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the STOCKS & INVESTMENTS issue

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Market Math 101 - Complexity = Investment Options

And the Tortoise Wins
There are no get-rich quick schemes or guaranteed returns. Consistency over time will win.

THE STOCKS & INVESTMENTS ISSUE

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INTRODUCTION

The information provided in this module will provide basic investment knowledge and help identify situations where it is appropriate to consult a professional.

Investing in stocks, bonds, and/or other investment vehicles provide the opportunity for the growth of your assets. The key is to put your money to work so that the wealth you already have will make more money for you. Investing over the long term will usually yield a higher return than a checking or savings account.

Unlike a bank or credit union, your funds are not federally insured; there is a risk of loss. Choosing a suitable investment is a complex issue; the advice of a trusted financial advisor may be required.

TERMS TO LEARN

Asset
A resource having monetary value that is owned by an individual or corporation.

Asset Classes
There are three basic asset classes (stocks, bonds, and cash), which behave differently from one another in varying economic and market conditions.

Basis Point
A measure of difference between yields or interest rates. The unit is one one-hundredth of one percent (0.01%). For example, if a bond begins with a yield of 5.50% and the yield increases over time to 5.62%, the increase is 12 basis points.

Bear Market
A prolonged period in which stock prices are falling in value.

Bid Price
The price a consumer is willing to pay for a bond on the open market.

Bond
A promise from a corporation or government to repay an investor the principal along with interest on a specific date. A bond is usually issued for a minimum of one year and pays a fixed interest rate, which means that the interest rate will remain the same for the entire term of the bond.

Bond Discount
The purchase price when a bond is selling at a price below par (or face value).

Bond Issuers
Corporations, municipalities, state, or government entities engaged in the distribution of bonds. A bond issue is a group of bonds offered by a particular issuer.

Bond Premium
The purchase price when a bond is selling at a price above par (or face value).

Bond Rating
Evaluation of the creditworthiness of issuers and securities.

Bull Market
A prolonged period in which stock prices are rising in value.

Call
Use of an option to pay off a bond before the maturity date. An early call is considered disadvantages because it forces an investor to find a new source of income in a lower interest-rate environment.

Call Price
The set price at which a bond may be redeemed by the issuer.

Call Risk
The risk faced by the holder of a callable bond that the bond issuer will redeem the bond prior to maturity.

Capital Appreciation
Increase in the value of a capital asset.

Capital Gain or Loss
The increase or decrease in the value of a stock or other asset. A stock capital gain or loss is not realized until the stock is sold. For example, if you purchase 100 shares of ABC stock for $10 per share, and the price increases to $50 per share, you would have a paper (unrealized) gain of $40 per share.
If you sold the same security at $50, you would then have a realized capital gain of $40 per share. With 100 shares sold, you would incur a realized capital gain of $4,000.

- Long-term capital gain refers to capital gains in assets that have been held for 12 months or more.

- Short-term capital gain refers to capital gains in assets that have been held for less than 12 months.

Capitalization
The sum of a corporation's stock, long-term debt, and retained earnings. Also called market capitalization.

Cash
In mutual fund investing, "cash" commonly refers to investments in savings instruments, such as certificates of deposit or money market accounts.

Closed-end Fund
A fund that offers a fixed number of shares which are traded on a stock exchange, just like stocks.

Common Stock
A security that represents ownership in a public corporation.

Convertibility
The option of exchanging a bond for a specified amount of stock. Bonds with this feature are called convertible bonds.

Cost Basis
Cost basis is used in calculating capital gains and losses for tax purposes. Generally, it is the portion of an investment on which the owner has already paid taxes.

Coupon Rate
The specified annual interest rate payable to the bondholder. This interest rate is based on the face value, and is also known as nominal yield.

Credit Risk
The possibility that an issuer will default or fail to pay principal and/or interest on outstanding bonds.

Current Yield
The expected rate of return calculated by dividing annual income by current price. For example, a $1,000 par bond that pays $70 (7%) but is bought for $800 has a current yield of 8 3/4 percent. (70 divided by 800 equals 0.0875.)

Custodian
An organization, typically a commercial bank, which has the legal responsibilities of safekeeping someone else's assets. These assets may be cash, securities, or vitually anything of value.

Defined Benefit Plan
An employer-sponsored retirement plan in which a retired employee receives a specific benefit based on salary history and years of service and in which the employer bears the investment risk.

Derivative
In finance, a derivative is a secruity with a price that is dependent upon or derived from one or more underlying assets. The derivative itself is merely a contract between two or more parties. Its value is determined by the fluctuations of the underlying asset. Comon underlying assets are stocks, bonds, commodities, currencies, interest rates, and market indexes.

Discount
A bond is usually issued in donominations of $1,000. If interest rates rise, the price of bonds drops. A bond that will be worth $1,000 at maturity may sell for $850. It is selling at a discount.

Distribution
(1) An investment company payment to its shareholder of dividents or capital gains realized from the sale of securities. The shareholder, not the investment company, pays taxes on the distribution. (2) A withdrawal from a mutual fund account.

Diversification
The strategy of lowering a portfolio's risk by investing in a variety of securities or other assets which are expected to react differently to changes in market conditions.

Dividend
Share of company's earnings/profit which is received by stock owners. Dividends may be paid in cash or as additional stock.

Dollar Cost Averaging
The method of accumulating assets by investing a fixed amount of dollars in securities at set intervals.

Dow Jones Industrial Average ("DOW")
The most widely used indicator of the overall condition of the stock market. It is composed of 30 widely traded blue chip stocks (large, well-established companies that are leaders in their respective industries).

Earnings Per Share (EPS)
The earnings returned on the initial investment amount.

Equity
Refers to ownership. If you own part or all of a company, your home, or any other property, the value of that property above any debts on the property represents your equity position. Also,the monetary value of a business or property in excess of claims or liens against it.

Exchange Traded Fund (ETF)
Index funds that trade like individual stocks on all of the major exchanges.

Expense Ratio
Charges that a mutual fund deducts from assets each year to help cover its expenses. It is expressed as a precentage of the assets held in the fund. The expense ratio includes fees for managing the assets of the fund, handling all administrative details such as mailing out prospectuses and annual reports, and satisfying IRS reporting requirements.

Face Value or Par Value
The redemption value of a bond appearing on the face of the certificate. This is the dollar value on whick the dividend or interest is figured and the amount to be repaid upon maturity. Par value for most bonds is $1,000.

Full Faith and Credit
A phrase indicating that a government entity promises full taxing authority and other revenue streams to ensure repayment of bondholders. This adds to the preceived safety of a bond.

High-yield ("junk") Bond
A bond with high credit risk. This type of bond has a high coupon rate, so investors will be willing to buy at a higher credit risk.

Index
A benchmark to measure financial or economic performance.

Index Fund
A mutual fund that keeps a portfolio of stocks designed to match the performance of a stock market or one of its sectors as measured by an index of selected stocks.

Inflation Risk
The possibility that an investment will lose puchasing power by not keeping up with the rate of inflation.

Initial Public Offering (IPO)
The first sale of a company's stock to the public.

Investment Objective
The goal that a fund's management pursues (i.e. capital growth, income, preservation of capital, etc.).

Limit Order

An order placed with a brokerage to buy or sell a set number of shares at a specified price or better. Limit orders allow an investor to limit the length of time an order can be outstanding before being canceled.

Margin

Borrowed money that is used to purchase securities. This practive is referred to as “buying on margin.”

Market Value

The current quoted price at which investors buy or sell a share of stock or bond at any given time.

Maturity

Date the principal is retured to the bondholder.

Mutual Fund

An investment company that invests money of its shareholders in a diversified group of securities of other corporations. This means that an investment company acquires money from many individual investors and invests in many types of investment vehicles (stocks, bonds, etc.) more effectively and efficiently than one individual investor could typically do.

National Association of Securities Deals Automated Quotation (NASDAQ)

A computerized stock exchange. Trading (buying and selling) is done over a network of computers and telephones.

Net Asset Value (NAV)

The dollar value of a single mutual fund share, based on the value of the underlying assets of the fund minus its liabilities, divided by the number of shares outstanding. It is calculated at the end of each business day.

Net Worth

The sum of an investor’s assets (such as real estate, securities, valuables, and cash) minus the sum of his or her debts (such as mortgages, car loans, and credit card balances).

Optimal Risk/Return Ration

The greatest returen for a given level of risk, or the lowest risk for a given rate of return.

Over-the-counter (OTC) Stock

Security not listed on a stock exchange; usually traded on NASDAQ.

Par

The value of a bond assigned by the issuer; also called face value.

Portfolio

A listing of all the securities held by an individual, mutual fund, retirement plan, or other entity.

Preferred Stock

A separate and/or secondary class of stock issued by some corporations. Preferred stock typically has limited or no voting rights, but its holders are paid dividends or receive repayment priority in the event the corporation is liquideated.

Price-to-book Ratio (P/B ratio)

Tells investors approximately how much they are paying for a company’s assets. It is calculated by dividing the market price of its stock by the company’s per-share book value. Book value is the representation of assets reported on the company’s balance sheet at cost.

Price-to-cash-flow Ratio

A measure of the market's expectations of a firm's future financial health, calculated by dividing the price per share by cash flow per share.

Price-to-earnings Ratio (P/E ratio)

A tool for comparing the prices of different common stocks by assessing how much the market is willing to pay for a share of each company's earnings. It is calculated by dividing the current market price of a stock by the earnings per share.

Price-to-sales Ratio (price/sales)

Indicates how much an investor is paying for a revenue stream represented in the ratio by "sales." Represents the amount an investor is willing to pay for a dollar generated from a particular company's operations.

Prospectus

The Securities Act of 1933 requrires this legal document for securities and mutual funds. A mutual fund prospectus contains certain information that helps an investor determine if the fund is an appropriate investment. Such information would include the fund's objectives, information about costs to the investor, etc.

Retained Earnings

The sum of a corporation's earnings remaining after payment of dividends to reinvest in its core business or to pay debt.

Risk

Risk in the marketplace means that the value of an investment, over time, may decrease rather than increase and could be worth less when sold then the original amount invested.

Russel 1000

Frank Russell Company index designed to track the performance of most major large-cap companies. The Russell 1000 measures the performance of the largest 1,000 securities in the Russell 3000 index.

S&P 500

Standard & Poor's 500 provides a broad overall view of the U.S. stock market. The index selects companies based upon their market size, liquidity, and sector.

Securities

This is a broad term encompassing various investment instruments that represent ownership of the issuer's assets and debt. Securities include, but are not limited to, stocks, bonds, and negtiable certificates of deposit.

- Debt securities are securities in which the investor loans money to an entity (corporation or government) that needs funds for a defined period of time. For example, if an investor purchases a two-year bond from the XYZ Company, he or she is loaning money to the company at a specified interest rate for two years.

- Equity securities are securities that represent the investor's partial ownership. For example, if an investor has stock of XYZ Company, he or she owns a portion of the company.

Securities and Exchange Commission (SEC)

Created by Congress to regulate the securities market and protect investors, the SEC is the primary overseer and regulator of the U.S. securities market.

Sector Performance

In general, how well a segment of the economy is doing (such as steel industry, computer technology, or medical research).

Shareholder
Any person or institution that owns shares (stock) in a company. Also called stockholder.

Short Sale
The sale of a security that one does not own but has borrowed in anticipation of making a profit by paying for it after its price has fallen.

Stock Market
A market linking buyers and sellers.

Stop Order
An order to buy or sell a security when its price reaches a particular point. It ensures a particular entry price, limits the investor's loss, or locks in the profit.

Systematic or Market Risk
The possibility that stock or bond markets will go down in value over time.

Taxable Equivalent Yield
The yield one would need to receive on a taxable bond to equal the tax-free yield of a municipal bond.

Volatility
The up and down fluctuations in the price os an investment instrument. The higher the volatility, the greater the difference between the peaks and valleys.

Yield
The interest paid by a company on its securities. For a bond, this may be expressed as a percentage of the face value (called "nominal yield" or "coupon rate") or as a percentage of the actual price the investor paid for the bond.

Yield-to-Maturity
The fully compounded rate of return paid out over a bond's life, from purchase date to maturity, including appreciation and earnings. It is the most comprehensive measure of yield.

Zero-coupon Bond
A bond sold at discount and paying no interest, but instead paying the holder the face value at maturity. A zero coupon bond stated at $1,000 but sold for $600 would yield the holder a total of $1,000 at maturity. The extra $400 the investor makes would be treated as interest.

STOCK MARKET

Defining It

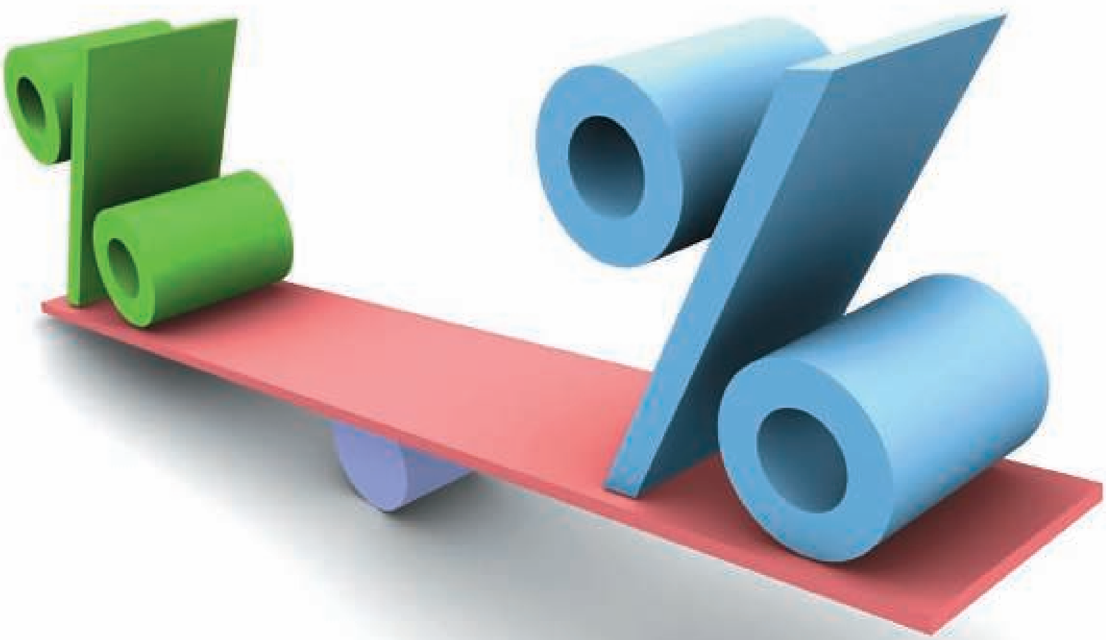
A market linking buyers and sellers. This market system is approved and regulated in the United States by the Securities and Exchange Commission (SEC).

Understanding It

- The stock market connects potential buyers and sellers of stocks of different companies.
- The U.S. stock market consists of the major exchanges, New York Stock Exchange [NYSE] and American Stock Exchange [AMEX], and the four regional exchanges, Boston, Philadelphia, Chicago, and Pacific. In any generic definition of the U.S. stock market, NASDAQ must also be included.
- There are also many overseas stock exchanges, such as the Honk Kong Stock Exchange, The Tokyo Stock Exchange (Nikkei), Mexico Stock Exchange (Bolsa Mexicana de Valores), the German Stock Exchange (DAX), and the London Stock Exchange (FTSE).
- Many company stocks are not listed on the major exchanges. These are generally called over-the-counter (OTC) stocks. Most OTC stocks trade on the NASDAQ, which uses a worldwide computer network for trading.
- In 1999, NASDAQ became the largest stock market in the U.S. in terms of dollar volume. It has overseas "branches" in several countries as well: NASDAQ Canada, NASDAQ Europe, and NASDAQ Japan.

Companies can issue common and preferred stocks.
There are advantages and disadvantages to both types.

	ADVANTAGES	DISADVANTAGES
COMMON STOCK	The right to vote in board elections and on certain policy matters. Theoretically allows investors unlimited growth potential as the stock price rises.	Can be volatile (higher risk) and carries the potential for significant loss because of its direct association with the business prospects of the issuing company. Has a low priority claim on dividends or company assets in the event of a bankruptcy.
PREFERRED STOCK	Offers a fixed dividend that has priority over any dividends paid to common stockholders. If a company goes bankrupt, preferred stockholders have a priority claim over common stockholders on the remaining assets, after creditors have been paid.	Does not include any voting rights. Does not typically offer the same growth potential as common stock.



STOCK SELECTING

The advantage of buying stock is a higher potential growth, thus greater potential reward, than a fixed investment, such as a Certificate of Deposit (CD) or Money Market account. This is because the stock owner is willing to assume some of the risk of ownership in a company.

Historically, the long-term capital growth of stocks has outpaced the interest paid on fixed investments.

The disadvantage of buying stock is that stock has a higher risk than fixed investments such as CDs or bank accounts or government bonds. CDs and bank accounts are backed by the Federal Deposit Insurance Corporation (FDIC), and government bonds pay a known rate of return and are backed by the faith and trust of the government. A single stock investment is especially risky because is lacks diversification. Mutual funds have less risk because they are more broadly diversified.

It is important that, before you purchase stock, you thoroughly research the company in which you intend to invest. Determine whether the company is financially strong, can withstand changes in its industry or in competitive demands, and whether or not its stock has the potential to increase in value.

A fundamental analysis of the company and a technical analysis of the stock are primary considerations for any potential investor. Publicly traded companies are required to provide their financial statements (annual reports).

Resources to help you with your research:

- Public library
- Internet
- Business magazines
- Company prospectus and/or annual report
- Brokers
- Investment research services (such as Standard & Poor's, Dow Jones, Lipper, Bloomberg, or Morningstar).

When determining the value of a company as an investment, you should scrutinize its financial statements, review the management team's background, compare its competitive position, and consider the long-term earning growth potential. Review fundamental data about the company including earnings, earnings estimates, revenues, dividends, income statements, balance sheets, cash flow and corporate information.

Most companies post annual and quarterly results on corporate websites.

ANNUAL REPORT

Reading an annual report is a critical part of thoroughly researching a company.

The balance sheet shows that the company owns (assets) and what it owes (liabilities) at the end of the fiscal year. The income statement, otherwise known as a profit and loss statement, shows income, expenses, and profits and losses.

Shareholder’s equity shows what’s left after subtracting liabilities from assets. The cash flow statement shows changes in the cash balances.

Price Valuation Ratios:

You should also review price valuation ratios of a company such as:

- Price-to-earnings
- Price-to-sales
- Price-to-book
- Price-to-cash-flow

Price-to-earnings ratio (P/E ratio)

The price-to-earnings ratio is the most common measure of the value of stocks. It shows the relationship between a stock price and its company's earnings per share.

The P/E ratio is calculated by dividing the current market price of the stock by the earnings per share over the last 12 months. For example, if a company is currently trading at $43 a share, and earnings over the last 12 months were $1.95 per share, the P/E ratio for the stock would be 22.05 ($43/$1.95).

The P/E ratio shows how much investors are willing to pay per dollar of earnings. If a company were currently trading at a P/E ratio of 20, the interpretation is that an investor is willing to pay $20 for $1 of current earnings.

In general, a high P/E ratio suggests that investors may expect higher earnings growth in the future compared to companies with a lower P/E ratio.

It is most effective when you compare the P/E ratios of one company to other companies in the same industry, to the market in general, or against the company's own historical P/E ratio.

Price-to-sales ratio (price/sales)

The price-to-sales ratio values a stock relative to its own past performance, other companies, or the market itself. It represents the amount an investor is willing to pay for a dollar generated from a particular company's operations.
Price-to-sales ratio is calculated by dividing the stock's current price by its revenue per share over the last 12 months. A low price-to-sales ratios is usually thought to be a better investment since the investor is paying less for each unit of sales. It is useful mainly when comparing similar companies.
Because it does not take any expenses or debts into account, price/sales is limited and only used when companies do not have a P/E ratio.

Price-to-book ratio (P/B ratio)

Book value refers to the net asset value of a company, calculated as total assets minus liabilities. The price-to-book ratio compares a stock's market value to the value of that company as indicated on its financial statements (book value).

It is calculated by dividing the current closing price of the stock by the most recent quarter's book value. This ratio also give some idea of whether you're paying too much for what would be left if the company went bankrupt immediately. The higher the ratio, the higher the premium the market is willing to pay for the company above its assets.

A lower P/B ratio could mean that the stock is undervalued and may signal a good investment opportunity; however, it could also mean that something is wrong with the company.

Price-to-cash-flow ratio

This is a measure of the market's expectations of a firm's future financial health. It is calculated by dividing the price per share by cash flow per share. This provides an indication of relative value, similar to the P/E ratio.

Other Considerations

Here are some additional items to research before making your final decision.

- Research the company's current management. Are they reputable?
- Search for recent press releases on the company.
- Are forecasts available from the company's various operating divisions?
- Check the sector performance. How are similar companies and industry as a whole doing?
- Read analyst recommendations. Are they favorable?
- Investigate technological or other advancements that may created a demand for the company's product or threaten to make their product obsolete.
- Compare the company's financial statements with those of its closest competitor.

Once you have obtained and reviewed the data, you may want to narrow your focus by taking ethics and personal interests into consideration. For example, would you avoid purchasing stock in a company that uses animals in research and development or in a company that distributes tobacco or alcohol products? These stocks, sometimes referred to as "sin stocks," may or may not be ones you want to purchase. However, you may have a personal interest in a company because it is a major employer in your community or because you work extensively with the products they provide. Taking this information into account will help you pick a stock. Of course, if you are still not sure, you can always turn to a professional advisor.

GENERIC STOCK TABLE

A stock table provides information about specific stocks. A generic example is explained below.

Monday, June 2, 2008								
1	2	3	4	5	6	7	8	9
52 Weeks								
HI - LO	SYM	DIV	VOL	YLD	PE	HI- LO	CLOSE	NET CHG
47 - 37	Z	2.30	335	5	10	43 - 40	42 3/8	+1

1 Hi-Lo

The first column is the highest and lowest prices at which the stock traded in the past year (52 weeks). In the sample, the highest price was $47; the lowest was $37.

2 Company Symbol (SYM)

This column is the abbreviated name of the firm issuing the stock. The symbol of the company stands next to the abbreviated name. In our sample, it is "Z." This symbol may be referred to as the company's ticker symbol.

3 Dividends (DIV)

Dividends are the amount a company pays to its stockholders. The third column is the annual dividend paid per share. In our example, it is $2.30.

4 Volume (VOL)

This column lists the volume of shares (in hundreds) that were traded that day. In our sample, on Monday, June 2, 2008, 33,500 shares were traded. Volume may give you an indication of the size of the market for a company's shares.

5 Yield (YLD)

This column approximates the dividend yield. The dividend yield is the current return on invested capital. It is used to compare dividend returns for firms that have different stock prices. The dividend yield is derived by dividing the current dividend by the closing stock price (#8). In our sample, the dividend yield is 5%, calculated as follows:
($2.30/$42.375 = 5.43%).

6 Price-to-earnings ratio (PE)

The P/E ratio compares the price per share to the earnings per share (EPS). It shows how much an investor is willing to pay for $1 of current EPS. P/E ratio is calculated by dividing price by EPS. In this example: ($42.375/$4.23 = 10).

7 Hi-Lo

This column represents the highest and lowest prices at which trades were completed during the trading day. In our example, the high was $43 and the low was $40.

8 Close

The last price at which a trade was made during the trading day. In our sample, it is 42 3/8 ($42.375).

9 Net Change (Net Chg)

The change between the closing price for the previous day and the current day. Let's say this company closed at 41 3/8 on the preceding business day. On Monday June 2, 2008, it closed higher by $1. The net change is measured in dollar value.

Broker

A broker is a licensed salesperson who handles the purchase and/or sale of stocks. The broker usually charges a commission and/or fee for these services. There are two types of brokers.

Full-service brokers advise you on investment opportunities, do necessary research on the market, and make recommendations. Full-service brokers will also place stock orders for you.

Discount brokers do not provide investment research or advice but place your stock orders according to your instructions.

To locate a broker to buy and/or sell stock:

- Get a referral from a satisfied friend or associate.
- Contact a brokerage firm.
- Refer to the phone book yellow pages.
- Call the local Chamber of Commerce.
- Look for local advertisements (newspapers, billboards).
- Many brokers give seminars. Attend a seminar.
- Search online

You may get some insight into how they do their jobs and whether their approach is compatible with your needs. To select a broker to buy and/or sell stock, determine if you want a full-service broker or a discount broker. Ask plenty of questions to determine if the broker's approach to investing and planning is compatible with yours.

For example:

- What is the broker's background?
- What licenses have been obtained?
- How long has he or she been a broker?
- How does the broker select stocks to recommend to clients?
- How does the broker receive payment for services?
- What is the average rate of return for clients?
- How often does the broker meet with clients to review their financial plans?

Trading Costs

Trading costs are the expenses incurred while buying or selling stocks and/or bonds. Trading costs usually include commissions, fees, and taxes on any realized capital gains.

Taxes On Stocks

There are two main ways income or profits from investing in stocks may be taxed:

- **Capital gains tax**
- **Dividend income tax**

Capital Gains Tax

A capital gain occurs when you sell an asset for a profit. That asset could be a house, land, machinery, stock, or a bond. When that happens, the capital gains tax comes into play. As applies to stocks, capital gains are the difference between your "basis" in the stock and the sales price. This difference is your profit or loss. The basis is usually what you paid for the stock. However, if you inherit the stock, the basis is the price.

If the difference between the basis and the sales price is negative, in other words, you lost money, you have a capital loss which you can use to offset capital gains.

There are two types of capital gains:

- **Long-term capital gains**
- **Short-term capital gains**

Understanding the difference is very important.

Long-term Capital Gains

You must hold the stock at least one full year to qualify for the long-term capital gains rates. This is extremely important, and stockholders are encouraged to make absolutely sure by holding the stock at least one year and a day. The tax on a long term capital gain is lower than what you will pay for a short-term capital gain.

Short-term Capital Gains

If you hold a stock less than one year before selling it, the IRS classifies the sale as a short-term capital gain and taxes the profit as ordinary income. This means you could pay 25% or more of your profit in taxes. Unless there is a compelling reason, hold on to the stock long enough to qualify for the long-term capital gains rates.

Dividend Income Tax

Companies that distribute their profits through dividends paid to you create a taxable event for you because the dividend is considered income. There is not much you can do to avoid some tax on dividends, unless you hold your stock in a qualified retirement plan in which the dividends are reinvested into your retirement plan.

BONDS

Bonds are debt securities, or IOUs, issued by corporations or governments. An investor who buys a bond is a creditor of the company, not an owner as a stockholder would be. By purchasing a bond, you are loaning money to the organization that issued it in exchange for a series of annual interest payments against the prinicipal or face value of the bond. The issuer repays the "loan" to you on the maturity date.

If you hold your bond until it matures, you get back all of the money you paid for it, unless the issuer has defaulted. Bonds mature at different times. They can be short-term (less than 5 years), intermediate-term (5-10 years), or long-term (more than 10 years). In general, the longer the maturity, the greater the amount of interest you will receive from the bond.

The bond issuer may decide to pay off a bond before its maturity date. This is known as calling a bond. Not all bonds are callable. Bonds are usually called because an issuer no longer needs to borrow the money. The issuer would then be able to avoid paying the remainder of interest due. The prospectus will indicate if a bond is callable or not.

A bond's market value is directly related to interest rates. As interest rates go up, the market prices of bonds go down and vice versa. Until a bond matures, its price on the secondary market constantly changes in response to changes in interest rates. If you sell your bond before it matures, the price may be more or less than you originally paid for it, depending on current interest rates.

For example: If an investor buys a bond with a coupon rate of 6%, and interest rates go up, a new bond issue might offer a 7% coupon rate. Since this means that an investor can earn more interest by purchasing the new bond, the value of the original bond is reduced. If the investor wanted to sell the original bond, they would have to discount the price enough to make up for its lower interest rate.

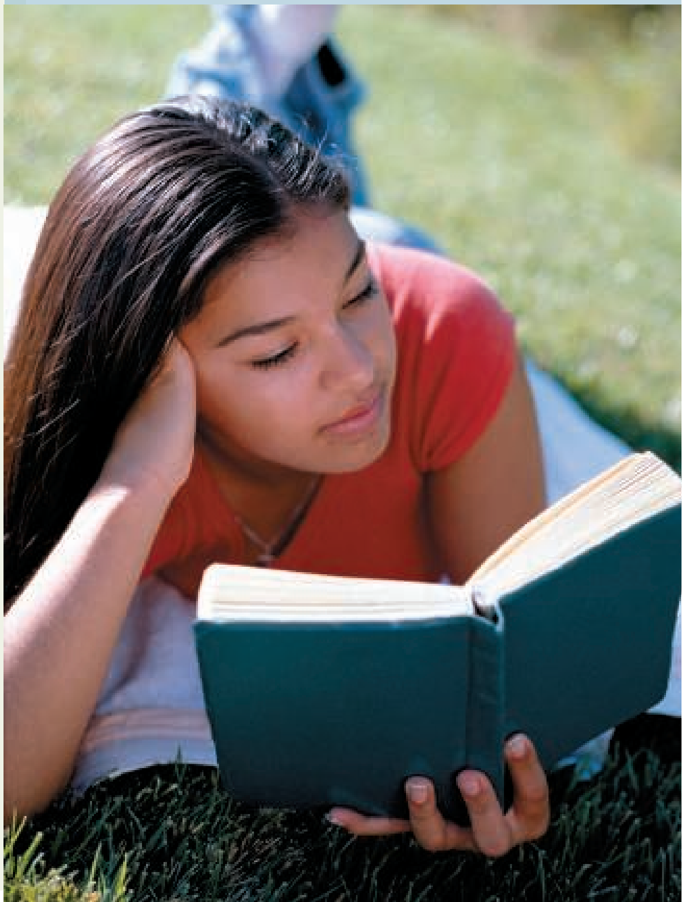
On the other hand, if interest rates go down, a new bond issue might offer only 5% coupon rate. If this happens, the original bond becomes more valuable and can be sold for a higher price (at a premium).

The other factor affecting the price of bonds is the credit quality of a bond. If a bond issuer is at risk for default, it will be assigned a low credit rating. Credit ratings are based on a grading system; AAA is the highest possible mark; C is the lowest rating. Rating agencies include Moody's Investors Services and Standard & Poor's.

Bonds are generally less volatile than stocks, but the cost of this safety typically results in lower long-term returns. Most investors who buy bonds do so in order to obtain a source of income, whereas the main reaon for buying stocks is to seek capital appreciation so assets grow for a future date.

Compared to CDs, money market accounts, and checking and savings accounts, bonds are generally more volatile and have a higher potential for profit.

Bonds are not great for making your money grow rapidly, but they can help to diversify your portfolio and provide a stable source of interest and return on principal.



Types Of Bonds

CORPORATE

A corporate bond is issued by a corporation and backed by the company's credit / and or assets. There are several different corporate bonds available.

- ### Industrial bond

  A bond issued by a corporation in industrial activities, such as manufacturing.

- ### Collateral trust bond

  A corporate bond backed by financial assets (such as a securities portfolio) of a corporation. The assets are held by a third-party trustee.

- ### Equipment trust certificate

  A bond secured by company equipment or physical assets. Among the most common issuers are airlines and railroads that need to finance new purchases or equipment. The equipment bought may be used as collateral.

- ### Mortgage bond

  A secured corporate bond backed by real estate. Because mortgage bond collateral provides a claim on a company's assets, these bonds are considered secure and high-grade.

- ### Junk bond

  A bond that is speculative, high-yielding, and issued by a company that typically finances its growth and operations with debt. Ratings companies usually assign low grades to these bonds.

MUNICIPAL

Municipal bonds are issued by a state or local government or its subdivisions. They are issued to raise money for industrial projects, housing, residential construction, and general revenue.

The interest earned on a municipal bond is usually free of federal income tax, and possibility of local and state taxes. The yield one would need to receive on a taxable bond to equal the tax-free yield of a municipal bond is called taxable equivalent yield.

There are several different municipal bonds available.

- ### Revenue bond

  A bond sold by a municipality to finance projects such as bridges, hospitals, power plants, and other local services. Also called limited obligation bonds, revenue bonds are secured by the revenue generated by those projects.

- ### General obligation bond (GO bond)

  An unsecured municipal bond. Its interest and principal are "covered" by the taxing authority and creditworthiness of the issuer. Interest payments on these bonds are paid by taxes and other revenues collected by the issuer. GO bonds finance municipal operations.

- ### Industrial-development bond

  A tax-exempt municipal bond sold to raise money for facilities for private enterprises. These bonds attract industries to areas that need economic development.

MBIA-insured bonds, AMBAC-insured bonds

Municipal bonds guaranteed by either the **Municipal Bond Insurance Association (MBIA)** or the **American Municipal Bond Assurance Corporation, (AMBAC)** two major bond insurance companies. To receive insurance from either of these groups, the municipality must take out a policy and pay a premium.

U.S. GOVERNMENT

One of the most popular types of bonds, U.S. government bonds are used to finance federal projects and are rated the highest of all bonds.

There are several different U.S. government bonds available.

• Agency bond

A bond issued by an agency of the federal government, such as the Student Loan Marketing Association (Sallie Mae). Government agencies are non-government corporations, and agency bonds are not guaranteed by the government.

• Collateralized mortgage obligation

A form of mortgage-backed security divided into sections in which investments are based on chosen maturity periods.

• Series EE bond

An interest-bearing savings bond issued at a discount from par which pays interest when it is redeemed. Savings bonds must be held a mini mum of one year.

The denominations range from $50 to $10,000, and the bonds are guaranteed to keep their face value in 20 years. Interest earned is exempt from state and local income taxes.

• Series HH bond

An interest-bearing savings bond issued at par (face value). The U.S. Treasury no longer issues HH bonds, but HH bonds already owned are secure. The interest, earned every six months on Series HH bonds, is exempt from state and local taxes.

The denominations range from $500 to $10,000, and the maturity period is usually ten years. The interest rates are reset on the 10th anniversary of the bond's issue date.

• Series I bond

A savings bond sold at full face value, with denominations ranging from $50 to $10,000. They earn interest from the first day of the issue month.

The interest is paid when the bond is redeemed. I bonds grow in value with inflation-indexed earnings for up to 30 years. The interest earned is subject to federal income tax, which can be deferred until redemption or final maturity.

• Treasury bill (T-bill)

T-bills are issued by the U.S. Treasury at auction at a discount from their face value. For example, you might pay $970 for a $1,000 bill. When the bill matures, you would be paid its face value of $1,000.

Your interest is the face value minus the purchase price – in this example, $30. The interest is determined by the discount rate, which is set when the bill is auctioned. Interest is exempt from state and local income taxes.

• Treasury bond (T-bond)

A bond issued by the U.S. Treasury to meet the government's financial needs. Treasury bonds are considered the safest bonds and are very popular with investors. They pay interest every six months until maturity.

At maturity, you are paid its face value. The interest is exempt from state and local income taxes. The price and interest rate are determined by auction.

• Treasury note (T-note)

T-notes are issued by the U.S. Treasury in terms of 2, 3, 5 and 10 years. They pay interest every six months until maturity. The price of a note may be greater than, less than, or equal to the face value of the note.

Notes are sold in increments of $1,000. When a note matures, you are paid its face value. Interest is exempt from state and local income taxes.

Treasury bonds, notes, and bills have no credit risk because they are backed by the full faith and credit of the U.S. government. They are subject to interest rate risk, however. This means that if interest rates go up, the value of the bond will decrease, and it will trade at a discount.

See www.savingsbonds.gov for more information.

Selecting a Bond

Before deciding to buy bonds, there are three factors to consider:

ISSUER

Bonds are issued by the U.S. Treasury, U.S. government agencies, corporations, and state or local governments. The issuer affects the credit risk (failure to pay principal and/or interest on outstanding bonds), which in turn affects the price.

MATURITY

The maturity date is the date when the bond issuer agrees to repay the principal (face value) of the loan. Bonds can be short-term (less than 5 years), intermediate-term (5-10 years), or long-term (more than 10 years). A bond that matures in one year is more predictable and less risky than a bond that matures in 20 years. The longer it takes to mature, the more it will fluctuate with changes in interest rates.

CREDIT QUALITY

A bond's quality is measured by the issuer's ability to pay interest and repay principal in a timely manner. Treasury bonds have the highest credit quality because they are backed by the "full faith and credit" of the U.S. government. Corporate high-yield ("junk") bonds have the lowest credit quality.

The following factors influence the interest (coupon) rate that a bond issuer offers:

- Bonds with low credit quality generally command higher interest rates to compensate investors for the risk that the loans won't be repaid on time or in full. Bonds with longer maturities generally carry higher interest rates because investors face the risk that the market value of the bond will decrease.

- Municipal bonds, issued by state and local governments, typically pay lower interest rates because the issuers are exempt from federal (and sometimes state) taxes.

Risks involved in buying bonds

Some typical risks for bonds are listed below. (These terms are defined in the Terms section):

- Call risk
- Credit risk

Certain types of bonds (for example, those issued and backed by the U.S. government) may offer less risk than many stocks. Other types, such as "junk bonds," can be more risky than many stocks. In general, the higher the rate of return a bond offers, the higher the credit risk is.

Advantages

Bonds tend to be more predictable than other securities because many of the financial variables associated with them are known at the time they are issued. They provide a source of fixed income for a defined period of time and generally provide a higher level of current income than cash investments, such as money market funds, bank checking accounts, and certificates of deposits (CDs).

Bonds generally produce more income than stocks, which tend to focus more on capital appreciation than on income generation.

Bonds provide diversification because the returns tend to fluctuate less than stock returns and frequently increase in value when stock returns diminish. They help to reduce a portfolio's overall volatility.

Income from municipal bonds is exempt from federal taxes and may be exempt from state taxes if the bonds were purchased from an issuer within the state.

Disadvantages

A bond's market value will decline during periods of rising interest rates. During periods of falling interest rates, corporate and municipal bond issuers may prepay, or call, their loans before maturity in order to reissue the loans at a lower rate. Investors, then, must reinvest this prepaid principal sooner than they had anticipated – and possibly at a lower interest rate.

Investors could lose money if a bond issuer defaults, that is, fails to make timely payments of principal and interest. The interest income earned from a bond investment remains the same over the life of the bond. The value of that income could be eroded by inflation.

The credit quality or market value of a bond could suffer in response to an event such as a merger, leveraged buyout, or other corporate restructuring. If a bond's credit rating is reduced, investors may have to sell it at a lower price than they intended. (This only applies if investors planned to sell the bond before the maturity date).

Most investors have neither the time nor the knowledge to research individual bond issues. Because bonds must generally be purchased in certain minimum amounts, it is difficult for most individual investors to purchase the broad number of bond issues necessary to provide meaningful investment diversification. Investors with an interest in bonds might find bond mutual funds (discussed in a later section) more convenient and more beneficial.

Purchasing a Bond

You can purchase U.S. Treasury bonds on the secondary market or directly from the Federal Reserve. When you purchase bonds directly from the Federal Reserve, you must buy new issues, but there are no broker commissions. The Treasury holds regularly scheduled government auctions four times a year: the first weeks of February, May, August, and November. You can enter competitive bids for Treasury securities.

You can also buy new-issue corporate bonds through bond dealers. Corporate bonds are IOUs issued by private and public corporations both in and outside the U.S. They are issued by public utilities, as well as by private sector firms such as transportation companies, financial services companies, and industrial corporations. The corporate bond market is quite large, with a lot of active trading.

When bonds are first issued, their prices, or face values, are fixed. Once issued, these prices can fluctuate in the secondary market because of changing interest rates. When bonds are first issued, bond dealers assist the issuer (a company or governmental body) in selling the bonds to the public, and for this, they are paid a commission from the proceeds of the sale.

Older bonds are sold through brokers on the secondary market. The secondary market consists of the over-the-counter (OTC) market, including the NASDAQ and stock exchanges such as the New York Stock Exchange (NYSE). Most bonds are sold over the counter. The OTC market consists of hundreds of banks and brokerages that buy and sell over the phone or via computer networks. Brokerage firms that deal in bonds have latitude to set prices for bonds they sell; however, all prices are negotiable. Bonds sold on the OTC market are usually sold in amounts greater than $5,000 at a time.

Note: Transaction fees may apply when you buy or sell bonds.

EXCHANGE TRADED FUNDS (ETF)

Exchange traded funds (ETFs) were established in 1993 as low-cost index funds that trade like stocks. They are bought and sold like individual stocks throughout the market day on the major exchanges. They offer portfolio exposure to the world's leading indexes. ETFs also allow investors to track indexes that may not be available in open-end index funds. The objective of an ETF is to achieve the same return as a particular market index. An ETF is similar to an index fund in that it will primarily invest in the securities of companies that are included in a selected market index.

For example, one type of ETF may invest in the stocks contained in the S&P 500, while another may invest in the stocks contained in the Russell 1000. ETFs also allow investors to participate in other asset classes, such as real estate and precious metals.

Structure of an ETF

All ETFs follow one of three important legal structures. This is a brief summarization of each.

Open-end Index Fund	Unit Investment Trust	Grantor Trust
This type of fund structure reinvests dividends on the date of receipt and pays them out via a quarterly cash distribution. This ETF design is also permitted to use derivatives and loan securities. It is registered under the SEC Investment Company Act of 1940. ETFs that utilize this legal structure include iShares and the Select Sector SPDRs (S&P Depository Receipts Trust Series 1).	This type of fund structure does not reinvest dividends in the fund, but pays them out via a quarterly cash distribution. To comply with the various diversification rules, this ETF design will sometimes deviate from the exact composition of a benchmark index. This type of fund is registered under the SEC Investment Company Act of 1940. The Diamonds, Cubes, and SPDRs follow this format.	This type of fund structure distributes dividends directly to shareholders and allows investors to retain their voting rights on the underlying securities within the fund. The original fund components of the index remain fixed, and this legal structure is not registered under the SEC Investment Company Act of 1940. Merrill Lynch's HOLDRs (Holding Company Depository Receipt) follow this format.

ETF ADVANTAGES

Lower expense ratios

The expense ratios of ETFs are consistently lower than actively managed mutual funds. Lower costs without the sacrifice of quality is a key attraction.

Tax efficiency

ETFs are renowned for their low portfolio turnover. For shareholders, this can translate into lower tax liabilities. ETFs trade like individual equities, so the investor controls the timing of gains.

Trading flexibility

ETFs trade throughout the market day and can be bought and sold at the click of a button. Traders can also buy ETFs on margin.

Tactical investment strategies

ETFs open a universe of sophisticated investment strategies, such as cash management, hedging tax loss, and repositioning.

ETF DISADVANTAGE

Commissions

Like stocks, you are usually charged for each transaction when trading exchange traded funds.

Purchasing

ETFs must be bought through a broker.

Trading

Unlike mutual funds, ETFs do not necessarily trade at the net asset value of their underlying holdings. This means an ETF could potentially trade near or below the value of the underlying portfolios.

Bid-Ask Spread

As with stocks, this is the amount by which the asking price exceeds the bid. This is essentially the difference in price between the highest price that a buyer is willing to pay and the lowest price at which the seller is willing to sell. Prices fluctuate so you might sell at a loss or buy at a higher price.

MUTUAL FUNDS

Investment companies are regulated by the Investment Company Act of 1940. Under this federal law, an investment company is defined as a company whose primary business is investing in securities. The Act of 1940 identifies three categories of investment companies, one of which is a management company. There are two types of management companies, closed-end companies, and open-end companies.

Closed-end companies are not continuously marketed. Only a specific number of shares were authorized and sold (hence the term closed-end). After all shares have been sold in the initial offering, these funds trade as OTC (over-the-counter) stocks. Their value is determined daily by market demand, not the underlying value of securities in the portfolio.

Open-end investment company shares are always newly-issued, trade continuously, and can be redeemed on demand at the current net asset value.

Open-end investment companies are more commonly referred to as mutual funds.

A mutual fund is a form of investment that pools money from many investors and invests the money in stocks, bonds, “cash” (fixed savings), or a combination. Individuals and institutions that invest in the same mutual fund share common goals and investment objectives. The funds are run by a manager or a team of managers that buy and sell securities to achieve the stated investment objective.

MUTUAL FUND ADVANTAGES

Diversification

Since mutual funds hold several different stocks, bonds, and cash within their portfolios, they provide immediate diversification and asset allocation to the investor.

Lower transaction costs

Mutual funds are able to take advantage of their buying and selling volume to reduce transaction costs for investors. When you buy a mutual fund, you are able to diversify without the numerous commission charges. Imagine if you had to buy the 10-20 stocks needed for diversification; the commission charges alone would eat up a good chunk of your savings. Add to this the fact that you would have to pay additional transaction fees every time you wanted to modify your portfolio. Mutual funds are able to make transactions on a much larger scale, so the costs are lower.

Liquidity

Selling and purchasing mutual fund shares can be done with relative ease. You can sell mutual funds at any time because they are as liquid as regular stocks. Both the liquidity and smaller minimum investments of mutual funds provide mutual fund investors the ability to make periodic investments through monthly purchase plans while taking advantage of dollar cost averaging.

Professional management

Mutual funds are run by a professional money manager. The manager uses the money you invest to buy and sell stocks strategically to increase the value of the portfolio. The professionals have the responsibility of thoroughly researching every investment before deciding to buy or sell, which relieves investors of that duty.

Simplicity

Buying a mutual fund is easy. The minimum investment is small, and most companies have automatic purchase plans in which as little as $50 can be invested monthly. Mutual funds are also highly regulated to protect the investor from consumer fraud.

MUTUAL FUND DISADVANTAGES

Fluctuating returns

Mutual funds are like many other types of investments; there are no guarantees. They are subject to the fluctuations of the market, and there is always the possibility that the value will depreciate. Mutual funds are not insured, nor do they protect against loss in a Bear market.

Costs

Mutual funds provide investors with professional managers. As a result, there are fees for management services in the form of loads, redemption fees, and annual operating fees, which affect the overall performance of the account.

Excess in cash

To maintain liquidity and the capacity to accommodate withdrawals, funds typically have to keep a large portion of their portfolio as cash. The money sitting around as cash would not be working for you.

Dilution

It is possible to have too much diversification. Because funds have small holdings in so many different companies, high returns from a few investments often don't make much difference to the overall return. Dilution is also the result of a successful fund getting too big. When money pours into funds that have had strong success, the manager often has trouble finding good investments for all the new money.

Taxes

When making decisions about buying and selling securities within the funds portfolio, fund managers do not consider your personal tax situation.

Risk

Mutual funds minimize some risk by holding several different stocks, bonds, etc, within the portfolio of the fund, but there are always risks involved with investing in the stock market.

Market risk

Also referred to as systematic risk, this term usually refers to risk in the equity markets. It can be caused by broad changes in the economy or by sudden traumatic events such as terrorist attacks, natural disaster, scandal, etc. Diversification across asset classes (stocks, bonds, and cash) can help moderate the effect of market risk.

Non-systematic risk

An unusual event that affects one company or segment of the market. Diversification also helps provide a cushion against such events.

Interest risk

Interest rates directly affect the bond market. The value (price) of a bond or bond mutual fund varies inversely with interest rates, thus introducing the potential for gain or loss in the principal amount invested.

Note: The risks for a particular mutual fund will be discussed in the fund prospectus.

INVESTMENT OBJECTIVES

There are 5 major investment objectives:

1. Aggressive Growth
2. Growth
3. Growth and Income
4. Balanced
5. Income

Aggressive growth

Stock funds with an aggressive growth objective invest in higher-risk investments that offer potential for high returns.

The goal is rapid growth of capital. These funds often invest in small or emerging companies that may see rapid growth.

Growth

Stock funds with a growth objective have a goal of increasing capital. Income for the present is not considered, nor is it seen as a secondary concern.

Growth companies are usually mature and have established a very strong, even dominant, market position in their industry.

Growth and income

These funds pursue both the increase of capital and current income. Growth potential and the ability to pay dividends are both factors used in selecting investments for this type of fund.

Balanced

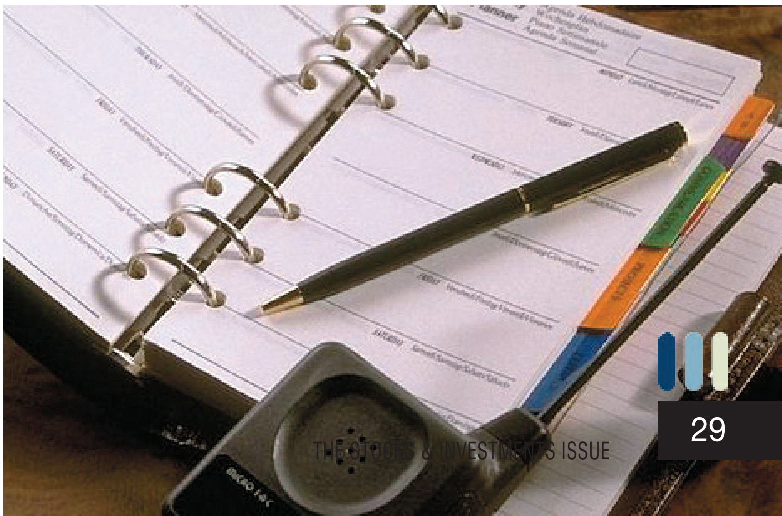
Funds with a balanced investment objective invest in a combination of stocks and bonds. The allocation percentages are usually fixed, and these funds generally have at least 25% of their assets in fixed-income securities.

They seek both income and growth of capital.

Income

Funds with this objective exclusively seek income from interest and dividends generated by investments in fixed-income securities such as bonds, bills, or cash.

Note: Information about the objective of a fund can be found in the prospectus.



MUTUAL FUND CATEGORIES

Mutual funds are generally categorized by:

1. Size
2. Investing Style
3. Market

Size

(small-, mid- or large-cap) - Small-cap stocks are typically defined as those of companies whose market capitalization is less than $1 billion. Mid-cap stocks are usually defined as those of companies with market capitalization between $1 billion and $10 billion.

Large-cap stocks are usually defined as those of companies with over $10 billion market capitalization. These cutoffs are provided only as a frame of reference; they may vary from one mutual fund tracking service to another.

Investing style

(growth vs. value) - The two main investing styles are growth and value. These two styles tend to rotate in and out of favor. Growth investing is a strategy of buying stock with accelerating earnings in hopes that the earnings will drive the stock prices higher.

Value investing is the strategy of buying stock at a price below what the investor thinks it is actually worth, with the expectation that the prices will go up and the investor will sell at a profit. Value stocks are usually considered to be less volatile than growth stocks, but they provide similar returns.

Market

(domestic or foreign) - A mutual fund may be classified by whether its assets are invested in the domestic market or foreign markets.

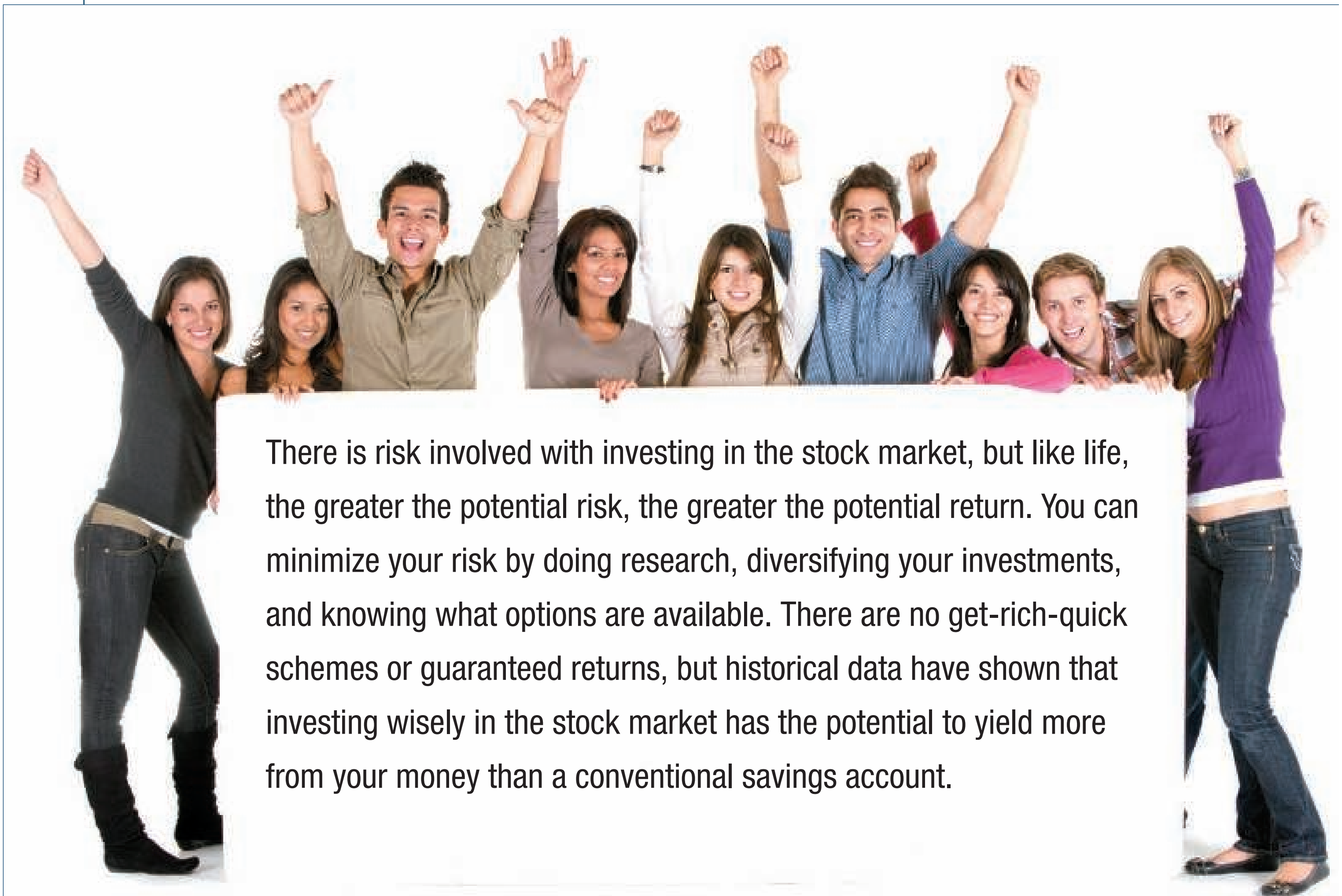
The domestic market includes stocks or other securities registered in the United States. The foreign market includes securities registered outside the U.S. Many mutual funds have holdings from both domestic and foreign markets. Based on which market most of its holdings are in, a fund may be known as a "domestic fund" or a "foreign fund."

There is another specialized category called sector funds. Sector funds invest heavily in one particular area of the market such technology, health care, real estate, or the airline industry.

Note: The prospectus will include information about a fund's size, investing style, and market.

Investing is the best way to secure your future. In this world there are two ways to earn income; one is to exchange your labor for dollars and the other is to have your money earn money for you. By starting early, making the right investments, and with ample planning, you can enjoy financial security more than you can imagine.

CONCLUSION



There is risk involved with investing in the stock market, but like life, the greater the potential risk, the greater the potential return. You can minimize your risk by doing research, diversifying your investments, and knowing what options are available. There are no get-rich-quick schemes or guaranteed returns, but historical data have shown that investing wisely in the stock market has the potential to yield more from your money than a conventional savings account.