Chapter 31: Investing

I-Summary: This chapter defines and discusses investing. Investing is using money to participate in a business enterprise that offers the possibility of profit. There are different types of securities, or tradable documents, that people can invest in. A bond is a security issued by a government or company in which it promises to pay back borrowed money at a fixed rate of interest on a specific date. A bond is debt and the buyer of the bond is the creditor. Most bonds are considered safe investments, especially those issued by governments or large, established companies. Stocks are shares of ownership in a corporation. Stocks are not debt as bonds are. Stockholders can earn money through dividends. Dividends are a share of the companies profits distributed to shareholders. Shareholders can also earn money by selling their stocks that are valued more than what they purchased them for. However, there is no promise that shareholders will get their money back or that they will receive income from owning stocks. Because of this, stocks are considered to have more risk than bonds. Mutual funds are funds created by investment firms that raise money from shareholders and invest it in a variety of stocks. If the stocks owned by the mutual fund make a profit, the mutual fund's shareholders earn a dividend.

I-Quiz

Quiz yourself to check your understanding. For each question, you will hear four answer choices. After you hear all four answer choices, choose your answer during the pause. Then you will hear the correct answer. Let's begin.

Question 1

Which term refers to the rate of interest on a bond?

a. commission
b. bond discount
c. coupon rate
d. maturity

Question 2

Which term refers to the fee charged by banks or brokerages when investors purchase securities?

a. commission

b. bond discount

c. coupon rate

d. maturity

Question 3

Which term refers to a share of profits given to stockholders?

a. commission

b. capital loss

c. capital gain

d. dividend

Question 4

Which type of security gives the owner the advantage of receiving cash dividends before common stockholders receive any?

a. common stocks

b. preferred stocks

c. corporate bonds

d. government bonds

Question 5

Which term refers to a pool of money collected from shareholders and used to invest in a variety of stocks

a. common stock

b. preferred stock

c. a mutual fund

d. a mutual bond

Answer Key

1. The correct answer is C, the coupon rate. The rate of interest on a bond is called the coupon rate or the yield.

2. The correct answer is A, commission. Investors can buy securities through banks or brokerages which charge a commission.

3. The correct answer is D, dividend. If a corporation makes money over a certain period of time, it can decide to distribute some of the profit to shareholders in the form of dividends.

4. The correct answer is B, preferred stocks. If a company is having financial problems, preferred stockholders will receive dividends before common stockholders.

5. The correct answer is C, a mutual fund. If the stocks owned by a mutual fund make a profit, then the mutual fund's shareholders earn a dividend.