Glossary of Financial Terms

active management: an investment management approach that aims to meet investor objectives such as growth, income and preservation of capital through informed, independent investment judgment. The opposite of passive management, or indexing, which seeks to replicate market performance through a portfolio that mirrors the composition of market indexes

adjusted gross income (AGI): the income amount on which an individual's federal income tax is figured. AGI is calculated by making adjustments to gross, or total, income from taxable sources minus certain deductions.

adviser: a financial professional who helps investors meet their financial needs and objectives through investments, tax planning, asset allocation, risk management, retirement planning and estate planning.

affiliate: generally, an "affiliate" of an issuer is a person (or company) that, directly or indirectly, controls or is controlled by, or is under common control with such issuer. Under the Investment Company Act of 1940, an affiliation can arise when a mutual fund owns more than five percent of the outstanding voting securities of a particular issuer.

alternative minimum tax (AMT): federal tax that seeks to prevent high-income taxpayers from avoiding significant tax liability by using exclusions, deductions and credits.

American Depositary Receipt (ADR): a certificate representing ownership of a specific number of shares of an international stock. ADRs allow U.S. investors to buy and trade shares of international companies on U.S. exchanges, rather than in overseas markets. ADRs trade in U.S. dollars and are bought and sold just like U.S. securities.

analyst: a research specialist who develops a detailed understanding of an industry or region.

annual report: a yearly record of a mutual fund's financial status that must be distributed to shareholders under Securities and Exchange Commission regulations. The report includes a review of the fund's operations as well as various financial statements.

annuity: a contract sold by life insurance companies that offers tax-deferral and, if elected, guaranteed payments to the annuitant (the beneficiary of these payments) for a specified period of time. Annuities are sold in units, not shares. A fixed annuity pays a fixed amount for the duration of the contract, while a variable annuity pays different amounts based on the performance of the underlying investments. The account value of an annuity is often at least partially guaranteed by the issuer.

appreciation: an increase in the value of an asset such as a stock, bond, commodity or parcel of real estate. See also capital appreciation and capital growth.

asset: anything with commercial or exchange value owned by a business, institution or individual. Examples include cash, real estate and investments. Mutual fund assets consist of the securities held in the fund's portfolio. The opposite of a liability.

asset allocation: the mix of assets in which money is invested, including stock and fixed-income investments, cash equivalents, and tangible assets such as real estate and collectibles. A central concept in financial planning and investment management, asset allocation affects both risk and return: Investing in a combination of investments can reduce risk and enhance returns through diversification.

asset-backed security: securities backed by payments received from a specified pool of receivables, such as mortgages, automobile loans or credit card accounts. The structure is intended to isolate the issuer of the securities from the bankruptcy risk of the originator of the receivables (for example, a bank or another provider of credit).

asset-based fee: an annual fee charged by some broker-dealers for advice, which usually ranges from 0.5% to 3% of assets. This fee is typically charged instead of a transaction-based fee.

audit: the examination of a mutual fund's accounting documents and financial statements by a professional accounting firm to verify their accuracy and conformity with generally accepted accounting principles.

auditor's report: the declaration of a professional accountant following the review of a mutual fund's financial statements. The report describes the scope and the findings of the review and is an important assurance to a lender or investor. The opinion of an auditor can be unqualified or qualified, depending on the extent of the audit performed and the auditor's confidence in the accuracy of the financial statements.

automatic investment plan: a program enabling mutual fund investors to purchase or sell fund shares automatically. For example, American Funds shareholders can have a fixed amount from a bank savings or checking account debited to buy fund shares on a weekly, monthly, quarterly or annual basis. Investing at regular intervals allows shareholders to benefit from dollar cost averaging.

average: a weighted, adjusted arithmetic mean of selected securities designed to represent the market or important segments of the market. The Dow Jones Industrial Average℠, the best known market average, is price-weighted.

average annual total return: the annual rate of return, including reinvestment of distributions, earned over a specific period of time.

averaging: an investment strategy that involves making regular dollar investments on a specified time schedule, regardless of price or direction of the market. In the long run, the investor buys more shares when the price is lower, so that the overall cost is lower than if a constant number of shares were bought at set intervals. Also known as dollar cost averaging or cost averaging.

back-end load: see contingent deferred sales charge.

balance sheet: see Statement of Assets and Liabilities.

balanced fund: a mutual fund which seeks to preserve capital and provide income to shareholders by holding a mix of bonds, common stocks, preferred stocks and short-term securities. Long-term growth of capital and income is also an objective of a balanced fund.

basis point: a unit used to measure changes in interest rates and bond yields. One basis point equals .01%, or 1/100 of 1%; 100 basis points equal 1%. A bond's yield that increased from 8.00% to 8.50% would be said to have risen 50 basis points.

bear market: a prolonged period of falling prices, typically defined as a 20% or greater drop from a market peak. A bear market in stocks is usually prompted by investors anticipating a decline in economic activity, while a bear market in bonds typically is caused by rising interest rates.

benchmark: an index or group of funds used to measure the performance of a mutual fund. Widely used benchmarks include Standard & Poor's 500 Composite Index℠ (for large-company funds), the Russell 2000® Index (small-company funds), the Morgan Stanley Capital International EAFE (Europe, Australasia, Far East) and World indexes (international and global funds) and the Lehman Brothers® Aggregate Bond Index (bond funds).

beneficiary: a person designated to receive an annuity payment, an inheritance in a will, or the proceeds of a life insurance policy or trust after the death of the owner, policyholder or plan participant.

blue chip: the stock of a nationally known company with a long record of profit growth and steady dividend payments, and a reputation for high-quality management, products and services. Examples of blue chip stocks include IBM®, General Electric® and Ford®.

board of directors: a group of individuals elected by the shareholders of a mutual fund empowered to carry out certain tasks defined in the fund's charter, such as appointing senior management, issuing additional shares and declaring dividends. Also called board of trustees.

bond: a debt instrument (IOU) issued by a corporation or government agency. In return for the use of the lender's money, the bond issuer promises to pay regular interest payments and return the principal (usually $1,000) upon maturity. A secured bond is backed by collateral which may be sold by the bondholder to satisfy a claim if the bond issuer fails to pay interest and principal. An unsecured bond, or debenture, is backed by the full faith and credit of the issuer but not by any specific collateral. Bondholders do not have any of the corporate ownership privileges of stockholders. Bonds are offered in a number of different forms, including convertible bonds, high-yield bonds, mortgage-backed bonds, municipal bonds and zero-coupon bonds.

bond fund: a mutual fund that primarily invests in bonds. Some bond funds specialize in a particular kind of bond, while others will diversify across categories.

bond rating: ratings are issued by independent rating agencies, such as Standard & Poor's and Moody's Investors Service℠. Ratings range from AAA (highly unlikely to default) to D (in default). Bonds rated BBB or above are considered investment grade.

broker: a person who acts as an intermediary between the buyer and seller of a security, usually for commission. Also, a financial professional who helps investors formulate financial plans with specific objectives and designs an investment program to help meet their needs and objectives (see financial professional). Since many brokerage firms operate both as brokers and as dealers, the term broker-dealer is often used.

bull market: a prolonged period of rising prices of stocks, bonds or commodities, generally prompted by investor optimism about company earnings and economic growth.

buy-and-hold: an investing strategy that calls for buying shares of a mutual fund and holding them for a long period. This allows the investor to participate in the long-term growth of companies and pay favorable capital gain tax rates.

capital appreciation: an increase in the value of a stock or other investment, as opposed to income from dividends or interest. See also capital growth.

capital gain: an increase in the value of a capital asset, calculated by the difference between the purchase price and the sale price of the investment. When an asset is sold, any capital gain that is realized from the sale is taxable.

capital gain distribution: the net long-term capital gain amount generated by a mutual fund from the sale of stocks or bonds, paid to shareholders on a per-share basis. Many shareholders elect to reinvest capital gain distributions, rather than take them in cash. American Funds shareholders can reinvest capital gains with no sales charge.

capital growth: an increase in the value of a stock or other investment, as opposed to income from dividends or interest. See also capital appreciation.

capitalization: see market capitalization.

cash and cash equivalents: short-term, highly liquid investments that are virtually as good as cash, such as corporate short-term notes and commercial paper. Cash equivalents generally have a maturity of less than three months.

certificate of deposit (CD): a negotiable debt instrument issued by a commercial bank to repay funds deposited for a defined period of time (usually from 14 days to several years). In addition to repaying the principal at maturity, a CD pays a market-determined interest rate. Individual CDs start at $100 and institutional CDs are issued in denominations of $100,000 or more.

Class 529 shares: named after the section of the Internal Revenue Code that created them, these shares were created to help investors save for higher education expenses through a tax-advantaged account.

Class A shares: shares sold with an up-front sales charge, which declines as the amount invested increases.

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Class B shares: shares sold without an up-front sales charge that carry higher annual expenses for a fixed period In addition, if shareholders sell shares during the first few years, they may be subject to a redemption fee, known as a contingent deferred sales charge, which declines over time.

Class C shares: shares sold without an up-front sales charge that carry higher annual expenses for a fixed period. In addition, if shareholders sell shares during the first year, they may be subject to a redemption fee, known as a contingent deferred sales charge.

collateralized mortgage obligation (CMO): a multi-class debt instrument backed by a pool of mortgage pass-through securities or mortgage loans. The issuer's obligation to make interest and principal payments is secured by the underlying portfolio.

commercial paper: short-term debt obligations (IOUs) issued by banks, corporations and other borrowers. Maturities range from two days to nine months. Though commercial paper is unsecured, it is generally backed by bank lines of credit and only issued by financially secure companies. Like bonds, commercial paper is rated by Moody's℠ and Standard & Poor's℠.

common stock: a class of securities representing ownership and control in a corporation. Common stockholders are generally entitled to vote on certain matters, such as election of directors, and may be entitled to dividends.

compounding: the ability of an asset to generate interest that is then added to principal and interest earned earlier. For example, if an investor puts $1,000 in a mutual fund that returns 10% each year, the account will be worth $1,100 at the end of the first year and $1,210 at the end of the second year. The extra $10 earned on the $100 return from the first year is the compound interest.

Consumer Price Index (CPI): used to measure changes in the general price level or inflation, the CPI measures prices of a fixed basket of goods bought by a typical consumer, including food, transportation, shelter, utilities, clothing and other items. It is widely used as a cost-of-living benchmark to adjust Social Security payments, tax brackets and other payment schedules. See also purchasing power.

contingent deferred sales charge (CDSC): an exit fee imposed on shares sold within a specified period by a mutual fund shareholder or a variable annuity contractholder. These charges are usually assessed on a sliding scale, such as 6% of amounts redeemed the first year, 5% the second year, 4% the third year, and so on. Also known as a back-end load.

convertible security: preferred stocks or bonds offering the right to exchange them for another security, usually common stock of the same company. Convertibles generally offer higher income than is available from common stock, together with greater appreciation potential than regular bonds.

correction: a sudden, temporary decline in stock or bond prices following a period of market strength. Because markets do not move straight up or down, corrections can be expected over a long-term investment horizon.

cost basis: the original price of an investment, used to determine capital gains.

coupon rate: the stated, fixed rate of interest paid by a fixed-income security, expressed as a percentage of the par value of the security. A bond with a par value of $1,000 that pays $80 a year has a coupon rate of 8%. Also called the nominal yield. See also yield.

Coverdell Education Savings Account (formerly Education IRA): an education savings account that allows parents, grandparents and others to contribute for the K–12 and higher education expenses of a child. Contributions are not tax-deductible, but withdrawals are tax-free if used for qualified expenses such as tuition and room and board. Rules for education savings accounts remain in effect until 2010 (unless extended by Congress).

credit rating: see bond rating.

credit risk: the possibility that a bond issuer will default on an obligation, i.e. fail to repay principal and interest in a timely manner. Also called default risk. See also risk.

cross-reinvesting: reinvesting dividends and/or capital gains between mutual funds of the same family.

currency futures: contracts in the futures markets for delivery in a major currency, such as the U.S. dollar, the Japanese yen or the British pound. The buyer of a currency futures contract acquires the right to purchase a particular amount of that currency by a specific date at a fixed exchange rate. These contracts are traded on exchanges throughout the world. Often used as a hedging mechanism to offset currency or interest rate risk.

CUSIP number: number identifying all stocks, registered bonds and mutual funds, assigned by the Committee on Uniform Securities Identification Procedures (CUSIP).

custodial account: an account created for the benefit of a minor, usually at a bank, mutual fund or brokerage, with an adult as custodian. The custodian manages cash and other property gifted to minors under the Uniform Gifts to Minors Act or the Uniform Transfers to Minors Act.

custodian of assets: an agent, bank, trust company or other organization that holds and safeguards the assets of a mutual fund. See custodial account.

cyclical stocks: stocks of companies whose earnings are tied to the business cycle. When economic and business conditions are good, a cyclical company prospers; when there is an economic downturn, the company suffers. Examples of cyclical stocks include housing and automobiles. Stocks of noncyclical industries such as food, insurance and pharmaceuticals are not as directly affected by economic changes.

dealer: an individual or entity that buys and sells securities for its own account. Since most brokerage firms operate both as brokers and as dealers, the term broker-dealer is commonly used.

debenture: unsecured debt backed only by the integrity of the borrower and documented by an agreement called an indenture. This differs from a secured bond, which is backed by specific collateral.

debt: a liability or obligation in the form of bonds, loan notes or mortgages owed to another person or persons and required to be paid by a specified date (maturity). Debt may or may not be secured.

debt security: another term for a bond.

defined benefit plan: a tax-deferred company retirement plan, such as a pension, in which the benefit to participants is defined in advance, based on criteria such as salary history and years of service, and in which the employer bears the investment risk.

defined contribution plan: an individual account plan, such as a 401(k), that provides a benefit based solely on the amount contributed to the participant's account plus or minus any income, expenses, gains and losses, and forfeitures that may be allocated to the account.

deflation: a decline in prices, often caused by a reduction in the supply of money or credit. The opposite of inflation.

developing markets: also known as emerging markets.

discount rate: the interest rate charged by the Federal Reserve for loans to member banks.

distribution: the payment of a dividend or capital gain realized by a mutual fund. Also, the payment of funds from a retirement or pension plan.

diversification: an investment strategy designed to reduce exposure to risk by combining a variety of investments, such as U.S. stocks, international stocks, bonds and cash, which are unlikely to all move in the same direction. Holding mutual funds with different objectives can help investors achieve diversification through the broad range of investments held in fund portfolios.

dividend: a distribution of investment income to shareholders. Dividends are taxable in the year they are received unless they are held in a tax-deferred account such as an IRA. The amount of a mutual fund dividend is authorized by the fund's board of directors.

dollar cost averaging: an investment strategy that involves the investment of fixed amounts over a specified time schedule, regardless of price or direction of the market. In the long run, investors buy more shares when the price is lower, so that the overall cost is lower than if a constant number of shares were bought at set intervals. Also known as averaging or cost averaging.

Dow Jones Industrial Average^{SM} (DJIA): a market indicator composed of 30 actively traded blue chip U.S. stocks. While the index attempts to be representative of the U.S. economy as a whole, it is somewhat heavily weighted toward industrials. The Dow is a price-weighted average, which means that the price movement of each stock is weighted equally regardless of its market capitalization.

earnings: the single most important factor in determining a stock's price, earnings represent a company's revenues minus cost of sales, operating expenses and taxes. Earnings per share are the portion of a company's profit allocated to each outstanding share of common stock.

Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA): legislation that introduced a number of significant retirement and education savings provisions intended to give investors more opportunities to reach their financial goals.

emerging markets: also known as developing markets.

Employee Retirement Income Security Act (ERISA): the 1974 federal law governing the operation of most private pension and benefit plans. The law eased pension eligibility rules and established guidelines for the management of pension funds.

equity: a security representing shares of ownership in a corporation, unlike a bond, which represents a loan to the issuer.

equity-income fund: a mutual fund that invests in a mixture of dividend-paying stocks and bonds to provide shareholders with current income and, as a secondary goal, growth of capital.

euro: the single currency adopted by 15 European countries as of January 1, 2008. Since January 1, 1999, the trading of securities and goods has been conducted only in euros. The European Central Bank oversees monetary policy.

exchange: see stock exchange.

exchange privilege: the right of a shareholder to switch from one mutual fund to another in the same family, usually at no additional charge. The IRS treats an exchange as a sale and subsequent purchase for tax purposes.

exchange rate: the price at which one currency can be converted into another currency. Most exchange rates fluctuate from day to day; others are fixed or pegged to the movement of a major currency.

executor: a person appointed by a Testator to carry out the directions and requests in his Will and to dispose of the property according to his testamentary provisions after his decease.

expense ratio: amount that shareholders pay annually for mutual fund expenses. Includes management fees, 12b-1 fees, administrative fees and operating costs. Expense ratios vary with the fund category; for example, a money market fund will generally have a lower expense ratio than a global equity fund, which has higher costs but also historically higher returns. American Funds expense ratios are all well below industry averages for most fund categories.

face value: the value of a bond, note, mortgage or other security. Most corporate bonds have a face value of $1,000, municipal bonds $5,000 and federal government bonds $10,000. Bonds fluctuate in price after they are issued, but the face value (or principal) is returned to the bondholder at maturity. Also known as par value.

Fannie Mae®: a publicly-owned, government-sponsored corporation that buys mortgages from lenders, pools them and sells them as mortgage-backed securities to investors on the open market. Though not general obligations of the U.S. Treasury, these mortgage pools are sponsored by the government and have relatively high bond ratings. Equity shares of Fannie Mae are traded on the New York Stock Exchange®. Fannie Mae was formerly called Federal National Mortgage Association.

federal agency notes & bonds: debt instruments issued by an agency of the federal government such as Fannie Mae. Though not general obligations of the U.S. Treasury, they are sponsored by the government and have relatively high bond ratings.

Federal Deposit Insurance Corporation (FDIC): a federal agency established in 1933 that insures funds on deposit (up to $100,000) in member banks and thrift institutions. Mutual fund assets are not FDIC-insured.

Federal Home Loan Mortgage Corporation (FHLMC): see Freddie Mac®.

Federal National Mortgage Association (FNMA): see Fannie Mae.

Federal Reserve Board: The seven-member Board of Governors that oversees Federal Reserve Banks, establishes monetary policy (interest rates, availability of credit, etc.) and monitors the economic health of the country.

fee-based program: a program offered by broker-dealers that permits investors to purchase mutual funds for an annual asset-based fee, rather than paying commissions or sales charges. Not all broker-dealers offer this program. Please consult your financial professional.

fiduciary: a person, company or association holding assets in trust for a beneficiary, and charged with the responsibility of investing the assets wisely. Examples of fiduciaries are executors of wills and estates, trustees and custodians.

financial professional: a financial professional who helps investors meet their needs and objectives through investments, tax planning, asset allocation, risk management, retirement planning and estate planning.

FINRA™ (Financial Industry Regulatory Authority): a non-governmental organization that regulates firms selling securities in the United States. The organization's objectives are to protect investors and ensure market integrity. Operating under the supervision of the Securities and Exchange Commission, FINRA educates investors, creates rules, enforces laws and regulations, examines securities firms and reviews their sales materials, and settles disputes. FINRA was created through the consolidation of the National Association of Securities Dealers (NASD) and the regulatory entities of the New York Stock Exchange. It also regulates The Nasdaq Stock Market®.

financial statements: the written record of the financial status of a mutual fund or company, usually published in the annual report. Includes a Statement of Assets and Liabilities, a Statement of Operations and a Statement of Changes in Net Assets.

fiscal year: an accounting period of 365 days (366 in leap years), at the end of which the corporate books are closed and profit or loss is determined. A fiscal year is not necessarily the same as the calendar year.

fixed-income fund: a mutual fund that invests in bonds and other fixed-income securities to provide shareholders with current income and to preserve capital.

fixed-income securities: securities that pay a specific interest rate, such as bonds, money market instruments and preferred stock.

floating rate note: debt instrument with a variable interest rate. Interest adjustments are made periodically and are tied to a money market index such as Treasury bill rates. They provide holders with some protection against rises in interest rates, but pay lower yields than fixed rate notes of the same maturity.

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Form 1099-DIV: a statement showing the dividends and capital gain distributions received by an account holder in the most recent tax year, sent by mutual fund companies to shareholders for tax return purposes.

Freddie Mac: government-chartered corporation that buys mortgage loans and distributes them as securities through dealers. Though not general obligations of the U.S. Treasury, these mortgage loans are sponsored by the government and have high bond ratings. Freddie Mac was formerly called Federal Home Loan Mortgage Corporation.

front-end load: a sales charge applied to the initial purchase of a mutual fund. See also load, contingent deferred sales charge (also known as back-end load) and no-load fund.

FTSE 100: the FTSE (pronounced “FOOT-see”) 100 Index represents 100 of the most highly capitalized companies on the London Stock Exchange. The FTSE is weighted by market capitalization, which means that larger companies have more of an impact than smaller ones when determining overall price movement of the index.

global fund: a mutual fund that invests in stocks or bonds throughout the world, including the United States (an international fund, on the other hand, invests only outside the U.S.). American Funds offers five global funds: New Perspective Fund, New World Fund, SMALLCAP World Fund, Capital World Growth and Income Fund, and Capital World Bond Fund.

Ginnie Mae® Government National Mortgage Association (GNMA): a government-owned agency, nicknamed Ginnie Mae, which buys mortgages from lending institutions and sells them to investors. Timely interest and principal payments on these mortgage pools are fully guaranteed by the U.S. government.

gross domestic product (GDP): the value of all goods and services produced nationwide. The GDP includes consumer and government purchases, private domestic investment, and net exports of goods and services.

growth fund: a mutual fund that seeks to provide shareholders with growth of capital by investing in companies with a history of rapidly growing earnings and generally higher price-to-earnings ratios. Growth funds are more volatile than income or money market funds, rising faster in bull markets and dropping more sharply in bear markets.

growth-and-income fund: a mutual fund that seeks to provide investors with growth of capital, as well as current income. These funds invest mainly in the common stock of companies with a history of solid growth and a record of consistent dividend payments.

growth investing: an investment style that emphasizes stocks with strong earnings and/or revenue growth or growth potential. Different from value investing, which favors buying stocks with lower price-to-earnings ratios and relatively high dividend yields, such as cyclical companies and mature industries.

growth stock: a stock that has exhibited above-average gains in earnings and is expected to maintain high levels of profit growth. Over the long run, growth stocks tend to outperform other stocks such as blue chips.

hedge: an investment made to offset the risk of adverse movements in a security, currency, interest rates or inflation rates.

high-yield bond: a bond rated BB or lower that pays a higher yield to compensate for its greater risk. These bonds are generally issued by companies without long track records of sales and earnings, or by those with questionable credit strength. Also known as a junk bond.

income fund: a mutual fund that seeks to provide current income for shareholders. Examples include bond funds and money market funds, which invest in corporate and government securities, and municipal bond funds, which invest in municipal securities that provide tax-free income. Equity-income funds seek income as their primary objective by investing in a mixture of stocks and bonds.

income stock: a stock paying relatively high and regular dividends. Industries known for income stocks include utilities, banks and insurance companies.

index: a statistical measure that shows changes in the economy or financial markets and serves as a benchmark against which economic and financial performance is measured. Examples include the Consumer Price Index and stock market indexes such as Standard & Poor's 500 Composite Index℠ and the Russell 2000® Index, which are weighted by market capitalization.

index fund: a mutual fund designed to replicate market performance by holding a portfolio that mirrors the composition of an index, such as the S&P 500.

Individual Retirement Account (IRA): a tax-deferred retirement account for individual investors. Earnings are tax-deferred (or tax-free, with a Roth IRA) until withdrawn. A 10% penalty generally applies to amounts withdrawn before age 59-1/2. Withdrawals from a traditional IRA must begin by age 70-1/2. Contributions may be deductible under certain circumstances, depending on income levels and retirement plan participation.

Individual Retirement Account (IRA) rollover: a tax-free reinvestment of a distribution from a qualified company retirement plan such as a 401(k) into an IRA. The rollover must be within 60 days of the distribution to qualify. This 60-day requirement may be waived by the IRS. An IRA rollover allows these funds to continue to accumulate tax-deferred until they are withdrawn.

inflation: the overall general upward price movement of goods and services in an economy, usually measured in the U.S. by the Consumer Price Index. Inflation is one of the major risks to investors over the long term because it erodes the purchasing power of their investments, especially slow-growing investments such as savings accounts and money market instruments.

interest: the fee charged by a lender to a borrower, usually expressed as an annual percentage of the principal. The rate depends on factors such as the credit risk and the inflation rate.

interest rate: the rate of interest charged for the use of money, usually expressed at an annual rate. The rate is derived by dividing the amount of interest by the amount of principal borrowed. For example, if a bank charged $50 per year in interest to borrow $1,000, the loan would have a 5% interest rate.

international fund: a mutual fund that invests outside the United States (a global fund, on the other hand, invests in stocks and bonds throughout the world, including the U.S.). Also called a non-U.S. fund.

Intestate: a person who dies who has not made a Will.

investment adviser: a person or organization employed by an individual or mutual fund to manage assets or provide investment advice.

investment company: a firm that invests the funds of investors in securities that meet stated investment objectives for individual or institutional clients, in return for a management fee. An investment company offers participants benefits such as diversification and professional money management. There are two types of investment companies: an open-end, or mutual fund, which has a floating number of shares and will redeem shares at any time at net asset value; and a closed-end, or investment trust, which has a fixed number of shares traded like a stock.

Investment Company Act of 1940: federal laws that regulate the registration and activities of investment companies, enforced by the Securities and Exchange Commission. The Act sets the standards by which mutual funds operate in areas such as advertising, reporting requirements, pricing and allocation of investments.

investment grade: a bond with a rating of AAA to BBB.

junk bond: a bond with a rating of BB or lower that pays a higher yield to compensate for its greater risk. These bonds are generally issued by companies without long track records of sales and earnings, or by those with questionable credit strength. Also known as a high-yield bond.

large cap: a company with a market capitalization of more than $8 billion. See also mid cap and small cap.

liability: a financial obligation, debt, claim or potential loss. Mutual fund liabilities include fund expenses and the cost of purchasing investments. The opposite of an asset.

Lipper, Inc.: a leading provider of data and analysis on mutual funds. Lipper publishes a number of indexes and averages for different categories of funds, as well as individual rankings of mutual funds in each category.

liquidity: the ability to buy or sell an asset quickly and in large volume without substantially affecting the asset's price.

load: a sales charge applied to the purchase of a mutual fund.

lump sum: a single payment for an amount due, as opposed to a series of periodic payments. People leaving a company may receive a lump-sum distribution of their pension, or beneficiaries of life insurance policies may receive a death benefit in a lump sum.

management fee: a charge paid to a mutual fund's investment adviser for its services. The annual fee is disclosed in each fund prospectus and is typically between 0.5% and 2%.

market: a public place where buyers and sellers make transactions, directly or via intermediaries. Sometimes refers to markets where securities are traded, or to the New York Stock Exchange® in particular.

market capitalization: the total market value of a company, as calculated by multiplying the company's outstanding shares by the current share price.

market timing: buying or selling securities based on economic factors such as the direction of interest rates or market indicators such as trends in stock prices and trading volume.

maturity: the date when a debt becomes due for payment. A bond due to mature on June 1, 2005, will return the bondholder's principal and final interest payment on that date. Also refers to a company or sector of the economy that is well-established and has little room for significant growth.

maximum offering price (MOP): the price of a share or value of an investment that reflects sales charges that have been assessed, unlike the net asset value, which does not account for sales charges.

mid cap: a company with a market capitalization between $1 billion and $8 billion. See also large cap and small cap.

money market: the market for short-term debt securities, such as commercial paper, certificates of deposit and Treasury bills, with a maturity of one year or less. Typically, these are safe, highly liquid investments.

money market fund: a mutual fund that invests in money market securities such as commercial paper, certificates of deposit, Treasury bills and other highly liquid and safe securities. Money market funds typically have very low expense ratios and interest is credited monthly to shareholders.

money market instruments: short-term debt securities, such as commercial paper, certificates of deposit and Treasury bills, with a maturity of one year or less. Typically, these are safe, highly liquid investments.

money purchase plan: a type of defined contribution plan in which employer contributions are mandatory and based on a percentage of employee compensation.

Morgan Stanley Capital International (MSCI) indexes: indexes maintained and produced by Morgan Stanley Capital International that track equity markets throughout the world. MSCI indexes are weighted by market capitalization and include various countries, regions and industries in both developed and emerging markets. The primary indexes are the MSCI EAFE Index and the MSCI World Index.

Morningstar®: a leading provider of data and analysis on mutual funds. Morningstar publishes reviews and commentary on mutual funds for individuals and corporations.

mortgage: a loan to finance the purchase of real estate, usually with specified payment periods and interest rates.

mortgage-backed security: a security backed by mortgages, such as those issued by Fannie Mae® and Freddie Mac®. Investors receive payments from the interest and principal on the underlying mortgages. The growth of mortgage-backed securities has helped keep mortgage money available for home financing. Also known as a pass-through security.

MSCI EAFE Index: acronym for the Europe, Australasia and Far East index produced by the Morgan Stanley Capital International (MSCI) group. Countries are represented in the index according to their approximate share of world market capitalization, and individual stocks are screened and weighted accordingly. The index is a widely-used benchmark for managers of international stock fund portfolios. See Morgan Stanley Capital International (MSCI) indexes.

MSCI World Index: an index of major world stock markets, including the U.S., produced by the Morgan Stanley Capital International (MSCI) group. Countries are represented in the index according to their approximate share of world market capitalization, and the weights are adjusted to reflect foreign currency fluctuations relative to the U.S. dollar. The index is a widely-used benchmark for managers of global stock fund portfolios.

multinational corporation: a company with production facilities or other assets in different countries that makes business decisions in a global context.

municipal bond: a bond issued by a state, city or local government to finance operations or special projects such as construction of public facilities. Interest on municipal bonds is often free of federal income taxes and/or state and local income taxes.

municipal bond fund: a mutual fund that invests in municipal bonds. Municipal bond funds are popular with investors who want to reduce their tax burden, because interest on municipal obligations is often free of federal income taxes and/or state and local income taxes.

mutual fund: a fund operated by an investment company that invests in one or more categories of assets, including stocks, bonds and money market instruments. All shareholders share in the gains and losses generated by the fund on an equal basis, proportional to the amount initially invested. Investors can redeem mutual fund shares on demand at net asset value. Mutual funds offer investors diversification and professional money management. A management fee is charged for these services, and there are other expenses, such as 12b-1 fees. Funds with a sales charge sold through brokers are called load funds, while those sold to investors directly by the fund companies are called no-load funds.

Nasdaq®: the Nasdaq® Composite Index is a measure of approximately 3,200 companies traded on the NASDAQ over-the-counter exchange. Many are technology and Internet related, although financial, consumer and industrial companies are represented as well. The NASDAQ is weighted by market capitalization, which means larger companies have more of an impact than smaller ones when determining overall price movement of the index.

NASD® (National Association of Securities Dealers℠): see FINRA™ (Financial Industry Regulation Authority).

net asset value (NAV): the market value of mutual fund shares, based on the value of the assets of the fund minus its liabilities, divided by the number of shares outstanding.

New York Stock Exchange® (NYSE®): the oldest and largest stock exchange in the U.S., located on Wall Street in New York City. Stocks, bonds and other securities are bought and sold at trading posts on the floor of the exchange. The NYSE is regulated by FINRA. Also known as the Big Board and The Exchange.

Nikkei Index©: the Nikkei (pronounced “NEE-kay”) Index is composed of 225 leading Japanese stocks traded on the Tokyo Stock Exchange. The index of blue chip Japanese companies is a price-weighted average, which means the price movement of each stock is measured equally regardless of market capitalization.

no-load fund: a mutual fund without a sales or redemption charge. No-load funds are sold directly from fund companies to shareholders, rather than through a financial professional. Despite the name, no-load funds do charge management and administrative fees.

nominal yield: the annual income received from a fixed-income security, expressed as a percentage of the par value of the security. A bond that pays $80 a year and has a par value of $1,000 has a nominal yield of 8%.

note: a short-term bond, usually with a maturity of five years or less.

over-the-counter (OTC): a security that is not traded on an organized exchange (also called an unlisted security). Over-the-counter stocks and bonds are bought and sold by brokers and dealers negotiating directly over the phone and by computer. The rules of OTC stock trading are written and enforced by FINRA™. Over-the-counter also refers to a market in which securities are traded through a telephone and computer network, rather than on the floor of an exchange.

par value: the value of a bond, note, mortgage or other security at the time it is issued. Generally, corporate bonds are issued with a par value of $1,000, municipal bonds with a par value of $5,000 and federal government bonds with a par value of $10,000. Bonds fluctuate in price after they are issued, but the par value (or principal) is returned to the bondholder at maturity. Also known as face value.

pass-through security: a security representing pooled debt obligations that passes income from debtors to its investors. The most common type is a mortgage-backed security; pass-throughs can also represent other assets such as student, credit card or automobile loans.

plan administrator: an entity or person assigned to manage a group's retirement savings plan. The plan administrator is responsible for all decisions relating to the operation of the plan.

plan sponsor: an organization or entity that offers a retirement plan to an employee group. For example, in the case of a plan maintained by a single employer, the plan sponsor is the employer. In the case of a plan maintained by one or more employers or organizations, the plan sponsor is the association, committee, joint board of trustees or other similar group of representatives of the parties involved.

portfolio: a collection of stocks, bonds and/or other investments owned by an individual, organization or mutual fund and designed to reduce risk through diversification.

portfolio counselor: an investment professional who invest the assets of shareholders.

portfolio turnover rate: the volume of a mutual fund's holdings that is sold and replaced with new securities annually, usually expressed as a percentage of the fund's total assets. A fund with a portfolio turnover of 25%, for example, holds assets for an average of about four years, while a fund with a portfolio turnover of 100% holds assets for an average of one year.

preferred stock: a type of stock which provides a specific dividend that is paid before dividends are paid to holders of common stock, and which takes precedence over common stock in the event of a company liquidation. Preferred stockholders do not usually have the voting rights that common stockholders do.

price-to-earnings (P/E) ratio: the current price of a stock divided by its earnings per share. The ratio reflects the cost of a given stock per dollar of current annual earnings and is the most common measure of a stock's expense. The higher the P/E, the more investors are paying, and therefore the more earnings growth they are expecting. High P/E stocks are typically young, fast-growing companies (growth stocks) that pay few or no dividends; while low P/E stocks tend to be low-growth, out-of-favor or blue chip companies with long records of stable earnings and dividends.

principal: the base amount invested by a mutual fund shareholder (does not include dividends or capital gains made on the investment over time).

private placement: the sale of securities directly to institutional investors, such as banks, mutual funds, insurance companies and pension funds. Unlike a public offering, a private placement does not have to be registered with the Securities and Exchange Commission, provided the securities are bought for investment purposes rather than for resale.

profit-sharing plan: a type of defined contribution plan funded with discretionary employer contributions and often tied to company profits.

prospectus: a legal document describing the history and objectives of a mutual fund, as well as the background of fund managers and key financial data such as expenses and fund assets. It is designed to provide investors with the information they need to make an informed decision about investing in a mutual fund.

proxy: a person or entity authorized to vote on behalf of shareholders, often in the election of the board of directors or resolutions submitted for the approval of fund shareholders.

public offering: the sale of new securities to public investors through an underwriting. All public offerings must meet the registration requirements of the Securities and Exchange Commission. Distinct from a private placement of new securities.

purchasing power: the value of money, as measured by the quantity and quality of products and services it can buy. As prices tend to move upwards, the purchasing power of individuals erodes over time. Purchasing power is frequently measured through the Consumer Price Index.

real rate of return: rate of return adjusted for inflation.

recession: a period of economic decline, generally defined as a decline in a country's gross domestic product for two or more consecutive quarters.

recordkeeper: a service provider that tracks participant records for a retirement plan.

redemption: the sale of mutual fund shares; also, the repayment of a bond or preferred stock issued at or prior to maturity.

research analyst: a research specialist whose primary responsibility is to develop a detailed understanding of an industry or region.

return: the annual gain or loss made on an investment. For stock mutual funds, the rate of return is determined by the level of dividends and capital gains made each year. For fixed-income securities, the return, or current yield, represents the coupon payment divided by the purchase price of the security.

rights of accumulation: the right of a mutual fund shareholder to receive a reduced sales charge based on previous investments in the same family of funds. Once the value of the shareholder's account reaches and maintains a particular breakpoint, each subsequent investment will receive the appropriate reduced sales charge.

risk: the possibility of an investment losing value. The risk level of a mutual fund depends on the types of securities held in the fund's portfolio. For example, a growth fund has more risk (and also historically higher returns) than a bond fund. Risk is often measured by looking at the volatility of an investment. Many types of risk exist, including inflation risk, interest rate risk and exchange rate risk.

rollover: a tax-free reinvestment of a distribution from a retirement plan into an IRA or other qualified plan, providing the reinvestment is completed within 60 days of the distribution. Also called IRA rollover. Or, more generally, the movement of funds from one investment to another.

Roth IRA: a type of Individual Retirement Account (IRA), which allows funds to grow tax-free, subject to certain restrictions (the account must be held for at least five years and withdrawals must be made after age 59-1/2). Taxes are paid on contributions to a Roth IRA, but qualified withdrawals are tax-free. Unlike a traditional IRA, there is no requirement to begin taking distributions at age 70-1/2.

Russell 2000® Index: a widely-used benchmark for mutual funds that invest in small-cap companies, representing 2,000 small companies with an average market capitalization of approximately $1.4 billion.

sales charge: see load

Securities and Exchange Commission (SEC): a federal regulatory agency responsible for promoting full disclosure in the securities industry and protecting investors against fraudulent and manipulative practices. All issues of securities must be registered with the SEC, and all national securities exchanges, investment firms, investment companies, financial professionals and over-the-counter brokers and dealers are supervised by the SEC. The SEC is responsible for enforcing federal laws regulating the securities industry, including the Investment Company Act of 1940.

security: a debt or equity instrument issued by a corporation, government or other organization, including stocks, bonds, notes, Treasuries and debentures.

SEP IRA: see Simplified Employee Pension (SEP) IRA.

share: a unit of ownership in a mutual fund or corporation.

shareholder: an owner of shares of a mutual fund or corporation. Mutual fund shareholders have the right to vote in the election of fund directors and other business conducted at shareholder meetings, often by proxy.

shareholder of record: the individual or entity registered as the owner of shares in a mutual fund or corporation. Shareholders generally hold accounts in their own name or in the name of their brokerage firm.

shares outstanding: shares of a mutual fund or company authorized in the charter and sold to shareholders. Shares that have been issued and subsequently repurchased by the fund or company are called treasury stock.

short-term securities: securities with a maturity of one year or less, such as money market instruments.

signature guarantee: a stamp or seal from a member firm of a domestic stock exchange or FINRA™, bank, savings association or credit union that is an eligible guarantor to authenticate a signature. A signature guarantee is typically required by a transfer agent to conduct certain transactions, such as an account ownership change. **A notary public is not an acceptable signature guarantor**.

SIMPLE IRA: a plan for small organizations that allows employees to contribute on a pretax basis, and requires the employer to make either matching contributions or a nonelective contribution for all eligible employees. These contributions are held in a special Individual Retirement Account (IRA) known as a SIMPLE IRA.

Simplified Employee Pension (SEP) IRA: a pension plan for owners of small companies in which the employer contributes to an Individual Retirement Account (IRA) on behalf of the employee. Employees do not benefit from making pretax contributions.

small cap: a company with a market capitalization below $1 billion.

Standard & Poor's 500℠ (S&P 500®): Standard & Poor's 500 Composite Index measures the change in value of 500 of the most widely held stocks on U.S. stock exchanges, which encompass a small number of companies headquartered abroad. The S&P 500 is weighted by market capitalization, which means larger companies have more of an impact than smaller ones when determining overall price movement of the index.

stock: a security representing shares of ownership in a corporation, as distinct from a bond, which represents a loan to the issuer. Owners of common stock receive dividends and are generally entitled to vote on the selection of directors and other important matters. Holders of preferred stock receive a specific dividend that is paid before any dividends are paid to holders of common stock, but they do not have voting rights.

stock exchange: a central location where securities are bought and sold. Brokers and dealers meet on the floor of the exchange to execute orders from investors to buy and sell securities. Each stock exchange sets its own requirements for membership. See New York Stock Exchange®.

stock fund: a mutual fund holding stocks. Many stock funds are designed to meet certain financial objectives, such as capital growth and dividend income. Some funds specialize in a category of stocks, such as large cap or international companies.

stock market: general term for the organized trading of securities through stock exchanges and over-the-counter. In the U.S., "the market" generally refers to the Dow Jones Industrial Average℠.

stock split: an increase in the number of shares outstanding of a company's stock. For example, if a stock with a par value of $200 splits 2-for-1, the price per share drops by half, to $100. At the same time, investors are given twice as many shares, so that the proportionate equity of each shareholder remains the same. The overall market capitalization of the company remains the same (in this example, $5 billion: 25 million x $200, or 50 million x $100). A stock with a very high share price is often split to make it more accessible to small investors.

stock symbol: a system of letters used to identify a stock or mutual fund. Symbols with up to three letters are used for stocks which trade on an exchange. Symbols with four and five letters are used for Nasdaq stocks. Symbols with five letters ending in X are used for mutual funds. Also called ticker symbol.

target date fund: a fund portfolio designed to help investors saving for retirement choose a single portfolio aligned with the year closest to their expected retirement date.

tax-deferred: term used to describe an investment on which earned income (interest, dividends and capital gains) is free from taxation until the investor begins to tap into the account. Examples include IRAs, 401(k)s and annuities.

tax-equivalent yield: the yield before taxes that a taxable bond would have to pay to be equal to the tax-free yield of a municipal bond. The tax-equivalent yield depends on an investor's tax bracket. The higher the tax bracket, the more attractive the tax-free income of a municipal bond becomes. For example, a tax-free yield of 7% is equivalent to a taxable yield of 9.3% for an investor in the 25% tax bracket and to a taxable yield of 10.4% for an investor in the 33% tax bracket.

tax-exempt fund: a mutual fund which invests in municipal bonds and is free from federal and/or state taxation. American Funds offers six tax-exempt funds.

tax-free distribution rate: the portion of dividends or capital gains paid out by a mutual fund that is free from individual taxation.

Testator: one who makes or has made a Will.

Testate: One who dies leaving a Will.

10-year Treasury note: the 10-year Treasury is widely recognized as the benchmark bond in determining interest rate trends.

ticker symbol: a system of letters used to identify a stock or mutual fund. Symbols with up to three letters are used for stocks which trade on an exchange. Symbols with four and five letters are used for Nasdaq stocks. Symbols with five letters ending in X are used for mutual funds.

total return: the gain or loss made on an investment over a certain time period, expressed as a percentage of the total amount invested. For stock mutual funds, the total return is determined by the level of dividends and capital appreciation of the holdings in the fund's portfolio. For bonds, total return represents the present value of all future coupon payments and the principal due back at maturity.

Traditional IRA: an Individual Retirement Account in which funds grow tax-deferred until they are withdrawn at age 59-1/2 or later. Mandatory distributions from a traditional IRA begin by age 70-1/2. Contributions are deductible against earned income under certain circumstances, depending on income levels and retirement plan participation.

transaction-based fee: a fee charged by a broker-dealer based on the dollar amount of a mutual fund transaction. This fee is typically charged instead of an asset-based fee.

transfer agent: an agent employed by a corporation or mutual fund to maintain shareholder records, including purchases, sales and account balances.

Treasuries: debt securities issued by the U.S. government and secured by its full faith and credit. Income from Treasury securities is exempt from state and local taxes..

Treasury bill: a short-term debt security with a maturity of one year or less issued by the U.S. government and secured by its full faith and credit. Treasury bills are issued at a discount from face value, usually $10,000, and do not pay interest. Their yields are watched closely by investors as a signal of interest rate trends. Also known as T-bills.

Treasury bond: a long-term debt security with a maturity of seven years or more issued by the U.S. government and secured by its full faith and credit. Treasury bonds are issued in minimum denominations of $1,000, pay interest semi-annually, and are exempt from state and local taxes.

Treasury note: an intermediate-term debt security with a maturity of one to seven years issued by the U.S. government and secured by its full faith and credit. Treasury notes are issued in denominations ranging from $1,000 to $1 million or more and, like other Treasuries, are exempt from state and local taxes.

treasury stock: shares that have been issued and subsequently repurchased by a mutual fund or company. They are known as treasury stock because the shares are held in the corporate treasury until they are reissued or retired. Treasury shares are not considered outstanding for the purposes of voting, dividends or earnings per share calculations.

trust: a legal arrangement in which an individual gives fiduciary control of assets to an individual or entity (the trustee) for the benefit of other individuals, called beneficiaries. A trust is often used when the assets involved are substantial, and when the creator of the trust wants to establish guidelines over how beneficiaries can use the assets.

trustee: an individual or entity holding assets in trust for the benefit of another person, called a beneficiary.

underwriter: an investment bank serving as the intermediary between an issuer of a security and the investing public. Generally, a group of investment banks assume the risk of buying a new issue of securities from a corporation or government entity and reselling them to the public. Underwriters make a profit on the difference between the price paid to the issuer of the security and the price offered to the public.

Uniform Gifts to Minors Act (UGMA): legislation that allows the transfer of assets to a minor, defined by most states as an individual under the age of 18. A custodian appointed by the donor manages the assets of an UGMA account until the child reaches majority age.

Uniform Transfers to Minors Act (UTMA): law which extends the Uniform Gift to Minors Act's definition of a gift to include real estate, fine art, patents and royalties. The law also raises the age for taking control of these assets to 21 in most states.

unit: the standard division of ownership in an annuity.

unmanaged: refers to an index or benchmark such as the S&P 500® that is not actively managed, but rather reflects movements in stock or bond markets.

up-front sales charge: a sales charge applied to the initial purchase of a mutual fund.

U.S. Treasury securities: debt securities issued by the U.S. government and secured by its full faith and credit. Income from Treasury securities is exempt from state and local taxes. Also known as Treasuries.

valuation: the process of determining the value of an asset or company. Stock analysts determine the value of a company based on current and future earnings, the market value of the company's assets and the balance sheet. A company with a high price-to-earnings ratio is said to have a high valuation or be highly valued. Bond analysts determine the value of a bond based on projections of future interest rates, and they use their valuation to determine whether a bond should be bought or sold at its current price.

value investing: an investment style that favors buying stocks with lower price-to-earnings ratios and relatively high dividend yields, such as cyclical companies and mature industries. Different from growth investing, which emphasizes stocks with strong earnings and/or revenue growth or growth potential.

variable annuity: a contract underwritten by life insurance companies that pays different amounts based on the performance of the underlying investments. This is opposed to a fixed annuity, which pays out a fixed amount for the duration of the contract. Annuities offer tax deferral and, if elected, guaranteed payments to the annuitant — the beneficiary of these payments — for a specified period of time. Annuities are sold in units, not shares. The account value of an annuity is often at least partially guaranteed by the issuer.

volatility: the size and frequency of fluctuations in the price of a security or mutual fund. Funds that hold stocks are generally more volatile than bond funds, since stocks generally have more frequent and pronounced price movements than bonds. Volatility is a key measure of the risk of a security or mutual fund. The more volatile the security, the greater the risk of losing money, though the greater risk is generally compensated by the potential for higher returns.

yield: the annual return on an investment, expressed as a percentage of the price. For stocks, yield is the annual dividend divided by the purchase price, also known as a dividend yield. For bonds, it is the coupon rate divided by the market price, called current yield. For example, a bond selling for $1,000 with a 10% coupon ($100 coupon payment) offers a 10% current yield; if that bond's price rises to $1,500, the yield would fall to 6.7%.

zero-coupon bond: a government or corporate bond which has no coupon payments and is sold at a deep discount to its face value, which the bondholder receives at maturity. The return on a zero-coupon bond is the appreciation of the security over time. Under U.S. tax law, holders of zero-coupons owe income tax on the interest that has accrued each year, even though the bondholder does not receive any cash until maturity.