

# Glossary

This file is not meant to be printed; it is 35 pages! We have created this helpful PDF so that you can find a term you want to better understand and click to be taken to the term's definition within this document. *Printing bad...clicking good.*

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## A

### Actively-managed fund

Managers of actively managed mutual funds buy and sell investments to achieve a particular goal, such as providing a certain level of return or beating a relevant benchmark.

As a result, they generally trade much more frequently than managers of passively managed funds whose goal is to mirror the performance of the index the fund tracks.

While actively managed funds may provide stronger returns than index funds over the long term, they often have higher management fees and provide more taxable income.

### Asset allocation

Asset allocation is a strategy, advocated by modern portfolio theory, for reducing risk in your investment portfolio in order to maximize return by investing in a diversified group of investments which tend to perform differently during different market environments. Asset allocation divides your assets among different broad categories of investments, called asset classes, such as stock, bonds, and cash.

An asset allocation model—specifically the percentages of your investment principal allocated to each asset class you're using—that's appropriate for you at any given time depends on many factors, such as the goals you're investing to achieve, how much time you have to invest, your tolerance for risk, the direction of interest rates, and the market outlook.

Ideally, you adjust or rebalance your portfolio from time to time to bring the allocation back in line with the model you've selected. Or, you might realign your model as your financial goals, your time frame, or the market situation changes.

## B

### Benchmark

Investment benchmarks are hypothetical investment portfolios that show how a specific set of assets performed over a specific period of time. These portfolios can help investors evaluate how their investments are performing versus how the benchmark is performing over the same time period. Unless you have a benchmark or standard, by which you can judge your investments' performance, you cannot know how your investments are doing.

Investors select benchmarks based on asset classes (equities, bonds, cash), size or capitalization (large-, mid-, and small-capitalization stocks), geography (international,

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regional, and emerging markets stocks and bonds), issuer (government versus private bonds), and investment style (value versus growth

## Bond

Bonds are debt securities issued by corporations and governments.

Bonds are, in fact, loans that you and other investors make to the issuers in return for the promise of being paid interest, usually but not always at a fixed rate, over the loan term.

The issuer also promises to repay the loan principal at maturity, on time, and in full.

Because most bonds pay interest on a regular basis, they are also described as fixed-income investments. While the term bond is used generically to describe all debt securities, bonds are specifically long-term investments, with maturities longer than ten years. (See also “Fixed Income Investments”.)

## Bond fund

A bond mutual fund sells shares in the fund to investors and uses the money it raises to invest in a portfolio of bonds to meet its investment objective—typically to provide regular income.

The appeal of bond funds is that you can usually invest a much smaller amount of money than you would need to buy a portfolio of bonds, making it easier to diversify your fixed-income investments. Another appeal of bond funds is that they are much more liquid than individual bonds, meaning you can get your investment back much quicker and easier.

Unlike individual bonds, however, bond funds have no maturity date and no guaranteed interest rate because their portfolios aren't fixed. Also unlike individual bonds, they don't promise to return your principal.

You can choose among a variety of bond funds with different investment strategies and levels of risk. Some funds invest in long-term, and others in short-term, bonds. Some buy government bonds, while others buy corporate bonds or municipal bonds. Finally, some buy investment-grade bonds, while others focus on high-yield bonds.

## C

### Capital gains distribution

When mutual fund companies sell investments that have increased in value, the profits, or capital gains, are passed on to their shareholders as capital gains distributions.

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These distributions are made on a regular schedule, often at the end of the year and are taxable at your regular capital gain rates, unless the funds are held in a tax-deferred or tax-free account.

Most funds offer the option of automatically reinvesting all or part of your capital gains distributions to buy more shares of the mutual fund.

## Capital gains tax

A capital gains tax is due on profits you realize on the sale of a capital asset, such as stock, bonds, or real estate.

Long-term gains, on assets you own more than a year, are taxed at a lower rate than ordinary income while short-term gains are taxed at your regular rate.

The long-term capital gains tax rates on most investments is 15% for anyone whose marginal federal tax rate is 25% or higher, and 5% for anyone whose marginal rate is 10% or 15%. There are some exceptions. For example, long-term gains on collectibles are taxed at 28%.

You are exempt from capital gains tax on profits of up to \$250,000 on the sale of your primary home if you're single and up to \$500,000 if you're married and file a joint return, provided you meet the other requirements for this exemption.

## Catch-up contribution

You are entitled to make an annual catch-up contribution to your employer sponsored retirement savings plan and individual retirement account (IRA) if you're 50 or older. The catch-up amounts, which are larger for employer plans than for IRAs, increase from time to time based on the rate of inflation. If you participate in an employer plan and also put money in an IRA, you are entitled to use both catch-up options.

## Common stock

When you own common stock, your shares represent ownership in the corporation and give you the right to vote for the company's board of directors and benefit from its financial success.

You may receive a portion of the company's profits as dividend payments if the board of directors declares a dividend. You also have the right to sell your stock and realize a capital gain if the share value increases.

But if the company falters and the price falls, your investment could lose some or all of its value.

## Convertible bond

Convertible bonds are corporate bonds that give you the option of converting their value into common stock of that company or redeeming them for cash when they mature.

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The details governing the conversion, such as the number of shares of stock you would receive, are set when the bonds are issued.

A convertible bond has a double appeal for investors: Its market value goes up if the stock price rises, but falls only to what it would be as a conventional bond if the stock prices fall. In other words, the upside potential is considered greater than the downside risk. While convertible bonds typically provide lower yields than conventional bonds from the same issuer, they may provide higher yields than the underlying stock.

## Corporate bond

Corporate bonds are debt securities issued by publicly held corporations to raise money for expansion or other business needs.

Corporate bonds typically pay a higher rate of interest than federal or municipal government bonds but the interest you earn is generally fully taxable.

You may be able to buy corporate bonds when issued or you may buy bonds in the secondary market at their current market price, which may be higher or lower than their price when issued. However, most individual investors buy corporate bonds through a mutual fund that specializes in those issues.

## Correlation

In investment terms, correlation is the extent to which the values of different types of investments move in tandem with one another in response to changing economic and market conditions.

Correlation is measured on a scale of -1 to +1. Investments with a correlation of +.5 to +1 tend to rise and fall in value at the same time. Investments with a negative correlation of -.5 to -1 are more likely to gain or lose value in opposing cycles.

## Cost basis

The cost basis is the original price of an asset—usually the purchase price plus commissions. You use the cost basis to calculate capital gains and capital losses, depreciation, and return on investment.

If you inherit assets, such as stocks or real estate, your cost basis is the asset's value on the date the person who left it to you died (or the date on which his or her estate was valued). This new valuation is known as a step-up in basis.

For example, if you buy a stock at \$20 a share and sell it for \$50 a share, your cost basis is \$20. If you sell, you owe capital gains tax on the \$30-a-share profit.

If you inherit stock that was bought at \$20 a share but valued at \$50 a share when that person died, your cost basis would be \$50 a share, and you'd owe no tax if you sold it at that price.

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## Custodial account

If you want to make investments on a minor's behalf, or transfer property you own to that person, you can open a custodial account with a bank, brokerage firm, mutual fund company, or insurance company.

You name an adult custodian for the account—either yourself or someone else—who is responsible for managing the account until the child reaches the age of majority.

That age may be 18, 21, or 25 depending on the state and the type of account you choose. At majority, the child has the legal right to control the account and use the assets as he or she chooses.

There may be some tax advantages in transferring assets to a minor. If the child is under 18, investment earnings below a specific level that Congress sets each year are taxed at the child's (presumably) lower marginal tax rate. For earnings above that specific level the child is taxed at their parents' marginal tax rate.

But if the child is 18 or older, all investment earnings are taxed at the child's rate—again, typically the lowest rate. In addition, gifts you make to the account are no longer part of your estate, which may reduce vulnerability to estate taxes. However, it's wise to review your plans with your legal and tax advisers.

One drawback of a custodial account is that the assets are considered the property of the child, and may reduce the amount of financial aid the child qualifies for when he or she enrolls in a college or university.

## D

### Defined contribution plan

In a defined contribution retirement plan, the benefits—that is, what you can expect to accumulate and ultimately withdraw from the plan—are not predetermined, as they are with a defined benefit plan.

Instead, the retirement income you receive will depend on how much is contributed to the plan, how it is invested, and what the return on the investment is.

One advantage of defined contribution plans, such as 401(k)s, 403(b)s, 457s, and profit-sharing plans, is that you often have some control over how your retirement dollars are invested. Your choice may include stock or bond mutual funds, annuities, guaranteed investment contracts (GICs), company stock, cash equivalents, or a combination of these choices.

An added benefit is that, if you switch jobs, you can take your accumulated retirement assets with you, either rolling them into an individual retirement plan (IRA) or a new employer's plan if the plan accepts transfers.

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## Diversification

Diversification is an investment strategy in which you spread your investment dollars among different sectors, industries, and securities within a number of asset classes.

A well-diversified stock portfolio, for example, might include small-, medium-, and large-cap domestic stocks, stocks in six or more sectors or industries, and international stocks. The goal is to protect the value of your overall portfolio in case a single security or market sector takes a serious downturn.

Diversification can help insulate your portfolio against market and management risks without significantly reducing the level of return you want. But finding the diversification mix that's right for your portfolio depends on your age, your assets, your tolerance for risk, and your investment goals.

## Dividend

Corporations may pay part of their earnings as dividends to you and other shareholders as a return on your investment. These dividends, which are often declared quarterly, are usually in the form of cash, but may be paid as additional shares or scrip. You may be able to reinvest cash dividends automatically to buy additional shares if the corporation offers a dividend reinvestment program (DRIP).

Mutual funds may also issue dividends to their shareholders on a monthly, quarterly, or yearly basis.

Dividends are taxable unless you own the investment through a tax-deferred account, such as an employer sponsored retirement plan or individual retirement annuity (IRA). That applies whether you reinvest them or not. However, dividends on most U.S. and many international stocks are considered qualifying dividends. That means you owe tax at your long-term capital gains rate provided you have owned the stocks the required length of time.

## E

### Early withdrawal

If you withdraw assets from a fixed-term investment, such as a certificate of deposit (CD), before it matures, it is considered an early withdrawal.

If you withdraw from an individual retirement account (IRA) or tax-deferred retirement savings plan before you turn 59 1/2, it is also considered early.

If you withdraw early, you usually have to pay a penalty imposed by the issuer (in the case of a CD) or the government (if it's an IRA or other tax-deferred or tax-free savings plan). However, you may be able to use the money in your account without penalty under certain circumstances. For example, if you withdraw IRA assets to pay for higher

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education, to buy a first home, or for other qualified reasons, the penalty is waived. But taxes will still be due on the tax-deferred portion of the withdrawal.

## Emerging markets fund

Emerging markets mutual funds invest primarily in the securities of countries in the process of building a market-based economy. Some funds specialize in the markets of a certain region, such as Latin America or Southeast Asia. Others invest in a global cross-section of countries and regions.

## Equity

In the broadest sense, equity means ownership. If you own stock, you have equity in, or own a portion—however small—of the company that issued the stock. Having equity is the opposite of owning a bond or commercial paper, which is a debt the company must repay to you.

Equity also means the difference between an asset's current market value—the amount it could be sold for—and any debt or claim against it. This is true if you own stock in a margin account. The stock may be worth \$50,000 in the marketplace, but if you have a loan balance of \$20,000 in your margin account because you financed the purchase, your equity in the stock is \$30,000.

## Equity fund

Equity funds are mutual funds that invest primarily in stock. The stock a fund buys—whether in small, up-and-coming companies or large, well-established firms—depends on the fund's investment objectives and management style.

## Exchange-traded fund (ETF)

Exchange-traded funds (ETFs) are listed on a stock exchange and trade like stock. You can use traditional stock trading techniques, such as stop orders, limit orders, margin purchases, and short sales when you buy or sell ETFs.

But ETFs also resemble mutual funds in some ways. For example, you buy shares of the ETF, which in turn owns a portfolio of stocks. ETF prices change throughout the trading day, in response to supply and demand, rather than just at the end of the trading day as open-end mutual fund prices do.

## Expense ratio

An expense ratio is the annualized percentage of a mutual fund's total assets deducted to cover operating and management expenses. Those expenses include employee salaries, custodial and transfer fees, distribution, marketing, and other costs of offering the fund. For example, if you own shares in a fund with a 1.25% expense ratio, \$1.25 of every

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\$100 is going toward fund expenses, or \$12.50 on an account valued at \$1,000. Since operating expenses are subtracted from the fund's assets they lower the return of the fund's investors. To continue with our previous example, if the fund earns a return of 5% in one year, shareholders who held that fund during the year only would have earned 3.75

Expense ratios vary from one fund company to another and among different types of funds. Typically, international equity funds have among the highest expense ratios, and index funds among the lowest.

## F

### Fiduciary

A fiduciary is an individual or organization legally responsible for holding or investing assets on behalf of someone else, usually called the beneficiary. The assets must be managed in the best interests of the beneficiary, not for the personal gain of the fiduciary.

However, the concept of acting responsibly can be broadly interpreted. For some fiduciaries, it may mean that their objective is to preserve principal in their clients' portfolios, and for others it could mean producing reasonable growth.

Executors, trustees, guardians, and agents with powers of attorney are examples of individuals with fiduciary responsibility. Firms known as registered investment advisers (RIAs), such as RamseyInvesting.com, are also fiduciaries.

### Financial planner

A financial planner evaluates your personal finances and helps you develop a financial plan to meet both your immediate needs and your long-term goals. Some, but not all, planners have credentials from professional organizations.

Some well-known credentials are Certified Financial Planner (CFP), Chartered Financial Consultant (ChFC), Certified Investment Management Analyst (CIMA), and Personal Financial Specialist (PFS).

A PFS is a Certified Public Accountant (CPA) who has passed an exam on financial planning. Some planners are also licensed to sell certain investment or insurance products.

Fee-only financial planners, such as RamseyInvesting.com, charge a percentage of assets under management, while others charge by the hour or collect a flat fee for a specific service. However, fee-only planners never sell products or earn sales commissions. Other planners don't charge a fee but earn commissions on the products they sell to you. Still others both charge fees and earn commissions but may offset their fees by the amount of commission they earn.

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## Fixed-income investment

Fixed-income investments typically pay interest or dividends on a regular schedule and may promise to return your principal at maturity, though that promise is not guaranteed in some cases. Examples of fixed income investments are government, corporate, and municipal bonds, preferred stock, and guaranteed investment contracts (GICs).

The advantage of holding fixed-income securities in an investment portfolio is that they provide regular, predictable income. But a potential disadvantage of holding them over an extended period, or to maturity in the case of bonds, is that they may not increase in value the way equity investments may. As a result, a portfolio overweight with fixed-income investments may make you more vulnerable to inflation risk.

## Form ADV

All investment advisory firms must register by filing a Form ADV either with the Securities and Exchange Commission or with the state securities regulator in the state where they principally work, depending on the amount of assets they manage.

The form is divided into two sections. Part 1 provides information about past disciplinary actions, if any, against the adviser. Part 2 summarizes the adviser's background, investment strategies, services, and fees.

If an advisory firm is registered with the SEC, you can obtain copies of Form ADV at the SEC's Investment Adviser Public Disclosure (IAPD) website ([www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov)).

Otherwise, you can request it directly from the adviser or your state securities regulator. You can find contact information on the website of the North American Securities Administrators Association ([www.nasaa.org](http://www.nasaa.org)).

## G

### Global fund

Global, or world, mutual funds invest in U.S. securities as well as those of other countries. In that way, they differ from international funds, which invest only in non-U.S. markets.

### Government bond

The term government bond is used to describe the debt securities issued by a government. In the U.S. they are issued by the federal government. Examples are U.S. Treasury bills, notes, and bonds. They're also known as government obligations. You can buy and sell these issues directly using a Treasury Direct account or through a broker.

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Treasuries are backed by the full faith and credit of the U.S. government and the interest they pay is exempt from state and local, though not federal, income taxes. The cash raised by the sale of treasuries is used to finance a variety of government activities.

Debt instruments issued by government agencies are also described as government bonds, or government securities, though they are not backed by the full faith and credit of the U.S. government. For example, bonds issued by the Government National Mortgage Association (Ginnie Mae) and the Tennessee Valley Authority (TVA) are government bonds.

## Green fund

A mutual fund that selects investments based on a commitment to environmental principles may be described as a green fund.

Not all green funds stress exactly the same values. A fund that seeks environmentally friendly businesses—say those that use alternative fuels—may not be concerned about what those companies manufacture.

Another fund may avoid any company in what it considers an unacceptable industry, despite the company's individual environmental record. In every case, the fund's approach is described in its prospectus.

## Growth and income fund

Growth and income mutual funds invest in securities that provide, as their name suggests, a combination of growth and income.

This type of fund generally funnels assets into common stocks of well-established companies that pay regular dividends and increase in value at a regular, if modest, rate. The balance of the fund's portfolio is in high-rated bonds and preferred stock.

# H

## High-yield bond

High-yield bonds (aka “junk bonds”) are bonds whose ratings from independent rating services are below investment grade.

As a result, to attract investors, issuers of high-yield bonds must pay a higher rate of interest than the rates that issuers of higher-rated bonds with the same maturity are paying. The higher rate translates to more income, which is the higher yield.

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## I

### Income fund

Income funds are mutual funds whose investment objective is to produce current income rather than long-term growth, typically by investing in bonds or sometimes a combination of bonds and preferred stock. Investors, especially those who have retired or are about to retire, may prefer income funds to potentially more volatile growth funds.

The amount of income a fund may generate is related to the risk posed by the investments that the fund makes and the return they generate. A fund that buys lower-grade bonds may provide substantially more income than a fund buying investment-grade bonds. But the same fund may also put your principal, or investment amount, at substantial risk.

### Index fund

An index fund is designed to mirror the performance of a stock or bond index, such as Standard & Poor's 500 Index (S&P 500) or the Russell 2000 Index. To achieve that goal, the fund purchases all of the securities in the index, or a representative sample of them, and adds or sells investments only when the securities in the index change. Each index fund aims to keep pace with its underlying index, not outperform it.

This strategy can produce strong returns during a bull market, when the index reflects increasing prices. But it may produce disappointing returns during economic downturns, when an actively managed fund might be able to take advantage of investment opportunities that may arise.

Because the typical index fund's portfolio is not actively managed, most index funds have lower-than-average management costs and smaller expense ratios. However, not all index funds tracking the same index provide the same level of performance, in large part because of different fee structures.

### Individual retirement arrangement (IRA)

Individual retirement arrangements (IRAs) provide tax incentives to encourage people who earn income to save for retirement.

There are two types of IRAs: tax-deferred traditional accounts and tax-free Roth accounts. With either type you usually can't make withdrawals without penalty before you turn 59 1/2. (More information on Roth IRAs below.)

With a traditional IRA you must begin to take required minimum distributions (RMD) by April 1 of the year following the year you turn 70 1/2. Earnings and deductible contributions are taxed at your regular rate as you withdraw.

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You can contribute to a traditional IRA regardless of your income, and you may qualify to deduct your contribution if your modified adjusted gross income is less than the ceiling for your tax filing status. You also qualify if you're not eligible to participate in an employer sponsored plan where you work.

You qualify for a Roth if your modified adjusted gross income is less than the ceiling for your filing status.

## Institutional fund

An institutional fund is a mutual fund that's available to large investors, such as pension funds and not-for-profit organizations, with substantial amounts to invest, or to smaller investors who work with an investment advisor, such as RamseyInvesting.com.

Typical institutional funds have higher minimum investments but lower fees than the retail funds that are available to the general public.

## Intermediate-term bond

Intermediate-term bonds mature in two to ten years from the date of issue.

## Internal rate of return (IRR)

The IRR of an investment is the interest rate at which the net present value of costs (negative cash flows) of the investment equals the net present value of the benefits (positive cash flows) of the investment.

Internal rates of return are commonly used to evaluate the desirability of investments or projects. The higher a project's internal rate of return, the more desirable it is to undertake the project. Assuming all projects require the same amount of up-front investment, the project with the highest IRR would be considered the best and undertaken first.

When used in context with personal investments, the IRR is the actual rate of return for investments because it takes into account the timing and size of cash flows in and out of the account.

## International fund

This type of mutual fund invests in stocks, bonds, or cash equivalents that are traded in non-U.S. markets, or in indexes that track international markets.

Like other funds, international funds have investment objectives and strategies, and pose some level of risk, such as the risk that currency fluctuations may greatly affect the fund's value.

Some international funds focus on countries with established economies, some on emerging markets, and some on a mix of the two.

U.S. investors may buy funds that invest in other markets to diversify their portfolios, since owning a fund is usually simpler than investing in individual securities abroad.

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A different group of funds, called global or world funds, also invest in overseas markets but also invest in securities issued in the U.S..

## Investment horizon

Your investment horizon is the length of time that you plan on holding a particular investment in order to achieve your specific investment goal. That horizon, sometimes called your time frame, may be fixed or flexible, depending on the nature of the goal and the investment decisions you take.

For example, paying for college is often a fixed goal because most students enroll the year they graduate from high school. Retirement may be a more flexible goal if you have the choice about when you will stop working.

The landscape can be more complicated if you have more than one investment goal, and therefore there's more than one horizon in the picture.

## IRA rollover

If you move assets from an existing individual retirement arrangement (IRA) or an employer sponsored retirement plan (i.e. 401(k) or 403(b)) to an IRA, you've completed an IRA rollover.

You owe no income tax on the money you move if you deposit the full amount into the new IRA within 60 days or arrange a direct transfer from the existing account to the new account.

If you're moving money from an employer's retirement plan to a rollover IRA yourself, the plan administrator is required to withhold 20% of the total.

That amount is refunded after you file your income tax return, provided you've deposited the full amount into the new account on time, including the 20% that's been withheld. Any amount you don't deposit within the 60-day period is considered an early withdrawal and you'll have to pay tax on it.

You might also have to pay a penalty for early withdrawal if you're younger than 59 1/2. But if you arrange a direct transfer from your plan to the rollover IRA nothing is withheld.

## J

None

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## K

### Keogh plan

Also known as an HR(10) plan , a Keogh is a tax deferred pension plan available to self-employed individuals or unincorporated businesses for retirement purposes. They include profit sharing plans, money purchase plans, and defined contribution or defined benefit plans.

Keoghs are known to have more administrative burdens and higher upkeep costs than Simplified Employee Pension (SEP) plans, but the contribution limits are higher, making Keoghs a popular option for many business owners and proprietors. The employer, not the employee, makes the contributions to Keogh plans, but the employee typically chooses the way the contributions are invested. Any earnings in an employee's account accumulate tax deferred, and withdrawals from the account are taxed at regular income tax rates.

If you're eligible to establish a qualified retirement plan, a Keogh may be attractive because there are several ways to structure the plan, you may be able to shelter more money than with other plans by electing the defined benefit alternative, and you have more control in establishing which employees qualify for the plan. However, the reporting requirements can be complex, making it wise to have professional help in setting up and administering a plan.

## L

### Load

If you buy a mutual fund through a broker or other financial professional, you pay a sales charge or commission, also called a load. The charge is generally figured as a percentage of your investment amount. Most load funds are sold by brokers or other investment professionals. The sales charge compensates them for their time.

If the charge is levied when you purchase the shares, it's called a front-end load. If you pay when you sell shares, it's called a back-end load or contingent deferred sales charge.

A level load, or 12b-1 fee , is an annual charge deducted from an investor's mutual fund assets to pay for distribution and marketing costs for as long as the investor holds the fund.

### Long-term capital gain (or loss)

When you sell a capital asset that you have owned for more than a year at a higher price than you paid to buy it, any profit on the sale is considered a long-term capital gain.

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If you sell for less than you paid to purchase the asset, you have a long-term capital loss.

Unlike short-term gains, which are taxed at your income tax rate, most long-term gains on most investments, including real estate and securities, are taxed at rates lower than the rates on ordinary income. You can deduct your long-term losses from your long-term gains, and your short-term losses from your short-term gains, to reduce the amount on which potential tax may be due. You may also be able to deduct up to \$3,000 in accumulated long-term losses from your ordinary income and carry forward losses you can't use in one tax year to deduct in the next tax year.

## M

### Management fee

A management fee is the percentage of your account value that an investment company or manager charges to handle your account.

Fees for passively managed index funds typically cost less than the fees for actively managed funds, though fees differ significantly from one fund company to another.

### Money market fund

Money market mutual funds invest in stable, short-term debt securities, such as commercial paper, Treasury bills, and certificates of deposit (CDs), and other short-term instruments.

The fund's management tries to maintain the value of each share in the fund at \$1.

Unlike bank money market accounts, money market mutual funds are not insured by the Federal Deposit Insurance Corporation (FDIC). However, since they're considered securities at most brokerage firms, they may be insured by the Securities Investor Protection Corporation (SIPC) against the bankruptcy of the firm. In addition, some funds offer private insurance comparable to FDIC coverage.

Tax-free money market funds invest in short-term municipal bonds and other tax-exempt short-term debt. No federal income tax is due on income distributions from these funds, and in some cases no state income tax.

While taxable funds may offer a slightly higher yield than tax-free funds, you pay income tax on all earnings distributions.

Many money market funds offer check-writing privileges, which do not trigger capital gains or losses, as writing a check against the value of a stock or bond fund would.

# Glossary

## Municipal bond fund

Municipal bond mutual funds invest in municipal bonds. Earnings from these funds are always free of federal income tax for all shareholders in the fund.

In addition, some mutual fund companies offer funds that invest exclusively in municipal bonds offered by a single state, which allows investors who live in that state to not pay state income tax, also.

One advantage of buying muni bond funds over individual muni bonds is that buyers can invest a much smaller amount of money than they would need to buy a municipal bond on their own. Another advantage of these funds is that they pay income monthly rather than semi-annually.

## Mutual fund

A mutual fund is a professionally managed investment product that sells shares to investors and pools the capital it raises to purchase investments.

A fund typically buys a diversified portfolio of stock, bonds, and money market securities, or a combination of stock and bonds, depending on the investment objectives of the fund. Mutual funds may also hold other investments, such as derivatives.

A fund that makes a continuous offering of its shares to the public and will buy any shares an investor wishes to redeem, or sell back, is known as an open-end fund. An open-end fund trades at net asset value (NAV).

Load funds—those that charge upfront or back-end sales fees—are sold through brokers or financial advisers. No-load funds are sold directly to investors by the investment company offering the fund. These funds, which don't charge sales fees, may use 12b-1 fees to pass on the cost of providing shareholder services.

All mutual funds charge management fees, though at different rates, and they may also levy other fees and charges, which are reported as the fund's expense ratio. These costs plus the trading costs, which aren't included in the expense ratio, reduce the return you realize from investing in the fund.

A fund that sells its shares to the public only until sales reach a predetermined level is known as a closed-end fund. The shares of a closed end fund trade in the market place the way common stock does, as opposed to its NAV.

## N

### Net asset value

The NAV is the dollar value of one share of a fund. It's calculated by totaling the value of the entire fund's holdings plus money waiting to be invested, subtracting operating expenses, and dividing by the number of outstanding shares.

# Glossary

The NAV is the price per share an open-end mutual fund pays when you redeem, or sell back, your shares. With no-load mutual funds, the NAV and the offering price, or what you pay to buy a share, are the same. With front-load funds, the offering price is the sum of the NAV and the sales charge per share and is sometimes known as the maximum offering price (MOP).

The NAV of an exchange traded fund (ETF) or a closed-end mutual fund may be higher or lower than the market price of a share of the fund. With an ETF, though, the difference is usually quite small because of a unique mechanism that allows institutional investors to buy or redeem large blocks of shares at the NAV with in-kind baskets of the fund's stocks.

## No-load mutual fund

You can buy a no-load mutual fund directly from the investment company that sponsors the fund. You pay no sales charge, or load, on the fund when you buy or sell shares. However, you may be charged a redemption fee if you sell before a certain time has elapsed in order to limit short-term turnover.

Some fund companies charge an annual fee, called a 12b-1 fee, to offset their marketing costs. Your share of this fee is a percentage of the value of your holdings in the fund.

You may also be able to buy no-load funds through a mutual fund network, sometimes known as a mutual fund supermarket, typically sponsored by a discount brokerage firm such as Schwab or Fidelity. If you have an account with the firm, you can choose among no-load funds sponsored by a number of different investment companies.

Load funds and no-load funds making similar investments tend to produce almost equivalent total returns over the long term—say ten years or more. But it can take an investor nearly that long to offset the higher cost of buying load funds.

## O

### Overweight

When you own more of a security, an asset class, or a subclass than your target asset allocation calls for, you are said to be overweight in that security, asset class, or subclass.

For example, if you have decided to invest 60% of your portfolio in stock and other equity investments, but your equity holdings account for 80% of your portfolio, you are overweight in equity.

In another use of the term, a securities analyst might recommend overweighting a particular security, which you might reasonably interpret as advice to buy.

# Glossary

## P

### Passively-managed fund

An index mutual fund or exchange traded fund is described as passively managed because the securities in its portfolio change only when the make-up of the index it tracks is changed.

For example, a mutual fund that tracks the Standard & Poor's 500 Index buys and sells only when the S&P index committee announces which companies have been added to and dropped from the index.

In contrast, when mutual funds are actively managed, their managers select investments with an eye to enabling the fund to achieve its investment objective and outperform its benchmark index. Their portfolios tend to change more frequently as a result. They also tend to have higher fees.

The performance of passively managed indexed investments and their risk profiles tend to correspond closely to the asset class or subclass that the index tracks. They tend to be more popular in bull markets when their returns reflect the market strength and less popular in bear markets when active managers may provide stronger returns.

### Portfolio

If you own more than one security, you have an investment portfolio.

You build your portfolio by buying additional stock, bonds, annuities, mutual funds, or other investments. Your goal is to increase the portfolio's value by selecting investments that you believe will go up in price.

According to modern portfolio theory, you can reduce your investment risk by creating a diversified portfolio that includes different asset classes and individual securities chosen from different segments, or subclasses, of those asset classes. That diversification is designed to take advantage of the potential for strong returns from at least some of the portfolio's investments in any economic climate.

### Portfolio manager

A portfolio manager is responsible for overseeing a collection of investments, either for an institution—such as a mutual fund, brokerage firm, insurance company, or pension fund—or for an individual.

It's the portfolio manager's job to invest the client's assets in a way that's appropriate to meet the client's goals. A portfolio manager develops investment strategies, selects individual investments, evaluates performance, and rebalances the portfolio as necessary.

# Glossary

Portfolio managers may also be referred to as fund managers or money managers and may be paid fees based on the value of the assets under management, the performance of the portfolio, or both.

## Prospectus

Each mutual fund provides a prospectus to potential investors, explaining its objectives, management team and policies, investment strategy, and performance. The prospectus also summarizes the fees the fund charges and analyzes the risks you take in investing in the fund. It is highly recommended that each investor review a fund's prospectus before investing in that fund.

## Q

### Qualified retirement plan

A qualified retirement plan is an employer sponsored plan that meets the requirements established by the Internal Revenue Service (IRS) and the U.S. Congress. Pensions, profit-sharing plans, money purchase plans, cash balance plans, SEP-IRAs, SIMPLEs, and 401(k)s are all examples of qualified plans, though each type works a little differently.

Employers may take a tax deduction for contributions to qualified plans, and in some plans employees may make tax-deferred contributions.

Among the other requirements, a qualified plan must provide for all eligible employees equivalently. That means the plan can't treat highly paid employees more generously than it does less-well paid employees.

In contrast, a nonqualified plan isn't subject to the same equivalently. In some plans, nonqualified contributions are made with after-tax dollars, either by the employer or the employee, although any earnings in the plan are tax deferred.

Mandatory federal withdrawal rules that apply to qualified plans do not apply in the same way to nonqualified plans, though nonqualified plans are subject to stringent regulation as well.

## R

### Real estate investment trust (REIT)

REITs are publicly traded companies that pool investors' capital to invest in a variety of real estate ventures, such as apartment and office buildings, shopping centers, medical facilities, industrial buildings, and hotels.

# Glossary

After a REIT has raised its investment capital, it trades on a stock market just as a closed-end mutual fund does.

There are three types of REITs: Equity REITs buy properties that produce income. Mortgage REITs invest in real estate loans. Hybrid REITs usually make both types of investments. All three are income-producing investments, and by law 90% of a REIT's taxable income must be distributed to investors. That means the yields on REITs may be higher than on other equity investments.

## Realized gain

When you sell an investment for more than you paid, you have a realized gain.

For example, if you buy a stock for \$20 a share and sell it for \$35 a share, you have a realized gain of \$15 a share. In contrast, if the price of the stock increases, and you don't sell, your gain is unrealized, or a paper profit.

Realizing your gains means you may owe tax on that profit when you sell unless the investment is tax exempt or you hold it in a tax-deferred or tax-free account. In a tax-deferred account, you can postpone paying the tax until you begin withdrawing from the account.

However, if taxes are due and you have owned the investment for more than a year when you sell, you pay tax at the long-term capital gains rate, which, for most types of investments, is lower than the rate at which you pay federal income tax on ordinary income.

## Registered investment advisor (RIA)

Investment advisers who register with the Securities and Exchange Commission (SEC) and agree to be regulated by SEC rules are known as registered investment advisers.

Only a small percentage of all investment advisers register, though being registered is often interpreted as a sign that the adviser meets a higher standard.

## Risk

According to modern investment theory, the greater the risk you take in making an investment, the greater your return has the potential to be if the investment succeeds.

For example, investing in a startup company carries substantial risk, since there is no guarantee that it will be profitable. But if it is, you're in a position to realize a greater gain than if you had invested a similar amount in an already established company.

As a rule of thumb, if you are unwilling to take at least some investment risk, you are likely to limit your investment return. For example, if you put your money into an insured bank deposit, which protects your principal, your real rate of return is unlikely to exceed inflation over an extended period.

# Glossary

## Risk tolerance

Risk tolerance is the extent to which you as an investor are comfortable with the risk of losing money on an investment. If you're unwilling to take the chance that an investment might drop in price, you have little or no risk tolerance.

On the other hand, if you're willing to take some risk by making investments that fluctuate in value, you have greater risk tolerance. The probable consequence of limiting investment risk is that you are vulnerable to inflation risk, or loss of buying power.

## Rollover

If you move your assets from one investment to another, it's called a rollover.

For example, if you move money from one individual retirement arrangement (IRA) to another IRA, that transaction is a rollover. In the same vein, if you move money from a qualified retirement plan, such as a 401(k), into an IRA, you create a rollover IRA.

Similarly, when a bond or certificate of deposit (CD) matures, you can roll over (i.e. reinvest) the assets into another bond or time deposit.

## Rollover IRA

A rollover IRA is an individual retirement arrangement you create with tax-deferred assets you move from an employer sponsored retirement plan to a self-directed investment account.

If you arrange for a direct rollover, the trustee of your employer's plan transfers the assets to the trustee you select for your IRA. In that case, the total value of the account moves from one to the other.

If you handle the rollover yourself, by getting a check from your employer's plan and depositing it in your IRA, your employer must withhold 20% of the total to prepay taxes that will be due if you fail to redeposit the full amount of the money you're moving into a tax-deferred account within 60 days.

## Roth 401(k)

The Roth 401(k) retirement plan, which was introduced in 2006, allows you to make after-tax contributions to your account.

Earnings may be withdrawn tax free, provided that you are at least 59 1/2 and your account has been open five years or more.

Both the Roth 401(k) and the traditional 401(k) have the same contribution limits and distribution requirements. You can add no more than the annual federal limit each year, and you must begin taking required minimum distributions (RMD) by April 1 of the year following the year you reach age 70 1/2. You can postpone RMDs if you are still working.

# Glossary

You may not move assets between traditional and Roth 401(k) accounts, though you may be able to split your annual contribution between the two. If you leave your job or retire, you can roll Roth 401(k) assets into a Roth IRA, just as you can roll traditional 401(k) assets into a traditional IRA.

Most 401(k) plans, including the Roth, are self-directed, which means you must choose specific investments from among those offered through the plan.

## Roth IRA

A Roth IRA is a variation on a traditional individual retirement arrangement (IRA). Because contributions are made with after-tax dollars, the Roth IRA allows you to withdraw your earnings completely tax free any time after you reach age 59 1/2, provided your account has been open at least five years. You may also be able to withdraw money earlier without penalty if you qualify for certain exceptions, such as using up to \$10,000 toward the purchase of a first home. And since a Roth IRA has no required minimum withdrawals, you can continue to accumulate tax-free earnings as long as you like.

You can make a nondeductible annual contribution, up to the annual federal limit, any year you have earned income, even after age 70 1/2, though you can never contribute more than you earn. If you are 50 or older, you may also make annual catch-up contributions.

## Security

Traditionally, a security was a physical document, such as stock or bond certificate, that represented your investment in that stock or bond. But with the advent of electronic recordkeeping, paper certificates have increasingly been replaced by electronic documentation.

In current general usage, the term security refers to the stock, bond, or other investment product itself rather than to evidence of ownership.

## Share

A share is a unit of ownership in a corporation or mutual fund, or an interest in a general or limited partnership. Though the word is sometimes used interchangeably with the word stock, you actually own shares of stock.

## Share class

Some stocks and certain mutual funds subdivide their shares into classes or groups to designate their special characteristics.

# Glossary

For example, the differences between Class A shares and Class B shares of stock may focus on voting rights, resale rights, or other provisions that enhance the power of certain shareholders. .

In the case of mutual funds, class designations indicate the way that sales charges, or loads, are levied. Class A shares have front-end loads, Class B shares have back-end loads, also called contingent deferred sales charges, and Class C shares have level loads.

## Shareholder

If you own stock in a corporation, you are a shareholder of that corporation.

You're considered a majority shareholder if you alone or in combination with other shareholders own more than half the company's outstanding shares, which allows you to control the outcome of a corporate vote. Otherwise, you are considered a minority shareholder.

In practice, however, it is possible to gain control by owning less than 51% of the shares, especially if there are a large number of shareholders or you own shares that carry extra voting power.

## SIMPLE

A SIMPLE, also known as a SIMPLE IRA, is short for Savings Incentive Match Plans for Employees, an employer sponsored retirement savings plan that may be offered by companies with fewer than 100 employees.

Employers must contribute to eligible employees' accounts each year in one of two ways. They can make a contribution equal to 2% of salary for every employee, or match dollar-for-dollar each employee's contribution to the plan, up to 3% of that employee's annual salary. A SIMPLE may be set up by establishing an IRA in each employee's name or as a 401(k). Congress sets an annual dollar limit on the tax-deferred amount an employee may contribute, based on the type of SIMPLE it is. Contribution ceilings for SIMPLE-IRAs are lower than for other employer sponsored plans.

You may withdraw assets from a SIMPLE without penalty if you are 59 1/2 or older and retired. And you must begin taking minimum required distributions by April 1 of the year following the year you turn 70 1/2 unless you're still working. Taxes are due on distributions at your regular tax rate. You may roll your assets over into another employer plan or an IRA if you leave your job for any reason or retire.

Two key differences between SIMPLEs and other employer plans are that your account must be open at least two years before you can withdraw or move the money, and the federal tax penalty for early withdrawal is 25% of the amount you take, rather than 10%.

# Glossary

## Simplified employee pension plan (SEP)

A SEP is a qualified retirement plan set up as an individual retirement arrangement (IRA) in an employee's name.

You can establish a SEP for yourself if you own a small business, or you may participate as an employee if you work for a company that sponsors such a plan.

The federal government sets the requirements for participation, the maximum annual contribution limits, and the rules governing withdrawals.

## Socially responsible fund

When socially responsible mutual funds, also known as green funds or conscience funds, select securities to meet their investment goals, the securities must also satisfy the fund's commitment to certain principles spelled out in the fund's prospectus.

Some common screens these funds may employ include social, environmental and good corporate governance criteria. For example, a socially responsible fund might not buy shares of a manufacturing company that operates factories that fund managers consider sweatshops. Or the fund might not buy shares of a food company that sells out-of-date products in emerging markets. Some funds only make investments that would be approved by a certain religion

Since the priorities of these funds vary, you may need to do some investigating to find one that matches your values.

## T

### Tax deferred

A tax-deferred account allows you to postpone income tax that would otherwise be due on employment or investment earnings you hold in the account until some point in the future, often when you retire.

For example, you can contribute pretax income to employer sponsored retirement plans, such as a 401(k) or 403(b). You owe no tax on any earnings in these plans, or in traditional individual retirement arrangements (IRAs), fixed and variable annuities, and some insurance policies until you withdraw the money. Then tax is due on the amounts you take out, at the same rate you pay on your regular income.

A big advantage of tax deferral is that earnings compound more quickly, since no money is being taken out of the account to pay taxes. But in return for postponing taxes, you agree to limited access to your money before you reach 59 1/2.

# Glossary

## Tax exempt

Some investments are tax exempt, which means you don't have to pay income tax on the earnings they produce. For example, the interest you receive on a municipal bond is generally exempt from federal income tax, and also exempt from state and local income tax if you live in the state where the bond was issued. However, if you sell the bond before maturity, any capital gain is taxable.

Similarly, dividends on bond mutual funds that invest in municipal bonds are exempt from federal income tax. And for residents of the issuing state for single-state funds, the dividends are also exempt from state and local taxes. Capital gains on these funds are never tax exempt.

Earnings in a Roth IRA are tax exempt when you withdraw them, provided your account has been open for five years or more and you're at least 59 1/2 years old. And earnings in 529 college savings plans and Coverdell education savings accounts (ESAs) are also tax exempt if the money is used to pay qualified education expenses.

## U

### Underweighted

When you own less of a security, an asset class, or a subclass than your target asset allocation calls for, you are said to be underweight in that security, asset class, or subclass.

For example, if you have decided to invest 30% of your portfolio in fixed-income investments, but your fixed-income holdings account for only 10% of your portfolio, you are underweight in fixed income.

In another use of the term, a securities analyst might recommend underweighting a particular security, which you might reasonably interpret as advice to sell.

### Uniform Gifts to Minors Act (UGMA)

Under the UGMA, you as an adult can set up a custodial account for a minor and put assets such as cash, securities, and mutual funds into it.

You pay no fees or charges to set up the account, and there is no limit on the amount you can put into it. To avoid owing potential gift tax, however, you may want to limit what you add each year to an amount that qualifies for the annual gift tax exclusion.

One advantage of an UGMA custodial account is that you can transfer to it assets that you expect to increase in value. That way, any capital gains occur in the account, and you avoid potential estate taxes that might have been due had you owned the asset at your death.

## Glossary

Children receive a portion of unearned income tax-free. For 2010 returns, the limit was \$950, meaning that a child doesn't have to pay taxes on any interest, dividends or capital gains up to this amount. The child would have to pay taxes on the next \$950, but at his or her usually lower tax rate.

Once the child's earnings exceed \$1,900, however, the preferential treatment ends. The earnings on those excess earnings are taxed at the parent's top marginal tax rate.

One potential disadvantage of a custodial account is that any gift to the account is irrevocable, which means that the assets become the property of the beneficiary from the moment they go into the account, even though as a minor he or she cannot legally control activity in the account or take money out. At majority, which occurs at 18, 21, or 25 depending on the state, the beneficiary may use the assets as he or she wishes.

In addition, if you are both the donor and the custodian, and die while the beneficiary is still a minor, the assets are considered part of your estate. That could make your estate's value large enough to be vulnerable to estate taxes.

### **Uniform Transfers to Minors Act (UTMA)**

The UTMA allows you as an adult to set up a custodial account for a minor, who owns any assets placed in the account, although he or she can't legally control the account until reaching the age of majority.

The UTMA is similar to the Uniform Gifts to Minors Act (UGMA) in many respects, but you can use an UTMA to gift assets in addition to cash and securities, including real estate, fine art, antiques, patents, and royalties.

You may choose to transfer assets that you expect to increase in value into the UTMA account. That way, any capital gains occur in the account, and you avoid potential estate taxes that might have been due had you owned the asset at your death.

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At majority, which occurs at 18, 21, or 25 depending on the state, the beneficiary may use the assets as he or she wishes. To avoid owing potential gift tax, you may want to limit what you add each year to an amount that qualifies for the annual gift tax exclusion.

# Glossary

In addition, if you are both the donor and the custodian, and die while the beneficiary is still a minor, the assets are considered part of your estate. That could make your estate's value large enough to be vulnerable to estate taxes.

## Unrealized gain

If you own an investment that has increased in value, your gain is unrealized until you sell and take your profit. You owe no income or capital gains tax on unrealized gains, sometimes known as paper profits, though you typically compute the value of your investment portfolio based on current—and unrealized—values.

## Unrealized loss

If the market price of a security you own drops below the amount you paid for it, you have an unrealized loss. The loss remains unrealized as long as you don't sell the security while the price is down.

One reason you might choose to sell at a loss, other than needing cash at that moment, is to prevent further losses in a security that seems headed for a still-lower price. You might also sell to create a capital loss, which you could use to offset capital gains.

## V

### Value fund

When a mutual fund manager buys primarily undervalued stocks for the fund's portfolio with the expectation that these stocks will increase in price, that fund is described as a value fund.

## W

### Withdrawal

A withdrawal is money you take out of your banking, brokerage firm, or other accounts.

If you withdraw from tax-deferred retirement accounts before you turn 59 1/2, you may owe a 10% early withdrawal penalty plus any income tax that's due on the amount.

In everyday usage, the term withdrawal is used interchangeably with distribution to describe money you take from your tax-deferred accounts, though distribution is actually the correct term.

# Glossary

## World fund

U.S.-based mutual funds that invest in securities from a number of countries, including the U.S., are known as world funds or global funds. Unlike international funds that buy only in overseas markets, world funds may keep as much as 75% of their investment portfolio in U.S. stocks or bonds.

Because world fund managers can choose from many markets, they are often able to invest in those companies providing the strongest performance in any given period.

## X

None

## Y

### Yield to maturity (YTM)

Yield to maturity is the most precise measure of a bond's anticipated return and is determined by its current market price, its coupon rate, and the years remaining until the bond matures.

Although YTM figures are complex to calculate, brokers will supply this information if you ask, or you can use a calculator programmed to provide YTM figures.

## Z

None

## #

### 12b-1 fee

A number of load and no-load mutual funds levy 12b-1 fees on the value of your mutual fund account to offset the fund's promotional and marketing expenses. These asset-based fees, which get their name from the Securities and Exchange Commission (SEC) ruling that describes them, typically amount to somewhere between 0.25% and 0.50% annually of the net assets in the fund.

A fund that charges 12b-1 fees must detail those expenses, along with other fees it imposes, in its prospectus.

# Glossary

## 401(k)

You participate in a 401(k) retirement savings plan by deferring part of your salary into an account set up in your name. Any earnings in the account are federal income tax deferred.

If you change jobs, 401(k) plans are portable, which means that you can move your accumulated assets to a new employer's plan, if the plan allows transfers, or to a rollover IRA.

With a traditional 401(k), you defer pretax income, which reduces the income tax you owe in the year you made the contribution. You pay tax on all withdrawals at your regular rate.

With the newer Roth 401(k), which is offered in some but not all plans, you contribute after-tax income. Earnings accumulate tax deferred, but your withdrawals are completely tax free if your account has been open at least five years and you're at least 59 1/2.

In either type of 401(k), you can defer up to the federal cap, plus an annual catch-up contribution if you're 50 or older. However, you may be able to contribute less than the cap if you're a highly compensated employee or if your employer limits contributions to a percentage of your salary. Your employer may match some or all of your contributions, based on the terms of the plan you participate in, but matching isn't required.

With a 401(k), you are responsible for making your own investment decisions by choosing from among investment alternatives offered by the plan. Those alternatives typically include separate accounts, mutual funds, annuities, fixed-income investments, and sometimes company stock.

You may owe an additional 10% federal tax penalty if you withdraw from a 401(k) before you reach 59 1/2. You must begin to take minimum required distributions by April 1 of the year following the year you turn 70 1/2 unless you're still working. But if you prefer, you can roll over your traditional 401(k) assets into a traditional IRA and your Roth 401(k) assets into a Roth IRA, where you wouldn't be required to take a minimum required distribution.

## 403(b)

A 403(b) plan, sometimes known as a tax-sheltered annuity (TSA) or a tax-deferred annuity (TDA), is an employer sponsored retirement savings plan for employees of not-for-profit organizations, such as colleges, hospitals, foundations, and cultural institutions.

Some employers offer 403(b) plans as a supplement to—rather than a replacement for—defined benefit pensions. Others offer them as the organization's only retirement plan.

Your contributions to a traditional 403(b) are tax deductible, and any earnings are tax deferred. Contributions to a Roth 403(b) are made with after-tax dollars, but the

## Glossary

withdrawals are tax free if the account has been open at least five years and you're 59 1/2 or older.

There's an annual contribution limit, but you can add an additional catch-up contribution if you're 50 or older.

With a 403(b), you are responsible for making your own investment decisions by choosing from among investment alternatives offered by the plan. You can roll over your assets to another employer's plan or an IRA when you leave your job, or to an IRA when you retire.

You may withdraw without penalty once you reach 59 1/2, or sometimes earlier if you retire. You must begin required withdrawals by April 1 of the year following the year you turn 70 1/2 unless you are still working. In that case, you can postpone withdrawals until April 1 following the year you retire.

### 529 college savings plan

Each 529 college savings plan is sponsored by a particular state or group of states, and while each plan is a little different, they share many basic elements.

When you invest in a 529 savings plan, any earnings in your account accumulate tax free, and you can make federally tax-free withdrawals to pay for qualified educational expenses, such as college tuition, room and board, and books at any accredited college, university, vocational, or technical program in the United States and a number of institutions overseas.

Some states also exempt earnings from state income tax, and may offer additional advantages to state residents, such as tax deductions for contributions.

You must name a beneficiary when you open a 529 savings plan account, but you may change beneficiaries if you wish, as long as the new beneficiary is a member of the same extended family as the original beneficiary.

In most cases, you may choose any state's plan, even if neither you nor your beneficiary live in that state. There are no income limits restricting who can contribute to a plan, and the lifetime contributions are more than \$300,000 in some states.

You can make a one-time contribution of \$60,000 without incurring potential gift tax, provided you don't make another contribution for five years. Or, you may prefer to add smaller amounts, up to the annual gift exclusion.

### 529 prepaid tuition plan

With a prepaid tuition plan, you purchase tuition credits at current rates to be used at some point in the future when your beneficiary attends one of the colleges or universities participating in the plan.

Most prepayment plans are sponsored by individual states and apply to the public institutions in the state, some state plans cover both public and private institutions in the

## Glossary

state, and the Independent 529 plan includes more than 200 participating private institutions nationwide.

In the case of state plans, either you or your beneficiary may have to live in the sponsoring state.

You owe no income tax on any appreciation in the value of the tuition credits if they are used to offset tuition, and you may be able to transfer the face value of the credits to a nonparticipating school if your child doesn't attend a participating one.

Some states and the Independent plan guarantee that your credits will cover the cost you prepay.

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