

Product characteristics and BRTI

Common stock

- Equity security representing ownership
- **Benefits**
 - Capital appreciation / growth
 - Dividends (only paid by some issuers)
- **Systemic risks**
 - Market risk
 - Inflation risk (short term only)
- **Non-systematic risks**
 - Business risk
 - Financial risk
 - Legislative risk
 - Regulatory risk
 - Political risk (foreign only)
 - Liquidity risk
- **Typical investor**
 - Young, more aggressive
 - Seeks capital appreciation
 - May seek dividend income from value stocks
- Growth stocks
 - Growing companies
 - May be minimally or unprofitable
 - Low or no dividend payouts, high P/E ratios
- Value (undervalued stocks)
 - Large, well-established companies
 - Typically pay dividends
 - High dividend payout ratios, low P/E ratios

Preferred stock

- Equity security representing ownership
- Pays fixed dividend rate based on par value (usually \$100)
- Potential features:
 - Cumulative vs. straight - skipper dividends
 - Callable - may be bought back by issuer
 - Convertible - into common stock of same issuer
 - Participating - extra dividends if company performs
- **Benefits**
 - Dividend income
 - Lower tax rates on income
- **Systematic risks**
 - Interest rate risk
 - Inflation risk
 - Reinvestment risk
- **Non-systematic risks**
 - Business or financial risk (threatens dividend payments)
 - Liquidity risk

Debt securities

- Represent debt obligations of issuers
- Pays fixed interest rate based on par value (\$1,000)
- Potential features:
 - Callable - may be bought back by issuer
 - Call premium = amount above par to be paid if called
 - Call protection = amount of time before callable
 - Convertible - into common stock of same issuer
 - Zero coupon - sold at discount, matures at par

Debt securities (continued)

- **Benefits**
 - Interest income
 - Capital appreciation if convertible
 - Variety of choices in the market
- **Systematic risks**
 - Interest rate risk (long maturity and low coupon)
 - Inflation risk (long maturity)
 - Reinvestment risk (except zero coupon)
- **Non-systematic risks**
 - Default (credit) risk
 - Investment grade = BBB or above
 - Speculative (junk) = BB or below
 - Liquidity risk
 - Legislative risk
 - Regulatory risk
 - Political risk (foreign only)
- **Typical investor**
 - Older, more conservative (unless junk bond)
 - Seeks income, especially in retirement

Corporate debt securities

- Commercial paper - short term (270 days or fewer), zero coupon
- Debenture - long term, unsecured bond
- Mortgage bond - secured by real estate or property
- Collateral trust cert - secured by securities or subsidiary

US government securities

- Treasury bill - 1 year or less, zero coupon
- Treasury note - 2-10 years, pays semi-annual interest
- Treasury bond - up to 30 years, pays semi-annual interest
- STRIPS - long term (up to 30 years), zero coupon
- TIPS - long term, pays semi-annual interest
 - Par value adjusts to inflation rate every 6 months
 - Greater of original or adjusted par paid at maturity

Municipal securities

- General obligation bonds
 - Non-self supporting debt
 - Funds public parks, schools, roads, etc.
 - Backed by property (ad valorem) taxes
 - Subject to debt limits and voter approval
- Revenue bonds
 - Self-supporting debt
 - Funds toll roads, stadiums, airports, etc.
 - Backed by user charges
 - Not subject to debt limits or voter approval
- Not subject to taxes if purchased by resident
 - Most suitable for high tax brackets
 - Not suitable for low tax brackets or retirement plans

Investment companies

- Classifications
 - Management companies (open and closed-end)
 - Unit investment trusts (UITs)
 - Face amount certificates
- Offer pooled investment opportunities
- Most suitable for investors seeking:
 - Instant diversification
 - Professional management (except fixed UITs)

Open-end management companies (mutual funds)

- Redeemable pooled portfolios of managed securities
- Active management
 - Attempting to "beat the market"
 - Intends to beat benchmark (e.g. S&P 500)
 - Higher expense ratios
- Passive management
 - Attempts to "match the market"
 - Intends to provide returns of benchmark, lower expense ratios
- Offered to investors at POP if front-end sales charge exists
- Offered to investors at NAV if no-load (no sales charge)
 - NAV is minimum price
- NAV influenced by:
 - Value of securities in portfolio
 - Distributions to investors (dividends or capital gains)
- NAV not influenced by demand for mutual fund shares
- May not be sold short or bought on margin

Close-end management companies (publicly traded funds)

- Negotiable pooled portfolios of managed securities
- NAV reports "book value" of shares
- Shares traded in market at the going market price
 - May be purchased above, below, or at NAV
- May be sold short or bought on margin

Exchange traded funds (ETFs)

- Structured as open-end management companies
- Typically are passively managed (match index)
- May be sold short or bought on margin
- Leveraged & inverse ETFs
 - Leveraged = track index at 2x or 3x rate
 - Inverse = tracks opposite index returns
 - Only suitable for aggressive and risk-tolerant investors

Types of funds

- Growth funds
 - Invest in growth common stocks, seek growth
- Value funds
 - Invest in value common stocks, seek growth and income
- Balanced funds
 - Invest in common & preferred stocks + bonds
 - Seek growth and income
- Growth & income funds
 - Invest in common & preferred stocks (equity only)
 - Seek growth and income
- Income funds
 - Invest in various securities seeking income
 - Types:
 - Equity income funds
 - Corporate debt funds
 - Government debt funds
 - Municipal debt funds
 - High yield (junk) bond funds
 - GNMA/FNMA/FGLMC funds
 - Money market funds - \$1.00 NAV at all times
- Asset allocation funds - seek fixed or variable asset allocation mix
- Life cycle funds - adjusts risk tolerance over time
- Sector/specialized funds - invests in specific sectors or regions of world
- Index funds - track a specified index