UNDERSTANDING AND MANAGING RISKS

A guide to help maintain balance in your portfolio

Long-term investing has two fundamental goals: pursuing return and managing risk. Knowing the different types of risks, and how to navigate them, can help you make more informed investment decisions. While some risks cannot be controlled, others can be managed. Understanding both types may help you and your advisor create strategies to weather all types of markets.

Whether you are investing in stocks, bonds or a number of asset classes, there are different kinds of risks that may affect your holdings. Working with your financial advisor, you can identify the risks that may affect your portfolio and implement strategies to help manage your investments as you work toward your goals.

Market/Systematic risk

There are risks inherent in the entire market that can affect the prices of all securities. A weak economy, rising inflation or a falling dollar, for example, can dampen investor enthusiasm and lead to market weakness that can last for an extended period. Historically, these market trends have been relatively short-term, and therefore, should not cause you to alter your long-term strategy.

Contagion risk

Contagion risk is the possibility that bad news about a high-profile company or country can depress securities prices for an entire industry or region. Keep in mind that contagion risk is largely an outcome of emotional rather than thoughtful investing. Consider changes to your portfolio only if a company or region becomes fundamentally unsound — not because it has temporarily fallen out of favor in the marketplace.

Political risk

Changes in monetary policy, tax regulation, deregulation and/or leadership may affect or be perceived to affect certain securities or sectors, adding to overall market volatility. This risk can be found in both developed and emerging economies.

Currency risk

This is the possibility that a country's currency will decline in value on the global market, reducing the worth of investments in that country. As with political risk, the potential for changing currency values is particularly important to consider when investing internationally.

Opportunity risk

When the markets take a downturn, many investors take their money out and park it in a bank or money market account for safekeeping. However, the stated rates of return, while guaranteed, limit the return potential of those assets. In fact, a market downturn is actually one of the better times to buy securities, because their prices are depressed. If the underlying fundamentals of a stock or bond are strong — the company is sound and is simply the victim of market sentiment — then a downturn may be a great opportunity to scoop up quality securities at bargain prices.

Long-term investment objectives

- manage US and non-US market risks
- pursue returns

Risk management strategies

- asset allocation
- diversification
- dollar-cost averaging
- periodic rebalancing

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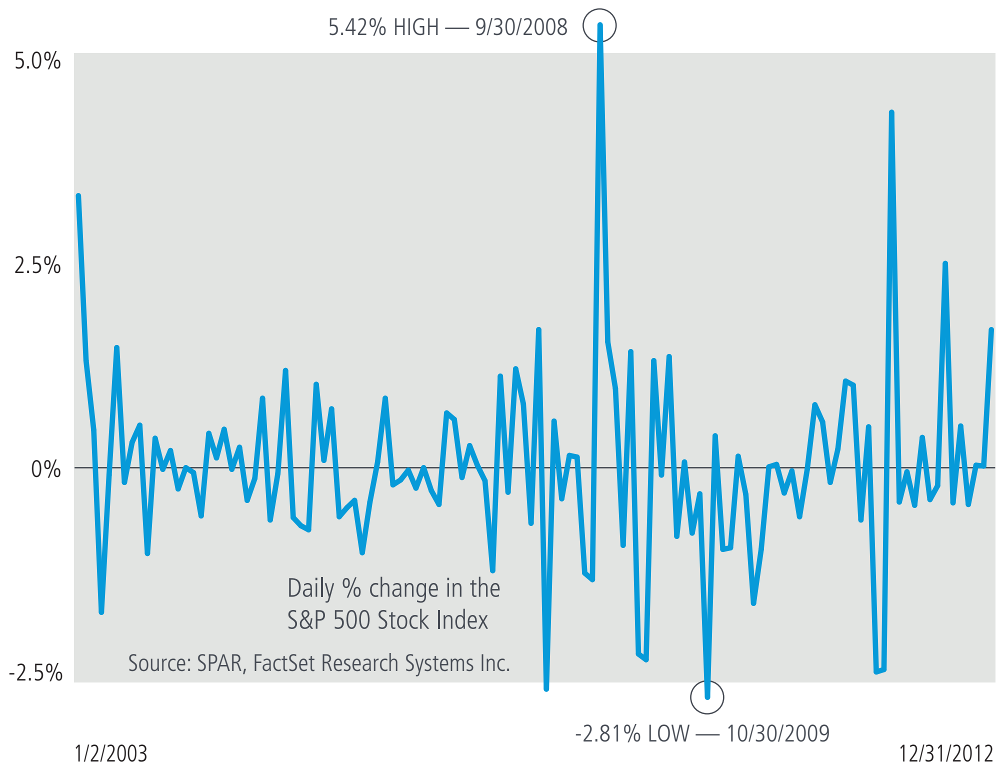
Volatility risk

Volatility is the measure of uncertainty or risk surrounding a security's value. Typically, the greater the volatility of a security, the riskier it is as an investment. Stocks historically have been more vulnerable to this risk than bond investments because they tend to be more actively traded. That said, the riskier investments typically also have higher return potential, so volatility can be tolerated if you have a long-term investment horizon. Your advisor can help you determine how much volatility risk is appropriate for you.

Stock market volatility over the past 10 years
(1/2003 to 12/2012)



Past performance does not guarantee future results.
Standard & Poor's 500 Stock Index measures the broad US stock market.

Inflation/Purchasing power risk

If the rate of inflation exceeds the rate of return on an investment, that investment's value is eroded. For instance, if the inflation rate (as measured by the cost of goods and services) is 3% and a one-year certificate of deposit (CD) is only earning 1%, assets invested in the CD are actually losing value. Long-term investors should consider keeping only a small percentage of their assets in short-term, low-interest investments to avoid the risk of losing value to inflation.

Credit risk

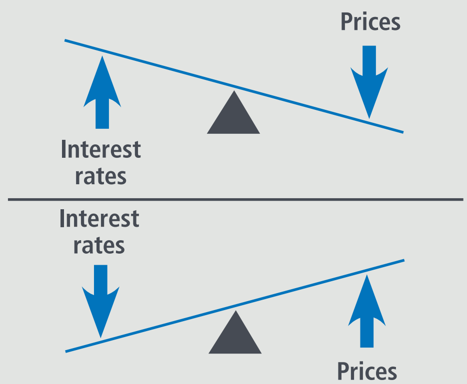
This is the possibility that a bond issuer will fail to make interest or principal payments in a timely manner because of underlying financial instability. Because a bond is essentially an IOU, any changes in an issuer's fundamental financial stability can jeopardize an issuer's ability to pay back its bondholders.

Interest rate risk

When interest rates rise, existing bonds can lose value in the marketplace because their interest payments cannot compete with newly issued bonds paying higher interest. For long-term bond investors, a buy-and-hold strategy is the best way to meet this risk. If you hold individual bonds until maturity, you will receive the full principal value, regardless of any short-term interest rate shifts. Likewise, bond fund investors can lessen interest rate risk by closely matching their bond holdings with their time horizons.

Liquidity risk

At any point in time, your assets — whether stocks, bonds or even your house — have a "fair market value," which is their value on the open market. If you need to sell your assets quickly when the market has little interest in them, you may find yourself unable to liquidate at a price that seems fair. This is liquidity risk. If your holdings, such as mutual fund shares, are being actively traded on an open market, your liquidity risk likely is low; if your assets are difficult to sell because the market for them is small (*i.e.*, few are interested in buying), this risk may be high.



Generally, when prevailing interest rates go up, the prices of existing bonds go down. That is because bond buyers typically prefer to purchase newly issued bonds with the higher coupons. Conversely, if interest rates go down, buyers are willing to pay a premium for older bonds with higher coupon rates than new bonds being issued with lower coupons.

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STRATEGIES TO HELP MANAGE RISK

Every market challenge can be met with a strategy aimed at reducing the negative effect on your portfolio. Work with your financial advisor to implement strategies that can keep your portfolio on track to work toward meeting your financial goals no matter what risks arise, keeping in mind your risk tolerance and time horizon. These strategies may include:

Allocating across all asset classes

Think about allocating your assets across all investment classes, including stocks, bonds and short-term instruments such as money market funds. Asset classes typically do not move in tandem with each other, so allocating across asset classes can lessen the volatility in your overall portfolio.

Diversifying stocks by region/industry

Diversifying your holdings within the US and globally ensures that your portfolio is not overly exposed to the volatility of only one country's market. A mix of large and small companies, growth and value stocks and holdings in various industries or countries can reduce the amount of market risk and volatility that your portfolio experiences.

Diversifying bonds by type and maturity

A mix of fixed-income securities that vary in type (such as corporate, government and municipal) can help lower your overall credit risk. Similarly, varying the length of maturity for your bond holdings may help reduce your portfolio's inflation and interest rate risk.

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Rebalancing periodically with market shifts

Your portfolio is dynamic. Over time, as the bond and stock markets rise and fall, you may have to revisit your mix of assets to make sure you still have the right balance of stocks, bonds and cash or cash equivalents (such as money markets). You may have to periodically rebalance your mix to prevent a significant rise or fall in the stock market from altering your target allocation and leaving your portfolio with a risk level that doesn't match your goals.

Dollar-cost averaging as you invest

If you regularly invest a fixed amount in stocks or bonds that match your needs, you effectively buy more securities or fund shares when stock prices drop and fewer when prices increase. With this method, you won't be over-investing in inflated securities or underinvesting when prices are down and good values can be found.

THE VALUE OF ADVICE

Of course, it is important to work with your financial advisor to fully understand the risks associated with any investment. He or she can guide you in trying to find the right risk/reward balance for your situation and build a well-diversified portfolio in line with your long-term goals. Your advisor can help you

- create a diversified portfolio that allows you to pursue the highest potential return for a certain level of risk over time
- develop strategies to help reduce exposure to the downside risks of your portfolio holdings
- put together an investment plan that helps you stay on track to reach your financial goals
- rebalance your portfolio periodically as markets rise and fall to ensure your equity and fixed-income allocations remain in line with your goals and risk tolerance.

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