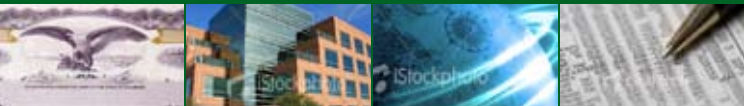


investor's guide

CORPORATE BONDS



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WHAT ARE CORPORATE BONDS?

Corporate bonds (also called “corporates”) are debt obligations, or IOUs, issued by privately- and publicly-owned corporations. When you buy a corporate bond, you essentially lend money to the entity that issued it. In return for the loan of your funds, the issuer agrees to pay you interest and to return the original loan amount – the *face value* or *principal* - when the bond matures or is called (the “maturity date” or “call date”). Unlike stocks, corporate bonds do not convey an ownership interest in the issuing corporation. Companies use the funds they raise from selling bonds for a variety of purposes, from building facilities to purchasing equipment to expanding their business.

Investors buy corporates for a variety of reasons:

- **Attractive yields.** Corporates usually offer higher yields than comparable-maturity government bonds. This higher yield is, however, generally accompanied by higher risks.
- **Periodic income.** Investors seeking steady income from their investments, while also preserving their principal, may include corporates in their fixed income portfolios.
- **Diversity.** Corporate bonds provide an opportunity to choose from a variety of sectors, structures, and credit-quality characteristics to address investment diversification objectives.

Liquidity. Large and liquid sectors of the corporate bond market can provide relatively quick and easy marketability for investors who want to sell a bond before maturity.

BASIC BOND TERMS

Issuance Form. Corporate bonds are issued in several forms:

- **Registered bonds.** Some corporate bonds are issued as certificates, with the owner's name printed on them. There are no coupons attached for the owner to submit for payment of interest. The issuer's agent or trustee sends the interest to the bondholder at the proper intervals, and forwards the principal at maturity.
- **Bearer bonds.** These are bonds that have no name printed on them, and have coupons attached. Anonymous and highly negotiable, bearer bonds are virtually equivalent to cash. The Tax Reform Act of 1982 ended the issuance of such bonds in the United States, but some remain in circulation today.
- **Book-entry bonds.** The most common form of issuance today, these are bonds for which certificates are not available to investors. With book-entry securities, a bond issue has, generally, only one master, or global, certificate, which is kept at a securities depository. The investor's ownership of book-entry bonds is recorded in the investor's brokerage account. The broker, in turn, holds a corresponding interest in the global certificate that is held by the depository. All interest and principal payments are forwarded to the depository, and from there to the brokerage account.

Maturity. One key feature of any bond is its maturity, the date until which the bond pays interest and on which it repays the principal.

Corporate bonds, in general, are divided into three maturity groups:

Short-term notes: Maturities of up to 5 years

Medium-term notes/bonds: Maturities of 5–12 years

Long-term bonds: Maturities greater than 12 years

Interest Rate Type. Another important feature of a bond is its structure. In a traditional bond structure, a specified amount of money is lent to the issuer for a specified period of time. In exchange, the issuer makes interest payments on a regular schedule for the life of the bond, with the full principal returned at maturity. The three types of interest rates that are the most common are:

- **Fixed-rate.** Most bonds still pay a traditional fixed interest rate, where a bond's interest rate is fixed to maturity.
- **Floating-rate.** Some bonds pay an interest rate that varies and is typically adjusted periodically according to an index tied to short-term Treasury bills or money markets. Such bonds offer protection against future increases in interest rates, and in exchange their yields are typically lower than those of comparable fixed-rate bonds.
- **Zero-coupon.** These bonds that have no periodic interest payments. Instead, they are sold at a deep discount to face value, and redeemed for the full face value at maturity, with the difference between that discount and the full face value representing the interest amount.

Yield. Yield is the rate of return on your bond investment. Yields vary to reflect the price movements in a bond caused by changes in prevailing interest rates, among other factors.

- **Current yield.** The current yield is the annual return on the dollar amount paid for a bond, regardless of its maturity. If you buy a bond at

par, the current yield equals its stated interest rate. Thus, the current yield on a par-value bond paying 6% is 6%.

However, if the market price of the bond is more or less than par, the current yield will be different. For example, if you buy a \$1,000 bond with a 6% stated interest rate after prevailing interest rates have risen above that level, you would pay less than par. Assuming your price is \$900, for example, the current yield would be 6.67% ($\$1,000 \times .06 / \900).

- **Yield to maturity.** A more meaningful figure is the *yield to maturity*, which tells you the total return you will receive if you hold a bond until maturity. It also enables you to compare bonds with different maturities and coupons. Yield to maturity includes all your interest to be received until maturity plus any capital gain you will realize (if you purchase the bond below par) or minus any capital loss you will suffer (if you purchase the bond above par) at maturity.
- **Yield to call.** The *yield to call* tells you the total return you would receive if you were to buy and hold the security until the call date. As an investor, you should be aware that this yield is valid only if the bond is called prior to maturity. The calculation of yield to call is based on the coupon rate, the length of time to the call date, and the market price of the bond.

Yield calculations can be obtained from your financial advisor or calculated on online resources such as investinginbonds.com.

TYPES OF CORPORATE BONDS

Bond Quality

- **Investment Grade.** Bonds considered to carry minimal likelihood of default are labeled “investment grade” and are rated Baa3 or higher by Moody’s, or BBB- or higher by Standard & Poor’s and Fitch Ratings.
- **High Yield.** Bonds with a rating of BB (Standard & Poor’s, Fitch Ratings) or Ba (Moody’s) or below are considered “speculative grade” as they a greater risk of default than bonds rated investment grade. Such bonds, most often referred to as “high-yield bonds”, are generally issued by newer or start-up companies, companies that have had financial problems, companies in a particularly competitive or volatile market or companies with aggressive financial and business policies.

High yield issuers must pay a higher interest rate to attract investors and compensate them for the risks associated with investing lower credit quality bonds. Organizations that issue high-yield debt may include U.S. corporations, U.S. banks, foreign governments and foreign corporations.

For more information on credit ratings, see the section labeled “Credit Analysis and Other Important Considerations: Credit Ratings”, later in this guide.

Some differences between investment grade and high yield corporates are:

- **Maturities.** High yield bond maturities are typically 10 years or less. Few high-yield issues have the longer maturities generally associated with investment-grade corporate and municipal bonds. In fact, many high-yield issues are called “notes” rather than bonds because of their shorter maturities.

- **Call protection.** Such protection often extends for the first five years for high yield bonds.

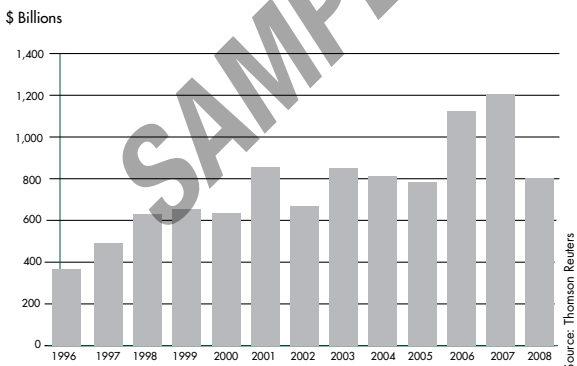
Bond Types. Both corporate investment grade and high yield bonds come in different varieties:

- **Straight cash bonds** are the corporate market's "plain vanilla" bond, offering a fixed coupon rate of interest that is paid in cash, usually in semiannual payments, through the maturity or call date.
- **Split-coupon bonds** offer one interest, or coupon, rate in the early years of the bond's life, followed by a second interest rate in later years. Split-coupon issues in which the interest rate increases in later years are also called step-up notes.
- **Pay-in-kind (PIK) bonds** allow the issuer the option of paying the bondholder interest either in cash or in additional securities.
- **Floating-rate and increasing-rate notes (IRNs)** pay fluctuating or adjusted rates of interest based on an interest rate benchmark or a schedule of payments.
- **Extendable reset notes** give the issuer the option of resetting the coupon rate and extending the bond's maturity at periodic intervals or at the time of specified events. In exchange for these options, the bondholder receives the right to sell, or "put," the bond back to the issuer.
- **Deferred-interest bonds** pay no interest to the bondholder until a future date.
- **Convertible bonds** may be converted into another security under stated terms. Most often that security is the corporate issuer's common stock.
- **Multi-tranche bonds** offer bondholders several tiers of investments within the same issue. Typically, the tiers may vary in their targeted maturities and credit quality.

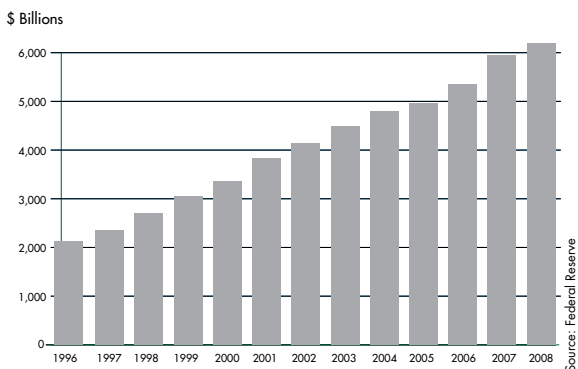
BOND MARKET CHARACTERISTICS

Size of Market. The corporate bond market is generally large and liquid; in 2008 daily trading volume was an estimated \$14.3 billion and total issuance was over \$800 billion. The total market value of outstanding corporate bonds in the United States at the end of 2008 was approximately \$6.2 trillion. A variety of investors participate in the corporate bond market, including individuals who invest in corporate bonds through direct ownership and/or through mutual funds; insurance companies; pension funds and other institutional investors.

CORPORATE BOND ISSUANCE 1986 - 2008



CORPORATE BONDS OUTSTANDING 1986 - 2008



Trading Venues. The vast majority of corporate bond transactions, even those involving exchange-listed issues, take place in the over-the-counter (OTC) market. This market does not have a central location, but rather is made up of brokers and dealers from around the country who trade debt securities over the phone or electronically. Market participants are increasingly using electronic transaction systems to assist in the trade execution process. Some bonds trade in the centralized environments of the New York Stock Exchange (NYSE) and American Stock Exchange (AMEX), but the bond trading volume on the exchanges is relatively small.

Bonds are traded on both a principal and agency basis. When a broker buys or sells bonds from their firms' inventory – or on a principal basis – clients do not pay an outright commission, but instead pay a markup that is built into the price quoted for the bond. If a broker has to go out into the market to find a particular bond for a customer, a commission may be charged. Commission rates and markups vary based on the type of bond and size of the transaction.

UNDERSTANDING THE RISKS

Interest Rate Risk. Like all bonds, the price of corporates rises when interest rates fall, and fall when interest rates rise. Generally speaking, the longer a bond's maturity, the greater the degree of price volatility. An investor holding a bond until maturity may be less concerned about these price fluctuations (which are known as interest-rate risk, or market risk), because he or she will receive the par, or face, value of the bond at maturity.

Investors should be aware of the inverse relationship between bond prices and interest rates — that is, the fact that bonds are worth less when interest rates rise. But the explanation is essentially straightforward:

- When interest rates rise, new issues come to market with higher coupon rates than older securities, making those older ones less attractive in comparison. Hence, their prices go down.
- When interest rates decline, new bond issues come to market with lower coupons than older securities, making those older, higher coupon bonds more attractive. Hence, their prices go up.

As a result, if an investor sells a bond before maturity, it may be worth more or less than at the time of purchase.

Various economic forces affect the level and direction of interest rates in the economy. Interest rates typically climb when the economy is growing, and fall during economic downturns. Inflation is one of the most influential forces on interest rates; rising inflation leads to rising interest rates, and moderating inflation leads to lower interest rates

Redemption Risks

- **Call features.** A bond's indenture (the legal document that spells out its terms and conditions) may contain a "call" feature. This provision gives the bond issuer the right to retire, or redeem, the bond, fully or partially, before the scheduled maturity date. For the issuer, the chief benefit of such a feature is that it may permit the issuer to replace outstanding debt with a lower coupon rate new issue if interest rates decline in the future.

A call feature creates uncertainty for the investor as to whether the bond will remain outstanding until its maturity date, especially in the case of a high coupon bond in a falling interest rate environment. Investors risk losing a bond paying a higher rate of interest when rates decline because the issuer may decide to call in their bonds. When a bond is called, the investor usually can only reinvest in securities with lower yields. Calls also tend to limit a bond's price

appreciation potential as the call risk increases at the same time as the price would be expected to rise.

Because a call feature puts the investor at a disadvantage, callable bonds carry higher yields than non-callable bonds, but higher yield alone is often not enough to induce investors to buy them. As further inducement, the issuer often sets the *call price*, the price investors must be paid if their bonds are called, higher than the principal value of the issue. The difference between the call price and principal is the *call premium*.

Generally, bondholders do have some protection against calls, and the right to call may be limited.

- **Sinking-fund provisions.** A sinking fund is money taken from a corporation's earnings that is used to redeem bonds periodically, before maturity, as specified in the indenture. If a bond issue has a sinking-fund provision, a certain portion of the issue must be retired each year. The bonds retired are usually selected by lottery.
- One investor benefit of a sinking fund is that it lowers the risk of default by reducing the amount of the corporation's outstanding debt over time. Another is that the fund provides price support to the issue, particularly in a period of rising interest rates. However, the disadvantage is that bondholders may receive a sinking-fund call at a price (often par) that may be lower than the current market price.
- **Other types of redemptions.** Bond investors should be aware of the possibility of certain other kinds of calls or redemptions prior to maturity. Some bonds, especially utility securities, may be called under what are known as Maintenance and Replacement fund provisions (which relate to upgrading plant and equipment). Others may be called under Release and Substitution clauses (which are designed to maintain the integrity of assets pledged as col-

lateral for some bonds) and Eminent Domain clauses (which have to do with paying off bonds when a governmental body confiscates or otherwise takes assets of the issuer).

- Redemption risks may be avoided by buying only non-callable bonds without sinking-fund provisions. When evaluating investment in callable bonds, investors should consider the yield to call rather than the yield to maturity.
- **Puts.** Just as some issuers have the right to call their bonds prior to maturity, some bonds include a provision granting investors the option to “put,” or redeem, the bond prior to maturity. At specified intervals, investors may “put” the bond back to the issuer for full face value plus accrued interest. In exchange for this privilege, such bonds have a somewhat lower yield than a comparable bond without a put feature.

Credit risk. Credit risk is the potential for loss resulting from an actual or perceived deterioration in the financial health of the issuing company. Two subcategories of credit risk are default risk and downgrade risk.

- **Default Risk.** Defaults occur when a company fails to pay an interest or principal payment to a debt holder as scheduled and as specified in its indenture. The risk of default on principal or interest, or both, is greater for high-yield bonds than for investment-grade bonds. Factors that may lead to default include business cycle volatility, excessive leverage or threats from competitors. In a corporate bankruptcy or dissolution, although secured bondholders and holders of senior debt issues may receive some distribution of corporate assets, it is rarely enough to “make whole” their total investment. Bonds of companies in default may trade at very low prices, if they trade at all, and liquidity may disappear.

- **Downgrade risk.** Downgrades result when a rating agency lowers its rating on a bond or the company that issued a bond; for example, a change by Standard & Poor's from a B to a CCC rating. Downgrades are usually accompanied by bond price declines. In some cases, the market anticipates downgrades by bidding down prices prior to the actual rating agency announcement. Before bonds are downgraded, agencies often place them on a "creditwatch" status, which also tends to cause price declines.

Liquidity risk. Liquidity risk refers to the investor's ability to sell a bond quickly and easily, as reflected in the size of the bid-ask spread, or the difference between the price at which buyers are willing to buy (the bid) and the price at which sellers are willing to sell (the ask) a bond. That spread is usually quite small for large, actively traded bond issues, reflecting ample liquidity. A wider spread indicates, among other things, greater liquidity risk. High-yield bonds may be less liquid than investment-grade bonds, depending on the issuer and the market conditions at any given time.

Economic risk. Economic risk describes the vulnerability of a bond to downturns in the economy. Virtually all types of high-yield bonds are vulnerable to economic risk. In recessions, high-yield bond prices typically fall more than investment-grade bonds, a reflection of their credit quality. When investors grow anxious about holding lower credit quality bonds, they may trade them for the higher-quality debt, such as U.S. Treasuries and investment-grade corporate bonds. This "flight to quality" particularly impacts high-yield issuers.

Company and industry "event" risk. Event risk encompasses a variety of pitfalls that can affect a company's ability to repay its debt obligations on time. These may include poor management, changes in management, failure to anticipate shifts in the company's markets, rising costs of raw materials, regulation and new competition. Events that adversely affect a whole industry can have a blanket effect on all the bonds in that sector.

UNDERSTANDING COLLATERALIZATION AND DEFAULTS

In the event a corporation goes out of business or defaults on its debt, bondholders, as creditors, have priority over stockholders in bankruptcy court. However, the order of priority among all the vying groups of creditors depends on the specific terms of each bond, among other factors.

If a company is liquidated, bondholders usually have priority over stockholders in a company's capital structure and are more likely to receive payment. The percentage of funds received through liquidation compared with the original investment is called the "recovery rate." One of the most important factors in the recovery rate is whether the bond is secured or unsecured. If a bond is secured, the issuer has pledged specific assets (known as *collateral*) that can be sold, if necessary, to pay the bondholders. Investors buying a secured bond will "pay" for this extra protection by receiving a lower interest rate than would be received on a comparable unsecured bond.

As the table below shows, the holders of "secured debt" and "unsecured senior debt" have the highest claim on corporate assets in a bankruptcy distribution. Even the holder of a low-rated bond is entitled to a share of a failing company's assets ahead of preferred or common stockholders.

PRIORITY OF CLAIMS
Secured Debt Holders
Unsecured Senior Debt Holders
Other Unsecured Subordinated Debt Holders
Preferred Stockholders
Common Stockholders

Debentures. Most corporate bonds are debentures — that is, unsecured debt obligations backed only by the issuer’s general credit and the capacity of its cash flow to repay interest and principal. However, even unsecured bonds usually have the protection of what is known as a “negative pledge provision.” This requires the issuer to provide security for the unsecured bonds in the event that it subsequently pledges its assets to secure other debt obligations.

Mortgage bonds. These are bonds for which real estate or other physical property has been pledged as collateral. They are mostly issued by public utilities.

There are various kinds of mortgage bonds, including: first, prior, overlying, junior, second, third, and so on. The designation reflects the priority of the lien, or legal claim, against the specified property. Investors should consider how much other debt of the issuer is secured by the same collateral, and whether the lien supporting that other debt is equal or prior to a bond’s lien when evaluating and investing in mortgage bonds.

Collateral trust bonds. A corporation may deposit stocks, bonds, and other securities with a trustee to back its bonds. The collateral must have a market value at the time of issuance at least equal to the value of the bonds.

Equipment trust certificates. Railroads and airlines are examples of companies that issue this type of bond as a way to pay for new equipment at relatively low interest rates. The title to the equipment is held by a trustee until the loan is paid off, and the investors who buy the certificates usually have a first claim on the equipment.

Subordinated debentures. Debt that is subordinated, or junior, has a lower priority than that of other bond-debt in terms of payment. Only after secured bonds and debentures are paid off can holders of subordinated debentures be paid. In exchange for this lower status in the event of

bankruptcy, investors in subordinated securities earn a higher rate of interest than is paid on senior securities.

Guaranteed bonds. Another form of security is a guarantee of one corporation's bonds by another corporation. For example, bonds issued by a subsidiary may be guaranteed by its parent corporation, or bonds issued by a joint venture between two companies may be guaranteed by both parent corporations. Guaranteed bonds become, in effect, debentures of the guaranteeing corporation, and benefit from its presumably better credit quality.

HOW CORPORATE BONDS ARE TAXED

The following basic information addresses the general tax issues for individuals investing in corporate bonds. For advice about your specific situation, you should consult your tax adviser.

Interest. The interest received from corporate bonds is subject to federal and state income tax.

Gains and losses. Corporate bond holdings may generate capital gains if sold or redeemed at a profit before maturity. If a bond is sold or redeemed after being held for one year or less, any gain is short-term capital gain and is taxed at the same rate as ordinary income. If a bond is sold or redeemed after being held for more than one year, any gain is long-term capital gain and is currently taxed at a maximum rate of 15%. Conversely, if a bond is sold or redeemed for less than its tax basis (which is generally its purchase price), the loss will normally be a capital loss. Capital losses will offset dollar-for-dollar an unlimited amount of capital gains realized on other investment (bonds, stocks, mutual funds, real estate, etc.). If capital losses exceed capital gains, an individual may currently deduct up to \$3,000 of net capital losses annually from ordinary income. Any net capital

losses in excess of \$3,000 can be carried forward and used in future years.

Original-issue discount. When bonds are issued at substantially less than par value, the difference between the face amount and the initial offering price is known as *original issue discount*. Zero-coupon bonds are the best-known variety of this category of bonds. The tax treatment of original issue discount bonds is particularly complicated, so it is essential to consult a tax attorney or adviser when considering such an investment. In general, the total amount of original issue discount will be included as income over the term of the bond based on a constant yield to maturity method, prior to the receipt of cash, even if the bondholder is an individual using the cash basis of accounting. Thus, a holder will have to pay tax each year on a portion of the original issue discount even though no actual cash interest is received. The amount of original issue discount that accrues during the time a holder owns the bond (i) constitutes interest includable in the holder's gross income and (ii) is added to the holder's tax basis for purposes of determining gain or loss on the maturity, redemption, sale, or other disposition of the bond. If an original issue discount bond is purchased at issuance and held to maturity, the investor will not recognize any additional gain or loss (and will not owe any taxes) at maturity because the investor will have already included the discount in income over the life of the bond.

CREDIT ANALYSIS AND OTHER IMPORTANT CONSIDERATIONS

CREDIT RATINGS

		MOODY'S	STANDARD & POOR'S	FITCH	
INVESTMENT GRADE	Strongest	Aaa	AAA	AAA	
	↓	Aa	AA	AA	
		A	A	A	
		Baa	BBB	BBB	
NON-INVESTMENT GRADE	↑	Ba	BB	BB	
		B	B	B	
		Caa	CCC	CCC	
		Ca	CC	CC	
		C	C	C	
		Weakest	C	D	D

Information on a corporate bond can be found in a document, known as an *offering document*, *prospectus* or *official statement*, which is usually provided to you by your investment advisor and helps an investor evaluate whether the bond issuer will be able to make its regularly scheduled interest payments for the term of the bond.

While no single source of information should be relied on exclusively, rating agencies, securities firms, and bank research staff monitor the various corporate, government and other issuers' financial condition and ability to make interest and principal payments when due. Your investment advisor, or sometimes the issuer of the bond, can supply you with current research.

Credit ratings. In the United States, major rating agencies include Moody's Investors Service, Standard & Poor's Corporation and Fitch Ratings. Each agency assigns its ratings based on analysis of the issuer's financial condition and management, economic and debt characteristics, and the specific revenue sources securing the bond. The highest ratings are AAA (S&P and Fitch Ratings) and Aaa (Moody's).

Bonds rated in the BBB-/Baa3 category or higher are considered *investment-grade*; bonds with lower ratings are considered *high yield*, or speculative.

Lower ratings are indicative of a bond that has a greater risk of default than a bond with higher ratings. It is important to understand that the high interest rate that generally accompanies a bond with a lower credit rating is being provided in exchange for the investor taking on the risk associated with a higher likelihood of default.

The rating agencies make their ratings available to the public through their ratings information desks and online through their respective websites. In addition, their published reports and ratings are available in many local libraries. Usually, rating agencies will signal they are considering a rating change by placing the bond on CreditWatch (S&P), Under Review (Moody's) or on Rating Watch (Fitch Ratings).

Not all credit rating agency evaluations result in the same credit rating, so it is important to review all available credit ratings. It is also important to read the credit reports and related updates to properly evaluate the underlying credit risks. You should bear in mind that ratings are opinions, and you should understand the context and rationale for each opinion. Investors should not rely solely on credit ratings as a measure of credit risk, but instead use a multitude of resources to assist in their evaluation and decision making.

Additional sources of information include recent independent news reports, formal issuer press releases, research reports and company financial statements.

Reviewing Your Investments

As described in this investor guide, there are many factors to be considered when evaluating a potential investment in corporate bonds. To review some of the risks discussed:

- Corporate bond prices fluctuate; the price might decline in the event of economic weakness or recession or if interest rates rise.

- A corporate bond's price may decline if the issuing company's credit rating is lowered or because of unexpected news or financial results at the issuing company, or within the company's industry.
- A bond may default if the issuer does not pay the interest or principal as required.
- An investor may have difficulty locating a buyer at certain times, as some bond investments may be less liquid than other types of investments.

Corporate bond investors require a tolerance for risk, along with the ability to weather periodic market downturns or unexpected events that negatively impact individual issues.

A review of corporate debt investments with your financial advisor should cover a variety of factors, including:

- analysis of the industry, including growth rates, special risks and leading companies;
- analysis of the bond issuer, including the company's position in its industry; new products; management stability; the outlook for growth in revenues and cash flow as captured in Earnings Before Interest, Taxes, Depreciation and Amortization, also called EBITDA; value of corporate assets and the debt maturity schedule; and
- analysis of the issue, including special provisions in the "bond indenture," covenants protecting the bondholder, use of the money raised in bond offerings, debt seniority, secondary market liquidity and call provisions.

In addition to the above, bond investors should consider addressing risk factors in this market by:

- Diversifying across issuers and industry segments;
- Adjusting portfolios over economic and market cycles;

- Monitoring rating agencies and other credit research; and
- Monitoring company and industry news.

Considerations of suitability and alignment with your investment objectives should always be taken into account before making any investment. Contact your financial advisor to discuss possible investments.

SAMPLE

GLOSSARY

Accrued interest. Interest deemed to be earned on a security but not yet paid to the investor.

Ask price. The price at which a seller offers to sell a security (also referred to as *offer price*).

Basis point. One one-hundredth (.01) of a percentage point. For example, eight percent would be equal to 800 basis points.

Bearer bond. A physical bond that does not identify its owner and is presumed to be owned by the person who holds it. In the United States it has not been legal to issue bearer bonds in the municipal or corporate markets since 1982. As a result, the only bearer bonds that still exist in the secondary market are long-dated maturities issued prior to 1982, which are becoming increasingly scarce. Among the disadvantages of bearer securities are that you must actually clip the coupons and present them to the issuer's trustee in order to receive your interest; and if the bonds are called, you will not automatically be alerted by the issuer or trustee as they do not know who the owners are.

Bid price. The price at which a buyer offers to purchase a security.

Bond fund. An investment vehicle which invests in a portfolio of bonds that is professionally managed. Types of bond funds include open-ended mutual funds, closed-end mutual funds, and exchange traded funds.

Book-entry. A method of recording and transferring ownership of securities electronically, eliminating the need for physical certificates.

Call. A one-way option of the issuer (not the investor) that allows the issuer to retire bonds by paying investors a stated price, usually a premium above the par value. Many high-yield bonds allow issuers to call bonds after the first five years.

Callable bonds. Bonds that are redeemable by the issuer prior to the maturity date, at a specified price at or above par.

Call premium. A dollar amount, usually stated as a percent of the principal amount called, paid by the issuer to the investor for exercising a call provision.

Cap. The maximum interest rate that may be paid on a floating-rate security.

Closed-end fund. A fund created with a fixed number of shares which are traded as listed securities on a stock exchange.

Collar. Upper and lower limits (*cap* and *floor*, respectively) on the interest rate of a floating-rate security.

Collateral. Assets pledged by a borrower to secure repayment of a loan or bond.

Compound interest. Interest that is calculated on the initial principal and previously paid interest.

Convertible bond. A corporate bond that can be exchanged, at the option of the holder, for a specific number of shares of the company's stock. Because a convertible bond is essentially a bond with a stock option built into it, it will usually offer a lower than prevailing rate of return.

Coupon. A bond's stated interest rate.

Credit rating. A formal evaluation of a company's financial health and ability to repay debt obligations, conducted by a rating agency such as Standard & Poor's, Moody's and Fitch Ratings. The agency's evaluation is summarized in a rating, such as BB.

Credit rating agency. A company that analyzes the credit worthiness of a company or security, and indicates that credit quality by means of a grade, or credit rating.

Current yield. The ratio of the interest rate payable on a bond to the actual market price of the bond, stated as a percentage. For example, a bond with a current market price of par (\$1,000) that pays eight percent (\$80) per year in interest would have a current yield of eight percent.

Current yield (CY). A calculation of the annual interest payment from a bond divided by the current market price of the bond.

CUSIP. The Committee on Uniform Security Identification Procedures was established by the American Bankers Association to develop a uniform method of identifying securities. CUSIP numbers are unique nine-character alphanumeric identifiers assigned to each series of securities.

Default. A borrower's failure to make timely payments of interest and principal when due or to meet other requirements related to the bonds, such as maintenance of collateral or financial covenants.

Discount. The amount by which the par value of a security exceeds its purchase price. For example, a \$1,000 par amount bond which is currently valued at \$980 would be said to be trading at a two percent discount.

Discount note. Short-term obligations issued at a discount from face value, with maturities ranging from one to 360 days. Discount notes have no periodic interest payments; the investor receives the note's face value at maturity. For example, a one year, \$1,000 face value discount note purchased at issue at a price of \$950, would yield \$50 or 5.26 percent ($\$50/\950).

Discount rate. The interest rate the Federal Reserve charges on loans to member banks.

Duration. The weighted maturity of a bond's cash flows, used in the estimation of its price sensitivity for a given change in interest rates.

Face. The principal amount of a security that appears on the face of the instrument.

Federal funds rate. The interest rate at which depository institutions lend balances at the Federal Reserve to other depository institutions overnight. The target federal funds rate is set by the Federal Reserve Board's Federal Open Market Committee and is a principal tool of monetary policy. For more information, see <http://www.federalreserve.gov/fomc/fundsrate.htm>.

Floating-rate bond. A bond whose interest rate is adjusted periodically according to a predetermined formula; it is usually linked to an interest rate index such as LIBOR.

Floor. The lower limit for the interest rate on a floating-rate bond.

Future Value. The value of an asset at a specified date in the future, calculated using a specified rate of return.

High-yield bond (or junk bond). Bonds rated Ba1 or BB+ or below, whose lower credit ratings indicate a higher risk of default. Due to the increased risk of default, typically issued at a higher yield than more creditworthy bonds.

Investment-grade bond (or high grade bond). Bonds rated Baa3 or BBB- or above, whose higher credit ratings indicate a lower risk of default. These bonds tend to issue at lower yields than less creditworthy bonds.

Issuer. The entity obligated to pay principal and interest on a bond it issues.

Interest. The amount of compensation charged by an investor for the use of assets, generally expressed as a percentage rate of par.

LIBOR (London Interbank Offered Rate). The rate banks charge each other for short-term eurodollar loans. LIBOR is frequently used as the base for resetting rates on floating-rate securities.

Liquidity or Marketability. A measure of the relative ease and speed with which a security can be purchased or sold in a secondary market.

Maturity. The date when the principal amount of a security is due to be repaid. Also the end of the life of a security.

Non-callable bond. A bond that cannot be called for redemption by the issuer before its specified maturity date.

Offer price (or ask; asking price). The price at which a seller offers to sell a security.

Par value. The principal amount of a bond due at maturity.

Paying agent. The entity, usually a designated bank or the office of the treasurer of the issuer, that pays the principal and interest of a bond.

Premium. The amount by which the price of a bond exceeds its principal amount.

Present value. The current value of a future payment or stream of payments, given a specified interest rate, also referred to as a discount rate.

Primary market. The market for new issues.

Principal. The face amount of a bond, payable at maturity (see par value).

Ratings. Designations used by credit rating agencies to give relative indications as to opinions of credit quality.

Recession. A downturn in economic activity on a large scale, such as in the U.S. economy. The Commerce Department defines a recession as two or more quarters of decline in output, as measured by Gross National Product (GNP) or Gross Domestic Product (GDP).

Recovery rate. The percentage of money recovered from the original bond in the case of an issuer default.

Registered bond. A bond whose owner is registered with the issuer or its agent. Transfer of ownership can only be accomplished if the bonds are properly endorsed by the registered owner.

Reinvestment risk. The risk that interest income or principal repayments will have to be reinvested at lower rates in a declining rate environment.

Risk. The measurable probability that an actual return will be different than expected. There are many types of risk such as market risk, credit risk, interest rate risk, exchange rate, liquidity risk, and political risk.

Secondary market. Market for issues previously offered or sold.

Secured bond. A bond that is backed by collateral.

Security. Collateral pledged by a bond issuer (debtor) to an investor (lender) to secure repayment of the loan.

Settlement date. The date for the delivery of bonds and payment of funds agreed to in a transaction.

Sinking fund. Money set aside by an issuer of bonds on a regular basis, for the specific purpose of redeeming debt. Bonds with such a feature are known as “sinking fund.”

Subordinated bond. A bond that has a lower priority than another bond’s claim to the same assets.

Total return. A measure of bond investment return that includes both interest and price change. The total return on investments is generally expressed as an annualized rate, and it assumes reinvestment of all interest back into the investment.

Trade date. The date upon which a bond is purchased or sold.

Transfer agent. The party appointed by an issuer to maintain records of bondholders, to cancel and issue certificates, and to address issues arising from lost, destroyed or stolen certificates.

Trustee. An entity designated by the issuer as the custodian of funds and official representative of bondholders. Trustees are appointed to ensure compliance with the trust indenture and represent bondholders to enforce their contract with the issuers.

Volatility. The propensity of a security’s price to rise or fall sharply.

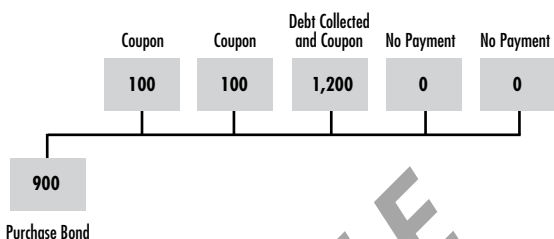
Unsecured bond. A bond that is not secured by collateral.

Yield. The annual percentage rate of return earned on a bond calculated by dividing the coupon interest rate by its purchase price.

Yield curve. A line tracing relative yields on a type of bond over a spectrum of maturities ranging from three months to 30 years.

Yield to call. The yield on a bond calculated by dividing the value all interest payments that will be paid until the call date, plus interest on interest, by the principal amount received on the call date at the call price, taking into consideration whatever gain or loss is realized from the bond at the call date.

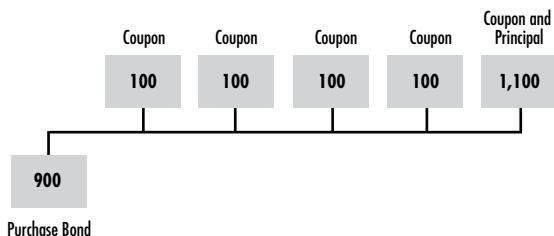
Example: You pay \$900 for a 5 year bond with a face value of \$1000. The bond pays an annual coupon of ten percent. This bond is called at year 3 for \$1,100.



The yield to call of this bond is 17.4 percent. This reflects the 3 years of coupon payments and the difference between the price paid and the call price. Had the bond not been called, the yield to maturity would have been 12.8 percent.

Yield to maturity. The yield on a bond calculated by dividing the value of all the interest payments that will be paid until the maturity date, plus interest on interest, by the principal amount received at the maturity date, taking in to consideration whatever gain or loss is realized from the bond at the maturity date.

Example: You pay \$900 for a 5 year bond a face value of \$1000. The bond pays an annual coupon of ten percent.



Here the yield to maturity is 12.8 percent. This reflects the coupon payments and the difference between the price and the face value of the bond.

Zero-coupon bond. A bond which does not make interest payments; instead the investor receives one payment, which includes principal and interest, at redemption (call or maturity). (See "Discount note.")

SAMPLE



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