Practice Quiz 11: Risk, Leverage, and Retirement Planning

1. Which of the following statements is **false**? (Only one is false.)

A) For a given change in interest rates, duration provides a better approximation for the change in a bond's price for a long-term bond than for a short-term bond.

B) The duration of a bond may be equal to its maturity.

C) For a given change in interest rates, the new price of a bond estimated using duration will always underestimate the actual new price of the bond (calculated by taking the present value of the cash flows).

D) The price of a longer-term bond is more sensitive to interest rate changes.

2. Discuss life-cycle investing as a retirement strategy.

3. Discuss the concept of leverage and state the formula for leverage ratio. Explain how leverage relates to risk.

4. For her town's annual summer festival, Abbey plans to open a hot dog stand with a $4,000 investment. She contributes $500 of her own money and borrows the remaining $3,500 from her parents (with no interest). If the project returns 6% on the $4,000 investment, what is the return on Abbey's equity?