

Chapter

8

*Financial
Mathematics:
Investing
Money*

▶ LEARNING GOALS

You will be able to develop your number sense in financial applications by

- Understanding and comparing the effects of simple interest and compound interest
- Determining how changes in the variables of an investment affect the return
- Being aware of a variety of different investment instruments
- Comparing different investment strategies

? What do you think it means to be financially literate, and how will being financially literate help you achieve your goals?



The video player shows a man in a dark suit and red tie (Tom Hamza) sitting at a table, talking to another man whose back is to the camera. A screen in the background displays 'THE AGENDA WITH STEVE PAIKIN'. The video player interface includes a progress bar at 00:13 / 13:15, a volume icon, a play button, and a 'tvo' logo on the chair.

Tom Hamza: Financial Literacy 101

The Agenda with Steve Paikin · 2,638 videos

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8.1

Simple Interest

term

The contracted duration of an investment or loan.

interest

The amount of money earned on an investment or paid on a loan.

fixed interest rate

An interest rate that is guaranteed not to change during the term of an investment or loan.

principal

The original amount of money invested or loaned.

maturity

The contracted end date of an investment or loan, at the end of the term.

future value

The amount, A , that an investment will be worth after a specified period of time.

GOAL

Solve problems that involve simple interest

simple interest

The amount of interest earned on an investment or paid on a loan based on the original amount (the principal) and the simple interest rate.

Communication | Tip

Interest rates are communicated as a percent for a time period. Since most often the time period is per year or **per annum** (abbreviated as **/a**), a given percent is assumed to be annual unless otherwise stated. For example, an interest rate of 4% means 4%/a or 4% interest per year.

SIMPLE Interest

Based on the **principal** (original amount) that is invested/borrowed. Interest is a certain percentage per **annum** (year). Often used for personal loans and short-term investments. The length of time for the investment/loan is called the **term**.

Interest = Principal x rate x time

$$I = Prt$$

&

$$A = P + I$$

OR

$$A = P + Prt$$

$$A = P(1 + rt)$$

- I - interest earned
- P - principal (original investment/loan)
- r - interest rate as a percent (change to a decimal)
- t - is ALWAYS time in years
(how long the money is invested/borrowed)
- A - amount of money including interest

APPLY the Math p. 446

0.025%

EXAMPLE 1 Solving a simple interest problem

Marty invested in a \$2500 guaranteed investment certificate (GIC) at 2.5% simple interest paid annually with a term of 10 years.

- a) How much interest will accumulate over the term of Marty's investment?
- b) What is the future value of his investment at maturity?

Paid Annually

NOTE:

Means that interest is paid only in yearly increments.

Amount

$$\begin{aligned}
 a) \quad I &= Prt \\
 &= 2500(0.025)(10) \\
 &= 625
 \end{aligned}$$

$$\begin{aligned}
 b) \quad A &= P + I \\
 &= 2500 + 625 \\
 &= \$3125.00
 \end{aligned}$$

EXAMPLE #2:

Betty-Ann's bank offers a simple interest rate of 4% per annum. How much interest would Betty-Ann earn on her investment of \$4000 after 8 months.

$$I = Prt$$

$$I = 4000 (0.04) (8/12)$$

$$I = \$106.67$$



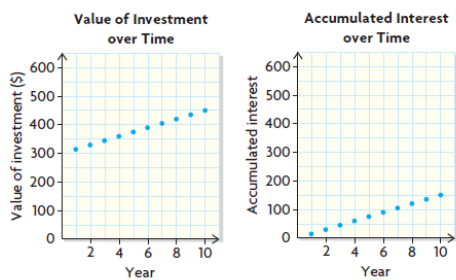
Time

SIMPLE INTEREST...

In Summary p. 451

Key Ideas

- Simple interest is determined only on the principal of an investment.
- The value of an investment that earns simple interest over time is a linear function. The accumulated simple interest earned over time is also a linear function. Since the interest is paid at the end of each period, the growth is not continuous. For example, the following graphs show principal of \$300 invested at 5% interest, paid annually, over a term of 10 years.



Need to Know

- The amount of simple interest earned on an investment can be determined using the formula

$$I = Prt$$

where I is the interest, P is the principal, r is the annual interest rate expressed as a decimal, and t is the time in years.

- The future value or amount, A , of an investment that earns simple interest can be determined using the formula

$$A = P + Prt$$

$$\text{or } A = P(1 + rt)$$

where P is the principal, r is the interest rate expressed as a decimal, and t is the time in years.

- Unless otherwise stated, an interest rate is assumed to be annual, or per annum.
- Even though interest rates are usually annual, interest can be paid out at different intervals, such as annually, semi-annually, monthly, weekly, and daily.

HOMEWORK...

p. 452: #1 - 6, 10, 11

$$I = Prt$$

&

$$A = P + I$$

OR

$$A = P + Prt$$

$$A = P(1 + rt)$$