Diversification Reading Quiz Answer Key PDF

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Which theory is closely associated with the concept of diversification?

A. Game Theory
B. Modern Portfolio Theory ✓
C. Chaos Theory
D. Quantum Theory

Which financial instrument is typically NOT used for diversification?

A. Stocks
B. Bonds
C. Real Estate
D. Savings Account ✓

What is a potential downside of over-diversification?

A. Increased risk
B. Lower returns ✓
C. Higher volatility
D. Reduced liquidity

Which type of diversification involves expanding products within the same market?

A. Vertical Diversification
B. Horizontal Diversification ✓
C. Concentric Diversification
D. Conglomerate Diversification

What is the primary goal of diversification in investment?

A. Maximize returns
B. Minimize risks ✓
C. Increase liquidity
D. Reduce taxes

Describe a real-world example of a company that successfully used diversification.

Amazon is a prime example of a company that successfully used diversification.

Which of the following is a benefit of diversification?

A. Guaranteed profits
B. Elimination of all risks
C. Reduction of volatility ✓
D. Increased complexity

Which risks can be reduced through diversification? (Select all that apply)

A. Market risk
B. Company-specific risk ✓
C. Industry-specific risk ✓
D. Inflation risk

Which financial instruments can be used for diversification? (Select all that apply)

A. Stocks ✓
B. Bonds ✓
C. Mutual Funds ✓
D. Derivatives

Discuss the potential impact of economic cycles on the effectiveness of diversification.

The effectiveness of diversification can be diminished during economic downturns when asset classes become correlated, while it tends to be more effective during economic expansions.

What is the efficient frontier, and how does it relate to diversification?

The efficient frontier is a graphical representation of the best possible risk-return combinations of a portfolio, achieved through diversification of assets to minimize risk while maximizing returns.

Explain how diversification can reduce risk in an investment portfolio.

Diversification can reduce risk in an investment portfolio by ensuring that not all investments are affected by the same market conditions, thereby lowering the overall volatility and potential losses.

Which of the following are types of diversification? (Select all that apply)

A. Horizontal Diversification ✓
B. Vertical Diversification ✓
C. Concentric Diversification ✓
D. Linear Diversification

What is the term for adding unrelated products to a business?

A. Horizontal Diversification
B. Vertical Diversification
C. Concentric Diversification
D. Conglomerate Diversification ✓

What is the relationship between risk and return in diversification?

A. Directly proportional ✓
B. Inversely proportional
C. No relationship
D. Random

Which of the following are benefits of diversification? (Select all that apply)

A. Risk reduction ✓
B. Higher volatility
C. Potential for higher returns ✓
D. Guaranteed profits

How does international diversification differ from domestic diversification?

International diversification differs from domestic diversification in that it involves investing in assets across multiple countries, thereby mitigating risks associated with economic fluctuations in a single country, whereas domestic diversification focuses on investments within one country's market.

What are the key differences between horizontal and vertical diversification?

The key differences between horizontal and vertical diversification are that horizontal diversification focuses on adding new products or services at the same level of the supply chain, whereas vertical diversification involves moving into different stages of production or distribution within the same industry.

Which strategies are involved in diversification? (Select all that apply)

A. Asset allocation ✓
B. Market timing
C. Stock picking
D. Sector rotation ✓

What are some challenges of diversification? (Select all that apply)

A. Over-diversification ✓
B. Increased costs ✓
C. Simplified management
D. Complexity in portfolio management ✓