RT, C, A

Expanded Learning Activity

Answer: High-quality responses should include a thorough discussion of why some people think the stock market is a big gamble. The discussion should also include the actual number of corporate bankruptcies and frauds in which people lost their money in relation to the number of publicly traded companies. High-quality responses should also include recommendations or advice or direction for a novice investor who thinks the stock market is a big gamble. Please refer to the sample writing assignment rubric in the solutions manual.

Section: 1.3; LO: 1.3; BT: S; Diff: M; TOT: 30 min; AACSB: C, RT, A

1.3 Practice Questions

(The Practice Questions do not appear in the printed textbook. Autogradable version is available in your Wiley course, with algorithmically changing values when applicable.)

1. Financial risk tolerance refers to your

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a. perception of the riskiness of a situation or investment.

b. preference when choosing between two or more investments.

c. willingness to engage in a risk in which an outcome is uncertain.

d. capacity to sustain an expected loss.

Answer: c; Section: 1.3; LO: 1.3; BT: C; Diff: E; TOT: 2 min; AACSB: K

2. The fact that nearly everyone would like to be wealthier rather than poorer refers to his or her risk

a. perception.

b. preference.

c. tolerance.

d. capacity.

Answer: b; Section: 1.3; LO: 1.3; BT: C; Diff: E; TOT: 2 min; AACSB: K

3. It is possible to increase your financial risk tolerance over time. What is the process of risk tolerance change?

a. Knowledge leads to confidence, which leads to experience, understanding, and an increase in risk tolerance.

b. Experience leads to understanding, which leads to confidence, knowledge, and an increase in risk tolerance.

c. Risk tolerance leads to confidence, which leads to understanding, experience, and increased knowledge.

d. Understanding leads to risk tolerance, which leads to experience, confidence, and increased knowledge.

Answer: a; Section: 1.3; LO: 1.3; BT: C; Diff: E; TOT: 2 min; AACSB: RT

4. Loraine is thinking about her future retirement goals and needs. She has 25 years until retirement. She needs to save quite a bit of money to reach her retirement goal. Unfortunately, Loraine's risk tolerance is low. Given these facts, what is the best recommendation for Loraine?

a. Postpone retirement to offset the fact that her tolerance for risk is so low.

b. Invest more aggressively knowing that she has time on her side to withstand any temporary setbacks with these riskier investments.

c. Obtain a second job to double her savings into low-risk investments.

d. Supplement her savings with the use of lottery tickets in the hopes of earning a large windfall.

Answer: b; Section: 1.3; LO: 1.3; BT: C; Diff: E; TOT: 2 min; AACSB: RT

5. Nicki is meeting with her financial planner. She is new to investing and does not have much experience in the markets. She recently took a risk-tolerance quiz and scored below average in terms of risk tolerance. Her financial planner is now recommending that she purchase shares in an aggressive mutual fund that invests in very risky small companies. The financial planner's argument is that Nicki needs to take risk to achieve decent returns. Do you agree with the financial planner?

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a. Yes, because the only way to make money is to take big risks.

b. No, because Nicki's risk tolerance does not match the mutual fund's risk profile.

c. Yes, because Nicki's risk tolerance should only be used to indicate the minimum level of risk she should take.

d. No, because the only way to make money is to take small incremental risks.

Answer: b; Section: 1.3; LO: 1.3; BT: C; Diff: E; TOT: 2 min; AACSB: RT

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1.4 Use your unique time perspective to create SMART financial goals.

1.4 Multiple-Choice Questions

1. a. Specific.

   Answer: a; Section: 1.4; LO: 1.4; BT: K; Diff: E; TOT: 2 min; AACSB: RT

2. d. Long term.

   Answer: d; Section: 1.4; LO: 1.4; BT: K; Diff: E; TOT: 2 min; AACSB: K

3. b. If the value of the assets were to fall, there would not be enough time to recoup the loss.

   Answer: b; Section: 1.4; LO: 1.4; BT: C; Diff: E; TOT: 2 min; AACSB: A

4. c. help you reach your long-term goals.

   Answer: c; Section: 1.4; LO: 1.4; BT: C; Diff: E; TOT: 2 min; AACSB: K

5. a. Past.

   Answer: a; Section: 1.4; LO: 1.4; BT: Ap; Diff: M; TOT: 2 min; AACSB: RT

   Solution: Most people view the world primarily from one of three time perspectives or lenses:

   - Past-oriented: based on memories, whether good or bad. Those who view past events negatively have the most trouble staying on their financial path. Diego is past-oriented.
   - Present-oriented: based on either (a) a hedonistic perspective (doing things for pleasure, experience, and excitement of the action) or (b) a fatalistic perspective (unable to visualize a meaningful future). Understandably, those with a fatalistic outlook sometimes have a hard time reaching their long-term financial goals.
   - Future-oriented: based on a calculation of the consequences of actions in terms of a future payoff. Those with a future orientation tend to be very goal-oriented. As such, they might do a better job of managing their personal financial situation in the long run but may miss out on some opportunities along the way.

6. c. Present-hedonistic.

   Answer: c; Section: 1.4; LO: 1.4; BT: Ap; Diff: M; TOT: 2 min; AACSB: RT

   Solution: Most people view the world primarily from one of three time perspectives or lenses:

   - Past-oriented: based on memories, whether good or bad. Those who view past events negatively have the most trouble staying on their financial path.
   - Present-oriented: based on either (a) a hedonistic perspective (doing things for pleasure, experience, and excitement of the action) or (b) a fatalistic perspective (unable to visualize a meaningful future). Understandably, those with a fatalistic

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outlook sometimes have a hard time reaching their long-term financial goals. Arnold has a present-hedonistic orientation.

- Future-oriented: based on a calculation of the consequences of actions in terms of a future payoff. Those with a future orientation tend to be very goal-oriented. As such, they might do a better job of managing their personal financial situation in the long run but may miss out on some opportunities along the way.

7. a. Those who resist temptation today.

   Answer: a; Section: 1.4; LO: 1.4; BT: C; Diff: E; TOT: 2 min; AACSB: K

8. c. 70%.

   Answer: c; Section: 1.4; LO: 1.4; BT: Ap; Diff: M; TOT: 2 min; AACSB: K

   Solution: The marshmallow experiment was first undertaken by Walter Mischel, a Columbia University faculty member, in the 1960s. Mischel was tempting young children with an almost irresistible treat. At the core of the temptation is the notion of time perspective. Mischel wanted to determine who was willing to forgo immediate rewards for a larger payoff in the future: It turns out that two-thirds of the children ate the marshmallow before the researcher returned. Subsequent research indicates that about 70% of Americans—both children and adults—fall prey to temptation. They tend to be impulsive and quick acting.

9. b. Receiving a bonus.

   Answer: b; Section: 1.4; LO: 1.4; BT: K; Diff: E; TOT: 2 min; AACSB: RT

10. c. People who hold a past negative time orientation have a hard time saving for the future.

    Answer: c; Section: 1.4; LO: 1.4; BT: Ap; Diff: M; TOT: 2 min; AACSB: RT

1.4 Adventures in Personal Finance

Short Answer

1. Answer: High-quality responses should include two SMART goals that address all the areas of a SMART goal. Please refer to the sample writing assignment rubric in the solutions manual.

   Section: 1.4; LO: 1.4; BT: Ap; Diff: M; TOT: 15 min; AACSB: RT, C

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2. Answer: a—3; b—5; c—1; d—4; e—2.

Solution:

a. Past-negative.	3. You let past experiences and emotions upset you and sometimes feel regretful.
b. Past-positive.	5. You love to daydream and think about the good things that have already happened to you.
c. Present-hedonistic.	1. You seek out pleasure, good times, and experiences when given the opportunity.
d. Present-fatalistic.	4. You would like to take control of your future but feel trapped and unable to change things today.
e. Future-oriented.	2. You strive to reach your goals, almost at any cost.

Section: 1.4; LO: 1.4; BT: C; Diff: E; TOT: 10 min; AACSB: K

3. Answer: High-quality responses should include a list of strategies for altering time perspectives. Please refer to the sample writing assignment rubric in the solutions manual.

Section: 1.4; LO: 1.4; BT: S; Diff: M; TOT: 20 min; AACSB: RT

4. Answer: High-quality responses should address each of the points (a)–(d) posed in the question. Please refer to the sample writing assignment rubric in the solutions manual.

Section: 1.4; LO: 1.4; BT: An; Diff: M; TOT: 20 min; AACSB: RT, C

Explore

1. Answer: High-quality responses should include a discussion of the advantages and disadvantages of SMART goals. Please refer to the sample writing assignment rubric in the solutions manual.

Section: 1.4; LO: 1.4; BT: An; Diff: M; TOT: 40 min; AACSB: A, C

2. Answer: High-quality responses should include two lists: (1) students' top 10 goals and (2) top 10 most common goals from the Internet. Students should also discuss these goals to determine how many of the goals are financial. Please refer to the sample writing assignment rubric in the solutions manual.

Section: 1.4; LO: 1.4; BT: An; Diff: M; TOT: 20 min; AACSB: RT, C, A

3. Answer: High-quality responses should include a discussion of the student's score on the inventory and the student's response to the score. Please refer to the sample writing assignment rubric in the solutions manual.

Section: 1.4; LO: 1.4; BT: An; Diff: M; TOT: 45 min; AACSB: RT, C, A

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Expanded Learning Activity

Answer: High-quality responses should include a discussion of the student's childhood, paying special attention to the way he or she made choices and how he or she was rewarded for those choices, and a discussion of how or whether he or she wants that to change. Please refer to the sample writing assignment rubric in the solutions manual.

Section: 1.4; LO: 1.4; BT: Ap; Diff: M; TOT: 30 min; AACSB: RT, C, A

1.4 Practice Questions

(The Practice Questions do not appear in the printed textbook. Autogradable version is available in your Wiley course, with algorithmically changing values when applicable.)

1. The "A" in SMART stands for
   a. actionable.
   b. always.
   c. available.
   d. attainable.

   Answer: d; Section: 1.4; LO: 1.4; BT: K; Diff: E; TOT: 2 min; AACSB: K

2. Which of the following goals is the most clearly stated?
   a. To retire in 20 years.
   b. To purchase an $18,000 car in 20 years.
   c. To fund a $3,500 vacation in San Diego in 9 months.
   d. To purchase a home in 7 years with a sizeable down payment.

   Answer: c; Section: 1.4; LO: 1.4; BT: C; Diff: E; TOT: 2 min; AACSB: RT

3. Kaylee has been dreaming of a grand vacation for several years. Last year, she started to save for this once-in-a-lifetime event. So far, she has saved $2,000 toward a goal of $25,000. Her plan is to travel in 6 years. What is Kaylee's goal time horizon?
   a. Short term.
   b. Short–intermediate term.
   c. Long–intermediate term.
   d. Long term.

   Answer: c; Section: 1.4; LO: 1.4; BT: C; Diff: E; TOT: 2 min; AACSB: K

4. Which of the following time orientations is most closely associated with a lack of goal orientation, a general feeling of hopelessness, and general pessimism?
   a. Past-positive.
   b. Past-negative.
   c. Present-hedonistic.
   d. Future goal oriented.

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Answer: b; Section: 1.4; LO: 1.4; BT: C; Diff: E; TOT: 2 min; AACSB: K

5. A person's time orientation can shape life outcomes. Which of the following is most closely associated with lifetime wealth accumulation?

   a. Present-hedonistic.

   b. Past-positive.

   c. Future goal.

   d. Present-fatalistic.

   Answer: c; Section: 1.4; LO: 1.4; BT: C; Diff: E; TOT: 2 min; AACSB: RT

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1.5 Describe strategies to overcome mental biases and improve financial decision making and well-being.

1.5 Multiple-Choice Questions

1. c. she feels that the likelihood of getting the full $550 is less than that of getting a guaranteed $515.

   Answer: c; Section: 1.5; LO: 1.5; BT: Ap; Diff: M; TOT: 2 min; AACSB: RT

   Solution: The status quo bias is your personal preference for keeping things just like they currently are. This bias is prevalent because most people are usually comfortable with their current situation, even when much better options are available. Melinda would not be changing her situation, regardless of which payment option she elects to take. Hyperbolic discounting is a form of procrastination, where a person places a greater value on the immediate option, while discounting a future greater benefit further away. However, if both benefits are not immediate, the greater benefit regardless of time will be of greater value. The choice of taking the money today over a greater sum in the future is a form of loss aversion: the feeling ". . . that the likelihood of getting the full $550 is less than getting a guaranteed $515."

2. b. Never buy stocks on a Monday.

   Answer: b; Section: 1.5; LO: 1.5; BT: Ap; Diff: M; TOT: 2 min; AACSB: K

   Solution: Heuristics are based on past experiences or learning that the mind applies to new situations. Most heuristics are automatic and rarely used with forethought. Although heuristics can help you make quick decisions, they sometimes lead to problematic choices and outcomes because of behavioral biases. "Never buy stocks on a Monday" is an example of confirmation bias, where past negative outcomes of purchasing stocks on a Monday lead to a belief that it's bad luck to do it.

3. c. status quo bias.

   Answer: c; Section: 1.5; LO: 1.5; BT: C; Diff: E; TOT: 2 min; AACSB: RT

4. c. Status quo.

   Answer: c; Section: 1.5; LO: 1.5; BT: Ap; Diff: M; TOT: 2 min; AACSB: RT

   Solution: The status quo bias is your personal preference for keeping things just like they currently are. This bias is prevalent because most people are usually comfortable with their current situation, even when much better options are available.

5. b. loss aversion.

   Answer: b; Section: 1.5; LO: 1.5; BT: Ap; Diff: M; TOT: 2 min; AACSB: RT

   Solution: Loss aversion is a behavioral bias toward losing money. Behavioral economists have concluded that if you lose, your emotional pain—your feelings of loss and the regret associated with making a bad decision—will also be two times as great as the joy of winning. As a result, people generally focus much of their attention on avoiding losses because the joy of a gain is smothered by the pain of a loss.

6. a. optimism bias.

   Answer: a; Section: 1.5; LO: 1.5; BT: Ap; Diff: M; TOT: 2 min; AACSB: RT

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Solution: Optimism bias is a behavioral bias toward having overconfidence and a lack of risk averseness. A history of taking risks without negative consequence builds this bias.

7. c. confirmatory bias.

   Answer: c; Section: 1.5; LO: 1.5; BT: Ap; Diff: M; TOT: 2 min; AACSB: K

   Solution: Confirmation bias is a behavioral bias where one wrongly believes that acts of skill lead toward successful outcomes rather than coincidence and chance. Rationalizing acts of expertise to confirm the assessments of successful outcomes will lead to overconfidence in future decisions.

8. b. Precommitting to decisions.

   Answer: b; Section: 1.5; LO: 1.5; BT: K; Diff: E; TOT: 2 min; AACSB: K

9. b. automating good decisions.

   Answer: b; Section: 1.5; LO: 1.5; BT: K; Diff: E; TOT: 2 min; AACSB: K

10. a. I only.

    Answer: a; Section: 1.5; LO: 1.5; BT: C; Diff: E; TOT: 2 min; AACSB: RT

1.5 Adventures in Personal Finance

Short Answer

1. Answer: a—2; b—5; c—1; d—3; e—4.

   Section: 1.5; LO: 1.5; BT: C; Diff: E; TOT: 10 min; AACSB: K

2. Answer: High-quality responses should include a list of three tasks and action steps to prevent procrastination on those tasks. Please refer to the sample writing assignment rubric in the solutions manual.

   Section: 1.5; LO: 1.5; BT: Ap; Diff: M; TOT: 10 min; AACSB: RT

3. Answer: High-quality responses should include a discussion of past experiences when overconfidence or optimism bias led to unwise decisions. Please refer to the sample writing assignment rubric in the solutions manual.

   Section: 1.5; LO: 1.5; BT: Ap; Diff: M; TOT: 15 min; AACSB: RT

4. Answer: High-quality responses should include a discussion of how a clear picture of your future financial goals influences or would influence current choices and whether a long-term goal or a clear picture of the future would be most impactful in reaching future goals. Please refer to the sample writing assignment rubric in the solutions manual.

   Section: 1.5; LO: 1.5; BT: S; Diff: H; TOT: 30 min; AACSB: RT, C

Explore

1. Answer: High-quality responses should describe the video that was watched, what the video was teaching, and the student's reaction to the video. Please refer to the sample writing assignment rubric in the solutions manual.

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Section: 1.5; LO: 1.5; BT: An; Diff: M; TOT: 30 min; AACSB: RT

2. Answer: High-quality responses should include a discussion of how automating bill payments will benefit the student. Please refer to the sample writing assignment rubric in the solutions manual.

   Section: 1.5; LO: 1.5; BT: Ap; Diff: M; TOT: 20 min; AACSB: RT, T, C

Expanded Learning Activity

Answer: High-quality responses should include a summary of findings, a "to-do" list for saving, and a discussion of any techniques that you find unethical or manipulative. Please refer to the sample writing assignment rubric in the solutions manual.

Section: 1.5; LO: 1.5; BT: Ap; Diff: M; TOT: 40 min; AACSB: RT, C, A

1.5 Practice Questions

(The Practice Questions do not appear in the printed textbook. Autogradable version is available in your Wiley course, with algorithmically changing values when applicable.)

1. Which of the following best describes a procrastinator?
   a. They value the present more than the future.
   b. They value the future more than the present.
   c. They value neither the future nor the present.
   d. They value the future and present equally.

   Answer: a; Section: 1.5; LO: 1.5; BT: K; Diff: E; TOT: 2 min; AACSB: RT

2. When people make financial decisions, they rely on
   a. cognitive evaluations.
   b. feelings.
   c. mental shortcuts.
   d. cognitive evaluations, feelings, and mental shortcuts.

   Answer: d; Section: 1.5; LO: 1.5; BT: K; Diff: E; TOT: 2 min; AACSB: RT

3. People become overconfident when they
   a. experience losses.
   b. procrastinate.
   c. seek out confirmation of their beliefs and opinions.
   d. focus on the present.

   Answer: c; Section: 1.5; LO: 1.5; BT: K; Diff: E; TOT: 2 min; AACSB: RT

4. Asking someone to start saving next week, rather than some time later, helps the person
   a. precommit to his or her decision.
   b. reduce his or her confirmation bias.

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c. increase future loss aversion.

d. stay focused on the achievement of long-term goals.

Answer: a; Section: 1.5; LO: 1.5; BT: K; Diff: E; TOT: 2 min; AACSB: RT, C

5. Which behavioral economics bias can result in someone forgoing possible long-term growth of assets because he or she wants his or her investments to be safe?

a. Loss aversion.

b. Overconfidence.

c. Status quo.

d. Optimism.

Answer: a; Section: 1.5; LO: 1.5; BT: K; Diff: E; TOT: 2 min; AACSB: RT

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Chapter 1 End-of-Chapter Summary Assessment

Continuing Case: Tarek's Financial Journey

a. Answer: Tarek most likely has a future time perspective. The answer is based on the following guidelines: Question 1—If you "agree" or "strongly agree" with this statement, you probably have a present perspective. Question 2—If you answered "agree" or "strongly agree" to this one, it means that you are likely directed by a future goal perspective. Question 3—Answering "agree" or "strongly agree" to this item means that you probably see the world using a past perspective.

ILLUSTRATION 1.4.3

Time Perspective Preferences

Time Perspective	**Past**	Positive	Loves thinking about all the fun things that have happened in the past.
		Negative	Fixated on all the bad things that have happened in the past.
	Present	Hedonistic	Living life day-to-day for pleasure.
		Fatalistic	Living for today with no meaningful future.
	Future	Goal Oriented	Willing to forgo pleasures today for happiness in the future.

Source: Adapted from P. G., Zimbardo and J. N. Boyd, "Putting Time in Perspective: A Valid, Reliable Individual-Difference Metric," *Journal of Personality and Social Psychology* (77, 1999), pp. 1271–1288.

Section: 1.5; LO: 1.5; BT: An; Diff: M; TOT: 5 min; AACSB: A

b. Answer: In general, those who hold a future perspective, particularly those who are goal-oriented, do a better job of managing their personal financial situation. This bodes well for Tarek as he attempts to reach his life and financial goals.

Section: 1.5; LO: 1.5; BT: Ap; Diff: M; TOT: 5 min; AACSB: A

c. Answer: 96 years.

Solution: Her two primary expenses include a lost income of $66,000 and educational expenses of $126,000. Combined, the cost of the master's degree will be $192,000. However, she is expecting to earn only $2,000 more per year. As such, her payback period is 96 years ($192,000/$2,000).

Section: 1.5; LO: 1.5; BT: An; Diff: M; TOT: 20 min; AACSB: A

d. Answer: It will take her approximately 96 years to break even on the costs associated with obtaining this particular degree. So, no, it does not make sense to invest in this master's degree at this time. An alternative is to obtain a master's degree from a less expensive college or university or work toward her degree on a part-time basis. Another alternative is to change her degree to something that offers a quicker payback period.

Section: 1.5; LO: 1.5; BT: Ap; Diff: M; TOT: 10 min; AACSB: A

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Calculating the Cost of Life's Financial Journey

a. Answer: 100.

Solution: 10% of 1,000 people is 100.

1,000 people × 0.10 = 100 people.

Section: 1.5; LO: 1.5; BT: An; Diff: M; TOT: 5 min; AACSB: RT

b. Answer: $400,000.

Solution: $\frac{\$2{,}000{,}000 \text{ prize}}{5 \text{ people}} = \$400{,}000 \text{ per person}$

Section: 1.5; LO: 1.5; BT: An; Diff: M; TOT: 5 min; AACSB: RT

c. Answer: $242.

Solution: Calculate the interest earned each year on the beginning balance, and add to your balance to calculate the ending balance. This calculation will compute the compound interest you earn every year.

First year: $200 balance × 0.10 interest rate = $20 interest earned. Ending balance = $220.

Second year: $220 balance × 0.10 interest rate = $22 interest earned. Ending balance = $242.

Section: 1.5; LO: 1.5; BT: An; Diff: M; TOT: 5 min; AACSB: RT

d. Answer: More than $102.

Solution: Calculate the interest earned each year on the beginning balance, and add to your balance to calculate the ending balance. This calculation will compute the compound interest you earn every year. After 5 years, the balance will be greater than $102, because it's $104.04 after 2 years.

First year: $100 balance × 0.02 interest rate = $2 interest earned. Ending balance = $102.

Second year: $102 balance × 0.02 interest rate = $2.04 interest earned. Ending balance = $104.04.

Section: 1.5; LO: 1.5; BT: An; Diff: M; TOT: 5 min; AACSB: RT

e. Answer: Less than today.

Solution: Inflation reduces purchasing power, whereas earning interest increases purchasing power. Since the inflation rate of 2% is greater than the 1% interest rate you can earn, you will lose purchasing power in this scenario by 1% per year.

Section: 1.5; LO: 1.5; BT: Ap; Diff: M; TOT: 5 min; AACSB: RT

f. Answer: False.

Solution: By owning one stock, you will risk your entire fortune on the stock. By diversifying your fortune by holding more than one stock, such as in a mutual fund, you are diversifying the business risk of any individual company that you own.

Section: 1.5; LO: 1.5; BT: Ap; Diff: M; TOT: 5 min; AACSB: RT

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Planning for the Future

a. Answer: Retirement is a long-term goal, purchasing the pickup truck is a short-term goal, and going back to college is a short–intermediate-term goal.

   Section: 1.5; LO: 1.5; BT: C; Diff: E; TOT: 5 min; AACSB: A

b. Answer: (1) Purchasing a new vehicle is important because having reliable transportation is essential to generating income and reducing maintenance expenses; (2) investing in human capital is also important as a way to increase earnings and assets; and (3) while retirement is very important, retiring this young is aspirational. Implementation of the other two goals will help Edmond achieve this retirement goal.

   Section: 1.5; LO: 1.5; BT: Ap; Diff: M; TOT: 5 min; AACSB: A

c. Answer: High-quality answers will answer all elements and clearly identify assumptions. For example, a student might assume that Edmond's new pickup truck will cost $46,000 in 2 years. This type of assumption will be critical for the SMART elements.

   Section: 1.5; LO: 1.5; BT: Ap; Diff: M; TOT: 10 min; AACSB: A

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