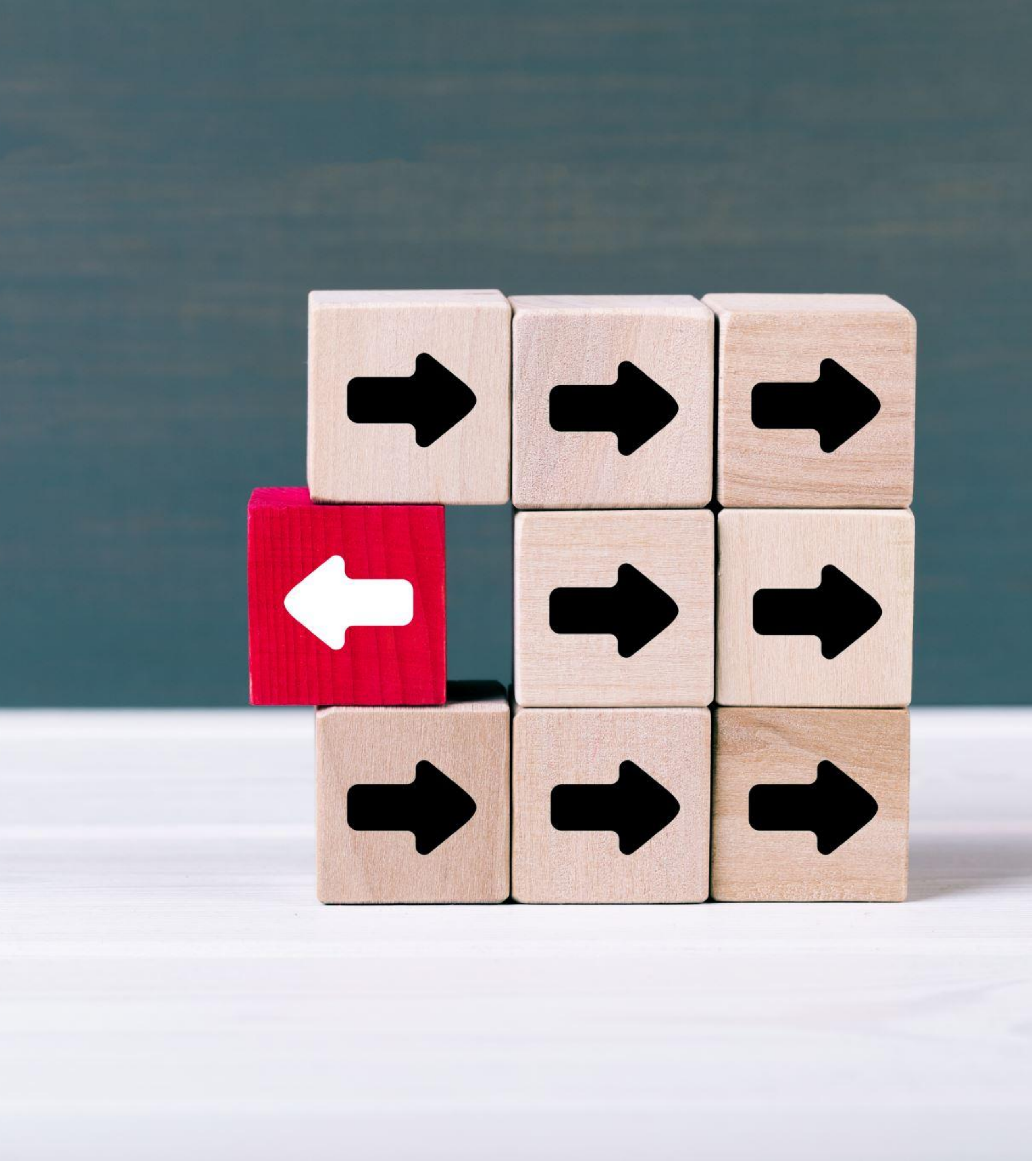
Intermediate Risk-Free Investments



1. Concept and Role

In finance, **risk-free investments** are those with **guaranteed returns and minimal uncertainty**.
They are used as a **benchmark** to compare other investments and to manage portfolio risk.

2. Common Instruments

- **Treasury Bills (T-Bills):** Short-term government securities (less than 1 year).
- **Treasury Bonds:** Long-term government debt with fixed interest.
- **Government Savings Bonds:** Designed for individuals; provide stable interest.
- **Money Market Accounts:** Low-risk accounts investing in short-term government debt.

3. Purpose and Strategies

Used to **stabilize portfolios** during volatile market conditions.

Serve as a **benchmark rate** in financial models like the **Capital Asset Pricing Model (CAPM)**.

Help investors **compare yields** across short- and long-term securities.

Risks and Limitations

Inflation Risk: Reduces purchasing power.

Currency Risk: Exchange rate changes for foreign investors.

Reinvestment Risk: Lower interest rates when reinvesting matured funds.

5. Conclusion

Intermediate investors use risk-free investments to **balance portfolios**, **manage liquidity**, and **set expectations** for returns in riskier assets.

Learning Assessment Question 1

What is the “risk-free rate”?

a) The guaranteed return on a risk-free investment
b) The highest rate in the market
c) The interest rate on loans
d) The rate banks charge borrowers

Question 2

Which investment is commonly used to represent the risk-free rate?

a) Treasury Bill
b) Corporate Bond
c) Stock Dividend
d) Real Estate Investment

Question 3

What does CAPM use the risk-free rate to calculate?

a) Stock price volatility

b) Expected return on risky assets

c) Inflation rate

d) Currency exchange rate

Question 4

What is the main limitation of risk-free investments?
a) They are not insured
b) They offer lower returns
c) They are not legal for institutions
d) They fluctuate wildly

Question 5

1. **Which of the following is a short-term risk-free investment?**
   a) 30-year Treasury bond
   b) Treasury Bill
   c) Real estate fund
   d) Corporate stock