

Consumers' risks and rewards



Comparing risks and rewards

Some financial decisions bring rewards. For example, a bank usually rewards you for depositing money in an account. This interest earned, is a form of income - just like wages from working.

Interest rates in Australia and most other Western industrialised countries, have been comparatively low since the **Global Financial Crisis (GFC)** in 2008. This has resulted in lower than usual earnings for consumers with money deposited in a bank.

Consumers with money to invest do have other options, such as:

- purchasing items that are expected to increase in value over time (for example, gold or collectible items, such as, art work)
- purchasing real estate - land and/or houses
- purchasing shares in businesses that are listed on the share market
- betting on events (for example, the result of a football game).

These differing investment types have varying financial rewards. For example, a transaction account at a bank may only earn 1% interest per year but the price of a share in a company may increase (or decrease) by 10% or more in one day.

Differing investment types also have varying levels of risk. For example, there is very little risk of losing the money deposited in a bank account as the banks are backed by the Australian Government but betting on the wrong team to win a football game will result in the loss of all the money.

Activity Is that risky? Is it rewarding?



Give each of the following examples of consumer investment a 'risk rating' from 1 (very low risk) to 5 (very high risk).

- a deposit in a transaction account at a bank
- purchasing a bar of gold
- purchasing a work by a famous American painter
- purchasing a work by a little-known Australian jewellery maker
- purchasing a house in the Perth metro area to rent out to others

- purchasing a house in a rural area in France to rent out to others
- purchasing shares in a large Australian mining company such as FMG
- purchasing shares in a small mining company that is exploring for a lithium deposit
- betting on the first player to kick a goal in a particular AFL game
- buying a lotto ticket for the weekend Powerball draw

Repeat the process this time giving each of the examples a 'reward rating' from 1 (very low reward) to 5 (very high reward).



An action often has a trade-off in Economics and Business. Investigate whether there is a trade-off between the risk and reward involved in consumer investment decisions.

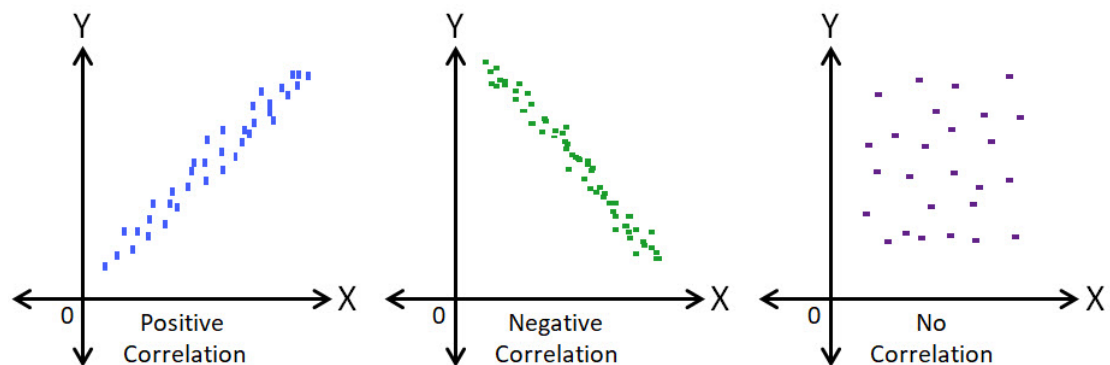
Would you predict that there is:

- no relationship between risk and reward, **or**
- a positive relationship between risk and reward (i.e. as risk increases reward increases), **or**
- a negative relationship between risk and reward (i.e. as risk increases reward decreases).



Use a scatter diagram to 'test' your prediction. With return rating on the vertical axis and risk rating on the horizontal axis, locate each of the ten examples of consumer investment based on your risk rating and reward rating for each.

A scatter diagram can show three possible relationships between the variables that are plotted as shown in the examples below.



Identify the relationship (if any) that your scatter diagram shows for risk and return.



Write a paragraph to describe, using examples, what the risk-reward trade-off is in the case of consumer investment.