Test Your Knowledge of Financial Basics

Working with a trusted financial professional is one of the best ways to help improve your overall financial situation, but it's not the only thing you can do. Educating yourself about personal finance concepts can help you better understand your advisor's recommendations, and result in more productive and potentially more prosperous financial planning discussions. Take this brief quiz to see how well you understand a few of the basics.

Questions

1. **How much should you set aside in liquid, low-risk savings in case of emergencies?**
    a. One to three months' worth of expenses
    b. Three to six months' worth of expenses
    c. Six to twelve months' worth of expenses
    d. It depends
2. **Diversification can eliminate risk from your portfolio.**
    a. True
    b. False
3. **Which of the following is a key benefit of a 401(k) plan?**
    a. You can withdraw money at any time for needs such as the purchase of a new car.
    b. The plan allows you to avoid paying taxes on a portion of your compensation.
    c. You may be eligible for an employer match, which is like earning a guaranteed return on your investment dollars.
    d. None of the above
4. **All of the money you have in a bank account is protected and guaranteed.**
    a. True
    b. False
5. **Which of the following is typically the best way to pursue your long-term goals?**
    a. Investing as conservatively as possible to minimize the chance of loss
    b. Investing equal amounts in stocks, bonds, and cash investments
    c. Investing 100% of your money in stocks
    d. Not enough information to decide

A little knowledge can go a long way in pursuing your financial goals. For more information about the topics in this article, or for other personal finance-related questions, speak with a trusted financial professional.

All investing involves risk, including the possible loss of principal.

Answers

1. d. Conventional wisdom often recommends setting aside three to six months' worth of living expenses in a liquid savings vehicle, such as a bank savings account or money market mutual fund. However, the answer really depends on your own individual situation. If your (and your spouse's) job is fairly secure and you have other assets, you may need as little as three months' worth of expenses in emergency savings. On the other hand, if you're a business owner in a volatile industry, you may need as much as a year's worth or more to carry you through uncertain periods.

2. b. Diversification is a smart investment strategy that helps you manage risk by spreading your investment dollars among different types of securities and asset classes, but it cannot eliminate risk entirely. You still run the risk of losing money.

3. c. Many employer-sponsored 401(k) plans offer a matching program, which is like earning a guaranteed return on your investment dollars. If your plan offers a match, you should try to contribute at least enough to take full advantage of it. (Note that some matching programs impose a vesting schedule, which means you will earn the right to the matching contributions over a period of time.)

Because 401(k) plans are designed to help you save for retirement, the federal government imposes rules about withdrawals for other purposes, including the possibility of paying a penalty tax for nonqualified withdrawals. You may be able to borrow money from your 401(k) if your plan allows, but this is generally recommended as a last resort in a financial emergency. Finally, traditional 401(k) plans do not help you avoid paying taxes on your income entirely, but they can help you defer taxes on your contribution dollars and investment earnings until retirement, when you might be in a lower tax bracket. With Roth 401(k)s, you pay taxes on your contribution dollars before investing, but qualified withdrawals will be free from federal, and in many cases, state taxes.

4. b. Deposits in banks covered by the Federal Deposit Insurance Corporation are protected up to $250,000 per depositor, per bank. This means that if a bank should fail, the federal government will protect depositors against losses in their accounts up to that limit. The FDIC does not protect against losses in stocks, bonds, mutual funds, life insurance policies, annuities, or municipal securities, even if those vehicles were purchased at an insured bank. It also does not protect items held in safe-deposit boxes or investments in Treasury bills.

5. d. To adequately pursue your long-term goals, it's best to speak with a financial professional before choosing a strategy. He or she will take into consideration your goals, your risk tolerance, and your time horizon, among other factors, to put together a well-diversified strategy that's appropriate for your needs. **Please do not hesitate to let us know if our team at Francis Financial can be of help!**