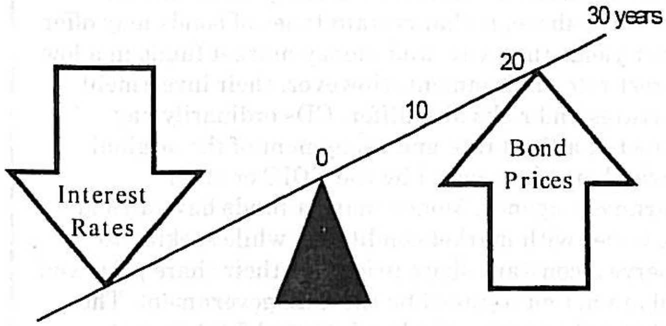
BOND FACTS CONTINUED

Q: How is the fluctuation of bond fund share price linked to interest rates?

A: The share price fluctuation of a bond fund is a concern to many investors. A fund's share price is based on its net asset value, determined each day by valuing all of the fund's portfolio investments, less expenses. The value of the bonds in a fund's portfolio changes daily, because of changes in the market price of the bonds held.



The value of these bonds changes for a variety of reasons, often in response to the movement of interest rates. You may consider the relationship of interest rates and a bond's price similar to that of the see-saw pictured above. In this inverse relationship, when interest rates go up, the price of a bond issued when interest raters were lower goes down. The reverse is also true – when interest rates fall, the price of a bond issued when interest rates were higher rises.

The degree of share price fluctuation caused by interest rate movements varies according to the maturity and type of bond held by the fund. Normally, a longer-term bond fund will experience more share price fluctuation than a shorter-term bond fund. This is because bonds with longer maturities are more sensitive to interest rate movements than bonds with shorter maturities. The table below provides some examples of how bonds of different maturity lengths react to a change in interest rates. A fund that holds high yield bonds and convertible bonds is less sensitive to interest rate movements. High yield bonds and convertible bonds resemble equity securities in that at times, their price movements are affected more by changes in the financial position of the issuer than by interest rate movements. One final point to consider is that a bond fund's share price generally tends to fluctuate less than the price of an individual bond due to the diversification of the fund's portfolio.

BOND PRICES AND INTEREST RATES

Bond Maturity	*Initial Principal of $1,000 and Yield of 10%**			
	1% Rise in Rates		1% Decline in Rates	
Short-Term *(2.5 year maturity)*	$979	-2.1%	$1,022	+2.2%
Intermediate-Term *(7 year maturity)*	$952	-4.8%	$1,051	+5.1%
Long-Term *(20 year maturity)*	$920	-8.0%	$1,092	+9.2%

*The 10% yield shown is hypothetical and is not intended to show, or project, the performance of any bond or bond fund for any period of time.

Q: Other than share price, how else does maturity length affect a bond fund?

A: The average maturity of a bond fund also affects its yield. Depending on market conditions, longer-term bond funds may provide a higher yield than shorter maturity bond funds of the same basis type. The reward of higher yields is a trade-off for a higher degree of fluctuation in a fund's share price. For example, a long-term corporate bond fund may have a higher yield and greater price fluctuation than a short-term corporate bond fund.

One important note, especially as to funds investing in lower-quality bonds: since a fund's "yield" is a function of its share price on the last day of the period for which the yield is measured, falling share prices tend to increase the yield artificially.

Q: How does portfolio credit quality affect a bond fund?

A: Credit quality is a measure of the degree of a bond's investment risk. Bond funds investing in bonds of a lower credit quality may offer higher yields, but they may also have a higher degree of investment risk. And the opposite is true for higher quality bond funds, such as funds investing in U.S. government securities, which typically offer relatively lower yields.